NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Policy Recommendations

NCRC Policy Recommendations for Economic Recovery

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Overview:
The Road to Economic Recovery

Failure to address the current foreclosure crisis has allowed the resulting economic damage to have the contagion effects of destroying family wealth, undermining the stability of neighborhoods and communities, imploding the financial markets, and plunging the US into a potentially deep and protracted recession. Moreover, rising unemployment is a critical component driving the foreclosure crisis. Although risky and reckless mortgage products explained the majority of foreclosures in the past, going forward, foreclosures will increasingly be driven by the effects of workers becoming unemployed.

A well-crafted economic recovery package can turn a dire economic circumstance into a major opportunity for the nation, especially for working families and communities. The current crisis provides America with a unique opportunity to channel billions of dollars into communities hardest hit by the foreclosure crisis and widespread unemployment and invest in programs and projects that will put the country back on solid economic footing.

The Obama Administration and Congress are attempting to stabilize the economy through various pieces of legislation and policies. Under the leadership of President Barack Obama, the federal government has put forth the most comprehensive foreclosure mitigation plan to date, the Homeowner Affordability and Stability Plan, that will channel $ 75 billion of spending toward loan modification in an effort to help struggling homeowners remain in their homes.

The economy continues to fray at the seams and communities hardest hit by the economic crisis are in dire need of assistance. The National Community Reinvestment Coalition (NCRC) supports the introduction of an economic recovery plan that will immediately target spending toward neighborhoods and communities hardest hit by massive foreclosures and widespread unemployment. The following policy recommendations should be considered when crafting a comprehensive strategy to restore the health and long-term sustainability of the US economy.

Contain the current foreclosure crisis

- Expand foreclosure prevention initiatives to include a broad-scale loan modification program such as the Homeowners Emergency Loan Program (HELP Now). This proposal would supplement current foreclosure prevention efforts by: 1) Removing the voluntary component of a loan modification program and mandating financial institution participation; 2) Addressing severely underwater mortgages (over 105% loan-to-value) and handling second-lien loan modifications; and 3) Providing cash incentives and safe-harbor provisions to mortgage servicers that workout sustainable loan modifications and reduce interest rates for five years.

- Enact legislation to reform the bankruptcy code to allow for the modification of debt on a primary residence. This would allow up to 600,000 families to avoid foreclosure at no cost to the taxpayer.

- Enact tenant protections to ensure that renters will not lose their residences because of foreclosure proceedings against their landlord.

- Enact expanded REO and foreclosed and abandoned property initiatives to help communities heavily concentrated with foreclosed properties.

- Expand temporary unemployment relief for homeowners who face foreclosure as a result of job loss.

Promote Infrastructure Projects that Create Jobs and Rebuild Communities

- Prioritize new investments in areas most severely devastated by the foreclosure crisis, areas with the greatest employment needs, and areas with historically inferior or poorly maintained infrastructures.

- Create jobs and rebuild communities by investing in the nation's deteriorating and under-maintained infrastructure.

- Prioritize new investments in housing, transportation, environmental hazard remediation, and green technologies.

- Prioritize new investments in communications technologies, such as fiber-optic cabling, in lower-income areas.

- Prioritize new investments in small businesses, which are the drivers of the US economy and are essential to sustainable employment growth rather than solely short-term job placement.

Restore Trust and Integrity to the Financial System

- Address the failed regulatory policies and lax oversight that led to the current financial crisis and contributed to decreased consumer confidence and a lack of trust on the part of investors (here and abroad) in the strength and stability of the US financial markets.

- Restructure regulation (including the modernization and expansion of the *Community Reinvestment Act*) and oversight of the credit markets to restore confidence, trust, and integrity in the US financial system and attract investors from around the world back to the US markets.

- Enact laws that address the reckless, deceptive, and predatory mortgage lending practices that caused massive foreclosures throughout the country and formed the epicenter of the current economic crisis.

Implement the Homeowners Emergency Loan Program (HELP NOW)

- With the HELP Now proposal (first proposed in January 2008), loans are purchased from investors by the government at discounted rates; loans are then resold to the private market and then modified.

- HELP Now targets mortgage loans to homeowners who are employed and have not experienced a reduction in income.

- HELP Now creates a three-year program in which broad-scale loan modification can be accomplished through either of two separate approaches:
  - Reverse Auction: The Treasury Department would purchase loans in reverse auction that would start at approximately 80% of fair market value, falling to as low as 50%, and /or loans held in securitized pools at a steep discount (equal to roughly the current market value).

  - Compel the Sale of Troubled Assets: 1) Employ the power of eminent domain to purchase whole loans or loans held in securitized pools when it serves a public purpose; 2) use Real Estate Mortgage Investment Conduit tax rules that justify the creation of a government-sponsored whole loan purchase program; 3) utilize the Constitutional provisions in the "Commerce Clause" and the "Spending Clause" to alter and rewrite Mortgage Backed Securities and other secondary market structures to accomplish meaningful loan modifications; and 4) use Troubled Asset Relief Program (TARP) language that authorizes the government to purchase troubled assets. (It is recommended that the Treasury Department remove the TARP provision that dictates that a servicer is not permitted to cancel a contract entered into with an investor.)

