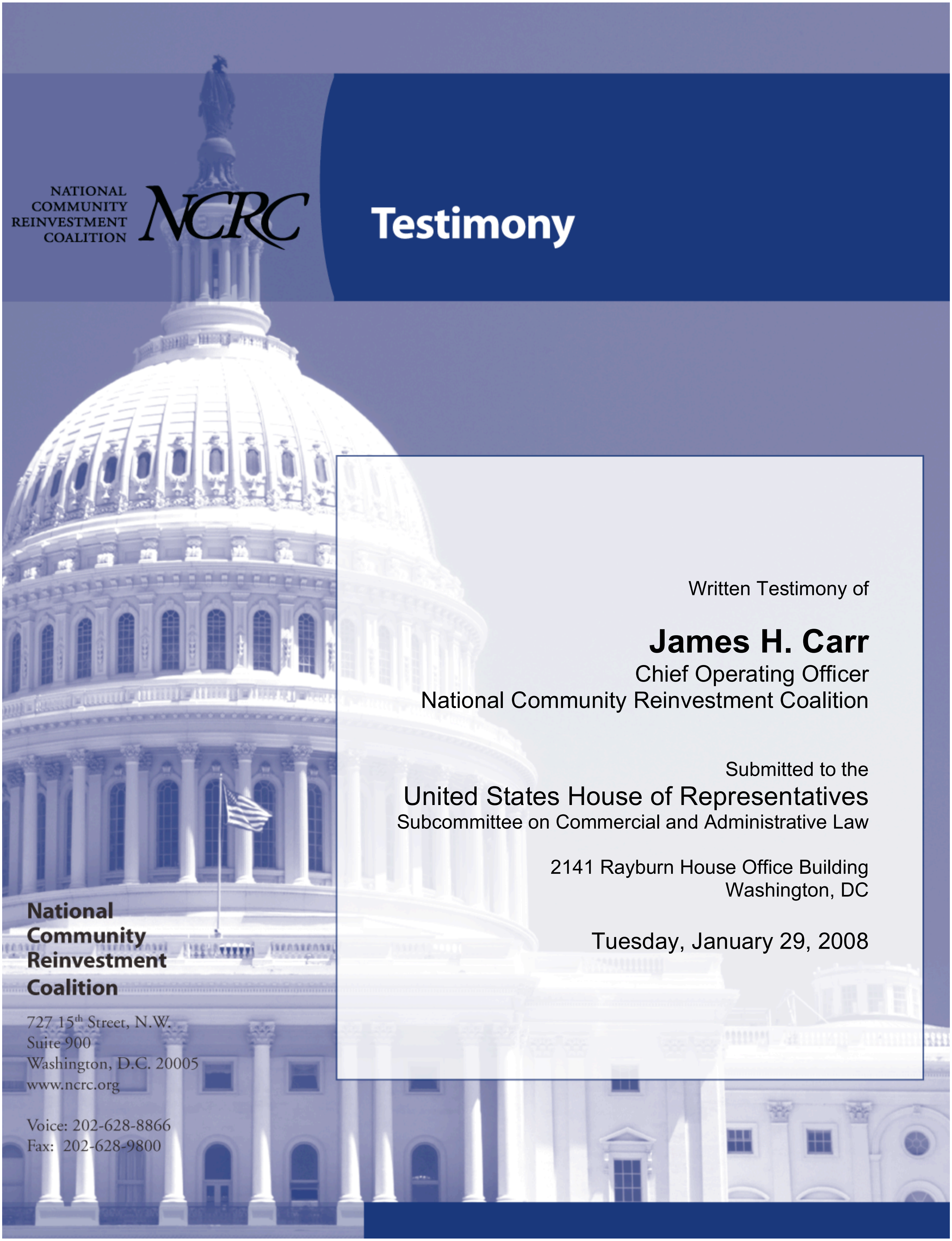

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Testimony

Written Testimony of

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National Community Reinvestment Coalition

Submitted to the

United States House of Representatives

Subcommittee on Commercial and Administrative Law

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Responding to the Foreclosure Crisis

James H. Carr
Chief Operating Officer
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> *"It is impossible to buy a toaster that has a one-in-five chance of bursting into flames and burning down your house. But it is possible to refinance your home with a mortgage that has a one-in-five chance of putting the family out on the street…."*
>
> Elizabeth Warren
> Leo Gottlieb Professor of Law
> Harvard University

Introduction

Regional economic downturns, speculation on skyrocketing home prices and rampant unfair and deceptive mortgage lending practices have combined to create the perfect foreclosure storm in America. According to the FDIC, there is roughly $1.3 trillion of outstanding subprime mortgage debt (Poirer, 2007). In 2006 alone, more than $600 billion of subprime mortgages were originated (Inside Mortgage Finance, 2006). RealtyTrac data shows roughly 450,000 homes experienced foreclosure in the third quarter of 2007, up a full 100 percent from the same period one year ago (Yoon, 2007). And, although foreclosures are most heavily concentrated in 12 to 20 states, foreclosures are up in 45 of 50 states. Federal Reserve Board Chairman Ben Bernanke reported that 21 percent of subprime adjustable-rate mortgages were ninety-days delinquent or more as of January 2008 and according to the Center for Responsible Lending (Center for Responsible Lending) fully one in five subprime loans are expected to fail (Bernanke, 2008; Center for Responsible Lending, 2007). That rate of foreclosure is estimated to translate into more than two million families losing their homes to foreclosure over the next year to 18 months (Center for Responsible Lending, 2007). Estimates of the full economic costs of the foreclosure crisis vary greatly. The projections share, however, a common theme: the prospect of significant financial costs that extent beyond the housing market.

