Understanding the Foreclosure Crisis:
Don't Believe the Hype!

By

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Introduction

Good morning. On behalf of the National Community Reinvestment Coalition, I am honored to speak with you this morning and share with you some thoughts on the context for, and continuing need to enforce, the Fair Housing Act of 1968.

Normally, I would begin a conversation on this issue with a review of historic acts of discrimination that led to the need for the Fair Housing Act. But today, America is in the grip of a foreclosure crisis unlike anything we have experienced for more than half a century. And, this crisis relates directly to the question of fair housing. So I will begin with a discussion of the foreclosure epidemic sweeping the country and relate it to the broader and historic issues of fair and equal housing access.

Duration of the Current Foreclosure Crisis

Some observers have argued that the worst is over, that the markets are already beginning to correct themselves, and that further government intervention is not necessary. This view is at odds with reality. Last year, there were roughly 1.5 million foreclosures. According to the Secretary of the Treasury, Henry Paulson, as many as 2.5 million could face the same fate this year alone. Moreover, as foreclosures mount, home prices slide, predisposing even more homeowners to foreclosure as home values sink far below the value of their mortgages. As foreclosures further weaken the economy, the resulting job losses become an additional contributor to the loss of more homes. Together, these actions create a reinforcing cycle of foreclosure, home price declines, job loss, foreclosure, the conclusion of which is not yet in sight.

Add to that toxic mix -- loans commonly referred to as Alt A Pay Option Arms. These loans allow consumers to treat mortgage loans like a credit card and make only minimal payments that don't even cover the full interest payments. Pay option arms are disproportinately investor loans, had little if any initial equity, and most are already upside down, underwater, in deep trouble. They are expected to begin failing in large numbers next year and continue to do so through 2011. In short, there is much more foreclosure pain waiting in the wings. And the near-and mid-term future of housing and homeownership is largely dependent on how long this crisis is allowed to fester.

Impacts on African American Families and Communities
The current foreclosure crisis will likely result in the greatest loss of wealth for African Americans since Reconstruction. According to Martin Eakes, Chief Executive Officer of the Center for Responsible Lending, close to 20 percent of African Americans may lose their homes by the time this crisis bottoms out. In an environment where fewer than half of blacks own their homes compared to roughly 75 percent of non-Hispanic white families, the impact on net wealth within the black community will be disastrous.

Because of the critical link between homeownership and wealth attainment, African Americans, on average, already hold only $10 of wealth for every $100 of savings of the typical non-Hispanic white household. We cannot afford that gap to widen. But it is already happening. Over the past several years, more than half of all home mortgages to African Americans and more than 40 percent to Latino households were high-cost subprime loans. And, today, the foreclosure rate on subprime loans is more than 10 times that of the prime market.

According to the nonprofit public policy organization -- United for a Fair Economy -- this loss of homeownership could translate into a total loss of wealth among African American and Latino households of between $164 and more than $200 billion.

Foreclosure Impacts Beyond Financial
Foreclosures are not just a financial crisis for families who experience them.

Families who lose their homes have to determine where next they are going to move.

Many families may have no savings left to afford a rental security deposit, and, even if they can afford the security deposit, their credit scores are so damaged that landlords will not accept their applications.

Parents must ponder what will become of their school-aged children who may have to relocate if parents are unable to find or afford an apartment within the same school district.

Parents also must cope with the anxieties of their children who may lose proximity to their friends and familiar surroundings.

And, children will face the harsh realization that their parents cannot protect them from being evicted from the safety of the place that should represent absolute security – the family home.

For communities, foreclosures are the start of a potential new blight on a community; a new location for possible crime, vandalism, the loss of neighbors and friends, and loss of additional community wealth.

For communities, foreclosures can also be the trigger for additional foreclosure as homes drop in value far below the outstanding loan balance, making holding on to the home an economic disaster.

