Written Statement of Mark Zandi
Chief Economist and Co-Founder
Moody's Economy.com

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Mr. Chairman and members of the Committee, my name is Mark Zandi; I am the Chief Economist and Co-founder of Moody's Economy.com.

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I will make six points in my remarks. First, the nation's housing and mortgage markets are suffering a very severe recession. Housing activity peaked over two years ago, and since then home sales have fallen nearly 20%, housing starts by 40%, and house prices by 5%. Over half the nation's housing markets are currently experiencing substantial price declines, with double-digit price declines occurring throughout Arizona, California, Florida, Nevada, in the Northeast Corridor and industrial Midwest. Further significant declines in construction and prices are likely throughout next year as a record amount of unsold housing inventory continues to mount give the impact of the recent subprime financial shock and its impact on the mortgage securities market and thus mortgage lenders. It is reasonable to expect national house prices to fall by at least 10% from their peak to their eventual trough late next year. This assumes that the economy will avoid recession and the Federal Reserve will continue to ease monetary policy.

Second, residential mortgage loan defaults and foreclosures are surging and without significant policy changes will continue to do so through 2008 and into 2009. Falling housing values, resetting adjustable mortgages for recent subprime and Alt-A borrowers, tighter lending underwriting standards, and most recently a weakening job market are conspiring to create the current unprecedented mortgage credit problems. I expect approximately 3 million mortgage loan defaults this year and next, of which 2 million will go through the entire foreclosure process, forcing these homeowners to leave their current homes. The impact on these households, their communities, and the broader economy will be substantial. Foreclosed sales are very costly after accounting for their substantial transaction costs, and serve to significantly depress already reeling housing markets, as foreclosed properties are generally sold at deep discounts to prevailing market prices. These discounts are estimated to be well over 30%.

Third, there is a substantial risk that the housing downturn and surging foreclosures will result in a national economic recession. The stunning decline in housing activity and prices is sure to severely crimp consumer spending into next year, and the job market appears increasingly weak as it struggles with layoffs in housing related industries. Regional economies such as California, Florida, Nevada and the industrial Midwest are already near or in recession.

Fourth, without a policy response, mortgage loan modification efforts are unlikely to prove effective in forestalling the increase in foreclosures. A recent Moody's survey of loan servicers found that very little modification had been done, at least through this past summer. There are a large number of impediments to modification efforts. Some tax, accounting and legal hurdles appear to have been overcome, but large differences in the incentives of first and second mortgage lien holders and the various investors in mortgage securities are proving to be daunting. While the total economic benefit of forestalling foreclosure is significant, these benefits do not accrue to all of the parties involved in determining whether to proceed with a loan modification.

Fifth, the legislation to give bankruptcy judges the authority in a Chapter 13 to modify mortgages by treating them as secured only up to the market value of the property will significantly reduce the number of foreclosures. To limit any potential abuses, Congress should provide firm guidelines to the bankruptcy courts, such as providing a formula for determining the term to maturity, the interest rate, and the property's market value. Properly designed, the legislation could reduce the number of foreclosures through early 2009 by at least 500,000. This would be very helpful in reducing the pressure on housing and mortgage markets and the broader economy.

Sixth, this legislation will not significantly raise the cost of mortgage credit, disrupt secondary markets, or lead to substantial abuses. Given that the total cost of foreclosure is much greater than that associated with a Chapter 13 bankruptcy there is no reason to believe that the cost of mortgage credit across all mortgage loan products should rise. Indeed, the cost of mortgage credit to prime borrowers may decline. The cost of second mortgage loans, such as piggy-back seconds, could rise, as they are likely to suffer most in bankruptcy, but such lending has played a clear contributing role in the current credit problems. There is also no evidence that secondary markets will be materially impacted, as other consumer loans which already have similar protection in Chapter 13 have well functioning secondary markets. The residential mortgage securities market will go through substantial changes in response to the recent financial shock and will easily adjust to the new rules. Abuses should also be limited given that a workout in Chapter 13 is a very costly process for borrowers. Indeed, the number of bankruptcy filings has remained surprisingly low since the late 2005 bankruptcy reform, likely reflecting the much higher costs to borrowers.

Finally, I think it is important that the changes to bankruptcy law in this legislation sunset after several years. Based on historical experience, changes to bankruptcy law can have unintended consequences. I believe the changes in this proposed legislation will have significant both short and long-term benefits, but lawmakers may decide otherwise after several years of experience. Allowing the legislation to sunset should also help assuage concerns that this legislation is an effort to re-address other issues in the bankruptcy code.

The housing market downturn is intensifying and mortgage foreclosures are surging. Odds are quickly rising that a self-reinforcing negative dynamic of foreclosures begetting house price declines begetting more foreclosures well develop in many neighborhoods across the country. There is no more efficacious way to short-circuit this cycle than adopting legislation to allow bankruptcy judges the authority to modify mortgages by treating them as secured only up to the market value of the property.