HOUSING AND ECONOMIC RECOVERY ACT OF 2008

I. Introduction

The early 2000s saw a substantial shift in home mortgage lending practices. Rather than financing mortgages through deposits received from customers, banks increasingly financed mortgages through bond markets.[1] This made it much easier to fund additional lending, and resulted in a dramatic increase in non-government-backed mortgages, many of which were "subprime" loans to borrowers with poor credentials and "jumbo" loans that exceeded the limits on government-backed mortgages.[2]

Unfortunately, many of these loans were "adjustable rate mortgages" (ARMs), the rates of which increased dramatically after a period of two years.[3] Thus, by the summer of 2008, many of these mortgages had resulted in repossessions of homes, which in turn led to a glut in the U.S. housing market and a substantial collapse in residential property values.[4] Lenders now saw not only massive defaults,[5] but a situation in which many residential properties were worth less than the value of the mortgage loan.[6] Lenders and investors in mortgage-backed securities lost substantial amounts of money, and many families were evicted from their homes.[7] In addition, the wave of foreclosures had external consequences on third parties: As foreclosures increased, they drove down nearby property values by producing unsightly boarded-up houses that sometimes also became magnets for criminal activity.[8]

Congress responded to this crisis by passing the Housing and Economic Recovery Act of 2008 ("HERA"), which President Bush signed into law on

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[1] *See* Nicholas Bagley, *Subprime Safeguards We Needed,* Wash. Post, Jan. 25, 2008, at A19.

[2] Jeff Manning, *Jumbo Mortgages: Real Estate Industry Could Find Prize Inside,* Oregonian, Jan. 26, 2008, at D01; Sam Ali, *Loaning Large: In New Jersey Mortgage Industry, Supersized Survives,* The Star-Ledger (Newark, N.J.), Sept. 21, 2007, at 47.

[3] *See* Renae Merle, *Mortgage Troubles Rise to Record Level; Recession, Job Losses Driving Distress,* Wash. Post, Dec. 6, 2008, at D01.

[4] Bill Bush, Geoff Dutton & Doug Haddix, *How the Mortgage Meltdown Affects You; Bursting Bubbles; Risky Mortgages Deflate Home Values as Entire Neighborhoods Pay the Price,* Columbus Dispatch, June 1, 2008, at 1G.

[5] *See* Steve Brown, *Mortgage Crisis, Pricier Homes Hit Foreclosure Lists, Million-Dollar Houses Double Their Numbers,* Dallas Morning News, July 4, 2008, at 1D (containing chart of foreclosure increases between 2007 and 2008).

[6] *See* Donna Rogers, *Swamped by Too Big a Mortgage? A Short Sale Might Get You Afloat,* Newsday, Apr. 10, 2009, at E06.

[7] *See* Bush et. al, *supra* note 4.

[8] Haya El Nasser, *Foreclosure Crisis Has Ripple Effect; Local Officials See More Crime, Blight, Less Tax Revenue,* USA Today, Mar. 11, 2008, at 3A. *But see* Bradley Campbell, *Has the Foreclosure Crisis Pacified Minneapolis' Most Dangerous Neighborhoods?*, City Pages, Aug. 6, 2008, http://www.citypages.com/2008-08-06/news/has-the-foreclosure-crisis-pacified-minneapolis-most-dangerous-neighborhoods (last visited Apr. 18, 2009) (on file with the Harvard Law School Library) (arguing that foreclosures have reduced crime by reducing the number of potential victims).

July 30, 2008.[9] As a legislative attempt to respond the housing bubble collapse, HERA represents the first of the so-called "bailout" provisions passed or proposed in the 110th Congress to deal with the recession that began in 2007, preceding the larger and more contentious bank and automobile manufacturer bailouts.[10]

This article will look at HERA in the context of five government aims: (1) helping government-sponsored entities (GSEs) that regulate the mortgage industry to handle the housing crisis; (2) providing relief for borrowers and lenders currently dealing with the effects of the housing crisis; (3) stabilizing the housing market; (4) remedying the social consequences of foreclosures; and (5) preventing a future housing crisis. The article describes the specific provisions of HERA and discusses how these provisions purported to achieve these ends. It then evaluates how successful HERA has been at accomplishing them, and considers subsequent proposals that also purport to achieve them. The article concludes that HERA has likely achieved the first goal by improving GSE regulation, and will probably experience more modest success with stabilizing the real estate market. At the same time, the article also concludes that it is at best unclear whether HERA has given effective relief to lenders and borrowers currently affected by the crisis, and it is probably insufficient to prevent a future crisis. Finally, the article argues that a scheme that allows borrowers to refinance their mortgages, but holds lenders accountable for at least some of their irresponsible loans, will remedy these failures of HERA.

II. Provisions of the Housing and Economic Recovery Act of 2008

At 260 pages, HERA is a substantial piece of legislation with at least twelve major parts. HERA's provisions generally focus on accomplishing the four aforementioned aims: (1) assisting GSEs that regulate the mortgage industry;[11] (2) providing relief to lenders and borrowers;[12] (3) stabilizing the housing market;[13] (4) remedying the social consequences of foreclosures;[14] and (5) preventing a future housing crisis.[15]

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[9] Pub. L. No. 110-289, 122 Stat. 2654 (2008) (to be codified at scattered sections of 12, 15, 26, 37, 38, and 42 U.S.C.A.) [hereinafter HERA].

[10] Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (bank or "financial bailout" signed into law by President Bush on Oct. 3, 2008) [hereinafter EESA]; Auto Industry Financing and Restructuring Act, H.R. 7321, 110th Cong. (2008) (proposed "auto bailout," which passed the House on Dec. 10, 2008, but failed to pass in the Senate).

[11] *See infra* Part II.A.

[12] *See infra* Part II.B.

[13] *See infra* Part II.C.

[14] *See infra* Part II.D.

[15] *See infra* Part II.E.

A. Assisting GSEs

The Federal Housing Finance Regulatory Reform Act includes safeguards against undercapitalization of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks by empowering the Director to act in three distinct situations. If the Director deems a regulated entity "undercapitalized," she may institute closer monitoring of the entity's activities, place restrictions on the entity's asset growth, and require prior approval of any new acquisitions and activities by the entity.[16] If she deems an entity "significantly undercapitalized," the Director may additionally call new elections for the entity's board of directors, dismiss directors or executive officers of the entity, require the entity to employ "qualified executive officers" subject to his or her approval, and restrict the compensation of the entity's executive officers.[17] Finally, if the Director classifies an entity as "critically undercapitalized," the FHFA may take control of the entity under a conservatorship.[18]

B. Providing Relief for Lenders and Borrowers

As lenders face the prospect of borrowers' failure to repay loans, so borrowers face loans that they cannot realistically afford to pay, and which often exceed the value of the residence securing them.[19] In order to provide relief for both groups, the HOPE for Homeowners Act ("HOPE"), creates a voluntary program that may allow homeowners to avoid foreclosure by refinancing their loans.[20] HOPE would reduce an eligible homeowner's loan debt to no greater than 90% of the appraised value of the property.[21] The lender would in turn waive all prepayment penalties, default fees, delinquency fees, and subordinate liens.[22] The refinanced loans, insured by the federal government,[23] would have an interest rate "commensurate with market rate interest rates on such types of loans."[24] HOPE bonds issued by the Treasury Department, at an amount up to $300 billion, will in turn fund the federal insurance program.[25]

The HOPE for Homeowners Act also restricts the program to loans on primary residences and prohibits participating mortgagors from granting a

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[16] *See* 12 U.S.C.A. § 4715(a)(2)(1) (West 2009).

