



Defaulting on the Dream

States Respond to America's Foreclosure Crisis



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The Pew Charitable Trusts applies the power of knowledge to solve today's most challenging problems. This report is a joint effort between Pew's Center on the States (PCS) and Pew's Health and Human Services (HHS) program. PCS identifies and encourages effective policy approaches to critical issues facing states. HHS' Family Financial Security portfolio seeks to advance common-sense solutions to help Americans save for tomorrow and manage debt today.

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Dear reader:

Is the American Dream slipping away? One in 33 current U.S. homeowners may be headed toward foreclosure in the coming years because of subprime loans, according to our new report, *Defaulting on the Dream*. In some states, the crisis is particularly acute—in Arizona, for instance, one in every 18 homeowners could lose their home; in Nevada, the ratio is one in 11.

The problem hardly stops there. Because of foreclosures in their communities, an additional 40 million homeowners may see their property values and their municipalities' tax bases drop by as much as \$356 billion in the next two years. Nearly every state is affected: in 47 states and Washington, D.C. the number of mortgage loans entering foreclosure as of December 2007 had increased by at least 20 percent since December 2006. Ten states alone could lose a total of \$6.6 billion in tax revenue in 2008, according to a recent analysis by the firm Global Insight.

The stakes are incredibly high. Homeownership is the primary vehicle through which American families build financial security. It also is an essential building block of state and local economies.

Defaulting on the Dream: States Respond to America's Foreclosure Crisis is the first-ever comprehensive look at what states have been doing to tackle this critical issue. It showcases approaches in two principal areas: (1) helping borrowers avoid foreclosure and keep their homes; and (2) preventing problematic loans from being made in the first place. This report recognizes that while some states moved quickly to respond, their approaches are not yet proven.

At this writing, federal lawmakers are deliberating important proposals to try to address the crisis. Among other measures, Congress is considering federal funds to expand counseling programs for homeowners at risk of foreclosure, tax-exempt bonds for localities to refinance subprime loans and a hefty increase in federally insured mortgages. It also is debating the need to strengthen underwriting standards.

While policy makers and the media have focused on the immediate foreclosure crisis, Pew, together with our partners, continues to call for more action to strengthen standards to prevent more troubling loans from being made in the future. While the causes of the current crisis are multifaceted, had these basic consumer protection safeguards been in place, we may have curtailed this current calamity. The need is particularly acute as Congress considers ways to rewrite loans for those borrowers currently facing foreclosure. In this arena, many states have taken the lead, requiring lenders to verify a borrower's income and ability to repay at the fully indexed interest rate and not just at the low initial "teaser" rate, requiring the escrow of taxes and insurance payments and documenting the value of the property being financed.

Most experts agree this is a national crisis that warrants a national response, with the federal government providing both leadership and funding. But Congress should take into account what some states already have put in motion to try to stem the foreclosure tide and prevent the crisis from happening again. In the absence of federal leadership, states have been experimenting with homeowner counseling, refinance programs, stronger regulation of lending practices and other actions. As it deliberates, Congress should be aware of how its decisions will impact states' efforts already underway—building on, rather than pre-empting, the strongest state statutes, and ensuring that states retain the flexibility to respond to local conditions and needs.

Defaulting on the Dream was researched and written by The Pew Charitable Trusts' Center on the States (PCS), in collaboration with Pew's Health and Human Services (HHS) program. PCS identifies and encourages effective policy approaches to critical issues facing states. HHS' Family Financial Security portfolio seeks to advance common-sense solutions to help Americans save for tomorrow and manage debt today. The Center for Responsible Lending, one of the portfolio's partners and a key source of data and analysis for this publication, focuses on expanding homeownership by curbing abusive lending practices.

We hope this report informs Congress' important deliberations and helps ensure that federal and state policy makers work closely together to address America's foreclosure crisis.

Sincerely,

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Overview

Few imaginable economic events send the same message of fear and foreboding in America as a housing crisis. For most Americans, their homes are their greatest asset. And for the states, industries dependent on housing are cornerstones for economic growth and fiscal stability.

Almost every state in the country has seen a significant increase in mortgage foreclosures, largely triggered by defaults on subprime mortgages. Yet greater challenges lay ahead. Based on new foreclosure projections by the Center for Responsible Lending, Pew estimates that one in 33 current U.S. homeowners will be in foreclosure, primarily in the next two years—the direct result of subprime loans made in 2005 and 2006. Among the states hardest hit are Nevada, where one in 11 homeowners could soon be in foreclosure; California, with one in 20; Florida, with one in 26, and Georgia, with one in 27.

In other states where the numbers are less severe, the situation is still troubling. If the economy tightens and home prices continue to fall, as many economists believe will be the case, more states and their residents will feel increasingly acute pain. The nation's foreclosure crisis does not discriminate by region or size. In states such as Colorado, Indiana, Maryland, Michigan, Ohio, Oregon, Rhode Island, Tennessee and Texas, at least one in 37 homeowners is projected to experience foreclosure as a result of a subprime loan.

Nationally, about 3.3 million home mortgages may default in 2007 and 2008, and more than two million homeowners could lose their homes, according to Mark Zandi, Moody's Economy.com's chief economist, who testified before the U.S. House Housing Financial Services Committee in February 2008.¹

The effects reach far beyond a single house on a single block. Homeowners are estimated to lose \$356 billion in home value because of nearby foreclosures, affecting nearly 40 million homes. The foreclosure problem also has spread to homeowners with prime loans—borrowers with solid credit histories. With home prices

falling and credit tightening, prime borrowers are facing the same financial stress as those with subprime credit.

While this is a national crisis, states and local municipalities arguably will be asked to carry a larger share of the foreclosure burden as tax revenues decline and they experience increased demands for police and other services to deal with vacant and abandoned properties.

A growing number of states have taken action, seeking at least to mitigate the damage to homeowners, lenders, municipalities and their own budgets. The severity and speed of the crisis have meant that, in many cases, states are experimenting with innovative but as yet unproven approaches. The jury is still out about whether and to what extent they will be effective. Still, several states among those hardest hit by foreclosures also have been among the most assertive in trying to address the problem.

These states are using a range of approaches to help residents at imminent risk of foreclosure from losing their homes. They are beefing up lending enforcement to prevent problematic loans from being made in the first place. And recognizing that the crisis demands a collaborative approach, they are bringing together all the major stakeholders, including lenders and representatives of the financial services market, to try to tackle the challenges comprehensively.

Ohio, for instance, launched a statewide campaign, including a 24-hour hotline, to encourage borrowers at risk of foreclosure to seek counseling. Ohio also sought involvement across the state to improve assistance for borrowers facing foreclosure, calling on lenders in the state to modify high-cost loans for homeowners. In early April, Governor Ted Strickland reached agreement with nine mortgage servicers on a significant effort to modify the terms of adjustable-rate subprime mortgages in Ohio. These and other actions sprang from a task force, created in March 2007 by the governor, that convened representatives from industry, government and the nonprofit sector to collaborate on policy recommendations.

Michigan now has two loan funds that help homeowners facing foreclosure, a statewide consumer education campaign and a task force; the state also requires greater disclosure of terms and conditions before a high-risk loan is made. California, which launched a task force last year, regulates mortgage brokers and high-risk loans and has issued a notice to loan servicers calling on them to agree to wholesale loan adjustments.

Although they had fewer loans in the foreclosure process as of December 2007, states such as Maryland and Massachusetts are taking similar steps, recognizing that they will face bigger problems if they do not act. Maryland recently passed sweeping emergency reforms, providing immediate help to distressed homeowners while strengthening the state's oversight of the mortgage industry. It extended the foreclosure process from 15 to 150 days, criminalized mortgage fraud, banned prepayment penalties and is seeking to prevent deceptive foreclosure rescue transactions. Massachusetts soon will provide borrowers in default on their mortgage payments 90 days to work with their mortgage servicers to try to avoid foreclosure. In addition, the state recently made \$2 million in grants available for foreclosure education, prevention and counseling initiatives.

Some states are contemplating more aggressive actions to delay foreclosure and its ripple effects on neighboring homes. In New York, legislators proposed a moratorium on foreclosures for one full year. Massachusetts, Minnesota and New Jersey have proposed six-month deferments of foreclosures, with Minnesota and New Jersey's proposals including some form of rent-back or partial payment from the delinquent borrower. These proposals to place long-term moratoria on foreclosures face steep industry opposition, but they highlight the pressure states are under to try to address the current crisis.

But given the scale of the crisis and the complexity of today's mortgage markets, states cannot go it alone, and it makes little sense to have 50 separate and specific responses. There is broad agreement that the

federal government should take a strong leadership role. As it considers a range of proposals, both to help more homeowners stave off foreclosure and to strengthen underwriting standards, Congress should understand what states already are doing and how its policy choices will affect those efforts. It also should ensure that states have flexibility to pursue measures that respond to their particular circumstances and needs and build on, rather than pre-empt, those actions that go the furthest in protecting homeowners from practices that undermine wise and responsible borrowing choices.

We have based our findings in this report on data and analysis that are comparable to information from well-respected industry analysts such as First American, Lehman Brothers, Merrill Lynch, Credit Suisse and Moody's Economy.com. We rely on the Mortgage Bankers Association's *National Delinquency Survey* to highlight foreclosure challenges at the end of December 2007. In addition, we use the Center for Responsible Lending's projections to draw attention to the estimated number of foreclosures and ripple effects from subprime loans made in 2005 and 2006. However, as any researcher will note, these data have limitations; for a more detailed description of our methodology, see page 6.²

We have used the best available data to describe the challenges that our nation and states may face. But the current policy debate has been limited by the lack of data on the actual number of loans that have ended in foreclosure. Policy makers need accurate, comprehensive and up-to-date information to fully understand their foreclosure problems and identify potential solutions. States have an important role to play here, and many are already building systems that link property descriptions, mortgage information and foreclosure actions. However, having 50 idiosyncratic foreclosure databases is not a solution. Instead, Congress and the states should consider ways to collect, maintain and share reliable and uniform information across all 50 states to more accurately describe current conditions and better assess the effectiveness of policy interventions.



Overview

Summary: Key Facts about the Foreclosure Crisis

The media have dubbed the current situation a “subprime mortgage crisis.” But the current foreclosure data and forthcoming trends show a more complex story, one in which a growing number of homeowners and prime loans are threatened. In short, nearly every homeowner and prospective homeowner is somehow affected by this crisis.

- ❌ Pew’s analysis estimates that one in 33 current U.S. homeowners nationwide is projected to face foreclosure, primarily in the next two years, as a result of a subprime loan made in 2005 and 2006.³
- ❌ Pew’s analysis of recent mortgage delinquency data found that subprime loans—high-risk loans to people who do not qualify for a prime or conventional loan because of low income or poor credit—make up just 14 percent of all mortgage loans being serviced, but more than half of all loans in foreclosure.⁴
- ❌ Nearly every state is affected: in 47 states and Washington, D.C. the number of mortgage loans entering foreclosure as of December 2007 had increased by at least 20 percent since December 2006.⁵
- ❌ Pew’s analysis found that projected subprime foreclosure challenges are spread across states more evenly, indicating that the foreclosure crisis is nationwide and not merely concentrated in a few states.⁶
- ❌ 10 states alone will lose a total of \$6.6 billion in tax revenue in 2008 as a result of the foreclosure crisis, according to a 2007 projection.⁷
- ❌ 1.6 million loans were in foreclosure or 90 days past due as of December 2007—up 55 percent from a year earlier.⁸
- ❌ More than 40.6 million homes across America are projected to lose value because of subprime foreclosures in their communities. Foreclosures may cost neighboring properties up to \$356 billion in home value over the next couple of years.⁹
- ❌ U.S. foreclosure starts, as of December 2007, involving prime adjustable-rate mortgages increased 158 percent in one year.¹⁰
- ❌ Homes in foreclosure usually sell far below market value, especially in today’s depressed real estate market, and unsold properties can be expensive to maintain. Lenders experience foreclosure losses ranging from 20 cents to 60 cents on the dollar, with one estimate of a typical lender’s foreclosure cost averaging \$58,800 in the early 2000s.¹¹

Overview

Summary: How States Have Responded to the Crisis

The foreclosure crisis facing America is a national challenge, and it requires a national response. The federal government must provide leadership and funding to address it. Among other measures, Congress at this writing is considering proposals that would provide federal funds to expand counseling programs for homeowners at risk of foreclosure, tax-exempt bonds for localities to refinance subprime loans and a hefty increase in federally insured mortgages. Congress also is contemplating strengthening underwriting standards.

