Testimony of

John Dodds

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My name is John Dodds, Director of the Philadelphia Unemployment Project, a non-profit membership organization that works with unemployed and low income people. We have worked on preventing foreclosures since the early 1980's.

Thank you Senator Specter for holding these hearings to highlight our efforts in Philadelphia to reduce mortgage foreclosures through the Mortgage Foreclosure Diversion Pilot Program.

We think that this program has the potential to be a national model. Certainly it is a godsend to distressed homeowners in the city of Philadelphia. What it does is set up a structured way, under the oversight of the courts, to modify the terms of unaffordable mortgages for Philadelphia homeowners.

While Philadelphia has not had the extreme increase in foreclosures that have been seen in other areas of the country the city has been targeted by the sub prime lenders. Sub prime loans became an ever growing part of mortgage lending in Philadelphia. In 2004 20% of all new mortgages were sub prime, in 2005 it was 31% and by 2006 37% of all new mortgages were sub prime. In many neighborhoods over 50% of the loans made in 2005 were sub prime. Clearly we had a problem that needed to be addressed before Philadelphia became another Cleveland or Phoenix.

As we know the growth of the subprime mortgage lending and other unconventional lending products has led to one of the most severe economic crises in decades in the United States. Massive defaults on these loans have rocked the financial industry and the stock market and are leading to a potentially devastating recession. We could debate who was at fault for this crisis- and we believe that a major cause was the mortgage industries becoming transfixed with the massive profits that subprime and other exotic mortgages products produced in the short term. Some homeowners joined the gold rush, while others were conned into taking loans that they would not be able to afford. So there are different points of view on who is at fault, but ultimately we need to find a solution to the economic crisis that we find ourselves in and the Diversion program has all the elements of that solution.

In my judgment the key to this national economic calamity is turning defaulting loans and foreclosures into performing loans that will generate a steady stream of income to shore up the mortgages backed securities that are at the root of the financial crisis. I am not alone in this assessment. FDIC Chair Sheila Bair, speaking on bail out efforts taken by the government, was quoted in the October 16 Wall Street Journal as saying, "But we're attacking it at the institutional level as opposed to the borrower level, and it's the borrowers defaulting. That is what's causing the distress at the institution level. So why not tackle the borrower problem?" An October 21 New York Times editorial stated "The unfortunate reality is that as long as millions of Americans continue to default on their mortgages and housing prices continue to slide, banks will continue to suffer big losses."

By managing the foreclosure process and requiring lenders and borrowers to sit down and negotiate with the aim of preventing a foreclosure, the Phhiladelphia Foreclosure Diversion Program has allowed subprime and defaulted loans to be modified and turned into performing loans. We have been impressed with the deals that have been secured for homeowners, particularly with families who had already been scheduled for Sheriffs Sale and were thus, quite far behind on mortgage payments. The first wave of properties stayed from Sheriff Sales scheduled from April to July of this year by the program have seen 230 homes permanently removed from sale and 200 others have had their sales postponed from one to five months. This is out of a total of 552 properties for a 78% success rate.

Our organization has been a part of the Diversion Program since the beginning, working with Judge Rizzo and the Foreclosure Steering Committee and we have handled a large number of cases. We have been tracking results and the early numbers are fairly incredible. Of 55 cases that PUP has handled from the June and August Conciliation Conferences 27 or 49% have had the mortgage modified. 13 more or 24% have a loan modification in process and the Sheriffs Sale has been postponed. Remember all of these homeowners had already been scheduled for Sheriffs Sale and most were substantially behind on their payments, some over 2 years. 73% of thses families secured or are in the process of securing a loan modification.

The Foreclosure Diversion Pilot Program gave them a second chance and allowed them to secure an affordable mortgage and keep their homes. Next to none of them would have been able to achieve these work outs without the Diversion Program. These are wins for families, wins for investors in mortgage backed securities and wins for communities that would have seen foreclosures and abandonment of properties.

Let me give some examples of loan modifications that have been negotiated. One homeowner was 18 months behind on his mortgage which was an Adjustable Rate Mortgage at 11.65%. Litton Loan Services agreed to reduce the loan to an 8% fixed rate and the monthly payments were reduced from $1,275 to $1,051. His arrears were capitalized. Another homeowner had a 10.75% ARM, which was reduced to a 6% fixed rate mortgage. Payments went down from $1,014 to $775. A third homeowner had her interest reduced from 13.75% to 8% for 5 years. Payments went down from $520 to $427. If all payments are made for the 5 years she would have her principal reduced by 3.5%.