[17] *Id.* §§ 4614(a), 4616 (West, Westlaw through Pub. L. No. 111-7).

[18] *Id.* § 4617 (West 2009); *see also* Posting of Steven M. Davidoff to Dealbook, http://dealbook.blogs.nytimes.com/2008/08/21/structuring-a-bailout. (Aug. 21, 2008, 10:35 EST). In fact, this has happened with Freddie Mae and Fannie Mac. *See* Part III(C)(2) *infra*.

[19] *See, e.g.*, Rogers, *supra* note 6.

[20] 12 U.S.C.A. § 1715z-23(b)(1)–(2) (West 2009).

[21] *See id.* § 1715z-23(e)(2)(B). To be eligible, a homeowner must certify that he has not intentionally defaulted on the loan or knowingly provided false information to the lender and must have a mortgage debt-to-income ratio of 31% or greater. *Id.* § 1715z-23(e)(1)(B).

[22] *Id.* § 1715z-23(e)(1)(3).

[23] *See id.* 1715z-23(d).

[24] *Id.* § 1715z-23(e)(1)(3).

[25] *See id.* §§ 1715z-23(m),(w).

second lien for five years, unless such lien is necessary to ensure the maintenance of property standards.[26] Furthermore, should the homeowner sell or dispose of the refinanced property, or should the mortgage be refinanced in the first five years of HOPE participation, the Secretary of the Treasury will receive a portion of the equity, ranging from 100% after one year to 50% after five years.[27]

C. *Stabilizing the Housing Market*

The housing and mortgage crisis has seen a glut on the residential housing market, resulting in a substantial decrease in home prices. HERA contains a number of provisions that could stabilize the market,[28] including: (1) a new tax credit for homebuyers;[29] (2) support for redevelopment of abandoned properties;[30] and (3) support for real estate investment.[31]

1. *Tax Credit for Homebuyers*

The Housing Assistance Tax Act of 2008, a series of amendments to the Internal Revenue Code of 1986, contains HERA's tax-related provisions. The Act temporarily increases the volume cap for the low-income housing tax credit and makes it easier to qualify for the credit.[32] The Act also creates a new first-time homebuyer credit of $7500, which the homebuyer must repay over a fifteen-year period,[33] and an additional deduction for real estate property taxes of up to $500 (or $1000 in case of a joint return).[34] As a standard deduction, it is available even to taxpayers who do not itemize.[35] In addition, the act provides for a temporary one-year increase in the ceiling for housing bonds,[36] and exempts interest on certain housing bonds from the alternative minimum tax.[37]

2. *Support for Redevelopment of Abandoned Properties*

A section of HERA entitled "Emergency Assistance for the Redevelopment of Abandoned and Foreclosed Homes" sets aside $4 billion of Treasury

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[26] *See* 12 U.S.C.A. § 1715z-23(e)(7),(11) (West 2009).
[27] *See id.* § 1715z-23(k)(1)(A),(F).
[28] I define "stabilize the market" as ending this glut through encouraging home sales, reducing the amount of homes on the market, and thus eventually raising prices.
[29] *See infra* Part II.C.1.
[30] *See infra* Part II.C.2.
[31] *See infra* Part II.C.3.
[32] *See* HERA, *supra* note 9, §§ 3002–05, 122 Stat. 2654, 2879–86 (West 2009).
[33] *See id.* § 3011(a), 122 Stat. 2654, 2888 (amending I.R.C. § 36 (2007)).
[34] *See id.* § 3012(b), 122 Stat. 2654, 2892 (amending I.R.C. § 63(c)).
[35] *See id.*
[36] 26 U.S.C.A. § 146(d)(5) (West 2009).
[37] *See* HERA, *supra* note 9, § 3022(a)(1), 122 Stat. 2654, 2893 (amending I.R.C. § 57(a)(5)(C)).

Department money "not otherwise appropriated for fiscal year 2008" for the "redevelopment of abandoned and foreclosed upon homes and residential properties."[38] Of this $4 billion sum $3.92 billion is appropriated to states for the purpose of financing mechanisms for the purchase and redevelopment of foreclosed upon homes and residential properties, including, but not limited to, establishing land banks, demolishing blighted structures, and redeveloping demolished or vacant properties.[39] The states may retain the revenue generated from the use of this funding during the first five years of the program; thereafter, they must deposit any new revenue in the U.S. Treasury.[40] At least 25% of the funds appropriated under this section must be used for the purchase and redevelopment of low- or moderate-income housing.[41]

3. *Support for Real Estate Investment*

HERA contains a title named "Reforms Related to Real Estate Investment Trusts," which simplifies the regulation of Real Estate Investment Trusts ("REITs").[42] For instance, foreign currency gains and income from hedging transactions are exempted from REIT income tests, and the Secretary may further exempt items of income at his discretion.[43] Simplifying the regulation of REITs may encourage more investors to put funds into REITs.[44] Even if this does not happen, it is also plausible that simplifying regulations and lowering taxes on REITs will allow a larger percentage of money put into REITs to go towards the improvement of properties.[45]

D. *Remedying Social Consequences*

Foreclosure has at least two negative social consequences. First, those removed from foreclosed residential property need to find housing. Second, foreclosures might have external consequences for neighbors by lowering property values or promoting blight and crime. HERA contains a number of

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[38] 42 U.S.C.A. § 5301 note, *amended by* HERA, Pub. L. No. 110-289, § 2301(a), 122 Stat. 2654, 2850 (West 2009).

[39] *See id.* § 5301 note, *amended by* HERA, Pub. L. No. 110-289, § 2301(c)(3), 122 Stat. 2654, 2851.

[40] *See id.* § 5301 note, *amended by* HERA, Pub. L. No. 110-289, § 2301(d)(4)(A)(ii)(I), 122 Stat. 2654, 2851.

[41] *See id.* § 5301 note, *amended by* HERA § 2301(f)(3)(A)(ii), 122 Stat. 2654, 2853.

[42] *See* Sec. & Exch. Comm'n, Real Estate Investment Trusts (July 14, 2004), http://www.sec.gov/answers/reits.htm (on file with Harvard Law School Library).

[43] *See* HERA, *supra* note 9, § 3031, 122 Stat. 2654, 2897–99.

[44] *See* World Bank, Int'l Fin. Corp. & Oxford Univ. Press, *Doing Business in 2005: Removing Obstacles to Growth* 2 (2005) (arguing that "simpler regulations can provide better social protections and a better economic climate for businesspeople [and] investors"). *Available at* http://rru.worldbank.org/Documents/DoingBusiness/DB-2005-Overview.pdf.

