

The background of the entire page is covered with a repeating pattern of small, light gray icons. Each icon set consists of a simple house silhouette and a stylized human figure walking, arranged in a staggered grid.

The

Win/Win

Solution

How Fixing The Housing Crisis Will Create
ONE MILLION JOBS

The New Bottom Line, 2011 • www.newbottomline.com • @NBLcampaign



But remember, it was the housing market that triggered this crisis. We put liquidity into the financial institutions and obviously they're doing fine. They're sitting on a trillion and a half of cash that they're not spending. But the reality is that the housing market is what triggered this crisis, and it's going to be the housing market that recovers. And that means to me, go out and buy up people's mortgages as we did during the Great Depression, and give them a mortgage that they can afford the payments to make, and then we will begin to come out of this problem."

Senator John McCain¹
August 7, 2011

America is more than three years into an economic crisis that shows no signs of abating. One in 10 Americans cannot find a job, one in five owes more on their mortgage than the home is actually worth, foreclosures continue to set a record pace, and family-owned small businesses are once again shuttering their doors as prospects re-emerge of even tougher times ahead. More and more Americans are losing faith in what has long made this country great – the belief that they can create a better life through hard work.

But the banks can do something right now to change all that. By writing down all underwater mortgages to market value, the nation's banks could:

- Pump **\$71 billion** into the economy every year;
 - In New York state the annual stimulus would equal \$1.25 billion
 - In Ohio, \$1.64 billion
 - In Florida, a staggering \$12 billion
- Create more than **one million jobs** annually;
 - In Massachusetts this would create over 35,000 jobs
 - In Illinois nearly 43,000 jobs
 - In California, over 300,000 jobs
- Save families an average **\$543 per month** on their mortgage payments;
- Help investors come out ahead compared with the negative financial impact of foreclosures
- **Fix the foreclosure crisis** once and for all.

The overhang of underwater mortgage debt is one of the primary drags on economic recovery. It continues to devour tens of billions of dollars annually, money that would otherwise go into our economy in the form of consumer spending. This increase in consumer demand would in turn help spur job creation and increase revenue for governments that have seen their tax income plummet as a result of the downturn.

To date, foreclosure prevention efforts have focused on making the banks whole for a period of time while doing little to fundamentally restructure and reduce the debt load carried by homeowners. The underlying assumption in this model – that if we wait it out, then things will get better – is not only flawed, but is actually worsening the pain for millions of families and continuing to undermine long-term prospects for a housing recovery. We need aggressive action now that creates a New Bottom Line for American homeowners.

The banks have it in their power to restore the American Dream of homeownership that helps build wealth for families. What's more is that we have already paid them the money to do it. American taxpayers came to the banks rescue with trillions in bailouts and backstops and now it is time for the banks to begin to undo the damage they caused and give back a working economy.

Why Should the Banks Pay?

Underwater homeowners owe \$709 billion more on their mortgages than their homes are worth. If banks wrote down the principals and interest rates on underwater mortgages to market value, it would save homeowners \$71 billion per year.

Banks received \$14 trillion in taxpayer-funder bailouts and backstops so that they would start lending to the American people again to jumpstart the economy. That never happened.² While some of this money has been paid back, much of this \$14 trillion has not and will never be returned. They should just subtract this \$709 billion off the trillions they still owe us.

\$709 billion is a fraction of the trillions they took, and it would go a long way towards reviving the economy. Furthermore, the bailout money was also intended to cushion the banks from losses on their toxic assets—a technical term for “bad loans.” We gave them money so that they could write down bad loans without going under. It only makes sense that they now write down underwater loans.