Pew's research found that states also have a critical role to play—and today, a growing number of state policy makers are taking action in three major ways: trying to help borrowers facing imminent risk of foreclosure to stay in their homes; preventing high-risk, high-cost mortgage loans from being made in the first place; and taking a comprehensive approach to the crisis by convening stakeholders to develop solutions.

HELPING CONSUMERS AVOID FORECLOSURE AND STAY IN THEIR HOMES

- ➔ Nine states have publicly supported mortgage refinance funds and have committed at least \$450 million in loan funds to help borrowers avoid foreclosure.¹²
- ➔ California, Massachusetts and Ohio are encouraging lenders to modify defaulted loans to help homeowners keep their homes.
- ➔ Nine states have implemented regulations that prevent foreclosure rescue scams.
- ➔ 20 states have partnered with the Homeownership Preservation Foundation to provide around-the clock consumer counseling hotlines.
- ➔ States such as Indiana, Maryland, Massachusetts and Ohio have led media campaigns to educate at-risk borrowers about how to seek help.
- ➔ California, Indiana and Minnesota mandate that lenders give borrowers in danger of defaulting early notice about available assistance.

REDUCING THE NUMBER OF HIGH-RISK LOANS BEING MADE

- ➔ 31 states regulate high-cost loan products.
- ➔ 24 states require or recommend consumer education and counseling.
- ➔ Nine states require mortgage brokers to consider or represent the interests of the borrower when recommending mortgages.

CONVENING STAKEHOLDERS TO DEVELOP COMPREHENSIVE SOLUTIONS

- ➔ 14 states have created foreclosure task forces to try to address the challenges of the crisis comprehensively, including bringing government leaders, lenders, advocates and experts to the table to work on solutions.

NOTE: See Appendix A for more detail on which states are doing what.

Our Data, Methodology and Limitations

Section 1.0

The research reviews and analyzes two principal data sets, one from the Mortgage Bankers Association's (MBA) 4Q 2007 *National Delinquency Survey* and, second, from the Center for Responsible Lending's (CRL) foreclosure projections and subprime spillover estimates. Both data sets are widely cited and used to understand the nature and magnitude of the nation's foreclosure challenges, but both also have limitations.

The Mortgage Bankers Association Data

The MBA quarterly data are based on survey sampling techniques and offer a point in time picture of loans in various stages of delinquency or in the foreclosure process. While they represent an estimate of the foreclosure challenges, they do not reflect the number of actual foreclosures that were finalized at the end of a given quarter. They also do not account for foreclosures that moved through the process and are no longer a part of the inventory. The MBA foreclosure estimates refer to all loans in the foreclosure process as well as loans that are seriously delinquent—90 days past due. We total the foreclosure inventory with the seriously delinquent loans to provide a snapshot of the estimated number of foreclosures at the end of 2007, because one can reasonably expect, looking at past trends, that loans 90 days past due likely will be referred to start foreclosure proceedings.

The Center for Responsible Lending Data

CRL's data are materially different than the MBA information and have different limitations. CRL's primary data, which was used to build the models for the cumulative foreclosure projections, came from a private source that

aggregated securitized loans from various lenders who had identified them as subprime. CRL had access to the data through a contractual arrangement with the provider. The CRL foreclosure projections were recently updated to be more comparable to subprime foreclosure estimates from Moody's Economy.com (<http://judiciary.house.gov/media/pdfs/Zandi080129.pdf>) and Merrill Lynch (The Market Economist, December 14, 2007). CRL also used data on outstanding subprime loans reported by the MBA in its 3Q 2007 *National Delinquency Survey* to calculate these updated foreclosure estimates. The MBA data are also the source for the subprime foreclosure starts. Like CRL's original projections from its *Losing Ground* study (December 2006), the updated data reflect only loans to owner-occupants in the 50 states and Washington, D.C., secured by a first-lien on a single-family home, condominium, townhouse or unit in a planned development. CRL estimates the likelihood that a given loan will be foreclosed upon for the lifetime of that loan. In other words, CRL's estimates take the total number of subprime loans disbursed during 2005 and 2006 and give the number of loans they expect will be foreclosed upon. This estimate includes foreclosures that will occur in 2008 as well as subsequent years, providing a larger window for foreclosures to occur than the MBA data. However, by restricting the sample to subprime loans made in 2005 and 2006 to owner-occupants, CRL's estimates miss a number of loans that will go into foreclosure in that same time period. More details on CRL's methodology can be found in the appendix of the *Losing Ground* report at <http://www.responsiblelending.org/pdfs/foreclosure-paper-report-2-17.pdf>.

CRL also provided subprime spillover data—that is, projections of the ripple effects of foreclosures on neighboring properties, and

municipalities and states' combined tax bases in the coming years. CRL calculated the estimated ripple effects examining 56,777 census tracts in the nation's 387 metropolitan statistical areas, using data on local housing densities and median house prices for each census tract. CRL's study assumed that the predicted foreclosures were evenly distributed throughout the tract, and researchers calculated the number of houses expected to be within an eighth of a mile of each foreclosure. The expected decline in property values were calculated using findings from another widely cited research study that found that each conventional foreclosure within an eighth of a mile of a single-family home results in a decline of 0.9 percent in value. This loss of equity was then aggregated to the state level. CRL's results do not include areas outside metropolitan statistical areas. One of the limitations, however, of this analysis is that it does not account for market variations and, while appropriate, the foreclosure projections from depreciating values and the average loss value may not reflect the potential differences around these values. CRL's foreclosure projections and subprime spillover data rely on a number of assumptions. For a full and detailed description of the assumptions and their caveats, please see <http://www.responsiblelending.org/issues/mortgage/research/>.

Other sources of foreclosure data may show different estimates, although the relative order of magnitude should be consistent. In many communities, vendors have developed databases of foreclosure filings with the intent of selling the information to real estate speculators interested in purchasing discounted property. These data vendors frequently receive media attention, but the quality of their data can be questionable. Policy makers should use a variety of data sources to monitor foreclosure trends in key markets and should also validate the data carefully before using it to make critical decisions.

Section 2.0

We conducted extensive interviews and document reviews to highlight state responses to the mounting foreclosure challenges facing all 50 states and the nation as a whole. In the section highlighting state actions, researchers describe the legislative and regulatory actions states have taken to try to mitigate the damage to homeowners, localities and state budgets. It is critical to note that we did not seek to evaluate the effectiveness of these responses, principally because most actions are relatively new and the data do not yet exist. While many state policy makers and researchers believe that these approaches are promising, the jury is still out on whether and to what degree they will deliver positive results.

Supplemental Fact Sheets and Estimated Number of Foreclosures Per Homeowner

For the nation overall and for each state, we projected the number of foreclosures per number of overall homeowners in the state that are anticipated to take place, primarily over the next two years, because of subprime loans. We developed individual fact sheets for the 50 states and Washington, D.C. that profile each state's foreclosure challenges and responses to those challenges to date. We calculated the ratio of projected foreclosures per owner-occupied housing units (homeowner), which allows us to account for the relative size of the states in estimating the relative impact of the subprime crisis. The U.S. Census Bureau's 2006 American Community Survey was used to obtain estimates for owner-occupied housing units. We used a method similar to the one used by RealtyTrac, a real estate Web site that tracks foreclosure properties, to rank the states. However, we used owner-occupied housing units as the denominator because our foreclosure projections are for loans to owner-occupants (homeowners).





Just the Facts

THE SCOPE AND SCALE OF THE CRISIS

The Foreclosure Wave Is Just Beginning

Based on projections by CRL, Pew estimates that one in 33 current U.S. homeowners will experience foreclosure, largely in the next two years, the direct result of subprime loans made in 2005 and 2006.

In 2007, predatory lending practices, aggressive loan marketing and the proliferation of high-cost subprime loans all converged into a perfect storm to push subprime mortgage foreclosures to record levels. (See Appendix B for an explanation of subprime lending and the foreclosure process.) As of December 2007, 2.9 million mortgage loans were past due, and while subprime loans account for only 14 percent of mortgage loans being serviced, they represent more than 50 percent of loans in foreclosure.¹³ Now, in early 2008, the pace of foreclosures continues to pick up. RealtyTrac, a real estate Web site that tracks foreclosure properties, released its *2007 U.S. Foreclosure Market Report*, finding that loans in some stage of foreclosure were up 79 percent from the previous year.¹⁴ In fact, most experts predict more than one million foreclosures will occur by 2009, particularly if home values continue to decline.¹⁵

As Exhibit 1 illustrates, nearly every state is feeling the impact of the crisis. A report by the MBA in March 2008 showed that in 47 states and Washington, D.C. mortgage loans entering foreclosure as of December 2007 had increased by at least 20 percent since December 2006. Only three states—Alaska, Montana and

Vermont—did not experience at least a 20 percent increase in foreclosure starts; less than 1 percent of the American population lives in those states.

The pain of the credit crisis has spread to prime borrowers, those with solid credit histories. In December 2007, 4.51 percent of prime borrowers were in delinquency or default on their mortgages—the highest rate since the MBA began tracking prime borrowers separately in 1998. Like subprime mortgages, many recent prime loans were adjustable-rate mortgages (ARM) that allowed consumers to pay little initially and more as the interest rates reset. With home prices falling and credit tightening, prime borrowers are facing the same financial stress as those with subprime credit.

In fact, U.S. foreclosure starts involving prime ARMs increased by 158 percent during the 12 months ending in the fourth quarter of 2007, according to the MBA. Arizona, Florida, Nevada and California were among the states hit hardest by ARM foreclosure starts.