[45] *See* Andrea James, *Tax Break Spurs Developer Interest in Neglected Lot,* Seattle Post-Intelligencer, Jan. 22, 2008, at C1 (suggesting that lower taxes may spur increased investment in real estate).

provisions that could counter-act these negative consequences by (1) expanding low-income housing stock;[46] (2) retarding the foreclosure process for individuals serving in the military;[47] and (3) promoting external increases in property value.[48]

1. *Expanding Low-Income Housing*

Though primarily concerned with regulating GSEs, the Federal Housing Finance Regulatory Reform Act also contains several provisions that may aid low-income home owners.[49] For instance, the Act requires the FHFA Director to establish annual goals with respect to mortgage purchases by regulated entities for single-family housing and multifamily special affordable housing.[50] The Act also creates a "duty to serve underserved markets" by requiring regulated entities to "provide leadership to the market in developing loan products and flexible underwriting guidelines to facilitate a secondary market for very low-, low-, and moderate-income families."[51] In addition, regulated enterprises must set aside a portion of their new business purchases to support two funds: the Housing Trust Fund and the Capital Magnet Fund.[52]

The Federal Housing Finance Regulatory Reform Act also creates the Housing Trust Fund to issue grants to state and tribal housing and community development agencies for the purposes of increasing and preserving the supply of rental housing for extremely low-income, very low-income, and homeless families and increasing homeownership among extremely low- and very low-income families.[53] A need-based formula established by the Director will determine the funds allocated to each state, though each state and the District of Columbia will receive at least $3 million per year.[54] These grants must satisfy federal accountability and transparency standards.[55]

The Secretary of the Treasury may use the Capital Magnet Fund for the purpose of carrying out a competitive grant program to attract private capital for, and increase investment in, the development, preservation, rehabilitation, or purchase of affordable housing for extremely low-, very low-, and

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46 *See infra* Part II.D.1.

47 *See infra* Part II.D.2.

48 *See infra* Part II.D.3.

49 *See* 154 Cong. Rec. E1630 (daily ed. July 31, 2008) (statement of Rep. Waters (D-Cal.)).

50 *See* 12 U.S.C.A. § 4561(a) (West 2009).

51 *Id.* § 4565(a)(1) (West 2009).

52 *See id.* § 4567(a) (West 2009). The set-aside amount is equal to 4.2 basis points for each dollar of the unpaid principal balance of the regulated entity's new business purchases. *See id.* §§ 4567(a)(1)(A), (a)(2)(A). The entities are prohibited from passing on the cost of these allocations to lenders. *See id.* § 4567(c).

53 *See id.* § 4568(a)(1) (West 2009).

54 *See id.* § 4568(c)(4)(C).

55 *See id.* § 4568(i); *see also* Federal Funding Accountability and Transparency Act of 2006, 31 U.S.C.A. § 6101 (2006).

low-income families.[56] The grant program may also fund related economic developments such as day care centers, workforce development centers, and healthcare centers that serve low-income communities.[57] Such grants may issue to either Treasury-certified Community Development Financial Institutions (CDFIs)[58] or nonprofit organizations having as one of their principal purposes the development or management of affordable housing.[59] These organizations may then use the grants to provide loans or capitalize funds used to aid residents of affordable housing.[60]

2. *Retarding Foreclosures*

HERA contains at least one provision that would alleviate the negative social consequences of foreclosure by postponing foreclosure itself: the Mortgage Foreclosure Protection for Servicemembers Act.[61] This act temporarily increases the maximum loan guarantee that the Department of Veterans Affairs can issue to the greater of 25% of the GSE's loan limit or 125% of the median area price.[62] It also temporarily increases the amount of time a lender must wait before foreclosing on a returning servicemember's home from three months to nine months,[63] and limits mortgage interest rate increases during active duty, and for one year thereafter, to 6%.[64] Finally, the Act creates a counseling program for servicemembers returning from active duty abroad, operated by the Department of Defense, which advises them on actions they can take to prevent or forestall mortgage foreclosure.[65]

3. *Positive External Increases in Property Value*

The REIT reform and property development for which HERA provides may have the additional consequence of alleviating the blight and property value loss associated with foreclosures.[66] Indeed, some government-sponsored property development programs could leave neighborhoods looking more aesthetically pleasing than before, thereby raising property values.[67]

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[56] *See* 12 U.S.C.A. § 4569(c)(1) (West 2009).

[57] *See id.* § 4569(c)(2).

[58] *See id.* § 4569(e)(1). A CDFI is an entity established to provide credit and financial services to underserved markets or populations. *See id.* § 4701.

[59] *See id.* § 4569(e)(2).

[60] *See id.* § 4568(f).

[61] HERA, *supra* note 9, § 2202-03, 122 Stat. 2654, 2848-50 (West 2009) (codified at 10 U.S.C.A. § 992 note, 50 U.S.C.A. app. §§ 527, 533).

[62] *See id.* § 2201, 122 Stat. 2654, 2845.

[63] 50 U.S.C.A. app. § 533(c).

[64] *See id.* § 527(a)(1).

[65] *See* 10 U.S.C.A. § 992 note.

[66] *See* Laura Crimaldi, *HUB Puts Its Money Where Its Blight Is,* BOSTON HERALD, Feb. 15, 2009, at 004 (suggesting that HERA money could be used to redevelop foreclosed property and keep it out of the hands of "unscrupulous" parties).

[67] *See* Scott Wartman, *Midway District Gets Spruce-Up Treatment,* CINCINNATI ENQUIRER, Feb. 9, 2009, at 1B (example of government program to improve neighborhood aesthetics).

Likewise, developing property rather than merely letting it remain idle is likely to reduce the crime increase effect, which requires vacant, unmonitored buildings that criminals can enter and use.[68] Therefore, apart from alleviating the housing glut, these sections can also compensate for the negative external consequences of the foreclosure wave.

E. Preventing a Future Crisis

HERA contains provisions that might help prevent another housing crisis in at least three ways: (1) by providing greater oversight of GSEs,[69] (2) by expanding government-backed financing options for homebuyers,[70] and (3) by regulating the private market for home financing.[71]

1. Improving GSE Oversight

The first part of HERA, the Federal Housing Finance Regulatory Reform Act, creates the Federal Housing Finance Agency ("FHFA"), a new independent federal agency.[72] The President appoints the Director of the FHFA, with advice and consent of the Senate, for a five-year term. The Director must be a citizen of the United States with "a demonstrated understanding of financial management or oversight" and "a demonstrated understanding of capital markets."[73] He receives advice from the newly-established Federal Housing Finance Oversight Board, which includes the Secretary of the Treasury, the Secretary of Housing and Urban Development ("HUD"), and the Chairman of the Securities and Exchange Commission ("SEC").[74]

In addition to the authority granted the FHFA discussed in Part A.1 above, the Federal Housing Finance Regulatory Reform Act also charges the FHFA with regulating the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac"), and the twelve Federal Home Loan Banks.[75] Specifically, the Act gives the FHFA the authority to ensure that the regulated entities "operate in a safe and sound manner"[76] with "adequate capital and internal controls," "foster liquid, efficient, competitive, and resilient national housing finance markets," comply with laws, rules, and regulations, and act "consistent[ly] with

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[68] *See* Douglas Goodman & Bruce Mann, *An Empirical Investigation of More Police Time: Crime and Midsize Cities, 1990 v. 2000* (July 25, 2005), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=770385 (finding evidence indicating that minimizing vacant buildings leads to a decrease in crime).

[69] *See infra* Part II.E.1.

[70] *See infra* Part II.E.2.

[71] *See infra* Part II.E.3.

[72] 12 U.S.C.A. § 4511(a) (West 2009).

[73] *Id.* § 4511(b)(1).

[74] *See id.* § 4513a(a), (c) (West 2009).

[75] *See id.* §§ 4502(20), 4511(b) (West 2009).