Banks can afford this. US banks are currently sitting on a historically high level of cash reserves of \$1.64 trillion.³ Under this proposal they would only be forgoing \$71 billion in payments annually, most of which would have been interest charges rather than principal payments. In 2010, the nation's top six banks alone paid out more than twice that figure in bonuses and compensation (\$146 billion).⁴ As part of the process, regulators may choose to change accounting rules to allow banks to realize the losses from these mortgage write-downs over a period of several years so they do not have to record the losses on their books all at once. In the past, regulators have been more than willing to modify accounting rules to help the banks, so it is only fitting that they do so now in order to jumpstart the economy by preventing foreclosures and creating jobs.

The banks created the housing crisis with their reckless and predatory lending practices. They should be held accountable for the damage they have done to our economy and be forced to do their part to clean up the mess they have created. Working families across the country have seen their home values plummet, have had their life savings wiped clean, have been powerless to help when their loved ones lost their jobs, and in too many cases watched helplessly while they lost their homes to banks that continue to post billion-dollar profits and pay out billion-dollar bonuses. Add to that the trillions in bailouts and backstops that taxpayers gave to the banks, and one thing is clear: We have already paid. Now it is the banks' turn.

A Vicious Cycle

All of the purported efforts thus far to resolve the jobs crisis have fallen flat. Even the 2009 stimulus bill, which succeeded in creating jobs, was not big enough to overcome the massive scale of the problem. The official unemployment rate still lingers near 10% and shows no signs of abating. All of the efforts to date have ignored a major underlying cause of the jobs crisis: the housing crisis. In July 2011, Nobel Prize winning economist Paul Krugman noted, “The big drag on the economy now is the overhang of household debt, largely created by the \$5.6 trillion in mortgage debt that households took on during the bubble years.”⁵

As of March 31, 2011, 23% of American homeowners were underwater on their mortgages. They owed banks \$709 billion more on their mortgages than their homes were worth.⁶ While homeownership was once lauded as the most effective way to build wealth, for these working families it has become an endless drain on household income. They have to pay down \$709 billion in principal before they can even start building equity in their homes.

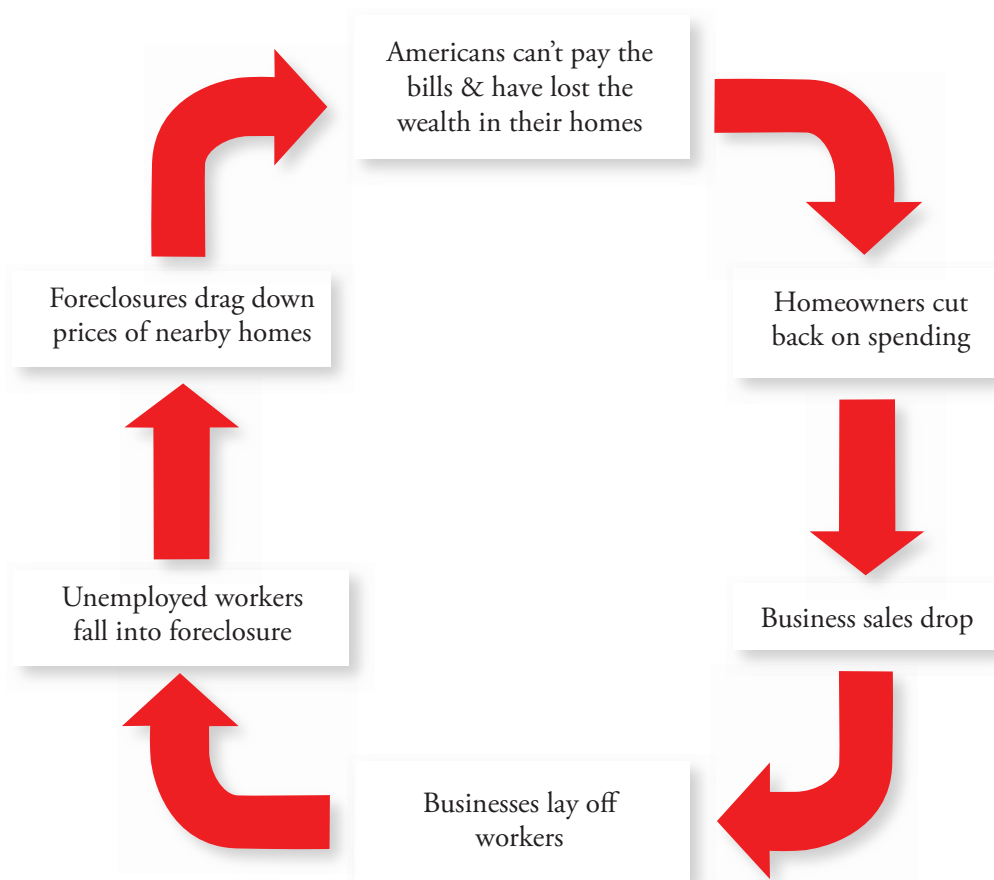
Meanwhile homeowners have seen banks cut their credit card limits in half and hike up their interest rates, or cancel their credit cards altogether. So as they try to pay their inflated boom-era mortgages with their modest recession-era salaries, they have also lost the ability to access money to make ends meet. This means a larger and larger share of