And for communities, the uncertainty of how, when, or if they will come back to life will leave many areas of concentrated foreclosures in an uncomfortable and disconcerting limbo for years to come.

This is the unfortunate reality for many African American communities across the nation struggling to survive the latest wave of setback in their quest to achieve equality in America.

But how did things get so bad?

Origins of the Subprime Crisis and Need for Intervention

Many observers argue that the subprime market's foreclosure crisis is a result of moderate-income minority borrowers getting into trouble by over-extending themselves to purchase a home. But when you hear those arguments, consider these words of the rap group Public Enemy, "Don't believe the hype"!

First, most subprime loans originated for at the past decade were for refinancing homes. Second, according to the Center for Responsible Lending, less than 10 percent were for first time homeownership. These statistics together mean that much of the subprime market damage was due to mortgage refinancing schemes that took advantage of financially vulnerable families who already owned their own homes and had already accumulated equity in their properties. Subprime lenders targeted those consumers to structure financing deals that literally flipped the equity away from their owners. And, for first time homeowners, they simply were exploited to the limits of their financial vulnerability.

Much of the resistance from policy makers to assist homebuyers going to foreclosure is the concern about creating "moral hazard". This idea implies that bailing people out of problems that resulted from bad or risky decisions may encourage them to make those bad decisions again.

Let's examine the bad decisions made by millions of families caught up in this foreclosure crisis.

They made the bad decision to trust their broker to be honest and help them secure the best loan for their circumstances;

They made the bad decision to trust their lender would offer them a product that was affordable to them;

They made the bad decision to trust the appraised value of their home was legitimate;

They made the bad decision to trust the regulatory supervision of the financial institutions to protect their rights as consumers;

In short, borrowers in the subprime market made the bad decision to trust that they would be treated with the same respect and protections as is the norm for the overwhelming majority of Americans who enter into homeownership through the prime market.

A moral hazard? But not in the classical economic meaning.

More Evidence on Unfair and Deceptive Lending
In fact, hundreds of studies, policy papers, refereed research articles, and print news stories have documented the abusive lending practices in the subprime market for more than a decade. The US Department of Justice pursued its first successful predatory lending case in 1996. Yet more than a decade later predatory lending was more widespread than ever. Widely reported abuses have been identified in the use of inappropriate loan products, inadequate underwriting, bloated appraisals, abusive prepayment penalties, excessive broker fees, steering borrowers to high cost products, and servicing abuses.

In recent years, a majority of subprime mortgages that were peddled to consumers were not structured or underwritten to sustain homeownership. Rather they were intended to lock borrowers into a financial relationship with mortgage brokers and mortgage finance companies whereby loans had to be refinanced, usually within two to three years, in order for mortgage payments to remain affordable.

With each refinancing came another set of upfront broker and mortgage finance fees, and servicing and securitization revenue. Subprime lending increasingly became more of a pyramid or ponzi scheme than legitimate housing finance. In fact, I first made that comment about the subprime market being a house of cards in January of this year and was concerned that phrase might be a little strong.

But, according to a report just released last week by the US Securities and Exchange Commission, reviewing the possible improprieties by the Wall Street Bond rating agencies (that gave investment grade ratings to subprime junk bonds), there were widespread problems within the rating firms. Of the many revealing observations of the SEC, the report quotes one bond rating analyst as stating, in an email: “Let’s hope we are all wealthy and retired by the time this house of cards falters”.

The subprime-mortgage assets being traded in that secondary markets gave the appearance of performing well, but in reality, required unrealistically high and unsustainably rising home prices to remain economically viable. But when home prices began to soften and then fall in 2006, the foundation under the subprime market's house of cards began to crumble, and with it, major segments of the US financial system. Today, the subprime market is in shambles, and with it, many of the nation's blue chip financial institutions that supported the subprime market. More than $400 billion in losses have been written off by major banks and investment firms. Billions in additional losses have yet to be recognized. The US financial system teeters today on the brink of collapse. And millions of families are losing their homes.