Collapse of the Subprime Market

In November 2007, the U.S. House of Representatives voted overwhelmingly to approve a comprehensive anti-predatory lending bill. One of the key provisions of that legislation bars financial institutions from making mortgage loans to consumers who cannot repay those loans (HR 3915). This provision serves as a metaphor for the dysfunctional practices that have come to define the subprime market over the past decade. Studies and reports on subprime loans reveal problems in almost every aspect of the subprime lending process (Carr et al., 2001; Carr, 2006; National Community Reinvestment Coalition, 2002, 2005, 2007; Center for Responsible Lending, 2007; Schloemer et al., 2006; Engel & McCoy, 2002). In fact, nearly a decade ago, the North Carolina legislature passed a law to prohibit predatory lending (North Carolina, 1999). Inappropriate loan products, inadequate underwriting, bloated appraisals, abusive prepayment penalties, excessive broker fees, steering borrowers to high cost products, and servicing abuses, have been widely reported (Calem et al., 2004; Eggert, 2004; Engel & McCoy, 2004; Farris & Richardson, 2004; Lax et al., 2004; Quercia et al., 2004; Renuart, 2004; Seifert, 2004; White, 2004; Wyly et al., 2004). Funding of subprime loans has also played a major role in the crisis. The rating of securities as investment grade products that were backed by loans that might aptly be described as subprime mortgage junk bonds fueled the funding pipeline that enabled the exponential growth of the subprime market. Without the extraordinary access to financing provided by securitization, the growth of the subprime market would have been greatly limited and the financial damage to homeowners and the economy significantly reduced.

Prior to securitization, banks were meticulous about making sure that borrowers could repay their loans. That was because banks held loans in their portfolio. In short, their own money, and that of their customers, was at risk. But with securitization, this self-regulatory incentive mechanism was lost.[1] And, despite this transformation of the markets, federal regulation of the mortgage lending industry grew increasingly inadequate. The result was increasingly risky behavior of mortgage lenders, particularly in the subprime market. In recent years, a majority of subprime mortgages peddled to consumers have not been 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. Securitization of the underlying assets allowed the risks of these products to be spread widely, literally to investors around the world (Landler, 2007; National Public Radio, 2007; Paletta & Hagerty, 2007; Werdigier, 2007). The result was that billions in profit were made while millions of families were put at high risk for foreclosure.

In reality, predatory lending increasingly became an unstable house of cards that gave the appearance of performing well, in an environment of unrealistically high and unsustainably rising home prices. In fact, irresponsible lending practices contributed greatly to the unsustainable ballooning of house prices by offering financing terms that created the illusion of affordability. When house prices began to soften in 2005, the foundation began to collapse under the subprime market's house of cards. But it was not until subprime market losses led to the implosion of a billion dollar Wall Street hedge fund that the subprime market's woes rose to public prominence and nearly daily press coverage (Morgenson, 2007). 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 $70 billion in losses have been written off by major banks and investment firms (Mavin, 2007). Billions in additional losses have yet to be recognized. According to Robert Barbera, chief economist at ITG, "there was financial alchemy at work." (Norris, 2007).

[1] An exception to this circumstance may be loans sold to Fannie Mae and Freddie Mac whereby the Government Sponsored Enterprises tend to have more strict underwriting guidelines and more aggressively exercise recourse for loans that do not conform to those underwriting requirements.

Estimating the Damage

According to the U.S. Joint Economic Committee of Congress (JEC), an estimated $71 billion in housing wealth will be lost directly as a result of foreclosures. An additional $32 billion in housing wealth will be lost indirectly by the spillover effects on neighboring properties (Joint Economic Committee, 2007). The Center for Responsible Lending estimates this combined loss of housing value at $164 billion (Schloemer et al., 2006). Moreover, recently released studies indicate the financial trauma will not be limited to losses in housing equity. As house prices slide, so do local real estate-based taxes. According to the U.S. Conference of Mayors, ten states alone will lose an estimated $6.6 billion in local revenue this year (Global Insight, 2007). That same report projects a one percentage point reduction in GDP growth, with a concomitant loss of more than a half a million jobs (Global Insight, 2007). The Wall Street Journal reports total estimated losses from subprime and similar mortgages on the order of the S&L crisis of the 1980s, ranging from $150 billion to $400 billion (Ip et al., 2007).

According to Martin Feldstein, President and CEO of the National Bureau of Economic Research, the chance of a recession is likely (Isidore, 2008; Berner & Greenlaw, 2007). The prospect of a recession is particularly troubling because an increasing loss of jobs will further destabilize the housing markets by placing an even greater number of borrowers at risk of foreclosure. And, if the stock market's performance in the opening days of 2008 is an indication of things to come, 2008 will be a difficult year. Stock market losses in the first three days of 2008 were the largest opening year three-day loss since 1932 (Karmin, 2008). Moreover, unlike the 2001 recession, consumers will not have the same access to home equity to help them weather the economic storm. Economic distress could also further expose weaknesses in the prime market and its growing troubles with pay-option adjustable mortgages or option ARMs (Reckard, 2007). Resets on option ARMS – which were mostly limited to the prime market – will peak in 2009 and 2010 (Credit Suisse, 2006).

