

*New Federal Initiatives Project*

**The Second “Helping Families Save Their  
Homes Act”**

**By  
Todd Zywicki and Jeffrey Frank\***

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### **Bill Tracking Information:**

H.R. 1106	S.895 (Similar / Companion Bill)
Introduced 2/23/2009	Introduced 4/24/2009
<u>Sponsor:</u> Rep. John Conyers (D-Mich.)	<u>Sponsor:</u> Sen. Christopher Dodd (D-Conn.)
<u>Disposition:</u> Passed House of Representatives 234Y - 191N - 7A/NP (3/5/2009)	<u>Disposition:</u> Reported by Committee, Placed on the Calendar

Congress is considering legislation to temporarily lift the statutory ban on the nonconsensual modification, or cramdown, of home mortgages.<sup>1</sup> The bill is called the Helping Families Save Their Homes Act of 2009.<sup>2</sup> It shares this moniker with a different bill which President Obama signed into law in May of 2009.<sup>3</sup> However, the already enacted version of the bill does not include key provisions modifying Chapter 13 of the Bankruptcy Code.<sup>4</sup>

The new bill essentially encourages loan servicers and those who hold current loans to participate in the Obama Administration's Making Home Affordable Program, by allowing existing homeowners to craft their own modification terms and then have those terms confirmed by a bankruptcy court over the objections of the holder of the loan. Under the proposed bill, the homeowner can extend the mortgage period up to 40 years, limit or freeze increases in adjustable interest rates, reset the interest rate to the current prime rate as of the date of the bankruptcy filing, and reduce the mortgage principal covered by the security agreement down to the value of their home.

The primary protections for the holders of loans consist of the prevention of discharge of a reduced loan, the requirement that the homeowner share a portion of any subsequent sale of their principal residence, and the possibility of offering the bankruptcy court competing payment plans, as long as they conform to some important parts of the Making Home Affordable Program guidelines and protect the principal of the loan. The court is free to confirm the competing plan, or may take account of the offer of a competing plan in determining whether the homeowner's plan should be confirmed.

### **The Bankruptcy Modification Provisions**

The key provisions of the bill allow debtors in Chapter 13 bankruptcy to offer a plan that satisfies the mortgage on their home by paying only the value of their home as determined by the bankruptcy court.<sup>5</sup> For the purpose of valuing the home, the bankruptcy court must apply the appraisal rules used by the Federal Housing Administration. Another major modification provision of the bill is that debtors can extend their mortgage up to 40 years from its original start date.<sup>6</sup> This gives a homeowner with a 30-year mortgage the right to take an additional decade to pay off the loan.

If they have an adjustable rate mortgage, debtors may also freeze, reduce, or delay any increases in the interest rate that could occur after they file bankruptcy.<sup>7</sup> The proposed modification may also provide that the debtor pay all interest accruing after the filing date at the average prime rate, as determined by the Federal Financial Institutions Examination Council.<sup>8</sup>

There are a large number of limitations on eligibility for mortgage modification. The loan must cover the debtor's principal residence, and must have originated before the bill becomes law in order to be subject to a modification plan.<sup>9</sup> The residence must also be subject to foreclosure by the holder of the loan, which will almost certainly be due to a lapse in payments by the debtor<sup>10</sup>.

In order to claim the benefit of reducing the value of the mortgage, debtors must make one of two certifications. Debtors may show that there is a scheduled foreclosure sale of their home within 30 days of their filing for bankruptcy.<sup>11</sup> Alternately, debtors may provide either the holder of the loan or the loan servicer with the income, expense, and debt statements they may file as part of the bankruptcy case.<sup>12</sup> If they elect this second option, they must consider any offer made by the loan holder or the servicer for a modification that conforms to the Obama Administration's guidelines under Homeowner Affordability and Sustainability Plan before having included any modification as part of a plan.<sup>13</sup>

The bill does offer some protection to the holder of the loan. It requires that debtors who have reduced the value of their mortgage split the proceeds of any future sale of their principal residence with the holder, if they have not received a discharge of their debts or completed their payment plan.<sup>14</sup> They must pay the holder a portion of the difference between the sale price and reduced mortgage up to a maximum amount of what the homeowner would have still owed under the unmodified loan.<sup>15</sup> The proportions are: 90% of that difference during the first year following the modification, 70% following the second year, 50% following the third year, 30% following the fourth year, and 10% following the fifth year.<sup>16</sup>

Another protection offered by the bill to the holder of the loan is a good faith requirement to plan confirmation, set forth in an amendment to 11 U.S.C. § 1325(a).<sup>17</sup> Although it is not dispositive of the court's good faith finding, the court must consider whether the holder of the loan or the servicer offered the debtor a qualified loan modification plan that would reduce the debtor's payments and overall debt without reducing the principal.<sup>18</sup> The court must not confirm any mortgage modification either by a debtor whom it deems able to pay its debts or by a debtor convicted of obtaining an advantage with respect to the credit to be modified by actual fraud.<sup>19</sup>

Additional provisions absolve the bankruptcy estate from liability for certain fees, and allow all modification plans affecting principal residences to waive any prepayment penalty that was part of the original mortgage terms.<sup>20</sup> The bill permits the debtor to obtain a discharge without having fully paid the holders of a modified loan, but prohibits discharge of any of the debt still due to that holder.<sup>21</sup> The holder of the loan is allowed to retain the lien on the debtor's residence until the later of payment of the reduced claim, completion of all plan payments, or discharge of debts.<sup>22</sup>

