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TESTIMONY

HELPING HOMEOWNEERS HARMED BY FORECLOSURES: ENSURING ACCOUNTABILITY AND TRANSPARENCY IN APPEALS
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United States Senate Committee on Banking, Housing, and Urban Affairs—Subcommittee on Housing, Transportation, and Community Development

Chairman Menendez, Ranking Member DeMint, and Members of the Subcommittee, thank you for inviting me to testify today. My name is Anthony B. Sanders. I am the Distinguished Professor of Real Estate Finance at George Mason University and senior scholar at the Mercatus Center. I was previously director of asset-backed and mortgage-backed securities research at Deutsche Bank and the co-author of "Securitization" (along with Andrew Davidson) as well as many housing finance and housing market publications.

MARKET CONDITIONS AND THE MORTGAGE MARKET

We are all painfully aware that home prices declined precipitously during from its peak in 2006/2007 resulting in a 32.5% decline (see Figure 1).[1] Owner's equity in household real estate fell 53.8% from its peak in 2006 (see Figure 2). While house prices are actually increasing in some areas of the county, they continue to fall in western and Midwest states (See Figure 3). According to Zillow, negative equity rose to 28.6 percent of single-family homes with mortgages in the third quarter of 2011. Unemployment and partial unemployment remains horrific at 8.6% and 15.6% (see Figure 4), respectively. According to the Bureau of Labor Statistics latest employment report, 315,000 people dropped out of the labor force while 120,000 non-farm jobs were created amounting to a net job loss of around 200,000.

The combination of a recession, a catastrophic decline in house prices, and continued unemployment levels not seen since The Great Depression has resulted in a staggering number of mortgage delinquencies, defaults and foreclosures. According to a December 1, 2011 LPS report,[2] mortgage delinquencies are down nearly 30 percent from the peak while the Foreclosure Inventory is at an all-time high.[3] As of October 2011, 2.33 million loans are less than 90 days delinquent, 1.76 million loans are 90+ days delinquent, and 2.21 million loans are in the foreclosure process. This sums to 6.30 million loans delinquent or in foreclosure in October. The foreclosures rates are correlated with declines in house prices (see Figure 5) and state unemployment rates (see Figure 6). Clearly, the housing market and high unemployment rates are a drag on the economy. Households have responded by reducing debt levels (see Figure 7) as a percentage of disposable income, whether voluntary or involuntary.

One of the problems facing the U.S. and global economy is debt saturation (see Figure 8). Europe is currently drowning in debt (see Figure 9), and the U.S. has serious indebtedness problems to the point where federal debt is growing faster than our industrial production (see Figure 10). This begs an obvious question: should Congress be encouraging households to take on more debt when bankruptcy and foreclosure allows the opportunity for households to shed burdensome debt?

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[1] The 32.5% decline is according to the Case-Shiller 20 City Index. If I use the FHFA house price index, the decline was 16.6%. The FHFA index excludes jumbo mortgages and other non-agency mortgage products, so the indices vary.
[2] http://www.lpsvcs.com/LPSCorporateInformation/NewsRoom/Pages/20111201.aspx.
[3] There are significant differences between states that process foreclosures following a judicial vs. non-judicial foreclosure process. http://www.lpsvcs.com/LPSCorporateInformation/NewsRoom/Pages/20111101a.aspx.

THE REMEDIES

The remedy for the housing market collapse and high unemployment rates is twofold: 1.) economic growth and 2.) getting foreclosed properties back into the economy. However, a series of federal programs, state programs, and litigation aimed at slowing the movement of households through the foreclosure process, even when foreclosure is in the household's best interest, are slowing the housing market recovery.[4]

One such action slowing the recovery is the agreement between federal agencies (OCC, Fed, and OTS) and large mortgage servicers over alleged borrower mistreatment in the foreclosure process.[5] Servicers would hire independent consultants to review foreclosures over the past two years in an attempt to discern whether borrowers were wrongfully harmed. Based on the outcome of the review, the agencies would then determine what restitution would be provided to the borrowers, if any.

THE FORECLOSURE REVIEW

What is the magnitude of the foreclosure review? Apparently, more than four million borrowers who lost their homes to foreclosure since they defaulted on their mortgages could potentially qualify for free reviews of their cases. The audits are available to those who were living in their homes and in some stage of foreclosure during 2009 or 2010 and had mortgages serviced by one of 24 companies hired by 14 banks.

