Plan to Cut Foreclosure Rate Clears Key Hurdle

By ELIZABETH WILLIAMSON and RUTH SIMON

WASHINGTON -- A Senate bill aimed at giving strapped homeowners more leverage in renegotiating their mortgages cleared a hurdle Thursday when Citigroup Inc. dropped its opposition.

The legislation, which is being advanced by top Senate Democrats, would let judges set new repayment terms for mortgage holders in bankruptcy court. Lawmakers say the measure is aimed at jump-starting broader efforts to renegotiate millions of underwater mortgages now weighing down the housing market.

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The proposal from Sen. Dick Durbin, an Illinois Democrat, to allow so-called mortgage "cramdowns," would apply only to homeowners who have filed for Chapter 13 bankruptcy protection. It is the first of several pieces of legislation Democrats intend to push this year to give homeowners more leverage in bargaining with banks and mortgage-servicing companies.

Nearly 10 million homeowners are having trouble making their mortgage payments, according to Moody's Economy.com. The proposed changes in bankruptcy rules could help as many as 800,000 troubled borrowers keep their homes, estimates Mark Zandi, chief economist at Moody's Economy.com.

The push to modify bankruptcy laws comes as the housing market and economy continue to weaken. The bill would allow bankruptcy judges to lower the principal and interest rates on mortgages, and to extend the terms of the loans. It would represent a major shift of power from lenders to debtors, who aren't allowed under current bankruptcy law to renegotiate their primary mortgages.

Cramdown Compromise

- Allows bankruptcy judges to lower interest rate, reduce principal, shorten the term of a primary mortgage, or any combination of the three.
- Homeowners must certify that they have tried to renegotiate loan with the lender outside bankruptcy court.
- Applies to all loans written before the date of enactment of the legislation, should it pass.

Senate Democrats want to include the proposal in an $800 billion economic-stimulus bill, which Congress hopes to pass by mid-February. Some supporters of the cramdown measure say that if it becomes law, the threat of a bankruptcy filing could make mortgage companies more willing to ease terms even for borrowers who don't file for bankruptcy.

Legislators had sought Citigroup's support because they feel that the measure has a better chance of passing quickly if it has support from the banking industry. Citigroup is one of the nation's largest mortgage lenders.

Until recently, Citigroup had fiercely opposed proposals to give bankruptcy judges latitude to change the terms of mortgages. Its about-face comes after the federal government has pumped $45 billion into the company since last fall. The government is now keeping the company on a tight leash.

In letters Thursday to congressional leaders, Citigroup Chief Executive Vikram Pandit praised the legislation as a way to help borrowers stay in their homes. "Given today's exceptional economic environment, we support its swift passage," he wrote.

Sen. Durbin said in an interview: "This is the breakthrough we've been waiting for. To have a major financial institution support this legislation will create an incentive for others to come our way. I want to congratulate Citi for being open-minded about this...and playing a major leadership role."

Two senior officials of the Mortgage Bankers Association, the nation's biggest trade and lobbying group for mortgage lenders, said in a joint statement on Thursday that the group remains opposed to cramdowns "because of the destabilizing effect it will have on an already turbulent mortgage market. We were surprised by the suddenness of the announcement and are still evaluating the proposed deal, but we believe there remain a number of crucial issues that need to be addressed."

Related Documents

- Letter from Citigroup to House
- Letter from Citigroup to Senate
- **Press Release:** Announcement of the Deal

"Citigroup has broken the dam," said New York Democratic Sen. Charles Schumer. "We are getting calls from many, many banks and banking associations saying they want to help."

Democrats have expressed frustration at the slow pace of existing efforts to encourage banks to voluntarily renegotiate mortgages in cases where homeowners owe more than their homes are worth.

Filing for Chapter 13 bankruptcy, under which debtors can work out a plan to reduce some debts and pay back creditors over three to five years, is a painful and potentially costly option for homeowners. The proceedings can cost borrowers about $4,000, according to Katherine Porter, a University of Iowa law professor, and result in a blot on personal credit reports for seven to 10 years. That could make getting credit in the future more costly.

Under current bankruptcy law, about half of Chapter 13 filers aren't able to keep paying their mortgages, and they ultimately lose their homes, judges and lawyers say. That's because debtors often have to make higher monthly mortgage payments than they did before bankruptcy, in part because their bankruptcy reorganization plans must include the payments they already missed, plus resulting financial penalties.

The proposal will still face substantial obstacles. Opponents of the proposed law change say it would undermine current contracts and make it more difficult and costly for borrowers to get credit in the future. Some say it could also encourage some borrowers to stop making loan payments.

One reason that reworking troubled loans has been so difficult is that billions of dollars worth of mortgages were packaged into securities and sold to investors. It's not clear how much leeway mortgage companies will have to rework loans that were bundled into securities and are now owned by diverse groups of investors, foreign and domestic.

According to the Mortgage Bankers Association, one in 10 homeowners -- about 4.6 million people -- are either delinquent on their mortgage payments or are in the process of foreclosure. The number of people filing for Chapter 13 bankruptcy rose to 263,756 in the first nine months of 2008, from 234,375 in the same period in 2007, according to the American Bankruptcy Institute.

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A Citibank ATM sign in New York. A mortgage deal reached by the company and top Senate Democrats marks a surprising change of direction by the financial-services industry.

Last year, under pressure from regulators and elected officials, banks rolled out a wide range of programs designed to modify mortgages to help homeowners keep their properties. These efforts have focused largely on reducing interest rates and extending terms, not on reducing loan amounts. Earlier efforts to rework troubled loans have had limited success.

Nearly 37% of homeowners whose mortgages were modified in the first quarter of 2008 defaulted again after six months, according to a report released last month by the Office of the Comptroller of the Currency and the Office of Thrift Supervision.

The agreement reached Thursday is tougher on lenders than any compromise discussed with them before the current congressional session began. Democrats now have the votes they need to pursue bold pro-consumer measures that were repeatedly defeated last year in the closely divided Senate. President-elect Barack Obama has supported changing the law for homeowners in bankruptcy.

Currently, bankruptcy judges can ratify reorganization plans that reduce principal owed on auto and student loans and mortgages on second homes. But they cannot modify the terms of a primary mortgage.

The Democrats' proposal allows judges to approve plans that make major reductions in home-loan debts, after homeowners certify that they have attempted to contact their lenders about a mortgage reduction before bankruptcy proceedings begin. Homeowners do not, however, have to have engaged in negotiations with their banks

The cramdown bill would apply to all mortgage loans, including subprime loans, written any time prior to the bill's date of enactment.

In a concession to lenders, a mortgage debt could be forgiven entirely only if the lender was found to have committed a major violation of the Truth in Lending Act. Under the bill's original language, the entire mortgage debt could be wiped away based on a violation of any number of state and federal consumer lending laws.

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