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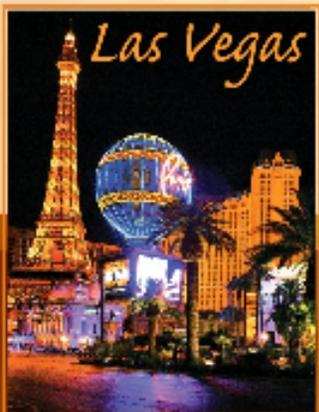


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Bankruptcy and The Mortgage Crisis: New Research

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Bankruptcy filings, mortgage defaults and foreclosures are closely related

- BAPCPA caused bankruptcies to fall and defaults to rise:
 - 3% for prime mortgages and
 - 14% for subprime mortgages.
- In general, more bankruptcies mean more mortgage defaults. Also more bankruptcies mean more foreclosures.

Foreclosures have very high costs:

- Ex-homeowners must relocate, neighborhood ties lost, kids must switch schools.
- Renters must also move.
- Some become homeless.
- Vacancies cause blight.
- Cities cut public services because taxes fall.
- Foreclosures cause more foreclosures.

Lenders foreclose too often

- Lenders lose $1/3$ to $1/2$ of their investment.
- But because lenders don't bear all the costs, they foreclose too often.

Government Programs to Reduce Foreclosures

- By encouraging lenders to modify mortgages instead of foreclosing.
- Obama Admin “Help for Homeowners” program:
 - 500,000 mortgages have started the modification process.
 - Only a few thousand have permanent modifications.
- But lenders have to agree to mods.

Why so few modifications?

- “Pooling and servicing agreements” discourage loan modifications/encourage foreclosures.
- Lenders lose if they modify mortgages:
 - 30% of mortgage defaults “self-cure” and
 - 30% - 45% re-default within 6 months,So lenders prefer foreclosure and resist modifications. Admin programs are unsuccessful because lenders can veto.

Does bankruptcy help homeowners?

- Chapter 13 helps homeowners save their homes, but it's not very effective.
- Only 1% of homeowners in Ch 13 save their homes when they otherwise would have lost them.
- Ch 13 is even less effective now, since lower home values mean fewer homeowners want to save their homes.

What about introducing cram-down of mortgages in Chapter 13?

- This would prevent lenders from vetoing modifications, so more would occur.
- Average reduction in mortgage payments if underwater mortgages are cut to current market value is \$150,000 over the life of the mortgage.
- This would cause many homeowners to file Chapter 13's, even if they can afford to repay.

Policy Dilemma

- Too few modifications occur now under government programs, because lenders must agree.
- But too many modifications would occur if cram-down in bankruptcy were introduced, because lenders can't veto.
- Which is better—we don't know!