[76] *Id.* § 4611(a)(1) (West 2009).

the public interest."[77] The FHFA may also review and reject any acquisition or transfer of a controlling interest in any of the entities it regulates.[78]

In addition, the Director may require regulated entities to submit regular reports on their finances, activities, and operations.[79] The FHFA also includes an Inspector General who may review regulated entities, and the agency in general may hire accountants, economists, and examiners to undertake additional review.[80] To carry out his duties, the Director may issue rules, regulations, guidelines, and standards as necessary.[81] These may include risk-based requirements for portfolio holdings and minimum capital levels for regulated entities.[82] The Director also has the power to withhold salary and block "golden parachute" payments for executives of regulated entities in cases of mismanagement.[83] Regulated entities also now require the approval of the Director before they can offer any new product.[84] The National Council of State Housing has described these regulatory powers as the type held by "banking regulators."[85]

2. *Expanding Government-Backed Financing Options*

Multiple sections of HERA expand government-backed financing options for homeowners. The Federal Housing Finance Regulatory Reform Act also changes the loan limits imposed on Fannie Mae and Freddie Mac, raising them to $417,000 for a mortgage secured by a single-family residence, $533,850 for a mortgage secured by a two-family residence, $645,300 for a mortgage secured by a three-family residence, and $801,950 for a mortgage secured by a four-family residence.[86] In areas deemed "high-cost," the act increases these limits to the lesser of 115% of the median house price or 150% of the loan limit.[87] On January 1 of each year, the FHFA may modify these limits in recognition of price changes.[88]

The FHA Modernization Act, another section of HERA that deals with government-backed financing options, increases the maximum value of a

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[77] *Id.* § 4513(a)(1)(i), (ii), (v) (West 2009).

[78] *See* 12 U.S.C.A. § 4513(a)(2)(A).

[79] *See id.* § 4514(a)(1) (West 2009).

[80] *See id.* § 4517(d), (h) (West 2009); *see also* Inspector General Act of 1978 § 3(a), 5 U.S.C. app. § 1 (2006).

[81] *See* 12 U.S.C.A. §§ 4502, 4526(a) (West 2009).

[82] *See id.* §§ 4611-12 (West 2009).

[83] *See id.* § 4518 (West 2009).

[84] *See id.* § 4541(a) (West 2009).

[85] NAT'L COUNCIL OF STATE HOUS. AGENCIES, HOUSING AND ECONOMIC RECOVERY ACT OF 2008, H.R. 3221, NCSHA SUMMARY 7 (2008), http://www.ncsha.org/uploads/NCSHA%20HR%203221%20Summary%20FINAL.pdf.

[86] 12 U.S.C.A. §§ 1454(a)(2), 1717(b)(2), *amended by* HERA, Pub. L. No. 110-289, §§ 1124(a)(1), (b)(1), 122 Stat. 2654, 2691–92 (West 2009).

[87] *See id.* §§ 1454(a)(2), 1717(b)(2), *amended by* HERA, Pub. L. No. 110-289, §§ 1124(a)(2), (b)(2), 122 Stat. 2654, 2692–93.

[88] *See id.* §§ 1454(a)(2), 1717(b)(2), *amended by* HERA, Pub. L. No. 110-289, §§ 1124 (a)(1), (b)(1), 122 Stat. 2654, 2691–92.

Federal Housing Administration ("FHA") loan to the lesser of 115% of the median home price in the area or 150% of the loan limit for a GSE (e.g., Fannie Mae or Freddie Mac).[89] The Act requires a 3.5% cash down payment for any FHA loan and prohibits the lender from financing the down payment.[90] While the Act raises insurance premiums on FHA loans,[91] it also prohibits new increases for premiums on multifamily loans until October 1, 2009,[92] and places a twelve-month moratorium on new risk-based premiums.[93] The FHA Modernization Act also expands FHA's Home Equity Conversion Mortgage ("HECM") program[94] by allowing the Secretary of HUD to insure home equity conversion mortgages.[95] It also includes three new counseling provisions. Participants in the HECM program now must undergo pre-mortgage counseling with an independent, qualified counselor.[96] In addition, the Act creates a three-year demonstration program offering prepurchase homeownership counseling designed to test the effectiveness of various forms of counseling for eligible homeowners.[97] Finally, the Act makes it easier for homeowners to qualify for post-purchase home counseling if they have experienced significant changes in financial status.[98]

The final part of the FHA Modernization Act reforms the FHA's Manufactured Housing Insurance Program.[99] The Act makes it easier for private financial institutions and Fannie Mae to fund the program and increases the maximum loan limits for manufactured housing.[100] The Act also limits increases in insurance premiums for manufactured housing.[101]

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[89] *See id.* § 1709(b)(2)(A), *amended by* HERA, Pub. L. No. 110-289, § 2112(a), 122 Stat. 2654, 2830–31 (West 2009).

[90] *See* 12 U.S.C.A. § 1709(b)(9)(A), (C), *amended by* HERA, § 2113, 122 Stat. 2654, 2831–32.

[91] *See id.* § 1709(c)(2), *amended by* HERA, § 2114(2), 122 Stat. 2654, 2832.

[92] *See id.* § 1709 note, *amended by* HERA, § 2130(a)(1), 122 Stat. 2654, 2842.

[93] *See id.* § 1701 note, *amended by* HERA, Pub. L. No. 110-289, § 2133(a), 122 Stat. 2654, 2843.

[94] Home Equity Conversion Mortgages, or "reverse mortgages," allow individuals to convert home equity into monthly payments. They are frequently targeted at senior citizens. U.S. Dep't of Hous. & Urban Dev., FHA's Home Equity Conversion Mortgage Program (Jan. 13, 2009), http://www.hud.gov/offices/hsg/sfh/hecm/hecm—df.cfm (on file with the Harvard Law School Library).

[95] *Compare* 12 U.S.C.A. § 1715z-20(m)(1) (West 2009) *with* HERA, Pub. L. No. 110-289, § 2122(a)(9), 122 Stat. 2654, 2836.

[96] 12 U.S.C.A. § 1715z-20(d)(2)(B).

[97] *See* HERA, *supra* note 9, § 2128(a), 122 Stat. 2654, 2841.

[98] *Compare* 12 U.S.C.A. § 1701x(c)(4) (West, Westlaw through Pub. L. No. 111-7) *with* HERA, Pub. L. No. 110-289, § 2127(1)(C), 122 Stat. 2654, 2841.

[99] *See* 12 U.S.C.A. §§ 1703 note, 1703(b)(8); *see also* U.S. Dep't of Hous. & Urban Dev., Manufactured Home Insurance Loan Program (Title I), http://www.hud.gov/offices/hsg/sfh/title/manuf14.cfm (last visited Mar. 17, 2009) (on file with the Harvard Law School Library).

[100] *Compare* 12 U.S.C.A. § 1703(b)(1) *with* HERA, Pub. L. No. 110-289, § 2145, 122 Stat. 2654, 2844–45.

[101] *Compare* 12 U.S.C.A. § 1703(f) *with* HERA, Pub. L. No. 110-289, § 2146(2), 122 Stat. 2654, 2845–46.