their monthly paychecks are going towards their mortgages, leaving little money for much else. As a result, these cash-strapped homeowners have been forced to cut back on spending and put essential purchases on hold.

This has a ripple effect throughout the economy. Real retail and food service sales in the U.S. fell a striking 7.1% between 2007 and 2010, in comparison to growing 5.7% in the three years before the housing bubble burst.⁷ This drop in sales has forced businesses to cut back and lay off millions of workers across the country. America's biggest banks have only compounded the problem by drastically cutting back on small business lending, smothering any hopes of an economic recovery. Seven million workers have lost their jobs since the recession started in January 2008.⁸

The foreclosure crisis is not limited to subprime borrowers. Laid off workers have an even harder time paying their bills. They fall behind on their mortgages and, eventually, often fall into foreclosure. The epidemic has spread to prime borrowers who had high credit scores and generally lower interest rates but who can no longer pay their mortgages because they have lost their jobs.⁹ According to the *New York Times*, unemployment is now the "primary cause of foreclosures."¹⁰ This further drags down the values of homes in their neighborhoods, making neighboring homeowners even more anxious about their own financial position, and causing the whole cycle to start all over again. In this way, the housing crisis and the jobs crisis feed off each other in a vicious cycle that is drowning the national economy (see Figure 1).

Figure 1: The Housing Crisis and the Jobs Crisis Fuel Each Other