The Office of the Comptroller of the Currency (OCC) has released its Interim Status Report dated November 2011.[6] The report discloses the independent consultants for the review, and there is no reason to believe that these independent consultants will skew or shape their findings to favor the servicers. Furthermore, given the level of scrutiny on the loan modification process and foreclosures and the lender/servicers' desires to put this process behind them, I am confident that all parties will handle the review process accurately and honestly.

My concern is not with the selection of independent consultants, but with the time and costs involved in such a laborious review process relative to the expected economic assessment of harm.

In addition to reviewing foreclosures at the request of the borrowers (and certain mandatory groups), there will also be a sampling of foreclosures to detect problems. Let us suppose that 4.5 million foreclosures are reviewed, and it costs an average of $2,500 per review.[7] If all 4.5 million foreclosures were reviewed, the process would cost $11.25 billion. So, depending on the number of borrowers that ask for a "free review" and the sampling size for all foreclosures, this entire process could be quite costly to lenders/servicers.

More importantly, what would be the penalties for harm done to borrowers relative to the cost? There will likely be egregious errors (such as violations of the law including foreclosure on active duty military personnel), but I would be surprised if those violations exceed 100 instances (or less than 2/10ths of 1% of the 4.5 million foreclosures). In terms of modification errors, there are likely to be less than 50,000 instances (or 1.11% of the 4.5 million foreclosures). In terms of technical errors (such as Robosigning), it is difficult forecast how many there will be, but technical errors like robosigning should not result in any financial harm to borrowers since they would be foreclosed upon after the documentation error is correct.

Suppose that the 100 instances of egregious errors cost $150,000 in financial harm (or $1,500,000). Furthermore suppose that the 50,000 instances of modification errors cost $20,000 in financial harm (or $1 billion). This projected remediation for financial harm is $1,001,500,000 (or 8.9% of the total possible cost for the review).

Once the review is completed and the remediation for financial harm is concluded, I urge everyone to put the foreclosure issue aside and allow the market to heal itself.

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[4] For example, while an emotional drain, foreclosure allows for debt reduction and increased labor mobility since the borrower is no longer tied to the home.

[5] See http://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47a.pdf.

[6] http://www.occ.treas.gov/news-issuances/news-releases/2011/nr-occ-2011-139a.pdf.

[7] For each loan reviewed, the range is about $1,500 to $5,000 with an average of about $2,500.

APPENDIX: FIGURES

Figure 1. The Case-Shiller 20-City Home Price Index and the FHFA House Price Index Since 2000