The ripple effects of this foreclosure crisis are not limited to the US. Securities backed by US subprime loans have been sold around the world and are impacting businesses and international markets. In September 2007, for example, subprime losses caused a run on the British bank Northern Rock, which prompted the Bank of England to issue a blanket guarantee of all deposits at U.K. banks (Werdigier, 2007). On November 12, 2007, the Asian equity markets fell sharply, in part, on US subprime market fears (National Public Radio, 2007). In December, Europe's Central Bank poured an unprecedented half trillion dollars into the financial system for short-term loans to banks hoping to avert a year-end meltdown in Europe's money markets (Paletta and Hagerty, 2007). In fact, even the remote fishing village of Narvki, in Norway, was reported to have been harmed by the US subprime market's collapse, due to their purchase of securities backed by US subprime loans (Landler, 2007).

The economic damage from the foreclosure crisis may not be limited to market losses. Legal actions are rising and may have a further chilling impact on lending. On January 8, 2008, the Mayor and City Council of Baltimore announced a lawsuit against Wells Fargo charging lending discrimination against black homebuyers (Morgenson, 2008; Mayor and City Council of Baltimore v. Wells Fargo, 2008). The suit claims that in 2006, 65 percent of loans made by Wells Fargo to black customers in Baltimore were high-cost mortgages; only 13 percent of loans to white customers were high-cost. A few days later, on January 11, the City of Cleveland sued 21 banks for their alleged inappropriate role in financing failed subprime mortgages in that city (Pierog, 2008). Depending on the success of these cases, other cities may follow suit. Also at this time, at least two states are pursuing legal actions against mortgage lenders for discrimination or fraud (Irwin & Johnson, 2008).

Finally, in January 2008, the FBI announced an ongoing criminal investigation of 14 companies for possible fraud in the subprime mortgage market. Although the names of the companies have not yet been released, fraud has been identified in all areas of the subprime mortgage market including; fraudulent underwriting, scam foreclosure rescue schemes, accounting fraud, insider trading, and trading of replicated mortgages on the secondary market. According to the FBI, mortgage fraud has been on the rise for the last few years, with the number of suspicious activities complaints rising from 3,000 in 2003 to over 48,000 cases in 2007, and is spreading nationwide (CNN, January 2008). The FBI is also working with the Securities and Exchange Commission, in its conduct of about three dozen civil investigations regarding the role of mortgage brokers, investment banks and due-diligence companies involved in the underwriting and securitization of loans. (Perez and Scannell, 2008). Dozens of lawsuits are piling up involving homeowners, lenders, Wall Street banks and investors (Bajaj, 2008).

Disproportionate Impact on Minorities

While high foreclosures are impacting families across the income and racial/ethnic spectrum, the families and communities most negatively impacted are African American and Latino. According to a 2006 Federal Reserve study, fully 45 percent of home loans to Latino households and 55 percent of home loans to African Americans, then outstanding, were subprime. These utilization rates of subprime lending are three to four times that of non-Hispanic white families (Avery et al, 2006; NCRC 2003; NCRC 2007).

The disproportionate negative financial impact on African American households is already evident. Between the second quarter of 2004 and that same period in 2007, the homeownership rate for blacks fell by more than 2.5 percentage points. This is significantly greater than the 0.6 percentage point decline for non-Hispanic white households. And, while the Latino homeownership rate has remained strong in the face of this financial crisis, millions of Hispanic families are, nevertheless, paying unnecessarily high mortgage costs to maintain their homes financed with predatory loan products. Avoiding foreclosure for these families has a real financial cost; families must pool financial resources to pay the mortgage, spend less for other necessities, or divert money away from their savings or limit or curtail sending remittances to families back home.

According to a 2008 report by the nonprofit policy center United for a Fair Economy, the foreclosure crisis will result in the greatest loss of wealth for people of color in recent US history. They estimate black/African American borrowers will lose between $71 billion and $122 billion, while Latino borrowers will lose between $76 billion and $129 billion (Rivera, 2008). As with other estimates of prospective economic impact, mentioned earlier in this paper, the preciseness of these numbers is unclear. But even if the estimates provided by United for a Fair Economy overstate the economic damage by a full 50 percent, the resulting damage on asset holdings for African Americans and Latinos would remain staggering for those households given their relative low wealth status at the outset.

Justification for Intervention

One of the most frequently expressed arguments against assisting homeowners facing foreclosure is concern for the moral hazard of aiding consumers who knowingly made risky choices. The most popular reflection of this sentiment is captured in the phrase "liar loans" which refers to low- or no-documentation loans on which it is argued that borrowers knowingly and intentionally provided inaccurate personal financial information. While it is likely true that some homeowners intentionally misled lenders about their incomes and savings, it is equally true that solicitation of factual information by subprime lenders was wanting. It is also likely that borrowers actually submitted truthful information about their employment and income. Later, unknown to the borrowers, the brokers may have inflated income or assets on the final loan application and failed to point out those inflated numbers when they had the borrowers initial the final loan applications at closing. It is plausible also that many financially non-sophisticated borrowers likely followed the lead of their brokers or lenders and provided information consistent with that which was required of them. Still other borrowers may have had no real understanding of the information contained on the contractual documents they signed. While the truth of what actually occurred is likely some combination of all of these explanations, the bottom line is that the problems now stemming from low- and no-doc loans could have been prevented if lending regulations had required more rigorous and serious documentation from borrowers in the subprime market.

