

## **Questions about principal reduction City Life/Vida Urbana – May, 2011**

Millions of American homeowners who can't afford their mortgage at the values of the housing bubble could afford their mortgage at current real value with a 30-year fixed rate mortgage. This would mean including principal reduction in loan modification.

That's what our movement has been demanding for 4 years. We have won this demand after foreclosure, but forcing the sale of the property back to the former owner or to the tenant occupants. But why isn't this happening during loan modification? Banks could actually save money by avoiding foreclosure. They could even get a share of equity appreciation.

Here are questions posed about our demand for principal reduction.

### **Why do we have the right to demand principal reduction?**

Wall St. Banks caused the financial crisis. The key element of this crisis was the creation of a housing bubble. Real estate prices escalated way past incomes. These same banks created incentives up and down the mortgage chain to lure/push buyers into predatory loans and to buy at inflated prices.

It's now clear (from Congressional hearings) that these banks knew the bubble would burst. This has left millions of homeowners with "underwater" loans (real value less than loan value). The banks should restore health to those borrowers, to their communities, and to the financial system by reducing principal and redoing loans at the real current value, which is also the historic trend value had the bubble not occurred.

### **Aren't we rewarding bad behavior? Isn't there a moral hazard issue here?**

It's ridiculous to hear Bank of America or JP Morgan Chase discussing someone else's moral problems. While individual borrowers may have made bad decisions, the impact of any individual borrower's decision is very tiny compared to the huge impact of the Wall St. created bubble.

Most borrowers did not get into trouble by "buying more home than they could afford", as banks allege. They got into trouble being told by everyone (bankers, mortgage brokers, realtors, government leaders, even pastors) that they should be regardless of the price because the price would only go up. Promises were made to refinance and never kept.

### **Why not just do loan modification by changing interest rates? Why principal reduction?**

It is widely acknowledged that the loan modification program has largely been a failure. The statistics to show this failure are usually that a small percentage of borrowers facing foreclosure have received permanent loan modification. A large reason for this failure is that banks allege an owner does not have sufficient income for the modification. However, that assessment is made on the loan value, not the real value. If banks included principal reduction in loan modification, a much larger percentage would be approved.

It would also cut down on defaults after loan modification. Successful loan modifications without principal reduction are often very bad, putting large balloon payments at the end of the mortgage. A homeowner will pay for 25 years and never gain equity. These modifications lead back into default and foreclosure.

### **Why should the banks agree to lose more money?**

Banks have already lost the money. The value of their holdings has declined dramatically after the housing bubble burst. Their books reflect values that are not real. Even the Federal Reserve Bank of Atlanta acknowledged that a bank saves money by doing principal reduction rather than letting a borrower go into foreclosure.

### **Why don't banks do more principal reduction if they would save money**

The Banks are convinced that they can keep many homeowners dipping into their savings, working 2 jobs, etc. to pay mortgages on the inflated bubble values. One way they hope to do this is by punishing owners wherever possible

After foreclosure, when they have to sell foreclosed REO property at real value, they refuse to sell that property back to the former owner or their family even if they can afford it. When non-profits make offers to buy occupied foreclosed buildings, Wall St. banks will often insist on eviction first. They want to make the pain of foreclosure as unbearable as possible.

For this to be done by Wall St. banks that have been bailed out with trillions of dollars by taxpayers is unconscionable.

### **Principal reduction is not how it works in the hard nosed business world**

Actually, it's exactly how it works. Bankers yell about the potential for homeowners to do "strategic defaults", to stop paying mortgages because they are underwater.

Of course, this is exactly what businesses do. In fact, Jon Stewart's Daily Show did a hilarious piece on the Mortgage Bankers Association. It started with clips of the MBA president attacking the immorality of strategic defaults. Then it uncovered that the MBA itself had strategically defaulted on its mortgage on the building it owned.

Bankruptcy judges can routinely alter the principal owed on second homes or yachts, but not on your first home, the primary form of wealth that average people have. This is a rather gross class inequity that further points out the injustice of not doing principal reductions for ordinary people.

### **Why hold rallies and demonstrations? Why not change the laws?**

The rallies are designed to change the laws, and Bank Tenant groups work actively through coalitions like MAAPL (Mass. Alliance Against Predatory Lending) to do that.

However, when the US Senate in May of 2009 considered a bill to allow bankruptcy judges to reduce principal on first homes, this measure was defeated, despite overwhelming Democratic Party control. Sen. Dick Durbin from Illinois commented that "The Banks own the place [the Senate]".