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THE FULL PICTURE: THE FORECLOSURE CRISIS

State	Total Estimated Number of Foreclosures, December 2007	Projected Foreclosures and Ripple Effects (Primarily 2008-2009)			Projected Foreclosures Per Homeowner (Primarily 2008-2009)	
		Estimated Foreclosures From Subprime Loans 2005-2006	No. of Neighboring Homes Experiencing Devaluation	Decrease in House Value/Tax Base from Foreclosure Effect (millions)	Owner-occupied housing units, 2006	Number of Projected Foreclosures to Homeowners
Alabama	23,013	21,330	209,052	\$406	1,289,272	1 out of 60
Alaska	1,135	3,831	47,404	\$190	148,249	1 out of 39
Arizona	38,048	85,726	1,201,327	\$8,687	1,523,041	1 out of 18
Arkansas	8,452	11,734	71,351	\$131	753,412	1 out of 64
California	228,133	355,682	7,505,584	\$107,196	7,102,197	1 out of 20
Colorado	32,040	49,923	748,652	\$3,183	1,269,421	1 out of 25
Connecticut	13,808	18,847	441,018	\$2,039	921,382	1 out of 49
Delaware	5,274	5,551	90,615	\$390	238,194	1 out of 43
District of Columbia	1,966	4,190	223,797	\$4,287	114,586	1 out of 27
Florida	186,093	194,796	3,667,230	\$35,856	4,994,101	1 out of 26
Georgia	67,126	83,686	630,218	\$1,817	2,285,179	1 out of 27
Hawaii	3,204	8,832	167,942	\$4,160	257,599	1 out of 29
Idaho	4,288	10,035	97,029	\$304	390,982	1 out of 39
Illinois	69,251	87,918	2,536,938	\$27,297	3,301,367	1 out of 38
Indiana	49,069	48,034	544,991	\$959	1,756,328	1 out of 37
Iowa	10,800	11,190	178,166	\$344	885,969	1 out of 79
Kansas	9,682	14,347	200,403	\$382	761,022	1 out of 53
Kentucky	17,241	21,153	249,727	\$498	1,167,081	1 out of 55
Louisiana	19,621	26,306	400,306	\$1,032	1,071,667	1 out of 41
Maine	5,064	6,597	42,127	\$134	399,076	1 out of 60
Maryland	27,491	55,693	1,220,574	\$12,133	1,450,411	1 out of 26
Massachusetts	26,787	32,976	1,013,548	\$7,992	1,588,359	1 out of 48
Michigan	91,081	79,893	1,414,411	\$3,798	2,908,273	1 out of 36
Minnesota	31,359	38,991	545,773	\$2,254	1,558,206	1 out of 40
Mississippi	13,502	15,439	77,449	\$144	760,318	1 out of 49
Missouri	27,366	42,727	705,446	\$1,792	1,628,838	1 out of 38
Montana	2,117	3,225	16,790	\$42	260,137	1 out of 81
Nebraska	5,504	7,390	132,896	\$250	475,899	1 out of 64
Nevada	28,783	51,881	557,286	\$6,537	580,705	1 out of 11
New Hampshire	6,599	7,422	57,628	\$203	363,652	1 out of 49
New Jersey	40,074	57,083	1,781,424	\$19,573	2,110,308	1 out of 37
New Mexico	4,959	9,093	151,430	\$513	505,915	1 out of 56
New York	61,978	124,601	3,552,642	\$65,136	3,940,942	1 out of 32
North Carolina	37,062	53,254	332,375	\$861	2,350,798	1 out of 44
North Dakota	891	1,103	23,761	\$51	181,666	1 out of 165
Ohio	91,188	85,618	1,392,990	\$2,850	3,150,239	1 out of 37
Oklahoma	14,727	20,157	256,261	\$427	950,407	1 out of 47
Oregon	8,578	27,827	466,877	\$2,549	939,123	1 out of 34
Pennsylvania	52,069	76,055	1,684,475	\$6,582	3,475,105	1 out of 46
Rhode Island	5,530	8,170	244,424	\$1,713	255,495	1 out of 31
South Carolina	21,797	27,996	179,309	\$477	1,165,464	1 out of 42
South Dakota	1,564	1,860	18,982	\$38	216,212	1 out of 116
Tennessee	31,020	46,218	441,703	\$967	1,660,152	1 out of 36
Texas	99,495	149,661	2,283,390	\$4,923	5,291,045	1 out of 35
Utah	7,025	23,286	310,442	\$1,317	585,929	1 out of 25
Vermont	1,344	2,122	6,460	\$22	182,389	1 out of 86
Virginia	30,372	62,174	1,035,979	\$6,953	2,030,284	1 out of 33
Washington	16,847	42,036	846,526	\$4,893	1,620,052	1 out of 39
West Virginia	4,002	6,218	40,886	\$80	554,791	1 out of 89
Wisconsin	21,049	26,334	557,251	\$1,900	1,571,129	1 out of 60
Wyoming	964	2,246	18,630	\$46	144,117	1 out of 64
US Total/average	1,606,430	2,258,457	40,621,895	\$356,310	75,086,485	1 out of 33

SOURCES: Foreclosure estimates from Pew Center on the States 2008, based on Mortgage Bankers Association, *National Delinquency Survey* (March 2008), Center for Responsible Lending, *Subprime Spillover* (Revised January 31, 2008), <http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html> (accessed February 14, 2007). Projections revised February 28, 2008. Number of owner-occupied housing units from U.S. Census Bureau, 2006 *American Community Survey*, U.S. Department of Commerce: Washington, D.C. NOTES: Estimated foreclosures in 2007 include the foreclosure inventory and seriously delinquent loans (90 days or more). MBA estimates how many loans in a particular quarter are delinquent or are concluding the foreclosure process; it takes into account all loans originated, including loans that were originated in the prior quarter that are likely to have started the foreclosure process. CRLs numbers reflect all loans originated in 2005-2006 and estimate the total number of loans in that vintage that will end up in foreclosure. CRLs projections of subprime foreclosures and spillover impact were updated to reflect newer estimates of subprime defaults as reported by Merrill Lynch (The Market Economist, December 14, 2007) and Moody's Economy.com (<http://judiciary.house.gov/media/pdfs/Zandi080129.pdf>). Additionally, foreclosure estimates were calculated using outstanding subprime loans reported by the MBA in its 3Q 2007 *National Delinquency Survey*; the latter was also the source for the subprime foreclosure starts. Spillover results do not include areas outside of metropolitan statistical areas. For additional information about the Center for Responsible Lending's methodology and its caveats, see link to Subprime Spillover report above. The number of projected foreclosures to current homeowners was calculated by dividing CRLs number of projected foreclosures to owner-occupant subprime loans by the number of owner-occupant households reported by the U.S. Census.

Although dire, the MBA's "point in time" foreclosure statistics do not show the full extent of the foreclosure problem, because they do not include the high number of subprime loans made recently that have yet to enter their peak foreclosure years. In a December 2006 study, CRL, which receives funding from Pew, estimated that one in every five subprime mortgages made in 2005 and 2006 ultimately will end in foreclosure.¹⁶ These projections have been updated for this report and refer to projected actual homes lost, not to late payments or foreclosures started but not completed. Based on historic patterns of default, states with higher numbers of subprime loans made in 2005 will be the most likely to have higher default (past due) and foreclosure rates in 2007 (see Exhibit 1 for the number of projected foreclosures).¹⁷

Based on an analysis of CRL's foreclosure projections, more challenges are looming. In the coming years, 2.26 million homeowners are likely to lose their homes as a result of their subprime loans made in 2005 and 2006. This translates to one in 33 homeowners nationally. In addition, unlike the MBA data (see Exhibit 2) that show that loans in the foreclosure process and over 90 days delinquent (estimated foreclosures) are concentrated in a few states, CRL's projections indicate the challenges are spread across states more evenly. Because CRL's projections focus exclusively on subprime loans made to owner-occupants in 2005 and 2006, they provide a conservative estimate of foreclosures in the coming years. The CRL data do not account for prime borrowers, investors or other loan types. (See Pew's supplemental state fact sheets for a state-by-state analysis of foreclosure estimates and their projected ripple effects on neighboring properties.)

A recent study estimates that correcting the current crisis could take up to five years.¹⁸ The current wave of foreclosures originated largely from loans with adjustable "teaser" rates that

reset to higher payments that borrowers cannot afford. The bulk of these loans will reset in 2008 and 2009, continuing until late 2011. Another study suggests that more than eight million loans will reset and nearly 1.9 million will foreclose, assuming house prices continue to drop.¹⁹

Some States and Communities Have Been Hit Especially Hard

More than half of all the nation's loans in foreclosure and seriously delinquent loans—90 days past due—are concentrated in seven states. As Exhibit 2 shows, while California has the largest share of all foreclosures in the U.S., it also has the largest share of U.S. loans. Ohio, Michigan, Illinois and Indiana, on the other hand, have a significantly larger share of all foreclosures and seriously delinquent loans than they do mortgage loans.

Within each state, foreclosures tend to be concentrated in neighborhoods that have disproportionately high shares of subprime lending. These areas typically are made up of non-white families with modest incomes. This geographic concentration of foreclosures further reduces the value of properties owned by lower-income residents in already weakened housing markets.

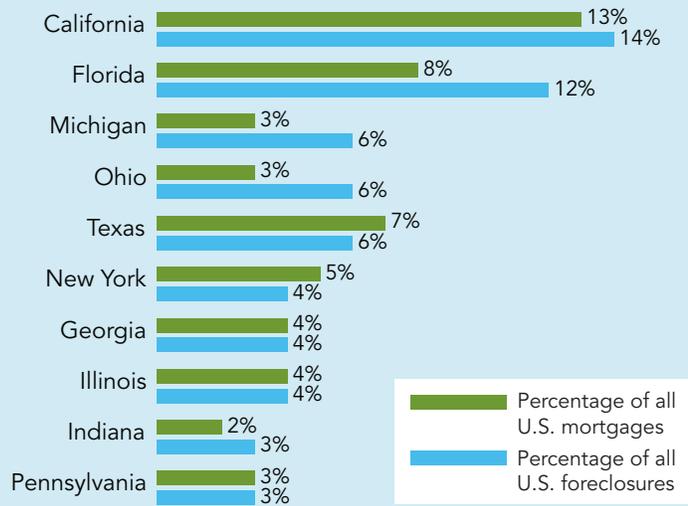
Everyone Suffers the Consequences

Foreclosure can have a devastating impact on homeowners and their families. It can ruin their credit for years, adversely affect their jobs and children's schooling, and take away what for many Americans is their principal investment opportunity and chance to get ahead. But the consequences stretch far beyond the exterior walls of their home.

Homes in foreclosure usually sell far below market value, especially in today's real estate market, and

Exhibit 2**THE HARDEST HIT: Where Foreclosures Are The Most Prevalent, December 2007**

The 10 states where estimated foreclosures are the most prevalent.



SOURCE: Pew Center on the States 2008, based on data from Mortgage Bankers Association National Delinquency Survey, (March 2008)
NOTE: Foreclosure numbers above reflect loans in the foreclosure process and 90 days delinquent at the end of 2007.

unsold properties can be expensive to maintain. Lenders experience foreclosure losses ranging from 20 cents to 60 cents on the dollar, with one estimate of a typical lender's foreclosure cost averaging \$58,800 in the early 2000s.²⁰

And neighbors and communities feel significant ripple effects. Close to 41 million homes across the nation are projected to decline in value by an average of \$8,800 because of subprime foreclosures that take place nearby, according to CRL's estimate of the impact of foreclosures from subprime mortgages made in 2005 and 2006. In addition, communities will likely experience a \$356 billion cumulative decrease in their house values and tax base from nearby foreclosures as a result of loans made in this two-year time period.²¹ (See Exhibit 1 for a state-by-state breakdown of projected reduced property values/tax base.) Moreover, homes in the foreclosure process may become vacant, leading to increased crime and other problems in the neighborhood.²²

State and local governments—and taxpayers—likely will experience significant fiscal pain. One study, focused on the City of Chicago, estimates that an abandoned, foreclosed property on average costs a municipality approximately \$7,000, although it can rack up more than \$30,000 in police, fire and code enforcement costs.²³ A 2007 analysis by Global Insight, a global economic and financial analysis firm, projects that property values will decline by \$519 billion in 2008 due to the number of homes in foreclosure from all loans, which depresses resale values over and above the decline expected from cyclical decreases in home values. For state and local governments that rely heavily on property taxes, real estate fees and sales taxes, this could mean a serious drop in revenue. The same study estimates that 10 states alone will lose a total of \$6.6 billion in tax revenue in 2008.²⁴

State governments and municipalities also are facing losses on subprime investments. Several state- and county-run investment pools—used by thousands of school, fire, water and other local districts—hold interests in structured investment vehicles that include subprime loans. “Nobody knows how much more pain is coming. State funds could lose hundreds of millions of dollars,” said Lynn Turner, chief accountant of the U.S. Securities and Exchange Commission from 1998 to 2001.²⁵

Finally, as recent news headlines suggest, the foreclosure crisis is wreaking havoc on the nation's economy at large. One study suggests foreclosures will reduce U.S. economic activity by \$166 billion in 2008 because of declines in the real estate and construction industries and in consumer spending.²⁶

The widespread impact of the crisis underscores a critical point: Everyone—borrowers, lenders, regulators, advocates, researchers and policy makers—must work together to find solutions.