While no-and low-documentation aspects of loan underwriting are important components of the foreclosure problems currently faced, they were not the only form of abuse. Many additional abuses contributed greatly to the current crisis including adjustable-rate mortgages with high payment shock, steering of borrowers to high cost loans, underwriting borrowers only at introductory rates, failure to include taxes and insurance when qualifying borrowers for loans, abusive and unearned broker fees, fraudulent appraisals, and failure to establish escrow accounts for borrowers. Few of these provisions or actions were in the control of borrowers; most of these actions provided no compensating benefits for borrowers that would have encouraged them knowingly to capitulate to the broker's/lender's terms (National Community Reinvestment Coalition, 2005).

The excessive abuses that have permeated the subprime market demand a comprehensive regulatory framework to ensure this behavior will not reoccur in the future. Failure to regulate the subprime market adequately has threatened the financial well being of millions of families, as well as the economy at large. In fact, most borrowers, prime and subprime, are now paying for the abusive subprime market activities, not just those who took out subprime loans. Nationally, home prices are down more than 5 percent with the prospect of a 15 percent or greater decline by 2009 (Makin, 2008). According to the Commerce Department, new home prices have fallen a full 13 percent nationwide with even greater home price declines in areas hardest hit by this crisis, such as California, Nevada, and Florida (USA Today, 2007). Falling home prices introduce greater volatility in the housing market by squeezing the equity from owners.

Moreover, available evidence does not support the argument that lenders and servicers can address the foreclosure crisis through voluntary loan workouts. According to Moody's Investors Service, only 3.5 percent of loans scheduled for interest rate resets in the first nine months of 2007 were modified. (Marfatia, 2007) Further, the Mortgage Bankers Association finds that fully 40 percent of subprime adjustable rate mortgages (ARMs) that went into foreclosure in the third quarter of 2007 were loans that had previously experienced a modification or repayment plan (Brinkmann, 2008). The principal challenge with the majority of current loan modifications is that they provide only temporary relief to consumers, rather than offering long-term affordable mortgage solutions. Temporary freezes in interest rates for relatively short periods of time, payment plans that add late payments and fees to the outstanding loan principal balances, and loan adjustments that address mortgage affordability, but do not take into account severe losses in home values, are typical of relief now offered.

Although the current credit crunch has squeezed much of the irresponsible and abusive lending practices from the subprime market, strong anti-predatory lending legislation is needed to ensure those practices do not return when housing markets recover. Legislation should address every aspect of the lending process including product type, underwriting standards and criteria, payment shock, special features (such as prepayment penalties), broker fees, appraisal standards, steering and marketing, and lender and securitizer accountability. Although many important improvements to the regulatory environment could be achieved through regulatory agency rule-making, legislation can address more comprehensively each institutional entity in the lending process. Moreover, legislative mandates would provide meaningful private relief to borrowers and have a greater level of permanency.

Both the Administration (Office of the Press Secretary, 2007) and Federal Reserve (Federal Reserve Board, 2007) are now on record acknowledging that unfair and deceptive practices contributed to the current foreclosure crisis. Moreover, a case can be made to assist families who knowingly made risky decisions. Consumers, for example, do not have the option to waive inspection of their vehicles even through millions might forgo the time and money for mandatory state inspections if allowed. Safety inspections for cars, as well as minimum safety standards for electrical appliances, toys, food, and other products protect consumers from personal harm, as well as damage to their neighbors. Regulating the markets – in a manner that provides a safe and sound financial environment and protects consumers from making risky choices that are beyond their reasonable ability to calculate, comprehend, or manage fully – is a reasonable role of government. As a result, rather than perceiving foreclosure intervention as a borrower bailout, it can better be justified as a bailout of the economy in response to lax regulation of the markets.

Current Initiatives

Although news on the foreclosure crisis is aired and printed on a daily basis, little assistance is available for consumers at risk of losing their homes. And, despite the growing and widely recognized existence of predatory lending, no national anti-predatory lending law has been enacted. The most significant initiatives currently available to at-risk homeowners are the HOPE Hotline initiative (offering borrower counseling), managed by the NeighborWorks Center for Foreclosure Solutions and the FHASecure program managed by the FHA. Also active is the National Homeownership Sustainability Fund (providing loan workouts and refinancing) managed by the National Community Reinvestment Coalition, and a similar initiative managed by the Neighborhood Assistance Corporation of America, the Home Save program.

Proposed, but not yet fully operational, is a proposed voluntary freeze on interest rates for select borrowers with adjustable subprime loans, as part of a HOPE NOW Partnership, led by the Department of the Treasury. Related to anti-predatory lending regulations, new rules have recently been proposed by the Federal Reserve Board. Also pending is floor action on anti-predatory lending legislation in the US Senate. An anti-predatory lending bill has recently passed in the US House of Representatives. Reform of the bankruptcy code is also being considered.