This program is a major step in the right direction. Prior to the Court Order promulgated by Judge Darnell Jones and run by Judge Annette Rizzo we had to rely on voluntary work outs from servicers. It was often a very frustrating process to try to get work outs for our clients with the lenders. You could find yourself in voice mail maze and trying to get someone on the phone could be a real problem. Servicers would lose track of files, different loan officers would take over the cases and there was often competition between the collections departments and the loss mitigation departments. Often both departments would be proceeding at the same time and a work out was being attempted at the same time as a file was being sent for Sheriffs Sale. This was caused by the tremendous volume of foreclosures from around the country and a culture within servicers that has focused on collections for decades rather than loss mitigation. It is hard for some servicers to switch to a role that has aspects of a social service agency. But now in Philadelphia we have a program that forces lenders to make a real effort to get an affordable loan for homeowners and has court oversight of the process.

Thus, we have a model, but it cannot be transferred nationally without some alterations. There is a capacity issue to get a program like the Foreclosure Diversion Pilot Program geared up to a much larger scale. Governor Corzine of New Jersey is planning to implement this program in New Jersey, starting with the seven counties with the highest foreclosure rates. The rest of the counties are to follow. Senator Specter has encouraged Pennsylvania counties to follow suit. Once more locations begin to use this model things will change. There is a need for additional housing counselors and legal services attorneys to make this work. I know that money for housing counseling has been allocated, but more may be required. Courts that do oversight may need additional dollars.

However, I think where the program could really bog down if were to be made a national program would be with the servicers. We still have to fight a culture of decades of foreclosures as the answer to a defaulting loan as well as understaffing of loss mitigation departments. The massive surge in foreclosures means that the case by case modifying of loans will take greatly expanded staffing for loss mitigation. Many thousands of homeowners just fall through the cracks today. The Diversion program forces servicers to consider workouts or the end result is just pushed back further and further by postponing of Sheriff Sales. However, part of the reason it works is that it is unique and not happening everywhere. And even now there are lenders who do not commit staff with authority to modify loans to participate in Conciliation Conferences.

The incentive of mortgage servicers is not the same as the incentive of investors to modify defaulting loans. While investors and financial institutions are being killed by defaulting loans and would benefit from having a performing loan, even at a reduced interest and principal the servicers of the loans are actually dis-incented to do loan modifications. They get paid to do foreclosures but not to do loan modifications. The managing director of Deutsche Bank Securities estimates that it costs servicers $750 to $1,000 to complete a loan modification. So while fixing these loans may be in the interest of the economy, homeowners and communities and the investors who hold the mortgage backed securities, we are relying on servicers who do have any incentive to do the right thing.

We have a great deal of money available to save the economy right now. We should be using it to modify these defaulting loans. Foreclosure activity rose 70% nationally in the third quarter of this year over the third quarter of 2007. Foreclosures undercut housing costs as they sell at steep discounts or remain vacant and pull down neighboring property values. Until these mortgages can perform and make the securities that they underlie have some value, we are not going to resolve the financial crisis in this country.

Just like we put billions of dollars into the banks, it seems to me that the government should take over the servicing of mortgages and make sure that servicers offer homeowners affordable work outs so that we can have performing loans and return some value to the so called "toxic securities" held by so many financial institutions. If we wanted to make mortgages performing loans the Philadelphia Foreclosure Diversion Program is a great model. But we must be sure that the interests of those servicing the loans are the same as those of the rest of the country. The Treasury or the FDIC should make sure that this is the case and use some of the $700 billion dollars the Congress has allocated to either buy out or take some controlling interest in mortgage servicers. Then, like the FDIC is doing with the IndyMac Bank that it took over, they could do large scale modifications of troubled mortgages. This would protect homeowners, communities, investors and the overall health of the nation. It is a win win situation for all of us and we hope that the Committee will give this idea serious consideration.

One last point I'd like to make is that the effort to change bankruptcy law to allow judges to modify loans in bankruptcy is an important initiative also. It is needed to guarantee that homeowners have a safety net if all other efforts fail. So far all efforts, even the Philadelphia Diversion Program, count on voluntary efforts by lenders. Bankruptcy reform would guarantee that a Sheriff Sale is halted and that a disinterested party could oversee the resolution of a mortgage default. I hope that the Congress speedily enactts legislation allowing judges to modify loans in the bankruptcy process.

Thank you.