WHY THE CRISIS IS HITTING NOW

For state and local policy makers, identifying the right set of reforms depends in part on understanding the cause of the problem.

Loans Become More Accessible—and Bring Higher Risk

In recent years, mortgage lending has fundamentally changed. More than 10,000 lending institutions were in business 20 years ago; today, just a few dozen lenders dominate. The source of capital for loans used to be deposits made by consumers and businesses; now the source is primarily bonds issued in financial markets. Loans today are often made by independent brokers who work on behalf of multiple lenders and who are compensated based on the size and terms of the loan rather than on how the loan performs.

Historically, borrowers who received loans had to meet rigid qualification requirements. But the advent of credit scoring and more comprehensive consumer data has allowed mortgage loans to be priced according to the calculated risk of mortgage applicants. These new mechanisms have enabled millions of borrowers to access credit they would have been denied in the past—but this access puts borrowers and lenders at risk of making serious financial mistakes and puts borrowers at risk of being preyed upon by unscrupulous lenders.

The Housing Market Booms, 2002-2006

From 2002 to 2006, home prices in many areas exceeded sustainable levels. Record numbers of loans were pushed through the mortgage lending system, with real estate markets promoting homes as an investment with rapid double-digit returns. Liberal lending practices allowed for growing numbers of prime and

subprime loans requiring no minimum downpayment; loans with adjustable or “teaser” rates that, after a short time, required payments often well beyond what the borrower could afford; loans that did not pay down principal (and in some cases even allowed it to grow); loan applications without documentation proving that the borrower could actually afford the loan; and overly aggressive real estate appraisers and loan brokers.

The Housing Bubble Bursts, 2006

During the housing boom, borrowers were told routinely that if all else failed, they could simply refinance their loans. However, when home prices stopped rising at record rates, the housing bubble burst and many borrowers found they owed more than their homes were worth. Investors providing mortgage capital lost confidence that loans were valuable assets. And as lenders began to tighten their loan requirements, many borrowers no longer had the option to refinance.

Foreclosures Increase Significantly, 2007

In the past, foreclosures often resulted from a change in the borrower’s situation: illness, job loss, divorce and the like. These problems still cause homeowners to default, but many of today’s foreclosures result from the structure of the loans themselves. A growing number of borrowers are missing payments because, as interest rates and monthly payment amounts reset, they can no longer afford the loan. In general, lenders do not benefit from foreclosure—so before initiating that process, many seek to offer borrowers other options. In fact, housing industry estimates suggest that of all the homes that entered the foreclosure process between 2001 and 2005, at least half of the borrowers were projected to have

avoided foreclosure because they were able to catch up on their loan payments or work out a new payment plan.²⁷ The potential “workout plans” include:

- Forbearance, in which borrowers reduce or suspend their payments for a period of time
- Repayment plans that enable a borrower to add past due amounts to future monthly payments
- Loan modifications that allow borrowers to add past due amounts to the principal balance, extend the term of the loan or reduce the interest rate
- Sales assistance, in which lenders help by making referrals to real estate agents and putting the home on the market with the understanding that the borrower will pay off the mortgage when the home sells

- Deed-in-lieu of foreclosure, in which the borrower returns the property to the investor, then walks away without a foreclosure mark on his or her credit history
- Pre-foreclosure sale (or “short” sale), in which the property is sold for less than is owed on the mortgage

But too many borrowers do not take advantage of these options. In fact, some researchers have estimated that as many as half of all borrowers who go into foreclosure never even contacted their lenders beforehand.²⁸ Why? Experts cite a number of reasons: borrowers are unaware of the alternatives; they are distracted by other family crises, such as illness or job loss; they are ashamed of the stigma of foreclosure; or they do not trust lenders. In addition, loans may be sold multiple times, making it unclear who actually controls them—so borrowers often do not know who to contact for help.

STATES SHOULD ACT NOW

As described above, America’s foreclosure crisis is likely to get worse before it gets better—and the impact will be felt not just by residents who lose their homes, but also by their neighbors, communities, municipalities, states and U.S. taxpayers as a whole. Homeownership is a fundamental aspect of families’ financial security, but—as this report makes clear—it also is critical to state and local governments’ fiscal health.

Federal policy makers must work to curb abusive subprime home loans and to strengthen underwriting standards, including, for example, such common-sense practices as requiring

lenders to verify a borrower’s income to help assure they can pay a loan’s teaser rate and the rate after the loan adjusts. But states also have an important—and immediate—role to play. Across the country, a growing number of policy leaders are recognizing the need to continue to encourage buyers to invest in homes—but to do so fully informed, with accurate information from scrupulous sources. Policy makers also understand the importance of helping buyers stay in their homes so that they can build equity and contribute to the stability and fiscal health of their communities, towns, states and nation.

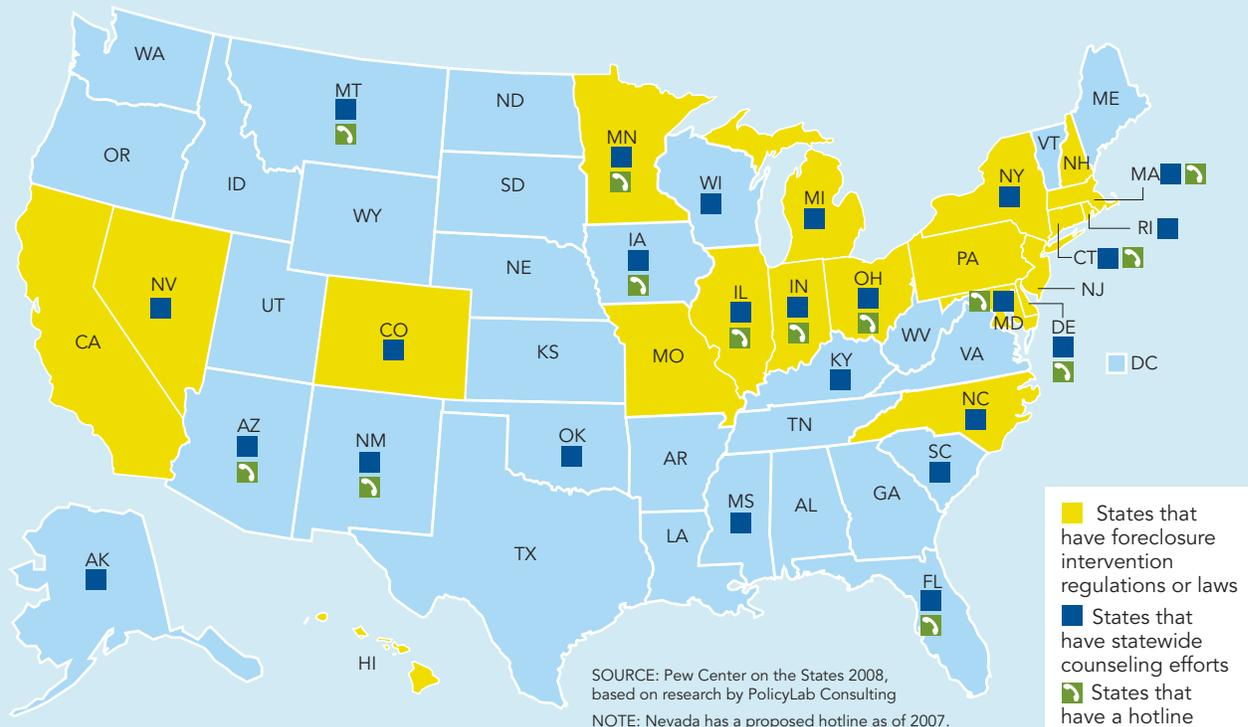
State Policy Responses

What can states do to stem the tide of foreclosures? While some may argue that tightening underwriting standards is no longer necessary, history has shown these problems will recur if action is not taken. Thus, states can regulate future subprime lending and create resources to help their residents avoid foreclosure. State housing finance agencies can be active in the mortgage market and they can use their access to capital through bonds. Governors can use their bully pulpits to promote consumer education and awareness. State attorneys general can help develop

comprehensive plans to manage defaults and foreclosures and play an important role in convening industry leaders who want to—and need to—be part of the solution. And state and local leaders can help encourage the federal government to take aggressive action to curb foreclosures and prevent more problems in the future through tighter regulation of lender practices. A growing number of states are pursuing a full range of policies to help homeowners and taxpayers mitigate the harm of the foreclosure crisis.

 Exhibit
 3

STATES RESPOND: HELPING HOMEOWNERS PREVENT FORECLOSURE



STATES ARE TAKING ACTION

States are exploring reforms in at least three key areas: (1) helping borrowers avoid foreclosure and stay in their homes; (2) preventing problematic loans from being made in the first place; and (3) forming state task forces that can convene all the major stakeholders to develop comprehensive solutions.

Federal Action to Curb High-Cost Lending

Home Ownership and Equity Protection Act (HOEPA) covers loans with high interest rates and fees, requiring added disclosures and banning certain product features. HOEPA is focused on refinance and home equity loans (also called “Section 32” loans); first lien mortgages with an annual percentage rate (APR) higher than 8 percentage points above the rate on Treasury securities of comparable maturity (usually a 30-year Treasury bond) and second mortgages with an APR more than 10 percentage points greater are also covered. HOEPA also applies when total fees and points are higher than 8 percent of the total loan amount (or more than \$547 in 2007 if the loan is under \$6,800). HOEPA includes the following provisions:

- HOEPA loans may not contain balloon payments due in fewer than five years and may not allow negative amortization, where monthly payments are too small to pay off the loan and inevitably cause an increase in the amount owed.
- HOEPA loans cannot contain prepayment penalties lasting more than five years.
- Lenders are required to underwrite loans based on the borrower’s ability to repay the loan and may not ‘flip’ or refinance a HOEPA loan into another HOEPA loan within the first 12 months, unless the new loan is in the borrower’s best interest.

Because of the high interest rate and fee thresholds that trigger federal restrictions under HOEPA, it is widely considered to affect few high-cost mortgages. More than a dozen states have followed the HOEPA model while taking a more comprehensive approach to high-cost lending.

To help borrowers avoid foreclosure and keep their homes, 20 states have launched formal foreclosure intervention or prevention initiatives. And 16 states have enacted both high-cost lending and foreclosure intervention laws (see Appendix A). In addition, 13 states have created counseling hotlines to help those at risk of foreclosure, and several states are encouraging lenders to work with borrowers to find alternatives to foreclosure.²⁹

Nine states have established loan funds that can be used to refinance borrowers who have loans they cannot afford or to provide short-term loans to help borrowers overcome financial difficulties (see Exhibit 4 on page 21). To date, a total of at least \$450 million in loan funds has been committed by states as a means of helping borrowers avoid foreclosure through short-term or emergency loans³⁰. To protect vulnerable borrowers from unscrupulous real estate investors, nine states have created laws regulating firms that claim to “rescue” borrowers from default.

In an effort to prevent problematic loans from being made, 31 states (see Exhibit 5 on page 24) have implemented laws that address predatory lending. The strongest of these laws extend and expand the provisions of the federal Home Ownership and Equity Protection Act (HOEPA), which regulates very high-cost subprime loans that carry high rates or fees (see “Federal Action to Curb High-Cost Lending”). However, most of those state laws, passed between 2002 and 2004, cover only a small portion of the total subprime loans made in the state—those with the highest rates or fees. More recently, a few states have addressed reckless underwriting through broader statutes that apply to subprime loans generally (see Appendix A). All 50 states have laws designed to regulate mortgage brokers or originators. However, only nine states require that mortgage brokers

consider or represent the interests of the borrower when recommending mortgages (see Exhibit 5 and Appendix A).