Breaking the Cycle

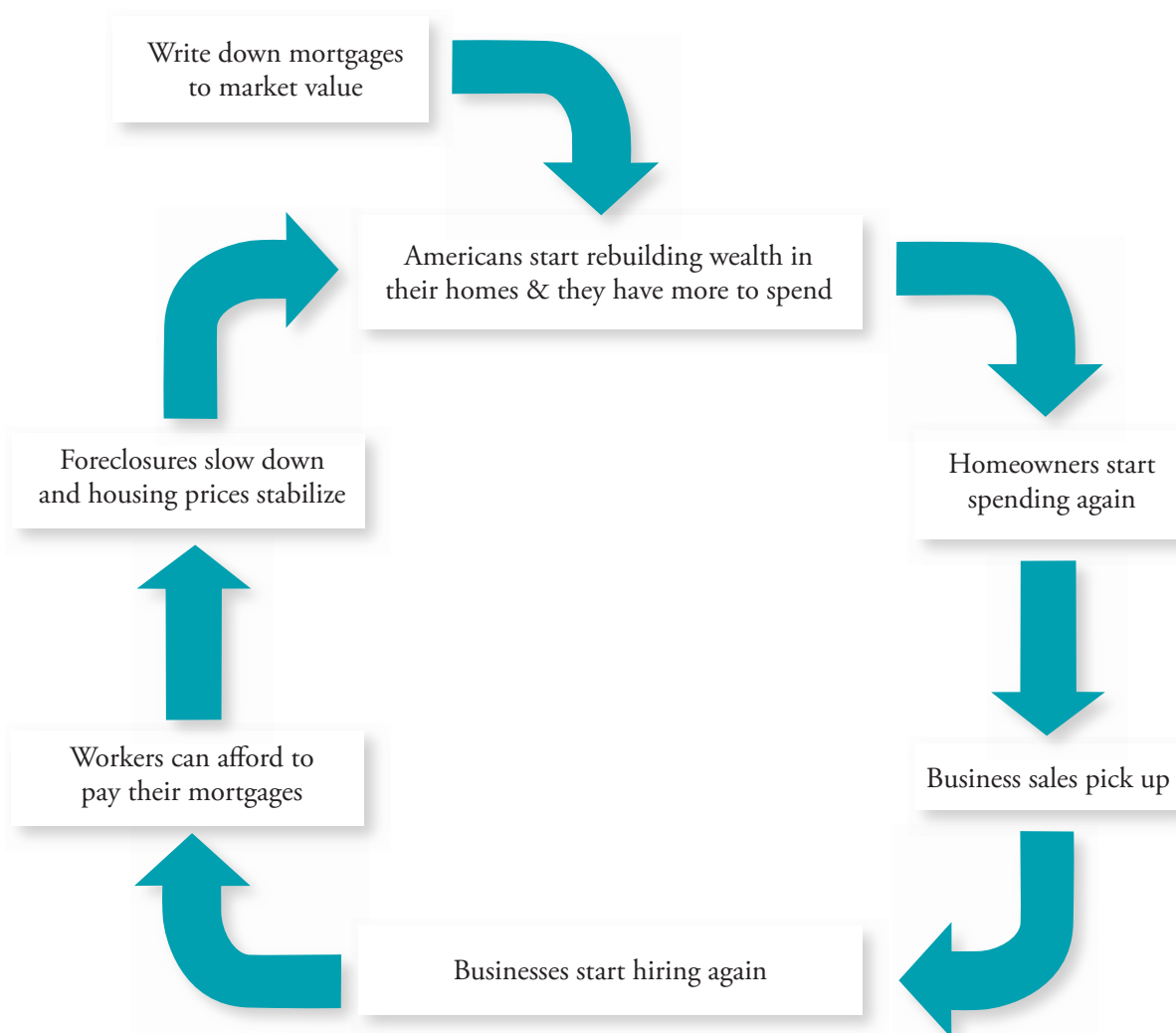
There is a simple way to break this cycle of devastation and get our heads back above water: write down the principals and interest rates on all underwater mortgages to market value. If banks wrote down all underwater mortgages to market value and refinanced the homeowners into 30-year, fixed-rate loans at current market interest rates, that would pump \$71 billion into the national economy. *A state-by-state breakdown can be found in Appendix A.*

Executing on this plan would lower homeowners' monthly mortgage payments by \$543 on average (\$6,516 per year), and would effectively serve as a direct cash stimulus into the economy, since cash-strapped homeowners would spend that money rather than invest it or set it aside. That would amount to \$6 billion every month that is currently going towards mortgage payments that could instead go towards buying groceries, school supplies, and other household necessities.

“If banks wrote down all underwater mortgages to market value and refinanced the homeowners into 30-year, fixed-rate loans at current market interest rates, that would pump \$71 billion into the national economy.”

As consumer demand picked up, businesses would start hiring again, creating new jobs. Putting \$71 billion into American consumers' pockets would create 1.05 million jobs.¹¹ The homeowners among these million newly-employed workers could afford to pay their mortgages and would stave off additional foreclosures. As foreclosures slowly subsided, housing prices would stabilize, and homeowners would be able to start rebuilding wealth in their homes again (see Figure 2).