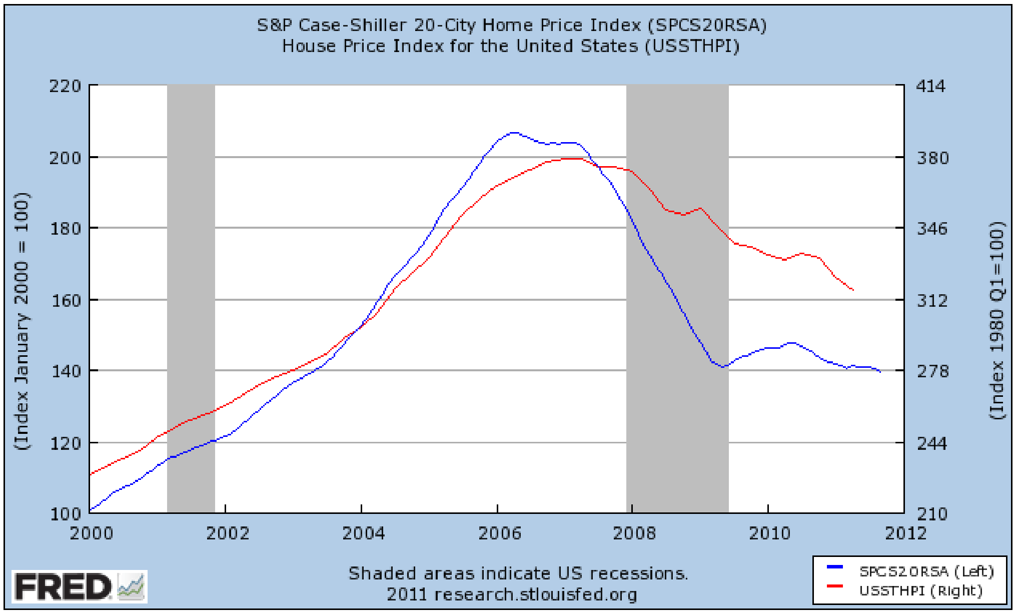

Figure 2. Owner's Equity in Household Real Estate – Net Worth

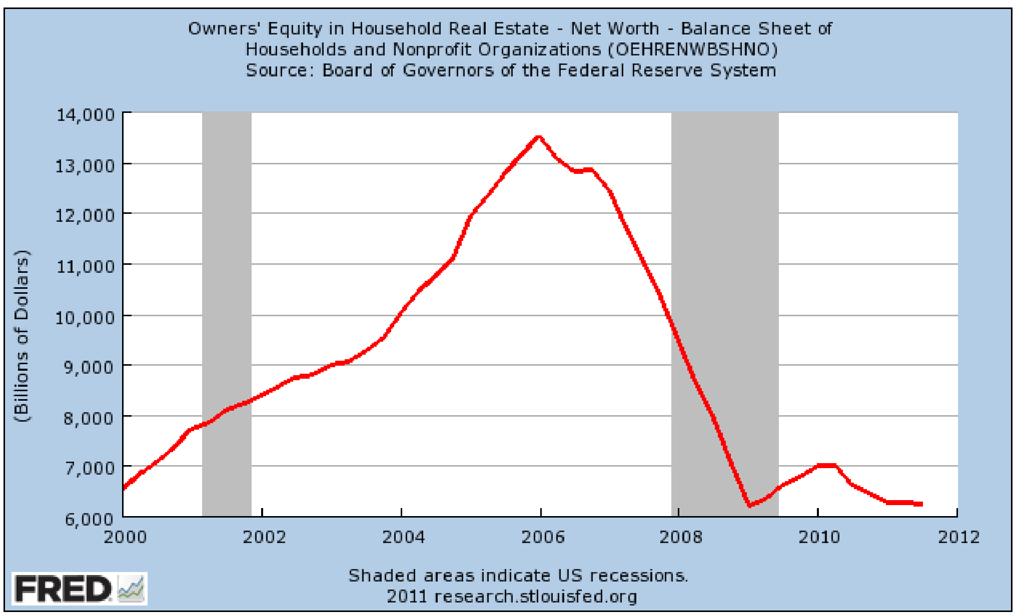

Figure 3. Recent 12 Month Change in House Prices (Including Distressed Sales)