Historic Discrimination

While this current foreclosure crisis is a disturbing chapter in the history of housing discrimination against African Americans, it is far from the first. America has a long and tortured history in this arena. And this historic discrimination in housing explains, overwhelmingly, the disparities in economic advancement of African Americans over the past century. For the better part of the 20th Century, housing discrimination was not only supported by public policies, programs and practices, but also often defined the discriminatory ground rules.

Public support for discrimination, for example, came in the form of Plessy v. Ferguson and "Separate but equal" that began the process of isolating African Americans from white communities. While the Supreme Court ruled that separate did not necessarily mean a denial of equal access, the entire purpose of separate but unequal was to undermine the emerging economic and political strength of blacks shortly after Emancipation Proclomation.

Public support for discrimination also came in the form of Jim Crow era restrictive covenants that denied the sale of homes in white communities to African Americans. Prior to restrictive covenants, black segregation was not a major issue in northern or southern cities. In fact, blacks were more likely to live among whites of their similar socioeconomic status in 1900 than they are today.

Public support for discrimination came in the form the Great Depression era's Home Owners Loan Corporation, a federal agency established to help homeowners facing foreclosures. HOLC failed to approve loans in African American communities, and it institutionalized redlining – the practice of denying loans to communities occupied by African Americans.

Public support for discrimination came in the form both the FHA and VA, the federal programs established to make homeownership affordable for the vast majority of American families, including returning veterans. FHA and VA underwriting criteria reinforced segregated residential patterns, and undermined home value appreciation and therefore wealth accummulation in African American communities. In fact, the common refrain in the real estate industry that property values will fall if a black family moves into the neighborhood came directly from a government imposed mandate!

And, public support for segregation came in the form of Urban Renewal, the program that literally bulldozed entire struggling working class African American communities and relocated blacks into bleak, desperate and unsafe concrete towers. Those concrete towers were monuments to racial injustice and human indecency and were unfit for human habitation, particularly for families with children.

The net result of these and many discriminatory actions was the creation of hyper-segregated, isolated, and disadvantaged communities that continue today to characterize the living conditions for millions of African Americans.

Value of History
The goal of highlighting this brief history is not to point fingers, assign blame or live in the past. Rather its important that Americans have a more accurate and clear understanding of the origins of, and reasons for, the severe economic and social desparities that exist today by race and ethnicity. As Nelson Mandela once observed: "True reconciliation does not consist of merely forgetting the past."

Giving Up
Moreover, material disadvantage is not the only damage that has occurred to residents impacted by decades of discrimination. Many communities now suffer from a poverty of hope that things will ever change.

We see can this poverty in disenfranchised urban communities every day.

We see it in the eyes of children who don't bother to study in school because they cannot even imagine a future that is materially better than the poverty they now experience

We see it on the faces of parents who have known a life of repeated frustration and despair about their inability to provide better for their families and themselves

We see it in the actions of young men who engage in obviously self-destructive behavior because they are disconnected from, and even invisible to, society and seek only to survive day to day

We see it in the faces of those who today are dealing with the shattered dreams of homeownership.

We see it in the gaze of the homeless, the hopeless, the disenfranchised, and the left behind – all who disproportionately occupy communities of color.

Fixing the Problems
Addressing historic discrimination and the current foreclosure crisis will take multiple actions.

(1) Assist homeowners heading into foreclosure;
(2) Purge predatory lending from the financial system; and

(3) Enforce antidiscrimination laws.

Contain the Current Foreclosure Crisis
To date, there has been no legislative response to address the magnitude and depth of the current foreclosure crisis. The most recent and promising legislation pending are companion bills that would expand FHA to enable it to refinance up to 400,000 additional loans that likely are heading to foreclosure between 2009 and 2013. While this is a start, it represents a very small portion of problem loans (about 2 months of foreclosures at the current rate). Moreover, for a variety of legislative and administrative reasons, the program is not likely to fully go into effect until early next year. By that time, more than another million households will have gone into foreclosure.