3. *Regulating the Private Market*

HERA also contains provisions that seek to regulate the private mortgage market. This includes the Secure and Fair Enforcement for Mortgage Licensing Act ("SAFE Act"), a licensing scheme for residential mortgage brokers and lenders.[102]

The SAFE Act encourages states, through the Conference of State Bank Supervisors ("CSBS")[103] and the American Association of Residential Mortgage Regulators ("AARMR"),[104] to establish a Nationwide Mortgage Licensing System and Registry.[105] The system is intended to accomplish several objectives, including: (1) providing uniform license applications and reporting requirements for state-licensed loan originators; (2) providing a comprehensive licensing and supervisory database; and (3) improving the flow of information to consumers.[106] The SAFE Act requires individual applicants to provide the new national database with their fingerprints, credit histories, and criminal histories.[107] It imposes a similar requirement on federal agencies, which must submit fingerprints, credit history, and criminal history for employees of depository institutions regulated by a federal banking agency or an institution regulated by the Farm Credit Administration.[108]

The SAFE Act also creates minimum standards for state license and registration schemes of mortgage brokers or lenders.[109] Applicants must meet several requirements, including never having had a license revoked in any governmental jurisdiction, having no felony convictions in the preceding seven years, and demonstrating financial responsibility, character, and fitness.[110] In addition, applicants must complete an education requirement of twenty hours, including three hours in federal law, three hours in ethics, and two hours in lending standards for the nontraditional mortgage product marketplace. They must also pass a written examination at the conclusion of the twenty hours.[111] The SAFE Act likewise imposes minimum standards for

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[102] *See* 12 U.S.C.A. § 5101 (West 2009).

[103] *See id.* § 5101. CSBS is an organization that represents state bank regulatory agencies and state-chartered banks before the federal government. *See* Conference of State Bank Supervisors, http://www.csbs.org/AM/Template.cfm?Section=Home (on file with the Harvard Law School Library).

[104] *See* 12 U.S.C.A. § 5101. AARMR is an organization that represents executives and employees of various states who are charged with regulating residential home mortgages. *See* American Association of Residential Mortgage Regulators, http://www.aarmr.org/ (on file with the Harvard Law School Library).

[105] *See* 12 U.S.C.A. § 5101.

[106] *Id.* § 5101(1), (2), (7).

[107] *Id.* § 1504(a) (West 2009).

[108] *See id.* § 5106(a) (West 2009).

[109] *See id.* § 5104.

[110] *See id.* § 5104(b)(1)-(3).

[111] *See* 12 U.S.C.A. § 5104(c)(1).

license or registration renewal, including a similar continuing education requirement.[112]

Finally, the SAFE Act prohibits any individual from operating as a loan originator without obtaining and annually maintaining a license or registration as a state-licensed loan originator.[113] Should a state fail to establish a licensing or registration system for loan originators within one or two years after the passage of HERA, the SAFE Act authorizes the Secretary of HUD to create a licensing and registry system operating within the offending state.[114] Likewise, should the states, CSBS, and AARMR fail to establish a national mortgage licensing system as requested, the Secretary may create such a system himself.[115] Both the states and HUD are authorized to examine records of any loan originator operating in any database that the state or HUD may operate under the SAFE Act.[116]

HERA also includes the Mortgage Disclosure Improvement Act, which expands the earlier Truth in Lending Act ("TILA").[117] This title expands the types of home loans subject to TILA's early disclosure requirements to any extension of credit that is secured by the dwelling of a consumer rather than just a residential mortgage transaction.[118] In addition, it requires that mortgage loan terms be disclosed no later than seven business days before closing.[119]

III. The Legislative and Policy Debate

A. Supporters

In Congress and in the media, supporters of the bill tended to stress two points: (1) the effect that HERA would have on alleviating the "spillover effects" of mortgage foreclosure (e.g., the decrease in property values of non-foreclosed homes when foreclosure happens nearby); and (2) the overall stabilizing effect that HERA would have on the housing and credit market as a whole.

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[112] *See id.* § 5105(a)(2) (West 2009).

[113] *See id.* § 5103(a)(1) (West 2009).

[114] *See id.* § 5107(a) (West 2009).

[115] *See id.* § 5108 (West 2009).

[116] *See id.* §§ 5113(a)(1), 5114 (West 2009).

[117] HERA, *supra* note 9, §§ 2501-03, 122 Stat. 2654, 2855–57 (West 2009) (amending 15 U.S.C.A. §§ 1601 note, 1638, 1638, 1640 note, 12 U.S.C.A. §§ 24, 338a); Truth in Lending Act, Pub. L. No. 90-321, 82 Stat. 146.

[118] HERA, *supra* note 9, §§ 2501-03, 122 Stat. 2654, 2855–57 (West 2009) (amending 15 U.S.C.A. §§ 1601 note, 1638, 1640, 1638 note, 12 U.S.C.A. §§ 24, 338a).

[119] *See* 15 U.S.C.A. § 1638(b)(2), *amended by* HERA § 2502(a)(4), 122 Stat. 2654, 2855 (West 2009).

1. *Spillover Effect*

Supporters of the bill focused on the importance of HERA less in terms of its effects on individual borrowers or lenders, and more on the ways in which the changes contained in HERA would affect communities at large. In the House debate on HERA, Rep. Maxine Waters (D-Cal.) noted the importance of protecting communities from the negative effect on neighboring home prices that foreclosures cause, warning that such decreases would likely contribute to the already existing problem of local revenue shortages for local governments that rely on property taxes.[120] She also observed that subprime lenders disproportionately targeted African-American and minority neighborhoods, and thus a failure to pass HERA would have a negative social justice effect.[121] Rep. Bob Etheridge (D-N.C.) claimed that in North Carolina, 330,000 homes had lost value due to the "spillover effect" of nearby foreclosures, and that his state currently stood to lose over $860 million in property value.[122] Rep. Betty McCollum (D-Minn.) echoed these concerns, arguing that HERA would allow the "purchase, rent, or rehabilitation of vacant foreclosed homes with the goal of occupying them as soon as possible," and that preventing a decline in property values would not only help local communities maintain revenue, but would also prevent higher rates of crime.[123]

2. *Stabilization Effect*

In the House debate, Rep. Etheridge claimed that HERA would stabilize the housing market not only through its provision for a $7500 tax credit,[124] but also through its reform of the FHA.[125] These reforms, he contended, would "strengthen [the market] and provide a better alternative to some of the riskier, more exotic loans that have spurred much of this crisis."[126]

Gary N. Smith of the Financial Times called the bill "good news," speaking favorably about the incentives it created for both home owners and banks to refinance and noting that, since homes were still good investments in most U.S. cities, the bill would benefit home buyers, home sellers, and home owners if it succeeded in getting credit flowing again.[127]

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[120] *See* 154 Cong. Rec. E1630 (daily ed. July 31, 2008) (statement of Rep. Waters).
[121] *See id.*
[122] *See* 154 Cong. Rec. E1556 (daily ed. July 25, 2008) (statement of Rep. Etheridge) [hereinafter Etheridge statement].
[123] *See* 154 Cong. Rec. E1564 (daily ed. July 25, 2008) (statement of Rep. McCollum).
[124] *See* Etheridge statement, *supra* note 122; *see also supra* Part II.C.1.
[125] *See* Etheridge statement, *supra* note 122.
[126] *Id.*
[127] Gary N. Smith, *The Housing and Economic Recovery Act of 2008: Why It Was Passed, How it Works, and Who Benefits*, FT Press, Aug. 5, 2008, http://www.ftpress.com/articles/article.aspx?p=1237072.

B. Critics

Criticism of HERA in the media generally falls along three lines: (1) the bill does not do enough to fix existing flaws or prevent future problems; (2) parties have insufficient incentives to take advantage of the bill; and (3) the bill is a confusing or irresponsible use of government institutions.