Figure 2: Writing Down Principals Would Break the Cycle



Doing Right by Investors

Banks that service mortgages often hide behind investors to explain why they refuse to write down mortgage principal in order to prevent foreclosure. Servicers claim that they are just middlemen and that they cannot reduce principal because the mortgages are actually owned by investors—public pension funds, Fannie Mae, Freddie Mac, other institutional investors, and, in many cases, banks themselves. However, a recent study by the Center for Responsibility (CRL) shows that these investors would typically be better off if servicers would agree to loan modifications with principal reduction rather than letting the homes fall into foreclosure.

When a servicer forecloses on a home, the investor is saddled with many foreclosure-related costs: legal fees, maintenance costs on the property, sales costs, etc. CRL estimates that for prime borrowers, these costs amount to 49% of the total unpaid principal on the mortgage, and that for subprime borrowers, they come to a staggering 75%.¹² Underwater homeowners owe \$709 billion more on their homes than they are worth. That represents just 36% of unpaid principal. It would be far cheaper for the investor to write down principal to market value than to suffer the consequences if these homes fall into foreclosure.

However, servicers have different incentives. Foreclosures typically do not cost servicers anything, but loan modifications do.¹³ And in fact, servicers can even make money on foreclosures through late fees and other foreclosure-related fees.¹⁴ According to the National Consumer Law Center, “A servicer deciding between a foreclosure and a loan modification faces the prospect of near certain loss if the loan is modified and no penalty, but potential profit, if the home is foreclosed.”¹⁵ As a result, servicers generally prefer foreclosure over loan modification, even if it is not in the investor’s interest.

But this view is short-sighted. Widespread principal reductions would help stabilize banks’ own balance sheets since the same banks that service mortgages also own billions of dollars worth of mortgage-backed securities (MBS) in their investment portfolios. There is currently a big cloud hanging over the banks’ MBS portfolios because no one knows how low housing prices will fall and how many more homes will go into foreclosure. Moreover, the large amount of negative equity is forcing many underwater homeowners to consider walking away from their homes, just like the Mortgage Bankers Association walked away from the mortgage on its headquarters building in Washington, DC in 2010.¹⁶ This adds an additional pall of uncertainty over the value of MBS. Writing down principals would stabilize the housing market and it would effectively put a floor on MBS prices. This would help all investors, including banks.

Creating a Working Economy

The American economy is chained to an out of proportion and crushing housing debt load. Chronic unemployment, foreclosures, and small business closings can all ultimately be traced back to the housing crisis. The banks hold the key to unlocking massive economic stimulus. By writing down underwater mortgages to market value, they would put more than \$6,500 into the pockets of the average underwater homeowner each year. With an extra \$6,500 families could afford expenses, big and small, that they have been putting off. This would have a ripple effect throughout the economy, and it would create more than one million jobs nationally. It would serve as the second stimulus that America so desperately needs, only without added costs to taxpayers.