And, remember the moral hazard issue? It relates to banks as well. But that has not stopped policy makers from dismissing it to bailout the banks. JP Morgan Chase was provided $29 billion in emergency financing to rescue Bear Stearns. The Federal Reserve has also established an emergency lending program for other investment houses. Moreover, the Federal Reserve Bank is increasingly accepting high-risk assets in return for the loans being made to investment houses. Although these actions have helped to calm concerns about the stability of the US financial system, losses from this program will be passed to US taxpayers.

Using the moral hazard argument against borrowers in light of the current aggressive financial support for banks, is not only inconsistent, it's irrational. The major threat to financial institutions currently is not a lack of liquidity, per se, but failing assets in the form of millions of additional foreclosures. Providing greater support for borrowers would, therefore, be a more efficient way to help put the legs back under the financial system, the economy, and consumers. But the Federal Reserve is not in a position to assist borrowers directly. Helping families modify their loans or refinance into more affordable loan products is an action that Congress and the Administration would need to take.

Leaving the Federal Reserve to solve the problems stemming from the foreclosure crisis, solely on the liquidity side of the coin is costly, circuitous, inefficient, and will not succeed. It's tantamount to trying to fill a bathtub full of water with the stopper out.

And, it should be noted that the aversion to assist struggling homeowners is not due to a concern by policymakers about spending taxpayer money. In January, Congress enacted an economic stimulus package with a price tag of more than $150 billion. Yet, none of those funds were directed at foreclosure mitigation – the core problem destabilizing the financial system and economy.

The National Community Reinvestment Coalition proposed early this year the establishment of a national Homeownership Emergency Loan Program, or HELP Now. This program would authorize the US Treasury to purchase loans in bulk, and at steep discounts (equal to their current mark-to-market value), from securitized pools and apply those discounts to borrowers with problem loans. The discounts would be transferred to homeowners with problem loans to enable them to modify or refinance those loans in a manner that would make them permanently affordable. This approach would incur some cost. But the magnitude of the cost would be modest compared to the cost of failing to arrest the foreclosure crisis.

Purge Predatory Lending From the Mortgage Finance System
Just Monday, the Federal Reserve Board issued new regulations pertaining to a broad range of lending practices in the mortgage industry. The comprehensiveness of the Federal Reserve Board's revised rules should dispel the notion that irresponsible borrowers were the principal cause for the current mortgage crisis. The rules address almost every aspect of lending, from underwriting and appraisal practices to marketing of products and more.

The rules take an important step forward in having consumers in the subprime market treated with the same professionalism and respect that borrowers routinely experience in the prime market. But there remain a number of trap doors for prospective home buyers that need to be eliminated. Those additional doors should be closed by a strong national anti-predatory lending law that can compliment and support the Fed's recent actions.

Of course, it is possible to over-regulate financial firms. And some observers are already saying that the Federal Reserve has gone to far. But the overwhelming evidence from the current foreclosure crisis makes it clear we are a long way from the danger of over-regulating.

We are a long way from over-regulation when the financial system is brought to a near collapse from either unfair, deceptive, and predatory practices or consumers exploiting weaknesses in the financial regulation of the markets.

We are a long way from over-regulation when the typical nonprofit home purchase counselor, operating on a shoestring budget, can better appraise the prospective performance of subprime loans, than highly compensated bond rating agency analysts, who classified hundreds of billions of dollars worth of subprime junk assets as investment-grade securities.

We are a long way from over-regulation when the nation's most financially vulnerable consumers have been allowed to suffer the worst financial damage – damage that has left thousands of communities across the nation literally in shambles, many in complete disarray.

We are a long way from over-regulation when, as Harvard University Law professor Elizabeth Warren has observed, consumers have better protection when buying a toaster or microwave oven than when buying the family home.