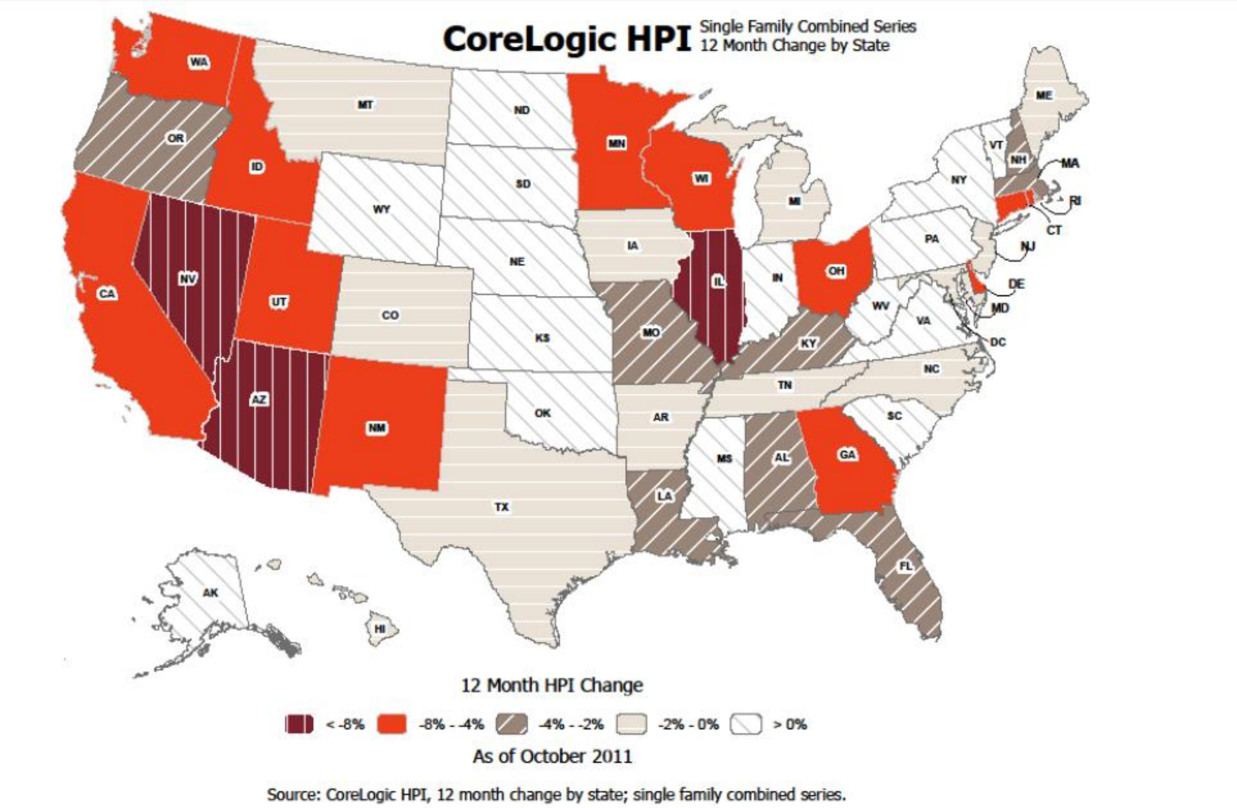

Figure 4. Civilian Unemployment and Total unemployed, plus all marginally attached workers plus total employed part time for economic reasons (U6RATE)