The NeighborWorks HOPE Hotline and FHASecure

The NeighborWorks HOPE Hotline is offered by the NeighborWorks Center for Foreclosure Solutions. NeighborWorks provides foreclosure prevention counseling through a toll-free 800 number. Consumers calling the HOPE hotline are generally referred to lenders participating in the Treasury HOPE NOW Alliance. As of the third quarter of 2007, that hotline was receiving 1,130 calls each day, resulting in nearly 199 foreclosure preventions daily. However, because the program does not have access to a refinancing option, as many as 87 of the 199 daily foreclosure avoidances (or more than 40 percent) result in selling of the home. Only 112, or 10 percent, of all calls received per day result in loan workouts. And even then, the details of those arrangements, and therefore the sustainability of the resolutions, are not known. A recent Congressional appropriation of $200 million to the NeighborWorks program should enable the HOPE Hotline to expand its network of foreclosure counseling agencies and improve its reach in assisting borrowers at risk of losing their homes. While it is not immediately known why so many foreclosure avoidances result in the loss of the home, providing the program with access to refinancing resources would enhance greatly the program's ability to assist families to maintain their homes.

The FHASecure program, introduced in August of 2007 and managed by the Federal Housing Administration (FHA), provides additional flexibilities in FHA underwriting guidelines that open the door to refinancing for borrowers who have good credit histories but cannot afford higher mortgage payments due to a loan reset (Office of the Press Secretary, 2007). Within the first three months of operation, FHASecure received more than 120,000 applications and assisted 35,000 homeowners to refinance their home loans. The FHA estimates it expects to assist 300,000 homeowners by the end of 2008. While not inconsequential, this estimate falls far short of the estimated more than two million households facing foreclosure (Office of the Press Secretary, 2007).[2]

NCRC National Homeownership Sustainability Fund

The National Homeownership Sustainability Fund (NHSF), managed by the National Community Reinvestment Coalition (NCRC), provides loan workouts and refinancing. NHSF assists families who hold high-risk mortgages or have experienced a change in financial circumstances that undermines their ability to repay. The program is a national effort with more than thirty participating NCRC member organizations in 15 states. It has assisted over 5,000 borrowers and estimates it has preserved $500 million in home equity.

NHSF is unique in that borrower assistance is not limited to counseling services. This is important because after receiving counseling, many borrowers remain unprepared to engage successfully in the detailed and sophisticated conversations required to rework a loan. This reality can be observed in the limited success of counseling programs currently to mitigate foreclosures. NHSF goes beyond counseling borrowers by providing homeowners with

[2] Although the FHASecure program is designed to assist consumers who would not qualify for existing FHA insurance, more than 98 percent of borrowers assisted to date would have qualified for existing FHA products; only 541 borrowers who are the primary focus of FHASecure, have been aided (Paletta, 2007).

expert mortgage advisors, who work on behalf of consumers, to tackle the complex and technical issues involved in a successful loan workout or securing refinancing. Beyond restructuring and refinancing loans, NHSF provides insight into unfair and deceptive lending practices that are unavailable without access to detailed loan files. Information gained through individual loan files has contributed to NCRC policy recommendations for new legislation, improved regulation and potential lawsuits (National Community Reinvestment Coalition & Woodstock Institute, 2006). Although relatively small in capacity to date, the real value of NHSF is its successful borrower support and assistance format that could become the model for a greatly expanded and successful federally supported homeownership sustainability program.

Other statewide and regional initiatives have been launched but are too numerous to be articulated in this article.

<u>Neighborhood Assistance Corporation of America Home Save Program</u>

Similar to the NCRC National Homeownership Sustainability Fund, the Home Save program, operated by the National Assistance Corporation of America (NACA) provides assistance that extends to helping borrowers refinance high cost loans. NACA offers several forms of assistance including a payment plan for borrowers with an affordable mortgage who are experiencing a short term financial setback, loan modification for homeowners that have an affordable payment but have experienced a long term financial setback, and loan restructuring or a refinance product for homeowners with high cost or otherwise unaffordable mortgage loans. In the fall of 2007, NACA announced a major partnership with Countrywide whereby Countrywide borrowers can receive assistance from NACA services. Participants in the Home Save Program complete a mortgage submission online, attend a workshop to learn about the process and options, meet with a mortgage consultant, are referred to an underwriter and ultimately have their file submitted to the lender for review. With 33 offices nationwide, NACA has committed one billion dollars to help homeowners (Home Save Program, 2008).

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<u>U.S. Department of Treasury</u>

On November 29, 2007, the U.S. Department of the Treasury announced an initiative to help troubled homeowners. The plan divides borrowers into three categories:

1. Homeowners who are more than 60 days delinquent or already in the foreclosure process (including those whose interest rates reset prior to January 1, 2008)

2. Homeowners who are facing a reset in their mortgage rate (on or after January 1, 2008) and are current on their loan payments, but are deemed to be able to repay the loan following reset; and

3. Homeowners facing a reset in their mortgage interest rates (as of January 1, 2008), but are deemed unable to pay the reset rate or refinance

The plan helps only one group of homeowners: those who face a rate increase but are deemed unable to pay the increase. For this group it recommends a five-year freeze on mortgage interest rates at their initial teaser rates. The plan is of limited assistance since it addresses only a small share of impacted borrowers. Analysts from Deutsche Bank forecast that only 90,000 of the 2.918 million borrowers who took out subprime adjustable-rate mortgages in 2004 through 2007 (approximately3 percent) will meet the requirements for relief under the plan (Shenn, 2007). In a separate study, the Center for Responsible Lending also estimates the plan will reach about 3 percent of at risk homeowners (CRL 2008). In fact, examining the details of this class of qualified borrowers offers insight into the narrow definition of who actually qualifies: "Owner-occupant borrowers with weak credit and a solid payment history on their securitized ARM loan with initial fixed rate of 36 months or less, originated between 1/1/05 and 7/31/07, with a LTV (loan-to-value) ratio of over 97 percent and which has an initial interest rate reset between 1/1/08 and 7/31/10 that will result in a payment increase of over 10 percent" (Rengert, 2008).