Finally, 14 states have created foreclosure task forces to try to address the crisis comprehensively. These task forces not only assess the specific

challenges faced by their states, but also bring together relevant stakeholders to develop informed recommendations for lawmakers (see Appendix A).

Nearly all of the actions described above were launched in the past two years.

HELPING BORROWERS AVOID FORECLOSURE AND KEEP THEIR HOMES

Expand Counseling and Legal Assistance for At-Risk Borrowers

Foreclosures can be avoided: In the current market, loan workouts may not be as effective as they were a short time ago.³¹ Nonetheless, the first step is for the homeowner to seek help.

Approximately 20 states have partnered with the Homeownership Preservation Foundation (HPF), which provides education and 24-hour counseling services through the “Homeowner’s HOPE Hotline.” Currently, HPF coordinates six U.S. Department of Housing and Urban Development (HUD)-certified housing counseling agencies to provide phone counseling. In addition, HPF has developed relationships with key servicing institutions to connect borrowers directly with their loan servicers if appropriate. This program plans to expand its capacity in 2008 to become the primary contact point for troubled borrowers.

In Colorado, a state initiative illustrates the value borrowers place on one-on-one, face-to-face time with a counselor. The Colorado Foreclosure Prevention Hotline, launched in February 2006 in response to a large number of requests for foreclosure prevention counseling, provides a toll-free number for Colorado residents to call for help. Callers are routed to a local service that can provide face-to-face counseling. Colorado’s hotline reports that 85 percent of callers

preferred appointments with local counseling agencies over telephone counseling.

Marketing activities and a strong leadership role by Colorado’s governor have successfully raised awareness of the hotline. The average monthly volume for the hotline is 1,769 calls, and year-to-date figures as of November 2007 showed that more than 18,000 calls had been placed to the hotline.³² A recent survey suggests that this approach is working: Four out of five callers who received counseling avoided foreclosure.³³ The success of the program stems from pairing homeowners at risk of foreclosure with local housing counselors in their community who can provide information about options in lieu of foreclosure. Counselors also help borrowers negotiate and communicate with their lenders.



To date, a total of at least \$450 million in loan funds has been committed by states as a means of helping borrowers avoid foreclosure through short-term or emergency loans.

Similarly, Michigan's Save the Dream hotline, operated by the Michigan State Housing Development Authority, was launched in 2007 to direct homeowners to a housing counselor in their county. The hotline was launched along with two new statewide loan refinance initiatives for borrowers facing default.

Many borrowers require legal assistance in addition to counseling. In Ohio, a statewide task force recommended improving homeowner access to legal information and counsel as part of the foreclosure process, as well as providing incentives for private attorneys to volunteer to represent borrowers in foreclosure cases. The task force also encouraged the governor and the court system to single out and publicly "recognize and honor attorneys who willingly recognize their essential role in mitigating the serious effect of the foreclosure crisis on Ohio's citizens and its economy."³⁴

Notify Borrowers About Help Earlier in the Process

In general, borrowers often do not know where to turn when they face a financial problem that prevents them from making a mortgage payment. Many borrowers are reluctant to call their lenders and most lack information about the alternatives that lenders can offer. In addition, borrowers may be unaware of the services that counselors or legal services can provide to help them reach an agreement with lenders.

Several states have explored ways to ensure that borrowers receive information about possible workout options that may help them avoid foreclosure early in the foreclosure process and to encourage borrowers at risk to work with lenders to obtain a loan modification or workout plan as soon as possible. California, Indiana and Minnesota, for instance, are working to have servicers and lenders provide borrowers with

information about their options earlier in the foreclosure process.

- California regulators have sought voluntary agreements with servicers to reach out to borrowers with high-risk, adjustable-rate loans so they can prepare for upcoming payment changes.
- Indiana requires that information about state-provided resources be included in foreclosure notices.
- Minnesota has required lenders to notify borrowers about state foreclosure counseling and assistance as well as about the availability of a referral service that provides access to HUD-approved housing counseling.

As long as resources are in place and lenders are willing to work with borrowers, these approaches could help borrowers proactively cure a default before the foreclosure progresses.

In addition, state leaders in Indiana, Maryland, Massachusetts and Ohio have developed media campaigns to convey the message that borrowers at risk of default can and should seek help. The campaigns include statements issued by the governor, press releases, Web site links and brochures providing service referrals. Private lenders have been supportive of these approaches and, in some cases, have provided funding for public awareness campaigns.

Encourage Lenders to Modify Loans in Default

One of the most important state efforts so far has been to encourage lenders to voluntarily modify loans that are likely to go into default or are already in default. While most lenders and servicers have shown a preference for modifying loans on a case-by-case basis, state leaders—from governors to directors of bank supervisory agencies—have pushed financial institutions to

modify adjustable-rate loans that meet certain criteria in order to affect more at-risk loans and have a greater impact on the problem.

Examples include efforts by governors in Arizona, California and Ohio, each of whom has worked with major lenders to obtain some agreement to modify loans on a broader scale. In addition, the Conference of State Banking Supervisors and a select group of state attorneys general have been exploring regulatory, statutory and legal actions to facilitate loan modifications for mortgages with significant short-term payment shocks.

These state-level efforts face a federally created obstacle. In fall 2007, the U.S. Department of Treasury and the U.S. Department of Housing and Urban Development (HUD) launched the “HOPE NOW” alliance to encourage housing counselors, loan servicers, investors and other mortgage market participants to form an alliance to “maximize outreach efforts to homeowners in distress to help them stay in their homes and create a unified, coordinated plan to reach and support as many homeowners as possible.”³⁵ HOPE NOW (discussed in greater detail in Section 3.0) represents 11 lenders servicing more than four out of five subprime loans, or 80 percent of the subprime market. Last December, the HOPE NOW alliance proposed a plan to freeze the interest rates for five years on loans that had been expected to go up. While the proposal intends to help borrowers by freezing interest rates, the problem is that this approach creates a template for wholesale loan modifications and could limit states’ abilities to negotiate an across-the-board extension of the terms of the loan, such as converting a 30-year loan to a 40-year loan, which would result in



Governors in California, Massachusetts and Ohio have encouraged lenders to modify loan terms on a larger scale. The Conference of State Banking Supervisors and a select group of state attorneys general have been exploring regulatory, statutory and legal actions to facilitate loan modifications for mortgages with significant payment shocks in the short term.

lower monthly payments, or a reduction in the amounts owed. Indeed, the State Foreclosure Prevention Working Group—comprising attorneys general and banking regulators from 11 states, including California, Iowa, New York and North Carolina—has noted that resets are not the key issue for many homeowners who are falling behind on their monthly payments.

Chicago’s HOPI City Model

In 2002, the city of Chicago and NHS Chicago, a leading nonprofit community development agency, began an initiative to address a near doubling of foreclosures in the city, most of which were concentrated in low-income neighborhoods where increasing numbers of vacant buildings began appearing on once stable blocks. Working with the Federal Reserve Bank of Chicago, NHS launched the Home Ownership Preservation Initiative (HOPI) with key lending, investment and servicing institutions. Seeking to preserve sustainable homeownership and to reclaim foreclosed homes as neighborhood assets, HOPI has met at least twice, annually releasing research on foreclosure trends and developing innovative new strategies, many of which have been replicated nationally.

According to the working group's analysis from February 2008, more than 30 percent of borrowers with subprime loans and/or ARMs—representing about 365,000 of the 1.1 million delinquent loans—are already at least 30 days past due on their mortgage payments even though they have not yet seen their first rate reset.³⁶ The interest rate freeze negotiated through HOPE NOW would not help these consumers. Still, states are encouraged by HOPE NOW to work with lenders and servicers to identify ways to ensure that objective standards are used to modify loans for a broad group of borrowers and to encourage lenders to reach the most borrowers possible through a wholesale approach.

Provide Publicly Supported, Short-Term Loans and Mortgage Refinance Funds for Borrowers

Collectively, nine states have committed at least \$450 million to homeowners facing foreclosure—to provide short-term or emergency loans to help borrowers overcome their financial difficulties (see Exhibit 4). These loan funds typically are funded by public and private sources, including proceeds from taxable bond issues. In other situations, pools are guaranteed or insured by state agencies to encourage private lenders to participate.

States have provided funding for short-term interventions designed to help borrowers when foreclosure proceedings are imminent. While these programs have proved effective in responding to significant job losses or other economic disruptions (for example, family or health emergencies), the changing nature of foreclosures brings new challenges. These emergency loan funds may be less effective in the current crisis because today's foreclosures are often the result of the loans themselves: the terms may have already damaged the financial stability of the borrower, and the loan may be based on a housing value that has already diminished. Nonetheless, state

loan funds have an important role to play in keeping communities stable by helping ensure that credit remains available for consumers when they need it—especially with housing values weakening and credit tightening up.

Pennsylvania's Homeowners' Emergency Mortgage Assistance Program (HEMAP) was one of the first state-led foreclosure assistance funds. Launched in the 1980s, when the state experienced record unemployment due to a massive transition away from manufacturing jobs, the program provides a limited number of short-term loans (up to two years and a maximum of \$60,000) to help borrowers bridge a period of unemployment. Loans are restricted to borrowers who are in default but have made good-faith efforts to make payments. All borrowers must work with local nonprofit housing counselors. HEMAP provides funds to nonprofit agencies to counsel delinquent homeowners and to help them apply for aid. The program makes mortgage payments directly to lenders on behalf of the borrowers during the emergency assistance period. These payments make up the difference between the applicant's monthly contribution and the lender's required payment. Pennsylvania requires that all lenders must send a notice about HEMAP to homeowners who are at least 60 days delinquent. Since its inception, Pennsylvania's program has helped more than 40,000 families maintain their homes.³⁷

HEMAP is considered an exemplary model, and other states have implemented similar programs. Delaware, Michigan, Massachusetts and North Carolina have recently created similar funds to provide small emergency assistance loans.

The Minnesota Housing Finance Agency, in conjunction with 18 nonprofit counseling agencies, offers counseling and loan funds to prevent mortgage foreclosure as part of the state's Foreclosure Prevention Assistance Program (FPAP). The program provides

delinquent mortgage borrowers with financial and debt-management counseling, help negotiating with lenders and assistance accessing emergency loans up to \$5,500. Nearly 100 loans equaling approximately \$427,000 were made in FY2007 (October 1, 2006 to September 30, 2007). As in Pennsylvania, lenders are required to notify delinquent borrowers about the availability of FPAP assistance.

In addition, half a dozen states offer troubled homeowners the option to refinance loans. Ohio, for example, launched the Opportunity Loan Refinance Program in April 2007 to help

borrowers refinance high-cost loans. The program offers 30-year, fixed-rate loans along with a 20-year, fixed-rate second mortgage to help with closing costs for eligible borrowers.