Discounting the purchase of these loans would strike a balance between assisting homeowners and ensuring that lenders, servicers, and securitizers are not rewarded for financing and servicing unfair, deceptive, and reckless price-inflated loans. The government's purchase of these assets through eminent domain laws will avoid any threat of litigation against servicers by investors—a commonly cited reason that loans are not being modified at a greater pace. The discounted loan price should be sufficient to writedown the loan balance of millions of loans at the least direct cost to the federal government so that they can be permanently refinanced or modified to ensure their long-term sustainability.

  - For example, a mortgage loan may have an outstanding balance of $200,000, but after paying fair market value, the loan would be reduced to $140,000 (assuming a 30% discount). That discount of $60,000 would be applied to reduce the loan interest rate and (where necessary) principal balance to create a sustainable affordable loan product <u>without any government investment or guarantee</u>. The government would be immediately reimbursed for the entire amount of its purchase and have no other obligation to the investor, lender, or borrower. Modified loans would immediately be resold to Fannie Mae or Freddie Mac.

- Standardized and mandatory underwriting criteria would be used to ensure loans are fair and based on the borrower's ability to repay.

- If the discounted price is insufficient to allow for an affordable loan modification, the Treasury Department can make a furthur discount to modify or refinance through the US Department of Housing and Urban Development or the Federal Housing Administration's Hope for Homeowners program. The government is could recapture a share of its equity investment when the property is sold or refinanced through a soft second and/or lien placed against the property.

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Enact Strong National Anti-Predatory Lending Legislation

Credit Suisse reported that 2.3 million foreclosures occurred in 2008 and forecast an additional 8-10 million foreclosures over the next five years. Inadequate anti-predatory lending legislation and lax regulatory oversight drove the predatory and abusive lending practices that caused the foreclosure crisis. NCRC supports the anti-predatory lending legislation introduced by Senator Christopher Dodd during the 110th Congress. The legislation, the *Home Ownership Preservation and Protection Act of 2007* (S 2452), provides strong consumer safeguards and assignee liability that will hold investors accountable for predatory and abusive lending practices. NCRC supports the reintroduction of S 2452, or the introduction of strong anti-predatory lending legislation that would:

- Expand consumer safeguards to include entities in the financial services industry including lenders, brokers, appraisers, and servicers.
- Eliminate prepayment penalties on subprime loans and require escrows for subprime loans.
- Require prudent underwriting that would eliminate the dangerous practice of qualifying borrowers based on the initial low teaser rate on adjustable rate loans.
- Prohibit appraisal fraud, prevent servicing abuses, and require servicers to promptly credit loan repayments from borrowers.
- Require servicers to make reasonable efforts to modify loans and avoid foreclosures in the cases of borrower delinquency, and also require pre-loan counseling before a borrower takes out a high-cost loan.
- Impose liability on investors for violations.
- Preserve the right of individual borrowers to seek redress in all cases and allow class action lawsuits when investors have not established due diligence procedures.

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Enact the *Community Reinvestment Act Modernization Act of 2009*

The *Community Reinvestment Act* (CRA) has been one of the most important laws for building wealth and revitalizing neighborhoods. In order to expand upon the benefits of CRA, the National Community Reinvestment Coalition in partnership with Rep. Eddie Bernice Johnson will introduce the CRA Modernization Act of 2009. This legislation will:

- Bolster the accountability of banks to all communities by requiring CRA exams in the great majority of geographical areas banks serve.
- Address racial disparities in lending by requiring CRA exams to explicitly consider lending and services to minorities in addition to low- to moderate-income communities.
- Penalize banks that engage in predatory and abusive lending practices and securitization activities by assigning these banks lower CRA ratings.
- Hold banks accountable by providing more publicly available bank ratings so that the general public can clearly discern disparities in bank performance.
- Further enhance accountability through improved data disclosure by: 1) Requiring that small business loan data include the race and gender of the small business owner; 2) making data on deposit accounts by neighborhood publicly available; and 3) linking the *Home Mortgage Disclosure Act* to a new loan performance database tracking foreclosures and loan modifications.
- Require federal regulatory agencies to hold more public hearings and meetings when banks merge.
- Require HMDA-like data for insurance companies and securities firms so that the general public, community organizations, and federal agencies can assess the availability of their products to borrowers and communities by race, gender, and income levels.
- Apply CRA to a variety of non-bank institutions including independent mortgage companies, mainstream credit unions, mortgage company affiliates of banks, insurance companies, and securities firms.
- Apply CRA more broadly throughout the financial services industry.

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Support Increased Investments in Small Businesses

- Small businesses and microenterprises are drivers of the US economy and their continued health and long-term sustainability are critical to increased economic activity and strong economic performance.