Appendix A: The Impact of Mortgage Writedowns by State

State	Underwater Mortgages	% of Homes in State Underwater	Total Negative Equity	Monthly Savings per Homeowner	Total Annual Stimulus	Jobs Created
Alabama	35,964	10.3%	\$1,438,560,000	\$353	\$152,244,947	2,250
Alaska	7,129	7.6%	\$285,160,000	\$413	\$35,293,102	522
Arizona	652,373	49.6%	\$39,142,380,000	\$512	\$4,011,324,632	59,288
Arkansas	24,614	10.1%	\$1,476,840,000	\$439	\$129,813,921	1,919
California	2,107,984	30.9%	\$196,042,512,000	\$810	\$20,488,099,906	302,819
Colorado	229,161	20.2%	\$9,166,440,000	\$428	\$1,176,528,555	17,389
Connecticut	105,851	12.9%	\$11,749,461,000	\$810	\$1,028,508,860	15,202
Delaware	25,696	14.1%	\$1,798,720,000	\$558	\$172,206,843	2,545
District of Columbia	14,639	14.7%	\$1,024,730,000	\$688	\$120,910,903	1,787
Florida	2,021,868	46.1%	\$121,312,080,000	\$498	\$12,080,041,389	178,546
Georgia	487,118	30.4%	\$19,484,720,000	\$386	\$2,253,790,272	33,312
Hawaii	22,403	9.9%	\$2,195,494,000	\$828	\$222,715,931	3,292
Idaho	59,335	24.2%	\$2,966,750,000	\$422	\$300,539,080	4,442
Illinois	483,517	21.7%	\$29,011,020,000	\$500	\$2,902,029,728	42,893
Indiana	66,654	10.9%	\$2,266,236,000	\$296	\$236,551,801	3,496
Iowa	31,077	8.8%	\$1,553,850,000	\$373	\$139,123,396	2,056
Kansas	30,755	10.3%	\$1,230,200,000	\$351	\$129,475,736	1,914
Kentucky	24,808	8.7%	\$1,488,480,000	\$440	\$130,955,897	1,936
Maryland	321,374	23.8%	\$19,282,440,000	\$559	\$2,156,879,818	31,879
Massachusetts	230,467	15.4%	\$27,656,040,000	\$867	\$2,398,214,610	35,446
Michigan	496,403	36.0%	\$19,856,120,000	\$344	\$2,046,798,843	30,252
Minnesota	91,811	16.1%	\$3,488,818,000	\$365	\$401,946,473	5,941
Missouri	122,200	15.7%	\$4,888,000,000	\$350	\$513,335,111	7,587
Montana	9,187	8.0%	\$551,220,000	\$481	\$53,022,450	784
Nebraska	20,537	9.3%	\$1,232,220,000	\$440	\$108,446,708	1,603
Nevada	358,241	62.6%	\$28,659,280,000	\$643	\$2,764,045,108	40,853
New Hampshire	40,361	18.7%	\$2,018,050,000	\$452	\$219,005,795	3,237
New Jersey	304,871	16.2%	\$21,340,970,000	\$613	\$2,242,091,380	33,139
New Mexico	32,538	13.4%	\$2,277,660,000	\$536	\$209,441,136	3,096
New York	114,899	6.2%	\$14,821,971,000	\$910	\$1,254,627,584	18,544
North Carolina	171,910	11.2%	\$8,595,500,000	\$425	\$875,725,445	12,943
North Dakota	3,469	6.9%	\$173,450,000	\$377	\$15,705,157	232
Ohio	482,048	21.9%	\$14,943,488,000	\$284	\$1,641,835,128	24,267
Oklahoma	27,050	6.5%	\$1,893,500,000	\$478	\$155,131,609	2,293
Oregon	119,533	17.2%	\$4,781,320,000	\$408	\$585,141,330	8,649
Pennsylvania	137,080	7.5%	\$9,595,600,000	\$511	\$841,374,542	12,436
Rhode Island	48,507	21.2%	\$3,395,490,000	\$558	\$324,970,702	4,803
South Carolina	93,104	15.2%	\$4,655,200,000	\$432	\$482,902,401	7,137
Tennessee	137,371	14.1%	\$5,494,840,000	\$346	\$570,787,231	8,436
Texas	335,446	10.1%	\$13,417,840,000	\$351	\$1,411,618,697	20,864
Utah	100,041	21.2%	\$5,002,050,000	\$461	\$552,862,824	8,171
Virginia	291,349	23.1%	\$17,480,940,000	\$576	\$2,014,240,650	29,771
Washington	238,476	16.9%	\$11,923,800,000	\$496	\$1,417,984,354	20,958



Underwater homeowners in each state



How state would benefit if there was widespread principle reduction

Appendix B: Methodology

To calculate the potential savings from writing down principals on all underwater mortgages to market value and refinancing them into 30-year fixed-rate mortgages at current interest rates, we first calculated how much underwater homeowners are currently paying on their mortgages. To arrive at this number, we needed to determine the total principal on underwater mortgages and the average interest rate that underwater homeowners are paying. According to data from CoreLogic's publicly available Negative Equity Report for the first quarter of 2011, as of March 31, 2011, and the total outstanding principal on underwater mortgages in the United States was \$2.0 trillion.