As of June 2007, the Ohio Housing Finance Agency (OHFA) planned to make more than 80 loans for approximately \$11 million. The new loans would then be purchased by OHFA using taxable bonds (at no cost to Ohio taxpayers). To date, \$100 million in taxable bonds have been allocated to fund the program. And the state's Foreclosure Prevention Task Force has asked OHFA to expand its underwriting criteria so that more homeowners can qualify for the program.³⁸

**Exhibit
4**

THE STATE OF LOAN FUNDS

State	Fund	Use	Amount (Committed/Pledged)
Connecticut	CT Families	Refinance to 30-year, fixed-rate, fully amortizing loans at 0.25 percent above Connecticut Housing Finance Agency's regular rate	\$50 million
Delaware	Emergency Mortgage Assistance Program	Up to \$15,000 emergency loan for borrowers in foreclosure to pay past due balance and/or up to 12 future mortgage payments	\$2 million
Maryland	Lifeline Refinance Mortgage Program	Borrowers with ARM or interest-only loans with upcoming reset can receive a 40-year fixed-rate loan, within income limits	\$100 million, including \$10 million loan loss reserve and \$25 million in housing agency bonds
Massachusetts	Home Saver Foreclosure Prevention Program	Borrowers up to 60 days behind and victims of predatory lending	\$250 million (pledged), including \$60 million in taxable bonds as guarantee
Michigan	Adjustable-Rate Mortgage Refinance	Refinance ARMs into below-market rate fixed-rate loans before delinquent	Funded by taxable bonds
	Rescue Refinance Program	Refinance ARMs into below-market rate fixed-rate loans after delinquent at risk of losing their home	Funded by taxable bonds
New Jersey	Homeownership Preservation Refinance Program	Refinance for borrowers who cannot afford the rate reset or other loan terms, or have been denied a loan modification for a 30- and 40-year, fixed-rate loan. Must meet income and maximum mortgage limits	\$30 million
New York	Keep the Dream Alive Mortgage Refinance Program	Borrowers with ARM or interest-only loan with upcoming reset can receive 40-year, fixed-rate loan, within income limits	\$100 million
Ohio	Opportunity Loan Refinance Program	Refinance ARMs into fixed-rate loans before delinquent, within income limits	\$100-500 million in taxable bond proceeds (\$100 million committed)
Pennsylvania	Refinance to an Affordable Loan	Pennsylvania Housing Finance Agency buys current loan for borrowers unable to afford their loan or who owe more than the home is worth	\$25 million bond issue
	Homeowner Equity Recovery Opportunity	Refinance ARMs into below-market rate fixed-rate loans for borrowers less than 60 days delinquent	\$25 million bond issue
	Emergency Mortgage Assistance Program	Short-term loans to bring payments up to date; also ongoing assistance with up to 24 payments	Approximately \$20 million annually from loan repayments and annual appropriation

SOURCE: Pew Center on the States 2008, based on research by PolicyLab Consulting

In July 2007, New York State launched the “Keep the Dream Alive” program. With \$100 million available, New York’s Housing Finance Agency aims to help 500 to 700 families refinance out of high-risk loans into affordable, low-interest loans. The program targets homeowners with interest-only, adjustable-rate or other unconventional loan terms. Borrowers must receive homeownership counseling from approved housing counseling agencies before loan approval. Critics say the program’s loan criteria are not broad enough to meet the needs of most New York City homeowners, but efforts are underway to expand the program.

Connecticut, Delaware, Massachusetts, Michigan and Pennsylvania also have announced refinance programs.

Prevent “Foreclosure Rescue” Scams

As foreclosure rates increase, many vulnerable borrowers may fall victim to scam artists who promise to rescue them from foreclosure through various lease-buyback or loan repayment schemes. These scams typically involve “foreclosure consultants” who charge clients a fee to help them avoid foreclosure. The consultants promise to work with the homeowner’s lender or servicer, but often do nothing more than what the borrower could do on his or her own. Equity property purchasers also make false promises to help homeowners stay in their homes. They encourage homeowners to sign their deeds over to them, and then rent or lease the property back to the homeowner, often with higher payments than the original mortgage amount. In many cases, homeowners do not realize they have given up ownership of the property.

At least nine states have enacted legislation aimed at preventing foreclosure rescue scams (see Appendix A). While most laws are very new, with the effects yet to be seen, many consumer

advocates believe they have made it more difficult for dishonest foreclosure consultants to operate. Such laws typically include the following provisions:

- A clear and conspicuous notice stating that consumers have the right to cancel an agreement with foreclosure consultants
- Required disclosure of terms and conditions, as well as a “right to rescind” period during which a consumer can cancel the transaction before the closing
- Terms that cap or limit fees that the foreclosure consultant can charge consumers, and terms that prohibit payment until all services are completed
- Terms that rescind or prevent the transfer of property to a foreclosure consultant
- Provisions that establish criminal and civil penalties for violating the regulations

In May 2005, Maryland became one of the first states to pass emergency legislation to address foreclosure rescue scams. The Maryland Protection of Homeowners in Foreclosure Act seeks to protect homeowners from unscrupulous organizations portraying themselves as rescue outfits. The law criminalizes predatory activities and permits the victim to receive damages if the consultant knowingly violates its provisions. Minnesota, Colorado, Illinois, Indiana, Massachusetts, New Hampshire and New York all enacted similar legislation between 2004 and



In May 2005, Maryland became one of the first states to pass emergency legislation to address foreclosure rescue scams.

2007. Massachusetts' regulations allow transfers of properties in the foreclosure process only between family members or through nonprofit organizations to protect consumers from rescue scams.

Colorado's Foreclosure Protection Act prohibits foreclosure consultants from charging up-front fees. The law also requires that all agreements made with a foreclosure consultant be in writing, in English, and translated into the borrower's

native language. Under this law, homeowners have a three-day right of rescission for any agreement signed with a foreclosure consultant.

Illinois' Mortgage Fraud Rescue Act of 2007 requires that any person who seeks to help a homeowner at risk of foreclosure must fully disclose in writing the terms of the services, all associated costs and a right of rescission. Any sale must be close to the home's appraised value, and violators are subject to criminal liability.

PREVENTING PROBLEMATIC LOANS FROM BEING MADE

Curb High-Cost Lending

Consumer protection is an important state issue and several states have been at the forefront of crafting strong regulations that can safeguard borrowers—and, ultimately, the lending industry and the economy as a whole—from taking on more expensive loans than they can safely manage. At least 31 states have passed laws similar to the federal Home Ownership and Equity Protection Act (HOEPA), which regulates very high-cost subprime loans that carry high rates or fees. After HOEPA was enacted, it became clear that many abusive lenders circumvented the law by taking advantage of loopholes in the definition of which loans it covered. For this reason, several states enacted new subprime lending laws to supplement HOEPA by covering a broader range of fees. These new provisions result in more loans being regulated, but they still account for only those loans in the highest cost portion of the market. However, some state efforts successfully curbed the first wave of predatory mortgage lending (largely centered on equity stripping)³⁹ with carefully crafted laws designed to weed out abusive practices.

North Carolina's predatory lending law is often cited as model legislation regulating high-cost loans; in fact, about a dozen states have adopted statutes that closely mimic it. The state uses the same APR triggers as HOEPA but has a lower fee trigger, requires counseling and bans prepayment penalties for loans under \$150,000. North Carolina's law also extends to other types of mortgages, including purchase loans; however, it excludes reverse mortgages and high-cost loans of more than \$300,000.

Reform Underwriting Standards

Underwriting standards in the subprime market have become extremely loose in recent years, which has been the key driver in today's foreclosure crisis. Building on laws passed earlier this decade, however, states are once again at the forefront of consumer protection. Congress, in its deliberations, should carefully examine and capitalize on what states have learned from these initiatives. In an effort to re-establish a stable marketplace for both borrowers and lenders, several states—including Colorado, Maine, Minnesota, North Carolina, Ohio and Massachusetts (by regulation)—have enacted bold legislation to curtail abusive lending

chance of foreclosure. For example, a review of a sample of stated-income loans found that 90 percent had inflated incomes, and “more disturbingly, almost 60 percent of the stated amounts were exaggerated by more than 50 percent.”⁴⁰ An increase in loans with few or no existing documents to verify a borrower’s income—“low doc” and “no doc” loans—has compounded the problems of underwriting and actual affordability. Recent laws in Colorado, Maine, Massachusetts, Minnesota, North Carolina and Ohio all require that income sources be verified.

Limit or Ban Predatory Prepayment Penalties

Prepayment penalties—the steep fee (often six months of interest) for paying off or refinancing a loan early—are included in about 70 percent of all subprime loans, compared with about 2 percent of prime loans. Subprime prepayment penalties trap borrowers in high-cost loans by subjecting them to the loss of significant home equity if they refinance.

- More than 35 states now regulate prepayment penalties.
- At least 10 states ban most prepayment penalties outright, including Maine, Minnesota and North Carolina.

Regulate Mortgage Brokers More Effectively

Because two thirds of all subprime loan applications are originated by mortgage brokers, many states are examining their role and looking for ways to create greater accountability for brokers who use unfair and deceptive tactics to push subprime financing on borrowers. While many consumers believe mortgage brokers may have a fiduciary duty to the borrowers they represent, only Illinois, Massachusetts, Minnesota and South Carolina have clear statutes that outline this legal relationship. Even where legal duties are undefined, many brokers do act responsibly and ethically on behalf of borrowers. Still, the current system provides incentives to

brokers that can be contrary to borrowers’ best interests. For instance, broker compensation is driven by yield-spread premiums—the fees paid to them for originating loans at higher rates than those for which the borrower would qualify.

New legislation or regulation also extends to tightened broker duties. Colorado, Maine, Massachusetts, Minnesota, North Carolina and Ohio are all recent examples. These states have established an obligation of good faith and fair dealing. And they require brokers to act in the borrower’s best interests, sell only mortgages that are appropriate for the particular borrower and disclose any compensation clearly and completely.

Prohibit Lenders from Steering Consumers to Higher-Cost Loans

Steering is the predatory lending practice of offering borrowers a higher-cost loan when the borrower could actually qualify for a better rate or better terms. Pricing disparities can be the result of a variety of factors, including inconsistent application of objective pricing criteria, targeting of families of color by higher-rate lenders or brokers and a lack of investment by lower-cost lenders in these communities. For example, recent data illustrate that communities of color continue to pay more for homeownership than white borrowers.⁴¹ In 2006, CRL found that for most types of subprime loans, black and Latino households are 30 percent more likely to be given a subprime loan even after controlling for legitimate risk factors.⁴²

Lenders and policy makers can take a multifaceted approach to ensuring that all borrowers, regardless of race, receive loans that are fair and sustainable. For instance, Massachusetts recently instituted regulations that ban steering, and several other states—including Minnesota, North Carolina and Ohio—have addressed steering through anti-predatory lending laws and broker regulations.

Enforce Regulations More Strictly

Most lenders do not keep the loans they make, but instead sell or “assign” the loan to other entities that bundle mortgages into securities for investment purposes. To address this market dynamic, some states have begun to provide greater enforcement authority to their mortgage regulators while also providing a private right of action for borrowers and establishing assignee liability, which means that lenders who make risky loans will be held liable even after selling the bad loan.

- Ohio has brought many mortgage protections under its Unfair and Deceptive Acts or Practices laws, thereby subjecting lenders to punitive measures for abusive loans.
- Maine has banned pre-dispute, mandatory arbitration; the ban ensures that borrowers can pursue legal claims through the courts.
- Maine and Rhode Island are the most recent of the dozen or so states to institute assignee liability for high-cost home loans.

Encourage Consumer Education and Counseling Before Loans Are Made

Homeowner counseling programs can help prevent foreclosures by making consumers aware of the intricacies of their mortgage decisions and by educating consumers about the pitfalls that accompany taking out an unaffordable mortgage or committing to a refinance that is not in their best interest. In fact, successful counseling requirements have been narrowly focused and have targeted a specific set of loans.⁴³ However, requiring counseling for a specific demographic or class of homeowners can be problematic.

Illinois provides a useful example. The Illinois Predatory Lending Database Law went into effect in January 2006. The law required mandatory counseling for any mortgage applicant living within 10 ZIP codes in Cook County and who had a credit score below a particular threshold or who had applied for a loan that had certain characteristics associated with risky loans. But the law was suspended less than 10 months later under immense scrutiny from consumer advocates and lenders, because it targeted individuals with particular credit scores who tended to be minorities or low-income consumers. As a result, the law was revised to expand its reach to all of Cook County and to re-focus counseling requirements by the type of loan, rather than by the credit history of the borrower.