Yet, even for those borrowers, the plan also faces a range of technical problems. Of primary concern is that most subprime loans are held in securitized loan pools. Freezing loan rates or reducing loan principal would constitute a change in the contractual terms of the subprime mortgage backed securities that could only be accomplished in conformance with pooling and servicing agreements between the investors and servicers or, barring that, with permission of the investors holding the security. Many pooling and servicing agreements, however, limit loan modifications to five percent of the loan pool. Where pooling and servicing agreements require an amendment to accommodate more loan modifications, it is unlikely that investors holding highly rated securities will voluntarily submit to receiving lower returns in order to help borrowers avoid foreclosure. Interviews with investment banking executives and experts do not look promising. According to Tom Deutsch who represented the American Securitization Forum in the development of the Treasury plan, "the rate freeze is totally voluntary and will be based totally on what investors decide is in their self-interests. There is no mandate here" (Andrews, 2007). And, according to Roger W. Kirby, Managing partner at Kirby McInerney, "Why would anybody in their right financial mind agree to a five-year price freeze..? "(Andrews, 2007, Makin, 2008).

If investors do agree to a 5-year freeze in rates, it is not clear how valuable that remedy would be in the long run. The plan does not indicate what might change for homeowners over the next five years that will enable them to pay an amount they cannot afford today. Much of the foreclosure problem faced today is directly attributable to borrowers accepting unaffordable mortgages in hopes that future home price appreciation will bail them out. Ironically, the Treasury's five-year solution relies on the same house of cards strategy that led to the current crisis. Moreover, few housing economists see house prices recovering sufficiently within the next five years to enable hundreds of thousands of homeowners to refinance successfully out of their high-cost mortgages. (Appelbaum 2008). The net effect of this plan would be to postpone the foreclosure crisis further into the future if home prices do not recover as desired. This could have a chilling long-term impact on home prices.

In addition, issues of fairness are raised by making only one of the three classes of borrowers mentioned above eligible for assistance. For example, the plan does not assist borrowers who face a reset, but are estimated (based on credit scores of 600 or higher) to be able to repay their loans. In other words, homeowners who have acted responsibly by remaining current on their loans and managed the difficult financial tradeoffs in order to maintain good credit scores, are penalized by the plan. As such, it flips the concept of risk-based pricing on its ear by enabling borrowers with low credit scores to receive low cost loans while requiring consumers with high credit ratings to pay the higher loan interest rates. Finally, it neither assists the economy nor promotes fairness to abandon borrowers who already have mortgages they cannot afford. Hundreds of thousands of families are currently in the foreclosure process. And, similar to homeowners whose rates do not change until this year, many were the victims of predatory lending or an otherwise poorly regulated mortgage market. Helping them retain their homes would have an immediate, positive impact on their communities and local economies.

Federal Reserve Board Proposed Anti-Predatory Lending Rules

On December 18, 2007, the Federal Reserve Board proposed a series of new rules aimed at purging unfair and deceptive lending practices from the mortgage market. The proposed rules address almost every aspect of the lending process. As such, they demonstrate the pervasiveness of predatory lending in the home mortgage market. At the same time, many of the proposals would limit, but not remove abuses from the market. Abusive broker fees, for example, are addressed by a requirement for greater disclosure. This rule would fail to protect consumers who have no idea of how much of a fee is reasonable or typical. Brokers remain able to charge as much as, if not more than, two full percentage points above what is required by a lender to close a loan. As a result, financially unsophisticated borrowers whose experience with the mortgage market is the weakest, would remain the most vulnerable to unfair and abusive fees.

The rules also, for example, require escrow for taxes and insurance for subprime loans; but, it allows borrowers to opt out of escrow after the first year. The only value of an opt-out would be to lower monthly mortgage payments. Inasmuch as taxes and insurance will, nevertheless, need to be paid, the value of the opt-out provision is unclear. This flexibility predisposes financially vulnerable consumers to making financial decisions that are not in their best interest or that of the housing finance system. Prepayment penalties, that have not been shown to provide any benefits to borrowers in the subprime market, are further restricted, but continue to be allowed. Several other provisions provide greater safety for consumers but fall short of fully purging the most harmful predatory lending practices from the subprime market. A 90-day comment period will enable thorough consideration of these and other measures. Rather than a one year opt-out, a more appropriate approach might be to require escrow until private mortgage insurance is no longer needed.