- In the past decade, small businesses (those with fewer than 500 employees) have created 60% - 80% of the nation's net new jobs each year.[i] During that time, minority-owned businesses made up more than half of the 2 million new enterprises started in the United States.[ii]

- Hispanics are opening businesses at three times the national average, and there are 1.2 million black-owned businesses in the United States with revenues of over $88 billion.

Small, minority-, and women-owned businesses have historically lacked adequate access to capital

- Minorities receive disproportionately fewer small business loans and federal contracts than non-minority business owners.[iii] By law, the federal government is required to award at least 23% of its contracts to small companies, with a goal of 5% allocated to women-owned firms and 5% to minority-owned firms; however it is widely reported that the government has yet to meet these goals.

Small, minority-, and women-owned businesses are suffering disproportionately in the current economic crisis

In a recent survey from the National Federation of Independent Business, more than a quarter of small business owners said the current economic downturn is threatening their ability to survive. Banks issued 40% fewer SBA-guaranteed loans in the third quarter of 2008 than they did the previous year.[iv]

- In October 2008, the Federal Reserve Board reported that 90% of US banks had tightened lending standards on small businesses in the previous three months.[v] Commercial banks (the most common source of credit for small businesses) have in general imposed more stringent credit standards and increased interest rate spreads and fees. [vi]

Expand Access to Credit

Without access to credit, businesses will ultimately fail. Businesses need loans to grow, purchase new equipment, provide working capital, and add inventory, resources, and capacity. NCRC recommends Congress enact legislation that supports programs that:

- Increase small business access to capital through traditional methods and expanded SBA and Minority Business Development Agency lending.

- Develop, test, and introduce new finance products, credit risk management techniques, and securitization structures.

- Enhance the flow of capital to the small business market through new products and guarantees that are not currently offered due to the size of the business loan, the collateral, the legal structure of the borrower or the legal structure of the originator.

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[i] *Wall Street Journal*, "Slump Batters Small Business, Threatening Owners' Dreams." December 20, 2008.

[ii] *The News Herald*, "Making their Mark." January 11, 2009.

[iii] Senator John Kerry, December 20, 2008.

[iv] Jakobson, Leo, CNN Money.com, "The SBA quagmire: building a ravaged agency." January 13, 2009.

[v] Ibid.

[vi] Governor Randall S. Kroszner "Effects of the Financial Crisis on Small Business."
Before the Committee on Small Business, U.S. House of Representatives, November 20, 2008.

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Reclaim Abandoned and Foreclosed Properties

Effects of Real Estate-Owned (REO) Properties on Communities

- REO inventories are highly concentrated. In 2008, the 100 largest metropolitan areas accounted for 78 percent of REOs despite containing just 65 percent of the nation's population[i].

- In the metropolitan areas of Las Vegas, Phoenix, Florida, and South Carolina, for example, high foreclosure rates have created new vacancy problems. In other areas, particularly Cleveland, Detroit, and Indianapolis, rising foreclosure rates and a growing inventory of bank-owned properties are exacerbating the pre-existing vacancy problems from the metropolitan areas' recent growth.

- Vacant and abandoned properties are spreading from low-income communities to middle-income suburban communities as prime and ALT-A loans begin to default at increasing rates.

Current Initiatives Are Not Enough

The *Housing and Economic Recovery Act* (HERA) was enacted in 2008 and authorized the Neighborhood Stabilization (NSP) Program to acquire and rehabilitate foreclosed homes for rental or homeownership. NSP provides $3.92 billion in funding to states to address needs resulting from foreclosures and subprime loans. The total national funding for this equates to approximately $2,500 for every mortgage that is either bank-owned or currently in foreclosure, as of the end of 2008.

Rebuild Neighborhoods, Beginning with Homes

Merely stabilizing neighborhoods is insufficient and inadequate to address the broader problems stemming from concentrated areas of foreclosures. Many neighborhoods, particularly low-income, already faced economic hardship before the foreclosure crisis further undermined their stability. These neighborhoods need investments most to help them not only stabilize, but rebuild.

NCRC recommends Congress enact legislation that supports REO initiatives that:

- Implements "early warning systems" to facilitate the transfer of properties through short sales rather than foreclosure.

- Improves individual and bulk acquisition of REO units in low- and moderate-income communities from lenders and servicers by leveraging innovative funding programs and sources to facilitate non-profit acquisitions of properties.

- Expands access to public- and private-sector financing for reclaiming REOs, such as the use of New Market Tax Credits.

- Forms partnerships to improve access to technical assistance, capital, and distressed housing inventory, including collaborative efforts with municipal courts to identify distressed properties.

- Uses alternative sustainable homeownership products such as lease-purchase programs.

- Requires HUD and/or the GAO to monitor the use and effectiveness of the Neighborhood Stabilization Program (NSP) and determine whether NSP funding levels should be increased and NSP guidelines and regulations revised.

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[i] Mallach, A. Stabilizing Communities: A Federal Response to the Secondary Impacts of the Foreclosure Crisis. February 2009.