TACKLING THE CRISIS COMPREHENSIVELY

Convene State Task Forces to Assess Challenges, Bring Stakeholders Together and Identify Needed Reforms

Today, 14 states have created task forces on foreclosure intervention to marshal resources, bring stakeholders together and implement a range of strategies (see Appendix A). Task forces typically include representatives from nonprofit agencies, state and local government and, in many cases, the financial industry. These alliances help identify state priorities and keep the issue of foreclosure in the public spotlight. States' task forces have focused on all of the policy reforms discussed in this report: from seeking to protect homeowners before they secure mortgage loans to offering short-term loans and mortgage refinancing to help homeowners stave off foreclosure.

The Massachusetts Mortgage Summit Working Groups, a state task force, works to implement strategies to address the foreclosure crisis. Convened by the state Division of Banks, a summit consisting of representatives from nonprofits, government and the mortgage lending industry was held in November 2006 and produced two working groups that focused on rules and enforcement and consumer education and foreclosure assistance. In April 2007, the groups issued a report titled, *Recommended Solutions to Prevent Foreclosures and Ensure Massachusetts Consumers Maintain the Dream of Homeownership*. (Exhibit 6 illustrates this group's primary findings.) In June 2007, Governor Deval Patrick submitted a legislative proposal (H.B. 4085) that drew upon the Mortgage Summit Groups' recommendations. His proposal criminalized mortgage fraud; created an information system to monitor and analyze foreclosures; required consumers applying for a nonconforming variable rate mortgage to get

counseling before obtaining the loan; and mandated that mortgage servicers file a 90-day notice of intent to foreclose with the homeowner and the Division of Banks. As of December 2007, the bill was still under consideration; however, the state's banking commissioner has already secured temporary stays for hundreds of homeowners in the foreclosure process, and has provided financing and counseling assistance to these families. In addition, the governor announced a \$250 million loan refinance program in July 2007; the attorney general has banned foreclosure rescue schemes; and the state senate passed an omnibus foreclosure relief measure.

Convened in March 2007 by Ohio's Governor Ted Strickland and chaired by the director of the state's Department of Commerce, the Ohio Foreclosure Prevention Task Force is made up of 25 members from government, industry and the nonprofit sector. The task force has approved 27 recommendations in the following areas:

- Development of public awareness campaigns
- Funding goals for counseling, including at least \$2 million in new state funds
- More flexibility within pooling and servicing agreements
- Improvements to Ohio's foreclosure processes, including expanding consumer access to counseling and legal assistance, encouraging mediation and alternative dispute resolution in foreclosure proceedings and expediting property transfers to the court or sheriff to minimize impact on surrounding neighborhoods
- Stronger protections for homeowners, requiring mortgage servicers to contact the state with details on the loan terms and history of the consumer before filing a foreclosure complaint

- Lender requirements that offer consumers the option of escrowing taxes and insurance
- Strategies for dealing with the aftermath of increased numbers of foreclosed homes, including reallocating resources to facilitate reinvestment in affected neighborhoods and to fund additional public foreclosure rescue measures for consumers

As a result of the recommendations outlined by the Ohio Foreclosure Prevention Task Force last September, Governor Strickland has sought the cooperation of mortgage lenders to address the increasing number of foreclosures in Ohio. The governor proposed a compact, which called for servicers to increase outreach and education to borrowers, especially in the areas of loan modifications and rate changes. Under the compact, the servicers were asked to take all measures to increase loan workouts, including adjusting their staff and resources to accommodate major improvements in preventative efforts and loss mitigation. If these efforts to modify loans should fail, lenders were required to provide adequate advance notification of the intent to proceed with foreclosure.

In early April 2008, Governor Strickland reached agreement with nine of 11 of Ohio's largest mortgage servicers on a significant effort to modify the terms of adjustable-rate mortgages across the state.

In addition to attempting to work with the state's major lenders to provide distressed homeowners relief, Governor Strickland directed the Ohio Department of Development (ODOD) to coordinate the distribution of \$2 million from the Ohio Housing Trust Fund for housing counseling services. The Trust Fund will be asked to provide an additional \$1 million to ODOD for a vacant housing demonstration program. Ohio also has an active loan fund (the Opportunity Loan

Refinance Fund) to help households in danger of foreclosure to refinance problematic loans.

Similarly, the New York State Banking Department launched the Halt Abusive Lending Transactions and Mortgage Fraud Campaign (HALT) in reaction to the state's growing number of foreclosures resulting from predatory lending. This interagency task force aims to counteract the harm caused by predatory lending through increased collaboration between lenders, communities and other stakeholders while working to strengthen community and local organizations' ability to combat predatory lending. HALT provides outreach and consumer counseling through public service announcements, a consumer helpline and grants that support consumer services, and partners with the State of New York Mortgage Agency to offer a 40-year fixed rate loan and to develop the "Keep the Dream" program that helps eligible subprime borrowers refinance their loans. The program also raises mortgage lending standards through better documentation of a borrower's capacity to pay loans, a unified systematic approach to loan modifications and the creation of a mortgage fraud unit and a national licensing system for mortgage loan originators.⁴⁴

Advocates in Colorado successfully pulled together various stakeholders in the public and private sectors, including representatives from the Colorado Division of Housing, JP Morgan Chase and the Colorado Association of Realtors, to form the Colorado Foreclosure Prevention Task Force.⁴⁵ This group's central achievement to date has been establishing a Colorado foreclosure hotline, which fields calls from state residents having trouble making their mortgage payments.

1. Criminalize Mortgage Fraud

Goal: Mortgage fraud becomes a criminal offense with a penalty of up to 10 years imprisonment and/or a \$50,000 fine. Multiple cases of fraud could receive up to 20 years imprisonment and fines up to \$500,000.

Status: Requires legislation or emergency regulation by the Office of the Attorney General.

2. Increase Mortgage Licensing Requirements

Goal: Support National Mortgage Licensing System (NMLS) and expand licensing requirements to include all mortgage originators, increase capitalization and net worth requirements for brokers and lenders and require minimum licensing requirements of five years for lenders and three years for brokers.

Status: Division of Banks proposed regulations for minimum experience requirements for brokers and lenders as well as increased net worth requirements and a surety bond for lenders and brokers.

3. Increase Funding for the Division of Banks

Goal: Increase funding for Division of Banks enforcement activities by increasing mortgage lender and broker fees.

Status: Governor proposed legislation to provide the Division of Banks funding for enforcement, which is under consideration.

4. Adopt Federal Guidance on Nontraditional Mortgages

Goal: Adopt parallel guidance that can be applied to lenders that are not federally regulated.

Status: Division of Banks adopted parallel guidance in January 2007 for nontraditional mortgages such as those with interest-only and payment option ARMs.

5. Change Foreclosure Laws

Goal: Improve rights of consumers in the foreclosure process.

Status: Governor supported legislation to require pre-foreclosure notification to homeowners and the Division of Banks and post-foreclosure reporting of costs and proceeds of the home sale.

6. Create Foreclosure Database

Goal: Division of Banks to develop a database to track information on pre-foreclosure notification and foreclosure petitions.

Status: Legislation introduced to require that the name and license number of lender and broker be recorded on all mortgages when filed with the registry of deeds.

7. Prevent Foreclosure Rescue Scams

Goal: Require that transactions with foreclosure consultants be in writing with no payment due until all services rendered. Provide a five-day grace period that enables consumers to cancel the contract.

Status: The attorney general introduced emergency regulations prohibiting unfair and deceptive foreclosure rescue scams to prevent the transfer of distressed property to for-profit entities charging a fee. Transfers between family members or involved nonprofit organizations are exempt.

8. Increase Consumer Awareness about Foreclosure and Increase Resources

Goal: Support of statewide and grassroots awareness campaign in multiple languages; increase availability of homeownership counseling and borrower workshops by nonprofit agencies.

Status: The state is developing a partnership with the Homeownership Preservation Foundation to offer counseling.

9. Create Foreclosure Intervention Products

Goal: Create a mortgage product to help consumers refinance unsustainable loans and provide credit enhancements for high-risk mortgages. Seek participation of private lenders.

Status: MassHousing, the state's housing finance agency, established a \$250 million Loan Refinance Program offering fixed-rate refinance loans.

Address Foreclosure Vacancies, Turnover and Blight

Even if a state adopts a wide range of reforms and approaches the crisis comprehensively, the reality is that many homes with unsustainable subprime mortgages will fall victim to foreclosure. While there is still a window of opportunity for state policy makers to mitigate the effects of foreclosure by carrying out some of the measures highlighted in this report, state and local officials need to consider strategies to directly manage the consequences of foreclosure in modest-income homeowner neighborhoods.

Foreclosed homes are frequently abandoned and left to vandals, disrepair and mismanagement for up to two years while banks work through the foreclosure process. While many localities have programs in place to manage troubled properties, these efforts were designed to deal with existing vacant properties, not to handle a rapidly rising tide of new, vacant homes in otherwise stable neighborhoods. With a large volume of properties entering foreclosure, efforts to manage vacant properties will become even more challenging. And these efforts will become increasingly important for neighborhood preservation and revitalization. According to our analysis of CRL's subprime spillover data, surrounding homeowners could lose \$356 billion cumulatively, simply by being in close proximity to foreclosed properties.⁴⁶ As a result, cities across the country could lose many billions in taxes and revenue from lost fees for services (for example, permits, water, garbage pick-up) provided by the public sector.

Both Massachusetts and Minnesota recently announced programs to address vacancies in the wake of the foreclosure crisis. The Ohio Foreclosure Prevention Task Force has recommended strategies to manage the aftermath of foreclosures. These state strategies and efforts emerging in other states generally include:

- Expediting property transfers once a foreclosure judgment is completed, which entails getting the property into the hands of the new owner as quickly as possible. Ohio uses a system in which specially appointed master commissioners administer the post-judgment process from entry of judgment to transfer of title. Ohio also is considering a two-track system that would move investor properties through foreclosure more quickly than owner-occupied properties, giving homeowners greater opportunity to remedy their situation.
- Providing grants for property rehabilitation. The cost of deferred maintenance and major repairs for homes in foreclosure can be significant. In some cases homes simply need to be demolished. Illinois and Minnesota have developed modest programs to recover properties that are lender real estate owned (REO)—homes that lenders have taken possession of and need to sell off—and turn them over to local community development organizations to renovate for first-time home buyers. While the number of recovered properties remains low, the renovated homes can have a significant impact by stabilizing neighborhoods that have experienced a wave of foreclosures.



Foreclosed homes are frequently abandoned and left to vandals, disrepair and mismanagement for up to two years while banks work through the foreclosure process.

- Providing support for municipal code enforcement to ensure abandoned properties are maintained and to make sure they do not create blight for neighboring properties; engaging in land banking to publically purchase, hold and maintain abandoned property for later public use; and supporting neighborhood planning and redevelopment efforts. Ohio has explored using tax foreclosures to secure properties or propel rehabilitation. State housing finance agencies can also use Low Income Housing Tax Credits to redevelop vacant properties.

Because REO properties are a depreciating asset, lenders are increasingly willing to sell them in bulk at a significant discount or even donate some properties to a public entity or nonprofit development agency. This arrangement can require significant capital resources, extensive negotiation and carefully managed housing construction activities. Combined with the scattered-site nature of single-family homes in foreclosure and the poor quality and location of the most depreciated REOs, taking on a portfolio of properties should be approached with great caution.

A related issue for homes in foreclosure affects those properties that contain one or more rental units. What happens to existing tenants? Paying renters provide some cash flow for maintenance, taxes and other expenses. But many potential new owners prefer an empty property in which they can invest and then lease to new tenants. There are few protections for renters living in a property in foreclosure, and many are evicted on short notice. Although few states have protections for renters, some have started to explore additional safeguards to provide extended availability of housing for renters in these situations—although many of these proposed fixes are temporary in nature. Lease-holding tenants in New Jersey, New Hampshire, Washington, D.C. and Massachusetts cannot be evicted by new owners unless the tenants have failed to pay the rent or have violated any other important lease term or law. In August 2007, North Carolina enacted a law increasing to 30 days the court notice given to tenants in properties containing 15 or more rental units. Illinois recently passed a law extending the notice period for tenants in foreclosed buildings to 120 days or the remainder of the lease, whichever is shorter.⁴⁷



National Initiatives

Congress has taken some steps and is actively considering others to address the current foreclosure crisis. The following federal initiatives are meant to complement states' actions and, if successful, they could significantly reduce the impact of subprime foreclosures nationwide.