Pending Anti-Predatory Lending Legislation

The U.S. House of Representatives recently passed an anti-predatory lending bill (HR 3915). This marks a starting point for effective legislation by addressing a range of unfair and deceptive practices. The bill as passed, however, allows brokers to continue steering customers toward high-cost loans and charging excessive and unjustifiable mortgage broker fees. Similar to the FRB proposed rules, the bill, for example, allows excessive broker fees with disclosure of those fees. Yet financially vulnerable borrowers have no way of determining which fees are appropriate and how much is too much. Failure to rein excessive mortgage broker fees will continue to leave homebuyers paying substantially more for their homes than is required based on their incomes and credit scores. In addition, this practice will continue predisposing consumers to greater risks of default. Moreover, the more financially vulnerable consumers are, the more likely they will be exploited through excess fees. This means moderate income and minority working families, as well as the elderly and women, will remain the disproportionate targets of subprime mortgage lending abuses.

The legislation also provides little additional accountability for securitizers who package and sell loans. Failure to hold lenders and securtizers accountable for packaging and selling products that involve unfair, deceptive, discriminatory or fraudulent terms, leaves the financing pipeline open to that behavior in the future. More stringent legislation has been proposed in the Senate (S.2452). That bill, as drafted, would eliminate the most serious predatory lending practices from the home mortgage lending market. At the time of this writing, however, its potential for passage is unclear.

Bankruptcy and Tax Law

Modification of loan terms, in the context of a bankruptcy proceeding, could offer immediate relief to homeowners currently facing foreclosure. But current bankruptcy law excludes the altering of loan terms on principal residences (Rao, et. al., 2007). Amending the code could enable judges in bankruptcy proceedings to examine loan characteristics to determine whether alternative arrangements might enable borrowers realistically to maintain their properties. It could also allow judges to determine whether loans contain characteristics that are suggestive of unfair and deceptive practices and specifically take these issues into account when modifying loans. HR 3609, the Emergency Home Ownership and Mortgage Equity Protection Act of 2007, amends federal bankruptcy law to allow bankruptcy judges to modify home mortgage loan terms. Although controversial, reform of the bankruptcy code could provide one of the most direct and immediate routes to foreclosure avoidance.

Vacant and Abandoned Properties

There is no proposed initiative that addresses the issue of vacant and abandoned properties. Because subprime lending is particularly concentrated in minority communities, and minority communities are the most financially vulnerable, the prospect of huge inventories of vacant properties in these areas is significant. While excessive levels of foreclosures can severely negatively impact even the most vibrant middle-income neighborhoods, large inventories of foreclosed properties in fragile minority areas can eviscerate the housing wealth of entire communities. In addition to foreclosure mitigation initiatives, important attention should be aimed at finding ways to secure vacant properties that are abandoned directly due to foreclosure, and return them quickly to productive and affordable use.

Broader Solutions Needed

The scale of the current foreclosure crisis, limitations on what qualifies borrowers for assistance by the various initiatives, limitations on proposed solutions (5-year interest rate freeze), and the technical difficulties involved in changing the underlying terms of mortgage assets held in securitized portfolios, all suggest the need for a more comprehensive remedy. When faced with a major foreclosure crisis resulting from the economic turmoil of the Great Depression, the federal government responded with a new housing finance agency, The Home Owners Loan Corporation (HOLC). A similar entity, the Resolution Trust Corporation (RTC), was established in the 1980s to aid in the clean-up of the failing savings and loan industry.

During the 1930s, for example, most loans were short-term and required refinancing to maintain homeownership. HOLC issued government bonds and refinanced consumers into long-term affordable fixed-rate mortgages and closed its doors seven years later after having stabilized the housing market. HOLC issued over one million loans between 1933 and 1936 and ended its operations as a solvent institution a few years later. Wall Street Without Walls, in cooperation with the Ford Foundation, and separately, the Center for American Progress, have recommended alternative strategies for foreclosure intervention that build on the HOLC concept (McCarthy & Ratcliffe, 2007; Jakabovics, 2007). Visiting American Enterprise Institute scholar John Makin, has suggested an RTC-type resolution mechanism might be considered (Makin, 2008).

An alternative proposal being developed by the National Community Reinvestment Coalition builds on the HOLC model, but relies on existing institutions such as FHA, Fannie Mae, Freddie Mac, or the Federal Home Loan Banks to provide financing or insure loans (NCRC, 2008). By avoiding the added time that would likely be required to create and staff a new agency, this proposal could become operational in much less time. The NCRC proposal recommends that the federal government offer to purchase, at a discount, loans held in securitized pools. Discounting the purchase of loan pools would strike a balance between assisting homeowners and ensuring that lenders and securitizers are not rewarded for financing predatory loans. Borrowers would then be allowed to refinance their loans at terms that are reasonable for their financial circumstances.

In addition to being affordable, fixed rate, self-amortizing mortgage products, refinanced loans would have their initial principal balance adjusted to reflect the current appraised value of the home. The discounted value of the home would be captured by the government in the form of a soft second mortgage, to be repaid at the time of the sale or refinancing of the home, from the home's future appreciated value. There would be no repayment obligation by homeowners required in excess of that which could be captured by appreciation. Losses would be borne by the federal government. Nonprofit intermediaries, that have expertise as home loan counselors, mortgage advisors, or lenders, would be funded to contact and assist borrowers to refinance. Studies have shown many borrowers are wary of contacting their lenders or servicers to request assistance. Given the level of unfair and deceptive practices in the subprime market, this concern is understandable.