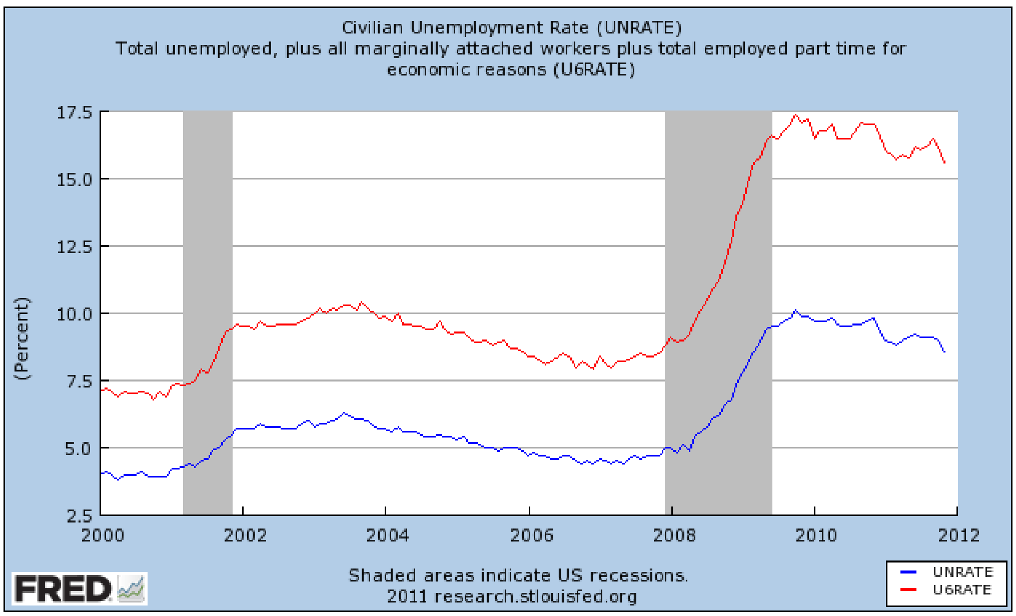

Figure 5. RealtyTrac Foreclosure Heat Map as of October 2011

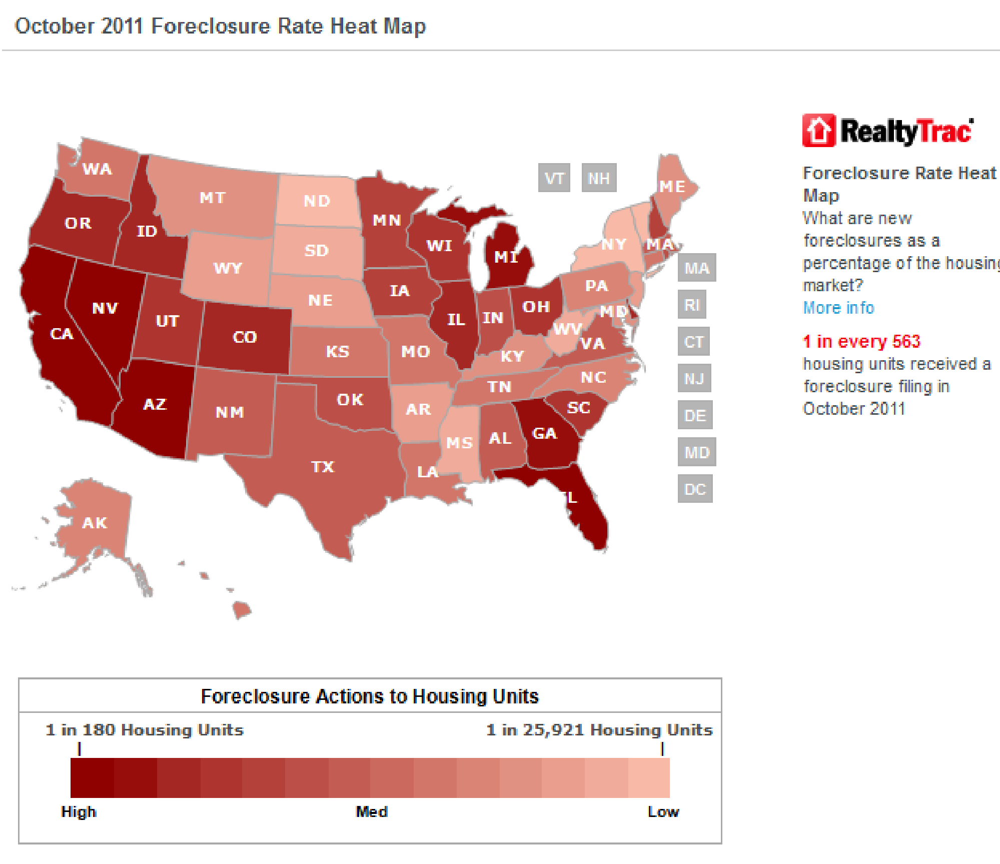

Figure 6. State Unemployment Rate

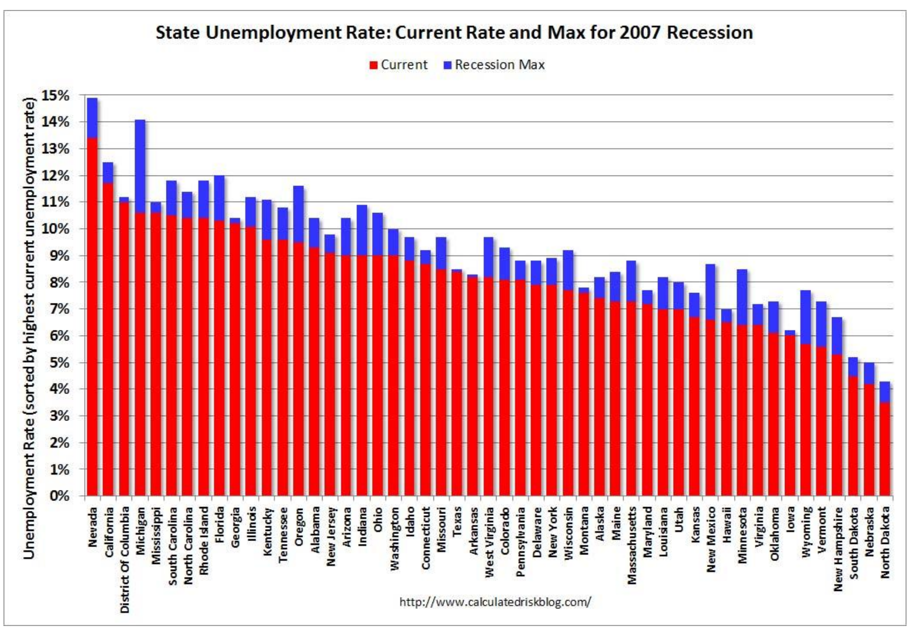

Figure 7. Household Debt Service Payments as a Percentage of Disposable Personal Income