1. Insufficiency

Critics have called HERA insufficient because it does not reform the relevant government institutions. For instance, Colin Barr of Fortune Magazine noted that, after HERA, Fannie Mae and Freddie Mac retain their "quasi-governmental status," quoting Jared Bernstein of the Economic Policy Institute as saying that such an "amorphous status" is "highly distortionary."[128]

Furthermore, critics have also attacked HERA as insufficient for not doing enough to prevent another housing or mortgage crisis in the future, insofar as HERA does not create any incentive for lenders or borrowers to behave responsibly. Rep. Todd Tiahrt (R-Kan.) raised this point during the House debate, calling the bill a "$300 billion taxpayer-funded government subsidizing of irresponsible lending behavior."[129] Rep. Scott Garrett (R-N.J.) cautioned that "[i]t's very plausible to suggest that if government bails everyone out of this mess that we will continue to bail out bad actors in the future, and the market discipline that currently remains will further erode."[130] Charles Lieberman of Advisors Capital Management mused that under HERA, "it might be impossible to imagine how the companies might ever fail."[131] In the New York Times, economist Robert Shiller argued that the bill did nothing to prevent a future mortgage crisis, and in order to accomplish that end, Congress must restructure how mortgages themselves are structured.[132] David John of the Heritage Foundation noted that the bill could create a windfall for borrowers who exaggerated their income in order to get a mortgage, stating that "if there's a lie at the beginning of the transaction, it shouldn't be rewarded."[133]

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[128] Colin Barr, *Fannie's New Watchdog: All Bark?*, FORTUNE, July 24, 2008, http://money.cnn.com/2008/07/24/news/watchdog.teeth.fortune/?postversion=2008072417.

[129] 154 CONG. REC. E986 (daily ed. May 21, 2008) (statement of Rep. Tiahrt).

[130] Frank Ahrens, *'Moral Hazard': Why Risk is Good,* WASH. POST, Mar. 19, 2008, at D01.

[131] Jeremy Pelofsky, *Bush Signs U.S. Housing Bill as Fannie Mae Grows,* REUTERS, July 30, 2008, http://www.reuters.com/article/topNews/idUSN3042756820080730?pageNumber=1&virtualBrandChannel=0.

[132] *See* Robert Shiller, *Mortgages of the Future*, N.Y. TIMES, Sept. 20, 2008, at BU6.

[133] Carolyn Said, *Legislating a Way out of the Housing Crisis; Politicians Offer Help for Homeowners, and Tighter Rules,* S.F. CHRON., Apr. 27, 2008, at C1.

2. Lack of Incentives

The parties to a mortgage may have insufficient incentives to take part in the program because refinancing under HERA might not generate a net gain for them. As a spokesperson for JP Morgan indicated, it would require lenders to say that they would prefer a smaller known dollar amount rather than a larger, uncertain one, and this determination requires "a lot of number crunching."[134] Others noted that in a credit crunch, banks may be unwilling or unable to reduce the principal on a mortgage.[135]

Not only might lenders be unwilling to participate, but borrowers might be reluctant as well. At least one commentator, Lou Barnes, has noted that HERA offers only slightly more favorable mortgage payments to buyers and costs them half of future appreciation and significant pride.[136] For these reasons, Barnes argued, many borrowers will simply walk away from their mortgages instead of accepting HERA refinancing, preferring to rent foreclosed houses at a lesser rate.[137] Traditional barriers to walking away from a mortgage, such as preventing a negative credit report, may be less effective during the crisis, since many borrowers eligible for HOPE for Homeowners already have bad credit, and the number of foreclosures is so high that having a "walk-away" on your credit history may seem "less menacing" in the future.[138] Barnes also argues that the fact that the new homebuyer tax credit must be repaid makes it inadvisable for buyers to take advantage of it.[139]

3. Government Irresponsibility

According to other critics, HERA is irresponsible due to the substantial cost it may impose on the taxpayers. The Secretary of HUD estimated that "roughly one third" of the mortgages involved in the refinancing program would end in foreclosure. With the federal government paying for such foreclosures, this creates a significant cost to the taxpayer notwithstanding HERA's other expenditures.[140] Former Government Accountability Office Comptroller General David M. Walker has noted that because the bill priva-

[134] *See* Sharon L. Lynch, *Housing Recovery Act Depends on Banks to Refinance Mortgages*, Bloomberg, Aug. 14, 2008, http://www.bloomberg.com/apps/news?pid=20601087&sid=aLOj1Jjg5wbc&refer=home (quoting Tom Kelly) (on file with the Harvard Law School Library).

[135] *See* Tom Petruno, *Big Welcome for Uncle's Housing Fix: 239 Points off the Dow*, L.A. Times Money & Co. Blog, July 28, 2008, http://latimesblogs.latimes.com/money_co/2008/07/wall-streets-wa.html.

[136] Lou Barnes, *Mortgage Credit News*, Boulder West Financial Services, Aug. 1, 2008, http://www.boulderwest.com/news/1861.html (on file with the Harvard Law School Library).

[137] *See id.*

[138] Alejandro Lazo, *Walking Away, and What It Leaves Behind; The Wide and Lasting Impact of Quitting a Mortgage*, Wash. Post, Jan. 10, 2009, at F01.

[139] *See* Barnes, *supra* note 136.

[140] Roger Runningen, *Bush Signs Measure for Homeowners, Fannie, Freddie,* Bloomberg, July 30, 2008, http://www.bloomberg.com/apps/news?pid=20601103&sid=am2yQY

tizes profits but socializes losses by extending credit to private entities, it creates only the possibility of loss for taxpayers, in contrast to previous bailouts that included a government equity stake.[141] Colin Barr has echoed similar concerns, arguing that the "quasi-governmental" status of Fannie Mae and Freddie Mac allows managers and shareholders to profit from housing booms, but places the cost of leaner times on taxpayers.[142] In the views of these critics, forcing taxpayers to shoulder the burden imposed by the actions of private entities seems not only unfair but irresponsible on the part of the federal government.

Critics also contend that HERA is irresponsible due to its use of government institutions for unusual purposes. For instance, Professor Robert Strauss of Carnegie Mellon University criticized the first-time homebuyer tax credit provision for making the IRS a lender, noting that buyers may be unaware that they eventually must repay their tax credit.[143] Another point of concern may lie in the fact that the government is intervening in the mortgage market more than it usually does, or via institutions that do not normally do so.

A final determination as to whether or not HERA is responsible requires a balancing between conflicting values of limited government and decisive government action during a crisis. There is unlikely to be an objective answer and the proper balance will be left to the political process. By passing HERA, Congress has made a political determination that the benefits of stemming the crisis outweigh the costs of spending and intervention.[144]

C. Implementation

1. Hope for Homeowners Refinancing

HUD officials indicated that the new initiatives created by HERA, particularly the HOPE for Homeowners refinancing, may not be available until as late as mid-2009, as HUD must undergo a long process before implementing new programs.[145] While this drew calls from Congress to speed up the

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ThqmxQ&refer=us (quoting HUD Secretary Steve Preston) (on file with the Harvard Law School Library).

[141] *See* David M. Herszenhorn, *Bush Signs Sweeping Housing Bill*, N.Y. TIMES, July 31, 2008, http://www.nytimes.com/2008/07/31/business/31housing.html?_r=1&scp=4&sq=%22housing%20rescue%20bill%22&st=cse (available online only).

[142] *See* Barr, *supra* note 128.

[143] *See* Lynch, *supra* note 134.

[144] For examples of this debate, see Steve Bruss, *Housing Crisis Will Cost Us All*, GREENVILLE NEWS (South Carolina), July 31, 2008, at 6A (calling parts of HERA "among the most irresponsible things that's come out of this whole mess"); *What Housing, Lending Groups Say About Law,* OKLAHOMAN, Aug. 2, 2008, at 2B (quoting groups that praise HERA).

