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Statement of the Shadow Financial Regulatory Committee on

Mortgage Delinquencies and Foreclosures

May 5, 2008

For most of the last year there has been growing concern with mortgage delinquencies and foreclosures. The focus has been on subprime adjustable rate mortgages, which after an initial period can reset to higher rates and already show uncomfortably high default rates. But the problem is also affecting conventional mortgages, though to a much lesser degree, as housing prices have started falling and have created negative equity.

Highly leveraged homeowners have little room for absorbing declines in housing value. With the collapse of the real estate bubble and increases in unemployment, many households face foreclosures and the rate of foreclosure continues to grow. Recognizing that many homeowners have little or no equity in their homes, congressional committees and various federal agencies have generated numerous plans aimed at restoring owner equity by allowing struggling homeowners to obtain a write-off of some of their outstanding debt and to refinance the balance into a federally guaranteed mortgage loan.

The plan advanced by Treasury Secretary Paulson last November tried to address the projected consequences of resets by urging a program of freezing the initial rates for five years for those borrowers who had met their payment obligations thus far. The plan did not address the situation of those already delinquent or in foreclosure, then estimated at around 600,000 borrowers. Many of them had obtained loans with little or no downpayment and had insufficient income to meet even low initial rates.

sum, foreclosure would still have to be instituted, but after a few examples the lesson would hopefully be learned.

(3) There are some questions relating to treatment of debt forgiveness under the Internal Revenue Code as income and of actively managed pools as REITs. Both seem to have been dealt with by recent legislation and IRS rulings.

The Committee has not endeavored to work out all details or obstacles, but offers the proposal as one deserving careful consideration. Its major benefits would be to facilitate private solutions that help lenders and borrowers in a balanced way, obviate the spillover costs of neighborhood deterioration, and not create incentives that would distort mortgage financing and induce even greater risk-taking by borrowers in the future.