Enforce Anti-Discrimination Laws
Fully 40 years after the passage of the Fair Housing Act housing discrimination is alive and well. The National Fair Housing Alliance conservatively estimates that each year, roughly

3.7 million instances of discrimination occur. Paired testing activities throughout NCRC's National Neighbors program support and reinforce NFHA's findings. Yet the response by federal agencies responsible for enforcement of fair housing laws is dismal.

In fact, in the middle of the worst foreclosure crisis in more than half a century, in a market for which steering high cost products to minority consumers is well-known and has been well documented, and where several states and cities are now filing law suits on behalf of their residents charging unfair and deceptive practices, there has not yet been a single major charge, made by federal financial regulatory agency, against a lender for predatory or biased lending.

A lack of funding is a major part of the problem, but not the only issue. Lack of appropriate coordination between various agencies responsible for enforcing civil rights and equal opportunity, and insufficient political stature at the federal administrative level of government also undermine progress on this essential national mandate.

In response to this contiued failure to enforce the law, the National Community Reinvestment Coalition recommends the establishment of a new cabinet level agency focused on Civil Rights Enforcement. This agency, let's call it the Department for an Inclusive Society, would report directly to the President of the United States and would monitor the enforecment activities of other agancies and provide guidance on how to improve their performance, so as to eliminate discrimination from our society once and for all. And, given the importance of housing to accessing opportunities for social and economic advancement, housing related laws would be among the new agency's highest priorities.

Enforcing the law would immediately open the door for millions of households who are prepared to access opportunities today -- and for whom their only impediment is an illegal denial of access.

Competitive Global Economy

The issue of discrimination has generally been argued solely on the basis of equality and justice. While those are important grounds, there is increasingly another critical reason to level the playing field by race and ethnicity. Globalization represents for America competitive challenges the nation has never previously experienced. Concern over the loss of jobs in the US grows on a daily basis and those jobs are increasingly moving up the employment food chain – more recently including highly skilled positions.

America cannot afford to stumble through the 21st Century. The risks are too great.

At the same time, consider that by the middle of this century, half of the U.S. population will consist of people of color. Yet this fastest growing share of the nation's population is disproportionately composed of people who are the least well-housed, have more tenuous connections to the labor and financial markets, are disproportionately isolated from quality educational opportunities, and achieve relatively low levels of wealth.

The influence of poorly educated students, for example, is already a growing concern for many business leaders and policy makers. According to a recent Blue Ribbon Commission on Higher Education, established by the National Conference of State Legislator in 2006, the U.S. is not prepared for the dramatically changing demographic shifts in our population. Moreover, consider these statistics. According to Harvard University professor Robert Samuelson, in the 1970s, the United States led the world in the graduation of PhDs in math, science, and engineering. By 2010, the EU will produce twice as many PhDs in these fields and China will produce 26 percent more. Now consider that China has a population of 1.3 billion compared to America's .3 billion. India also is an education juggernaut – also with a population of over 1 billion.

In this environment, the United Negro College Fund's slogan has never been more meaningful, "A mind is a terrible thing to waste."

Conclusion

Few, if any laws, are more important than those that ensure the civil rights of our citizenry. The cornerstone of a democracy is equality. And equality demands the full and equal rights of all people, we the people, not be inhibited by artificial barriers raised due to the individual's race/ethnicity, gender, or other personal characteristics as defined by law.

Discrimination is irrational and counterproductive to the common good of the nation. It stifles human potential, undermines the economic and social wellbeing of communities, and limits the nation from reaching its full potential as a fully inclusive and competitive society. Access to decent affordable housing in safe vibrant neighborhoods is central to economic and social mobility

While the current foreclosure crisis may seem to be at the end of the road, particularly for those communities facing massive losses of homes, remember the words of Malcolm X: "Stumbling is not falling. Every defeat, every heartbreak, every loss contains its own seed, its own lesson, on how to improve next time."

There will be a next time.

In fact, it's November 4th.

Vote!

Don't stumble!

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