[145] *See* Paul Jackson, *Housing Act Passes Congress, Questions Emerge*, HOUSINGWIRE, July 26, 2008, http://www.housingwire.com/2008/07/26/as-housing-act-passes-questions-emerge/.

process,[146] by the end of 2008 "very little" of the $300 billion available to the refinancing program had actually been used.[147] The failure stems in part from the fact that investors holding mortgage loans would incur losses from refinancing, and from the fact that lenders are refusing to cooperate in the program, as they are unwilling to give up money that is already owed them.[148] In fact, by December 2008 only 312 applications for HERA refinancing had been received—far short of the 400,000 anticipated.[149] A new amendment to HERA, which would increase the amount of loan eligible for refinancing, failed to significantly improve this problem.[150]

2. *Regulatory Reform*

While the refinancing provisions of HERA have gone largely ignored, the Bush administration did take steps to implement provisions of the bill relating to government oversight of GSEs. On September 7, 2008, the Federal Housing Finance Agency (created by HERA) announced that it would use its HERA powers to place Fannie Mae and Freddie Mac under government conservatorship, citing fears that the entities were severely undercapitalized.[151] Under the conservatorship, the government will purchase preferred stock and mortgage-backed securities from Fannie Mae and Freddie Mac, as well as establish temporary "secured credit lending facilities" for Fannie Mae, Freddie Mac, and the Federal Home Loan Banks.[152]

IV. Subsequent Proposals

Since HERA's passage, both policymakers and academics have proposed new legislation to address the mortgage relief issue. These proposals would create alternative avenues to mortgage relief, either through bankruptcy, the Troubled Asset Relief Program ("TARP"), entirely new statutory provisions, or some combination thereof.

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[146] *See id.*

[147] Anton Troianovski, *Real-Estate Markets Still Plumb for Bottom*, Wall St. J., Jan. 2, 2009, at R7.

[148] *See id*. *See also* Dina ElBoghdady, *HUD Chief Calls Aid on Mortgages a Failure,* Wash. Post, Dec. 17 2008, at A1.

[149] *See id.*

[150] *See* EESA, *supra* note 10, § 124, 122 Stat. 3765, 3791; *see also* ElBoghdady, *supra* note 148.

[151] Federal Housing Finance Agency, Statement of FHFA Director James B. Lockhart at 5-6, Sept. 7, 2008, *available at* http://www.ofheo.gov/media/statements/FHFAStatement9708.pdf [hereinafter Lockhart Statement]; Jay Hancock, *Bailout May Bring Buyers In From Cold; Takeover of Fannie, Freddie Should Restore Stability, Hope,* Balt. Sun, Sept. 7, 2008, at 1A.

[152] Treasury Dep't., Statement by Secretary Henry M. Paulson, Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers, Sept. 7, 2008, *available at* http://www.treas.gov/press/releases/hp1129.htm; *see also* Zachary A. Goldfarb, *Treasury to Rescue Fannie and Freddie*, Wash. Post, Sept. 7, 2008, at A01.

A. *Helping Families Save Their Homes in Bankruptcy Act*

Senator Dick Durbin (D-Ill.) introduced the Helping Families Save Their Homes in Bankruptcy Act of 2009,[153] which would allow a bankruptcy judge to reduce mortgage debt on a primary residence if the debt exceeds the current value of the property.[154] The bill also gives bankruptcy courts the authority to modify adjustable interest rates to lower, fixed rates.[155] The 2009 version of the act is the latest version of a proposal that Senator Durbin has been promoting since at least late 2007,[156] and to which President Obama's Secretary of HUD, Shaun Donovan, has also given his support.[157] A major mortgage lender, Citigroup, has also backed the proposal.[158] Legal economist Eric Posner likewise favors the Durbin proposal, stating that while it does have potential flaws, it "makes good sense" and would likely result in fewer foreclosures, thus preserving the value of more homes.[159] On March 5, 2009, the Durbin bill, introduced by Rep. John Conyers (D-Mich.),[160] passed the House by a vote of 234-191.[161]

B. *TARP-2*

On January 9, 2009, Rep. Barney Frank (D-Mass.) introduced the TARP Reform and Accountability Act of 2009 ("TARP-2").[162] Though primarily a reform of the earlier financial services bailout act, TARP-2 "has new provisions for [the] Treasury [Department] to operate a $40 billion to $100 billion program for loan modifications through a number of alternatives including a systematic loan modification program, a buy-down of second-lien mortgages, or an incentive program for servicers that must be approved by the TARP Financial Oversight Board."[163] These provisions may promote renegotiations of mortgage debt between financial service companies and debtors without forcing the service companies to bear the cost of repurchase.

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153 S. 61, 111th Cong. (2009).

154 *See id.* § 2.

155 *See id.* § 4.

156 *See* Dennis Conrad, *Durbin Puts Mortgage Foreclosures Under National Spotlight*, Assoc. Press State & Local Wire, Dec. 5, 2007.

157 *See Office of Senator Dick Durbin, Durbin Discusses Foreclosure Crisis, Mortgage Bankruptcy Reform with Housing Secretary Nominee*, States News Service, Jan. 14, 2009.

158 *See* James Oliphant, *Lender Agrees to Loan Changes; Citigroup Backs a Plan Allowing Bankruptcy Judges to Alter Terms*, L.A. Times, Jan. 9, 2009, at C1.

159 Posting of Eric Posner to Volokh Conspiracy, Chapter 13 and the Durbin Mortgage Modification Bill, http://volokh.com/archives/archive_2009_01_18-2009_01_24.shtml#1232596135 (Jan. 21, 2009, 22:48 EST).

160 *See* Helping Families Save Their Homes in Bankruptcy Act of 2009, H.R. 200, 111th Cong. (2009).

161 155 Cong. Rec. H3023-24 (daily ed. Mar. 5, 2009).

162 H.R. 384, 111th Cong. (2009).

163 H.R. 384, 111th Cong. (2009).

Steven M. Davidoff has sharply criticized TARP-2 as "bailout creep" and has expressed concern that the government was proposing to void private contracts, noting that "[r]espect for contracts should be a big deal, and a contract [should be] abrogated by government only when the public interest strictly requires it."[164] Posner, while noting that TARP-2 "isn't as crazy as Davidoff thinks" and could solve collective action problems with respect to loan modifications, expressed concern that because TARP-2 contained vague language such as "reasonably foreseeable" and "good faith," it could be "exploited to pummel" investors in mortgage-backed securities.[165] Posner also noted that banks could use TARP-2 to cause a significant decrease in the value of mortgage-backed securities, thus forcing the government to inject more money into banks via bailout legislation.[166]

A proposed modification to TARP-2 replaces the voiding of contract provisions with the creation of an "aggregator bank" to purchase "bad" mortgage-backed securities and then modify the terms of the mortgages.[167] Paul Krugman has expressed concern that the government would be unable to correctly price these assets, and thus it would be difficult to ensure that the aggregator bank would not be a "huge giveaway to financial firms[.]"[168] Posner has called the aggregator proposal an "improvement" on TARP-2 and notes that it would lower the cost of modifying mortgage loans by ensuring that some holders of mortgage-backed securities do not hold out of any renegotiation scheme by demanding higher prices.[169] Thus, he sees an aggregator bank as another solution to the collective action problem.[170] TARP-2 passed the House on January 21, 2009 by a vote of 260-166, without the aggregator modification.[171]

C. Zingales Proposal

Professor Luigi Zingales of the University of Chicago Graduate School of Business has suggested that Congress should pass a law giving homeowners in zip codes where house prices dropped by more than 20% since the time they bought their property the option to re-contract their mortgage at a lower debt in exchange for giving the lender an equity stake in the prop-

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[164] *Id.*

[165] Posting of Eric Posner to Volokh Conspiracy, http://volokh.com/archives/archive_2009_01_18-2009_01_24.shtml#1232381598 (Jan. 19, 2009, 11:13 EST) [hereinafter Posner Jan. 19 Post].