Determining the average interest rate on these mortgages proved difficult due to inadequate information, so instead we used the interest rate from 2006, which is a conservative figure. According to the Federal Reserve Board's H.15 Release, in 2006, the going interest rate on a 30-year, fixed-rate, conventional mortgage was 6.41%. This is conservative because it assumes that all of these underwater homeowners were prime borrowers with conventional mortgages. Many of these underwater homeowners were subprime borrowers that had substantially higher interest rates. Furthermore, in the ten years from 1997 through 2006, the average interest rate on a conventional mortgage was 6.75%, higher than the 6.41% figure we used.

Using a mortgage calculation formula in Microsoft Excel, we calculated that the monthly mortgage payment on \$2.0 trillion for a 30-year, fixed-rate loan at 6.41% interest would be \$12.4 billion. This is the pre-modification monthly mortgage payment.

The next step was calculating what the payments would be if principals were written down to market value and reset to current interest rates. To ascertain the principal for market value mortgages, we once again turned to CoreLogic's Negative Equity Report. According to the report, in the first quarter of 2011, there were 10.9 million underwater mortgages nationally, and the average underwater mortgage had \$65,000 in negative equity. That means that in total, underwater homeowners owed \$709 billion more on their homes than they were worth. The principal on market value mortgages, therefore, should be \$1.3 trillion. To get the current market interest rate, we again used figures from the Federal Reserve Board's H.15 Release. According to the release, the going interest rate on a 30-year, fixed-rate, conventional mortgage as of July 2011 was 4.55%.

According to the mortgage calculation formula, the monthly mortgage payment on \$1.3 trillion for a 30-year, fixed rate loan at 4.55% interest is \$6.5 billion. This is the post-modification monthly mortgage payment. That means that after modification, total mortgage payments on underwater mortgages would drop \$5.9 billion per month, or \$71 billion annually. That means that over the 30-year life of the mortgage, homeowners would save \$2.1 trillion.

To calculate the jobs impact of this figure, we relied on a study by Robert Pollin and Heidi Garret-Peltier that showed that giving Americans a \$1 billion tax break for personal consumption would create 14,800 jobs, which translates to \$67,658 per job.¹⁷ Reducing homeowners' monthly mortgage payments would have a similar impact to a tax cut for personal consumption by freeing up dollars for households to use on other things like buying groceries and school supplies. We therefore divided the \$71 billion in annual savings by \$67,658 per job to determine that loan modifications with principal and interest rate write-downs to market value would create 1.05 million jobs.

For the state-by-state analysis, we applied our same methodology to the state-level data found in CoreLogic's Negative Equity Report. Unless more precise data was available, the average negative equity per underwater home by state was rounded to the nearest \$10,000. CoreLogic did not list data for Louisiana, Maine, Mississippi, South Dakota, Vermont, West Virginia, or Wyoming, so we also left those states out of our state-by-state analysis. Due to rounding errors and the fact that we did not have state-level data for a handful of states, the state totals in Appendix A do not add up to the national total.

Endnotes

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- 11 Based on calculation that giving Americans \$1 billion for personal consumption would add 14,800 jobs into the economy, which means that it takes \$67,658 to create one job: Pollin, Robert and Heidi Garrett-Peltier. *The U.S. Employment Effects of Military and Domestic Spending Priorities: An Updated Analysis*. Political Economy Research Institute, University of Massachusetts, Amherst. p. 5. Oct 2009. http://www.peri.umass.edu/fileadmin/pdf/published_study/spending_priorities_PERI.pdf
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