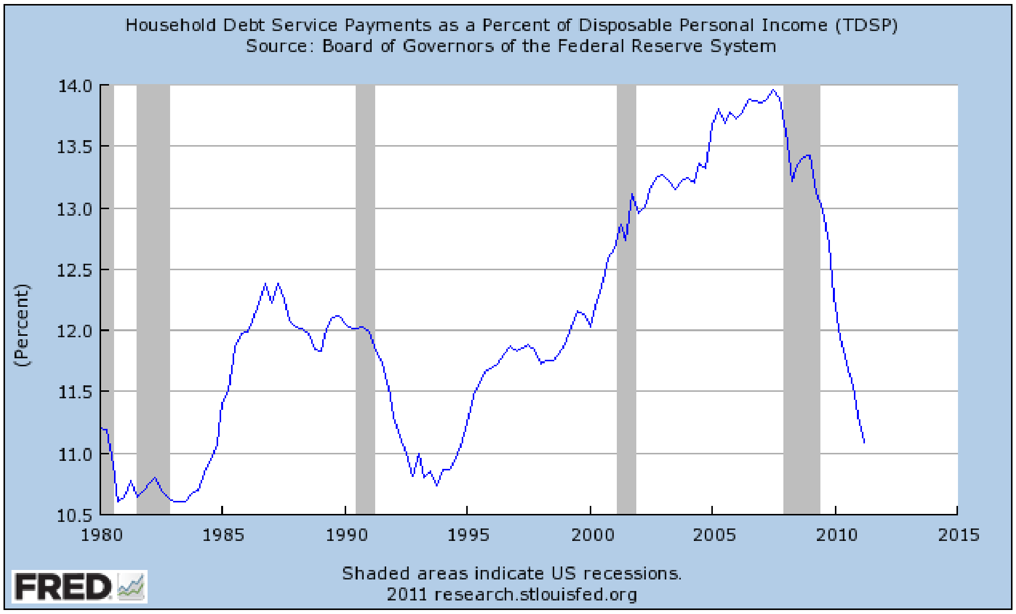

Figure 8. Global Debt as Percentage of GDP

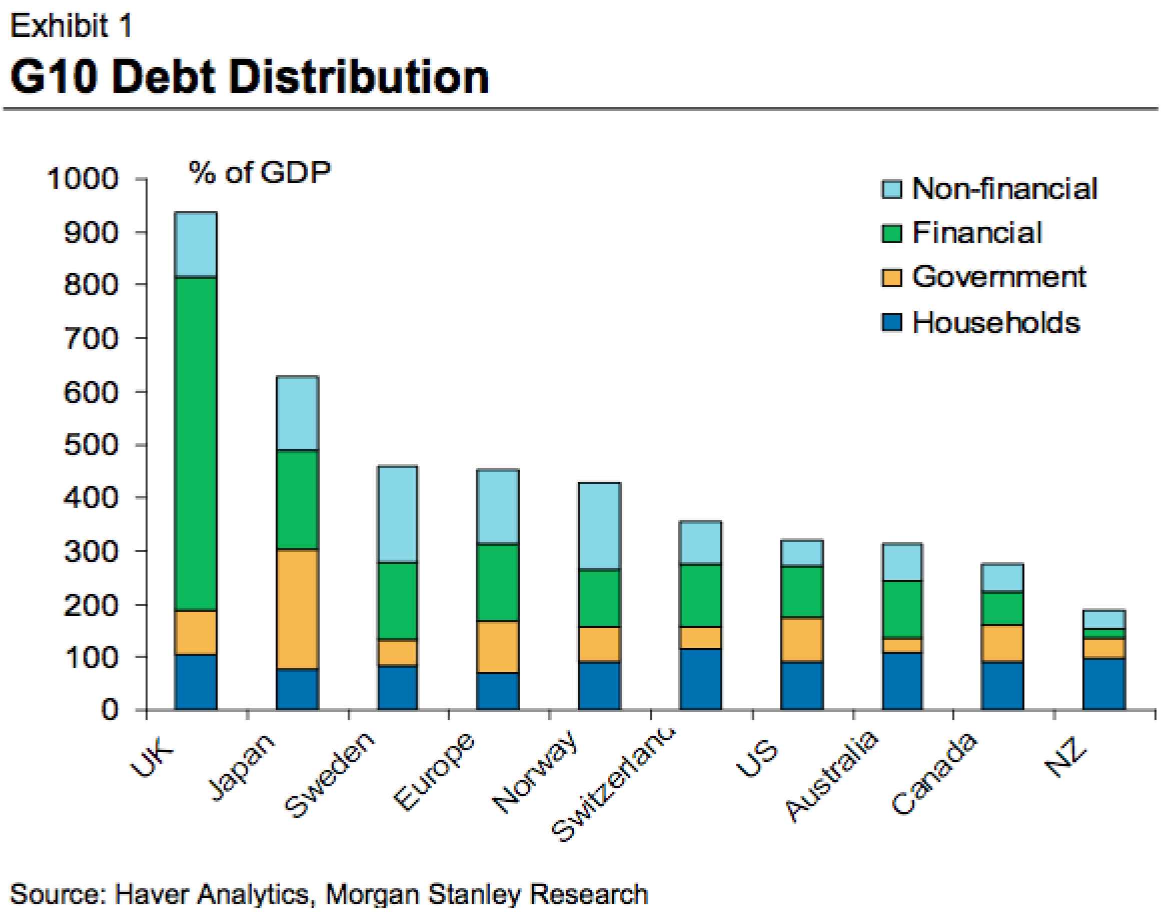

Figure 9. European Debt to GDP

Hit # <GO> to select an index or <TAB> to change date.

EU Govt Debt as % of GDP — Page 1/2

Source Copyright European Communities 1995-2010

			Current Value	Current Date	Previous (12/31/09) Value	Previous Date	Pct Chng
1)	Debt as % of GDP Belgium	EUDB60BE	96.20	12/10	95.90	12/09	.31
2)	Debt as % of GDP Germany	EUDB60DE	83.20	12/10	74.40	12/09	11.83
3)	Debt as % of GDP Spain	EUDB60ES	61.00	12/10	53.80	12/09	13.38
4)	Debt as % of GDP France	EUDB60FR	82.30	12/10	79.00	12/09	4.18
5)	Debt as % of GDP Ireland	EUDB60IE	92.50	12/10	65.20	12/09	41.87
6)	Debt as % of GDP Italy	EUDB60IT	118.40	12/10	115.50	12/09	2.51
7)	Debt as % of GDP Luxembourg	EUDB60LU	19.10	12/10	14.80	12/09	29.05
8)	Debt as % of GDP Netherland	EUDB60NL	62.90	12/10	60.80	12/09	3.45