The final piece of the proposal would empower the US Department of Housing and Urban Development (HUD) with expanded authority and resources to develop a plan, work with nonprofit development organizations to address foreclosed and vacant and abandoned properties. The focus of HUD's efforts would be to ensure that properties are returned to productive *and affordable* use as quickly as possible. As part of this program, consumers who have recently experienced a foreclosure would have a right of first refusal to repurchase their homes, assuming those properties are part of the program's REO inventory and assuming borrowers qualifiy for a mortgage under the new program guidelines. Regarding other vacant and abandoned properties, HUD might rely on or borrow from major successful initiatives (such as the City of Chicago's *Troubled Building Initiative*[3]) or institutions (such as Smart Growth America[4]) with expertise in the field.

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[3] Since 2003, the Troubled Buildings Initiative, part of the city of Chicago's department of Housing, compels landlords to maintain safe and drug-free environments for City residents. Primary areas of concern include neighborhood gang and drug activity, disconnection of utilities that place residents at risk, and lack of maintenance or repairs that creates dangerous conditions for residents. The city partners with non-profit organizations to reclaim foreclosed, vacant and abandoned properties to strengthen city blocks and neighborhoods. In the first three years of the program, over 2,500 units were rehabilitated or repaired.
(City of Chicago website. 2008)

[4] The National Vacant Properties campaign is a joint partnership between Smart Growth America, LISC and the Metropolitan Institute at Virginia Tech. The goal of this campaign is to help communities prevent abandonment, reclaim vacant properties, and once again become vital places to live. The campaign builds a national network of leaders and experts; provides tools to communities; raises awareness through communications; and provides technical assistance and training. The National Vacant

Conclusion

Many economists propose allowing the market to correct itself despite the reality that this approach would leave millions of families to slip into foreclosure. But, given the role that unfair and deceptive practices have played in creating the current crisis, and the reality that *all* Americans are paying the cost of regulatory failure, responsible public policy demands a thoughtful and meaningful response. As Harvard University Law Professor Elizabeth Warren points out, families have better consumer protection buying a toaster or microwave oven than purchasing a home (Warren, 2007). Recently, thousands of toys with lead-based paint were found to be imported into America. If those toys with lead-based paint had been allowed to remain on the market to the point of harming our children, providing compensation to families would not be referred to as a "bailout." Responsibility would have been accepted at the national level for failing to protect American consumers and immediate intervention would have ensued. And the companies that were negligent in their duty to protect the public would have been held accountable. The time has come to help consumers who have been financially damaged by failed regulatory policy in the mortgage arena as well.

Now is the time to eliminate predatory lending practices from occurring in the future. Just as it would not have been an acceptable compromise to have removed some, but not all, lead-based toys from the store shelves; it should not be acceptable to remove some, but not all, unfair and deceptive practices from the mortgage markets. The American public deserves better. Moreover, additional efforts should be made to ensure the U.S. financial services system, in general, works for everyone. Financial services in low- and moderate-income and minority working communities are generally high cost and counter-productive to building savings and good credit histories (Carr & Schuetz, 2001; Casky, 1004; Stegman, 1999). Legislative mandates to ensure more equitable credit availability, such as the Community Reinvestment Act, Equal Credit Opportunity Act, Truth in Lending Act and Home Ownership and Equity Protection Act should be continuously updated to accommodate changes in the financial services market place. Moreover, CRA and related acts must be meaningfully enforced. Expansion of CRA coverage to a broader class of financial institutions, for example, could have prevented much of the subprime market's worst abuses. Most of the subprime market's unfair and deceptive practices were the work of non-CRA covered mortgage lending institutions.

Finally, federal investments in financial innovation for disadvantaged communities are also warranted and overdue. Innovative products, such as Shared Equity Mortgages, that could better align the interests of investors and borrowers, have great potential (Caplin et al., 2007). Shared equity mortgages allow investors to take an equity stake in homes, usually repaid by the long-term appreciating value of homes. Because investors gain when homeowners sustain their homes and housing markets are healthy, investors and homeowners have a common financial interest. In addition, innovative savings and consumer credit programs have been documented or promoted by a range of research and policy institutions such as the Center for Financial Services Innovations, Center for American Progress, The Brookings Institution, the New America Foundation, United for a Fair Economy, and the Insight Center for Community Economic Development. Federal support, which could move pilot programs and demonstration initiatives to larger-scale efforts, has unfortunately been lacking. The current

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Properties Campaign has worked with nonprofits, elected officials and residents in 14 states. (*National Vacant Properties Campaign Website. 2008)* crisis demonstrates that one key component to a robust and sound economy is the inclusion and full participation of all households in an efficiently functioning and responsibly regulated financial system. The National Community Reinvestment Coalition, under the rubric of the "Financially Inclusive Society," is examining ways in which the many thoughtful financial innovations that have been developed over the past decade, can be better prioritized and organized into a comprehensive legislative proposal, that might one day lead to true equality of access to financial services for all Americans.

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About NCRC

The National Community Reinvestment Coalition (NCRC) is an association of more than 600 community-based organizations that promote access to basic banking services including credit and savings, to create and sustain affordable housing, job development and vibrant communities for America's working families. Our members include community reinvestment organizations, community development corporations, local and state government agencies, faith-based institutions, community organizing and civil rights groups, minority and women-owned business associations, local and social service providers from across the nation.