[166] *See id.*

[167] *See id. See also* Robert Schmidt & Rich Miller, *Obama Financial Rescue May Revive Effort to Resolve Bad Assets*, Bloomberg, Jan. 17, 2009, http://www.bloomberg.com/apps/news?pid=20601087&sid=aEs9iy5D54Rw&refer=home; Posner Jan. 19 Post, *supra* note 165.

[168] The Conscience of a Liberal, http://krugman.blogs.nytimes.com/2009/01/17/bad-bank-bafflement (Jan. 17, 2009, at 15:32 EST).

[169] Posner Jan. 19 Post, *supra* note 165.

[170] *See id.*

[171] 155 Cong. Rec. H418 (daily ed. Jan. 21, 2009).

erty.[172] Eric Posner has described the Zingales plan as a direct alternative to the Durbin proposal.[173]

Posner has noted that while the Zingales plan involves a far less costly process than the bankruptcy-focused Durbin proposal, and its zip code limit and equity stake provisions would discourage opportunistic use of the law, it would be problematic to give banks an equity stake in property that may be of little to no value and that would be very difficult to accurately value.[174] He also notes that the plan could be politically unpopular, because it would give significant profits to speculators.[175]

D. Mayer-Morrison-Piskorski Proposal

Three professors at Columbia University—Christopher Mayer, Edward Morrison, and Tomasz Piskorski—have proposed their own scheme to address the housing and foreclosure crisis.[176] The proposal has two parts. First, mortgage providers would be able to avoid lawsuits from investors over loan modifications if they had a good faith belief that the modification would increase the value of the security (by preventing foreclosure).[177] Second, the proposal would use TARP funds to compensate mortgage providers for the cost of renegotiating mortgage debt.[178] This compensation would be large enough to, in theory, compensate mortgage services for both the transaction costs and the potential risks of loan modification.[179]

Posner contrasts the Mayer-Morrison-Piskorski proposal with earlier plans by noting that unlike many housing crisis proposals, it gives mortgage services a "share of the upside" on renegotiation and thus aligns the interests of involved parties.[180] However, Posner also expresses concern that the proposal could "reinflate a credit and housing bubble" by giving creditors the expectation that in any future financial crisis, the government would take the same steps, and that a taxpayer subsidy could cause excessive renegotiation of loans, even in cases where default could be avoided or where default would be economically efficient.[181]

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[172] *See* Posting of Eric Posner to the Volokh Conspiracy, http://volokh.com/archives/archive_2009_01_18-2009_01_24.shtml#1232638414 (Jan. 22, 2009, 10:33 EST).

[173] *See id.*

[174] *See id.*

[175] *See id.*

[176] Christopher Mayer et al., *A New Proposal for Loan Modifications* (2009), http://www4.gsb.columbia.edu/null?&exclusive=filemgr.download&file_id=53861.

[177] *See* Posner Jan. 19 Post, *supra* note 165.

[178] *See id.*

[179] *See* Posting of Eric Posner to the Volokh Conspiracy, http://volokh.com/archives/archive_2009_02_01-2009_02_07.shtml#1233788467 (Feb. 4, 2009, 18:01 EST).

[180] *Id.*

[181] *Id.*

V. Conclusion

HERA is probably not a sufficient government response to the mortgage and housing crisis, and is at best only partially successful. Let us look at the five aforementioned aims of the bill: (1) assisting GSEs that regulate the mortgage industry;[182] (2) providing relief to lenders and borrowers;[183] (3) stabilizing the housing market;[184](4) remedying the social consequences of foreclosures;[185] and (5) preventing a future housing crisis.[186]

On the issue of assisting GSEs, HERA appears to be working. The Bush administration invoked the new conservatorship provisions as at least a temporary guard against the undercapitalization or collapse of Fannie Mae and Freddie Mac. At the worst, it is unclear that further action is necessary.

On the issue of helping existing borrowers and lenders, the Hope for Homeowners Act appears to be a complete failure. Perhaps neither lenders nor borrowers see a need for government-backed refinancing, in which case this is not a problem. Alternatively, borrowers and lenders may want refinancing options, for which HOPE for Homeowners may have failed to provide adequately. If that is the case, further action is probably necessary. As commentators have linked the failure of HOPE for Homeowners to the reluctance of investors to accept refinancing, Congress might resolve this particular failure of HERA with a bill that allows borrowers to decrease their debt without the involvement of lenders. Any of the four proposals described above in Section IV could accomplish this.

On the issue of stabilizing the housing market, HERA contains provisions that might help reduce the housing glut and promote home buying. Many of these measures are limited, however: REIT reform will affect only properties owned by investment trusts and the new tax credit is only temporary and must be repaid. Thus, HERA may have stabilized the market only to a limited extent—it remains to be seen whether this is enough.

On the issue of remedying the social consequences of foreclosures, HERA presents a fairly robust package of measures that may each relieve those hurt by the foreclosure crisis in different ways: by preventing foreclosures in the first place, by creating low-income housing for those evicted from their homes, or by increasing property values generally. Because some of these provisions are limited (for instance, only to veterans), HERA's impact may not be dramatic, but once again only time will tell if it is sufficient to remedy these more widespread, pernicious externalities of the foreclosure crisis.

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[182] *See supra* Part II.A.
[183] *See supra* Part II.B.
[184] *See supra* Part II.C.
[185] *See supra* Part II.D.
[186] *See supra* Part II.E.

Finally, HERA seems to fail with respect to the goal of preventing a future housing crisis. While it creates a robust new oversight mechanism for GSEs that might prevent a crisis based on GSE missteps, it does not address what some critics see as the fundamental flaws of GSEs. Worse, by cushioning the blow of the mortgage crisis and setting a precedent for government aid to failed financial institutions during crises, HERA may create perverse incentives for both lenders and borrowers to continue to behave irresponsibly. Once again, a proposal that allows borrowers to unilaterally reduce their debt—such as any of the four proposals above—may become punitive towards lenders who issue too many risky loans and affect this goal of HERA.

It seems clear that even if its existing provisions work as planned, HERA is only a partial response to the mortgage crisis, and the 111th Congress and Obama administration should explore additional measures. Specifically, they should seek a way to allow borrowers to reduce their mortgage debt even when borrowers or investors in mortgage-backed securities refuse to cooperate. Additionally, if the housing market continues to decline, Congress and the Obama administration should explore broader measures to both decrease the glut of houses on the market and increase property values.

Finally, even if HERA proves to be a failure, it may prove notable for re-introducing the "bailout" mechanism during the recession that began in 2007. Two other bailout attempts—the successful banking bill and the unsuccessful automobile industry bill—followed HERA, and both of these were larger and more contentious. If the new Congress and administration continue to address the recession in a similar manner, HERA may be remembered not for any effect that it may have had, but for the precedent that it set.

—*Bruce Arthur**

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