### **The Bill's Relation to the *Making Home Affordable* Program**

By requiring the debtor to consider the offer of a qualified loan modification program, the bill aims to foster support for the Obama Administration's plan to promote modifications outside of bankruptcy.<sup>23</sup> While the bill references guidelines under the Homeowner Affordability and Stability Plan,<sup>24</sup> it appears that the Administration has given the Plan and its guidelines a new

name: the Making Home Affordable Program.<sup>25</sup> Under this Program, the lender must reduce the borrower's monthly mortgage payment to 38% of the borrower's income and comply with additional requirements.<sup>26</sup> After this initial reduction, the Program will fully finance modifications that reduce payments to as low as 31% of the borrower's income.<sup>27</sup> The Program also contemplates additional money incentives to loan holders, servicers, and borrowers to make modifications resulting in the rescue of high risk loans.<sup>28</sup>

In addition to considering whether the refusal of a Making Home Affordable offer constitutes bad faith, the court may confirm a competing plan that meets the Program's payment-reduction guidelines.<sup>29</sup> The holder of the loan with the senior security interest in the debtor's principal residence may offer a competing plan.<sup>30</sup> The court may only confirm the competing plan if it determines that, after allowance of expenses that would normally be permitted under a § 1325(b)(3) calculation as well as debts and fees the debtor otherwise has to pay, the debtor could pay a 30-year fully amortizing loan at the interest rate offered by the competing plan.

If the bill were passed as written, Congress would express its sense that no foreclosures ought to occur on any principal residences secured by a first mortgage until the Obama Administration's foreclosure mitigation programs are implemented.<sup>31</sup> While those programs are already well underway, this expression and the operative bankruptcy provisions of the bill make it clear that its passage would indicate a Congressional policy of pushing current borrower-lender relationships towards these programs through the Bankruptcy Code.

*\* Todd Zywicki is a George Mason University Foundation Professor of Law and teaches in the areas of bankruptcy and contracts. Jeffrey Frank is a 2011 J.D. Candidate at the George Mason University School of Law.*

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<sup>1</sup> A "cramdown" is traditionally defined as the confirmation of a bankruptcy plan that binds creditors and debtors over the opposition of some of the creditors. *See* BLACK'S LAW DICTIONARY 423 (9th ed. 2009). Although it has traditionally referred to Chapter 11, an analogous process is contained in 11 U.S.C. § 1325(a) (5) (2009) (allowing confirmation of a payment plan under conditions which do not require acceptance by the holders of claims). Most commentators also refer to this as cramdown.

<sup>2</sup> Helping Families Save Their Homes Act of 2009, H.R. 1106, 111th Cong. (Feb. 23, 2009), S. 895, 111th Cong. (April 24, 2009).

<sup>3</sup> Pub. L. No. 111-22 123 Stat. 163 (2009).

<sup>4</sup> *Compare id. with* H.R. 1106; S. 895.

<sup>5</sup> H.R. 1106 at § 103(1) (2009) (allowing reduction of the claim to the allowed secured claim as determined in 11 U.S.C. § 506(a) (1)); *see also* 11 U.S.C. § 506(a) (1) (2009) (capping the value of an allowed secured claim to the value of the property serving as the security).

<sup>6</sup> *See* H.R. 1106 at § 103(1) (2009) (providing for an extension for a maximum time of either 40 years minus the time the loan has been outstanding or the time remaining on the loan, whichever is longer).

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

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- <sup>10</sup> *Id.*
- <sup>11</sup> H.R. 1106 at § 103(1) (2009).
- <sup>12</sup> *Id.*
- <sup>13</sup> *Id.*
- <sup>14</sup> *Id.*
- <sup>15</sup> *Id.*
- <sup>16</sup> H.R. 1106 at § 103(1) (2009).
- <sup>17</sup> H.R. 1106 at § 105(a)(1) (2009).
- <sup>18</sup> *Id.* A qualified loan modification must reduce a debtor's overall payments without charging any fees or imposing negative amortization for any period as a one of the conditions.
- <sup>19</sup> *Id.*
- <sup>20</sup> H.R. 1106 at § 104 (2009).
- <sup>21</sup> H.R. 1106 at § 106 (2009).
- <sup>22</sup> H.R. 1106 at § 105 (2009).
- <sup>23</sup> H.R. 1106 at § 100 (2009).
- <sup>24</sup> *Id.*
- <sup>25</sup> *Compare* Homeowner Affordability and Stability Plan, available at <http://www.financialstability.gov/latest/tg33.html>; *with* Making Home Affordable: Updated Detailed Program Description, available at [http://www.treas.gov/press/releases/reports/housing\\_fact\\_sheet.pdf](http://www.treas.gov/press/releases/reports/housing_fact_sheet.pdf).
- <sup>26</sup> Making Home Affordable: Updated Detailed Program Description, *supra* note 21.
- <sup>27</sup> Making Home Affordable: Updated Detailed Program Description, *supra* note 21.
- <sup>28</sup> Making Home Affordable: Updated Detailed Program Description, *supra* note 21.
- <sup>29</sup> H.R. 1106 at § 105 (2009).
- <sup>30</sup> *Id.*
- <sup>31</sup> H.R. 1106 at § 401 (2009).

### **Related Links:**

Helping Families Save Their Homes Act of 2009, H.R.1106: <http://thomas.loc.gov/cgi-bin/bdquery/z?d111:HR01106>:

"Don't Let Judges Tear Up Mortgage Contracts: That's the last thing troubled securities markets need" by Todd Zywicki, *Wall Street Journal*:  
<http://online.wsj.com/article/SB123449016984380499.html>