9)	Debt as % of GDP Austria	EUDB60AT	71.80	12/10	69.50	12/09	3.31
10)	Debt as % of GDP Portugal	EUDB60PT	93.30	12/10	83.00	12/09	12.41
11)	Debt as % of GDP Finland	EUDB60FI	48.30	12/10	43.30	12/09	11.55
12)	Debt as % of GDP Eurozone	EUDBEURO	85.30	12/10	79.80	12/09	6.89
13)	Debt as % of GDP Greece	EUDB60GR	144.90	12/10	129.30	12/09	12.06
14)	Debt as % of GDP EU 15	EUDB6015	60.40	12/07	62.80	12/06	-3.82
15)	Debt as % of GDP Denmark	EUDB60DK	43.70	12/10	41.80	12/09	4.55
16)	Debt as % of GDP Sweden	EUDB60SE	39.70	12/10	42.70	12/09	-7.03
17)	Debt as % of GDP UK	EUDB60UK	79.90	12/10	69.60	12/09	14.80
18)	Debt as % of GDP Slovakia	EUDBSK	41.00	12/10	35.50	12/09	15.49
19)	Debt as % of GDP Slovenia	EUDBSI	38.80	12/10	35.30	12/09	9.92
20)	Debt as % of GDP Poland	EUDBPL	54.90	12/10	50.90	12/09	7.86

Figure 10. Federal Debt versus Industrial Production