FHASecure

Launched in August 2007, this program is aimed at helping homeowners refinance certain ARMs. Unlike traditional FHA-insured mortgages, the program allows even delinquent borrowers to refinance if their delinquency results from an ARM resetting to a higher rate. This program applies only to owner-occupied homes (no investors) with existing non-FHA ARM loans that have or will reset between June 2005 and December 2009. The program is available to homeowners with mortgages under a certain dollar amount, which varies by geographic region (for instance, the temporary limit is 729,750 for high cost areas.)⁴⁸

HOPE NOW Alliance

As described earlier, the federal HOPE NOW alliance represents 11 lenders servicing more than four out of five subprime loans.⁴⁹

A significant part of the HOPE NOW effort is aimed at modifying loans by freezing the interest rate at the current level. The plan was announced in December 2007, and is a voluntary effort by the private sector to address the national foreclosure challenge. However, this program only targets a limited number of homeowners facing foreclosure. To be eligible, homeowners must have had good payment histories, taken

their loans out between January 2005 and July 2006, face loan resets that result in a payment increase of 10 percent or more, and had a loan to value ratio of over 97 percent. The program uses a direct mail campaign to contact at-risk homeowners and encourage them to call the Homeownership Preservation Foundation's national hotline (888-995-HOPE). In November 2007, the alliance sent more than 200,000 letters to at-risk homeowners.⁵⁰

Because HOPE NOW is entirely voluntary, it will have an impact only to the extent that lenders and servicers agree to modify loans. This plan does not address or alleviate any of the problems that have prevented lenders and servicers from modifying loans to date (for example, the interplay between first and second lien holders and the mismatched incentives between servicers and investors). The plan excludes borrowers who have already defaulted on their loans and are already on track to lose their homes in foreclosure. The plan also excludes all borrowers whose rates reset before January 1, 2008, which accounts for most borrowers with loans that originated prior to 2006. An even more recent Treasury plan, "Project Lifeline," provides a "pause" that would temporarily halt foreclosure proceedings for some borrowers, but only for 30 days.

In mid-January 2008, the MBA released statistics on the number of loan modifications its members accomplished in the third quarter of 2007. The data reveal that the number of initiated foreclosures outstripped loan modifications by a seven-to-one margin (384,388 to 53,573). For subprime ARMs—the root of the current foreclosure crisis—servicers modified

Court-Supervised Loan Modifications: Current Law Excludes Bankrupt Homeowners from Relief

The risk of foreclosure is highest for several million families who hold subprime loans with “exploding” adjustable interest rates that are set to rise sharply, resulting in massive and often unaffordable payment increases. If these homeowners are unable to make their payments, refinance the mortgage or sell their home, current law gives them only limited options: loan modification by lenders or foreclosure.

Given that lenders currently are not voluntarily modifying loans in significant numbers, one of the potential options for homeowners who would otherwise lose their homes would be a loan modification through the bankruptcy process. But that avenue is legally closed to them, because current federal law specifies that the mortgage on the primary residence is the only debt that bankruptcy courts cannot modify. However, such bankruptcy relief is available on other types of debts, including loans on commercial real estate, investment properties and even yachts. Congress provided a similar type of bankruptcy relief to family farmers during the farm crisis of the 1980s, and this remains part of the bankruptcy code today.

CRL estimates that changing the federal bankruptcy law to allow court-ordered loan modifications for homeowners in bankruptcy could prevent 600,000 foreclosures. (For more information, see <http://www.responsiblelending.org/issues/mortgage/solutions/hr-3609-compromise-bill-permitting-court-supervised-loan-modifications-would-save-600-000-homes.html>.) Both the U.S. House of Representatives and a key U.S. Senate committee are considering bankruptcy reform to help homeowners. Current proposals include the following provisions:

- Modifications that incur no cost to the U.S. Treasury
- Relief efforts that narrowly target families who would otherwise lose their homes, excluding families who do not need assistance
- Programs that help maintain property values for families who live near homes at risk of foreclosure
- Efforts that save American families not facing foreclosure \$72.5 billion by averting neighboring foreclosures
- Guarantees for lenders that they will obtain at least the value they would through foreclosure (given that a foreclosure sale can recover only the market value of the home)
- Expedited processes that save lenders the high cost and significant delays of foreclosures

While homeowners generally turn to the drastic solution of bankruptcy only as a last resort, the proposed bankruptcy reform would potentially cover a significant number of homeowners, especially those who will not qualify for FHASecure and HOPE NOW programs.

almost 13,000 loans nationwide, initiating foreclosures 13 times more often (166,415 to 12,741). A day after the MBA's numbers were released, HOPE NOW reported, based on separate data, that there were 120,000 loan modifications in the second half of 2007. The absence of detailed information leads to questions of whether the modifications implemented are sustainable. In any case, the available evidence suggests that the rate of voluntary loan modifications is well outpaced by the wave of foreclosures. In fact, the number of foreclosure starts reported by the MBA in the third quarter outnumbered the number of loan modifications reported by HOPE NOW for the third and fourth quarters combined, by a margin of three to one.⁵¹

National Mortgage Licensing System

All states have implemented licensing requirements and standards for individual loan originators that include education requirements, testing and criminal background checks. Beginning in early 2008, state-licensed lenders, brokers and loan officers in seven states will be able to

use the Web-based National Mortgage Licensing System (NMLS), administered by the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators, to apply for, update and renew their licenses online.

While NMLS does not cover banks that are chartered by federal or state governments, CSBS estimates that the online database will help ensure accountability because it will cover approximately 70 percent of all loan originators.

MEASURING OUTCOMES

All of the programs and proposed plans discussed in this report will amount to very little without follow through on all levels, so measuring the results of these efforts is essential. Without such information, it is impossible to measure lenders' results against their proposed plans.

Foreclosure filings are public records, typically maintained by county governments. Gaining access to these data can be difficult, however, unless the filings are recorded in an electronic format and released for analysis. In many

communities, vendors have developed foreclosure filing databases with the intent to sell the information to real estate speculators. These data vendors frequently receive media attention, but the quality of their data can be questionable. State policy makers could certainly use these and other data sources, after verification, to monitor foreclosure trends in key markets.

The lack of regularly reported data has been a significant concern to critics of the HOPE NOW loan modification plan. The plan encourages

What to Measure

ACCOUNTABILITY MEASURES AND DATA TO BE COLLECTED

For hotline and counseling efforts:

- How borrowers heard about service
- Main reason for delinquency
- Loan amount
- Income
- Number of payments behind
- Type of loan (ARM, interest only)
- Lender/servicer name
- Date of foreclosure filing
- Cumulative length of counseling
- Property address

For loan programs:

- Number of loans
- Amount of loans
- Type of loans and type of previous loans refinanced
- Loan repayment rates

For prosecution of fraud:

- Type of fraud
- Dollar value lost or at risk
- Referrals to other services

For vacant property reclamation:

- Number of properties
- Appraised values
- Repair and/or rehabilitation investment
- Resale value
- Demographics of new occupants

loan servicers to report extensive data on the number and types of loan modifications, but these reports are required to go to investors in mortgage-backed securities only—not to regulators, policy makers or the general public.⁵²

Two national efforts are underway to collect consistent data on loan servicing activity, although both of these rely on voluntary compliance by servicers. First, a working group of the Conference of State Banking Supervisors and State Attorneys General (CSBS/AG) has developed a framework for collecting state-level data on loan servicing activities and outcomes. In addition, the national HOPE NOW alliance

has been developing metrics for measuring the activities of servicers. However, both the CSBS/AG and HOPE NOW data collection efforts are likely to release data in an aggregate form, rather than providing lender- and geography-specific information.

At least two states have introduced bills to make data reporting mandatory. California is considering legislation that would require all servicers to report data on a monthly basis for all subprime and nontraditional mortgages. This lender-specific data would then be posted on government agency Web sites. Maryland has introduced a similar proposal.

Resources

For more information and help in designing state responses to the foreclosure crisis, policy makers can refer to the following resources. (This list is not comprehensive.)

Board of Governors of the Federal Reserve

The Board of Governors of the Federal Reserve oversees state-chartered banks and trust companies that belong to the Federal Reserve System. The Board provides educational information and offers a list of resources and referral agencies to help consumers avoid foreclosure and to assist borrowers who have already entered the foreclosure process. www.federalreserveeducation.org/pfed/foreclosure/

Center for Responsible Lending

The Center for Responsible Lending (CRL) is a unit of the Center for Community Self-Help (Self-Help), based in Durham, N.C. Recognizing that lack of legal representation is an obstacle for families facing foreclosure, CRL created the Institute for Foreclosure Legal Assistance (IFLA), a project managed by the National Association of Consumer Advocates, which funds organizations that provide legal representation to families facing foreclosure due to subprime lending.⁵³ www.responsiblelending.org/ifla.html

Federal Housing Administration

The Federal Housing Administration, a subsection of the U.S. Department of Housing and Urban Development that monitors lenders and provides mortgage insurance, offers consumer education and resources on its Web site for individuals and families in danger of losing their homes. http://portal.hud.gov/portal/page?_pageid=33,717348&_dad=portal&_schema=PORTAL

Homeowners' Emergency Mortgage Assistance Program (HEMAP)

One of the first of its kind, HEMAP provides eligible Pennsylvania residents who are facing foreclosure with assistance through its loan fund. www.phfa.org

Homeownership Preservation Foundation

The Homeownership Preservation Foundation (HPF) creates partnerships with local governments, nonprofit organizations, borrowers and lenders to help families overcome obstacles that could result in the loss of their homes. HPF offers 1-888-995-HOPE, a national homeowner assistance hotline to help individuals and families who are struggling financially to avoid foreclosure. www.995hope.org

Minnesota: Foreclosure Prevention Assistance Program

Minnesota's Housing Finance Agency, partnering with 18 nonprofit counseling agencies, has created the Foreclosure Prevention Assistance Program to provide counseling and some financial assistance to homeowners in danger of foreclosure. www.mnhousing.gov/partners/lenders/programs/MHFA_001511.aspx

National Consumer Law Center

The National Consumer Law Center (NCLC) helps consumers, their advocates and policy makers to use powerful consumer laws to build financial security and promote marketplace justice for vulnerable individuals and families. NCLC presents information about mortgage servicing and foreclosure prevention, offering a book and CD-ROM about foreclosure prevention. www.consumerlaw.org

NeighborWorks® America

NeighborWorks America, a national nonprofit organization that works to revitalize communities through affordable housing opportunities, training and technical assistance, has created the Center for Foreclosure Solutions, which works to reduce the rate of foreclosures as well as the negative impact of foreclosures on borrowers and communities. The Center convenes stakeholders and supports a coordinated foreclosure prevention and intervention strategy in communities nationwide. The Center provides tips for avoiding foreclosure, background information, counseling training courses and a database of other resources. In FY2008, Congress charged NeighborWorks America with administering a \$180 million national foreclosure mitigation counseling program. www.nw.org

New York: "Keep the Dream Alive" Program

The State of New York Mortgage Agency's "Keep the Dream Alive" program works to refinance high-risk loans into 30- or 40-year, fixed-rate loans. The program has \$100 million available and aims to help between 500 and 700 families refinance their loans in danger of foreclosure. www.nyhomes.org/home/index.asp?page=489

Office of the Comptroller of the Currency

The Office of the Comptroller of the Currency (OCC), a bureau of the U.S. Department of the Treasury, regulates all national banks. In June 2007, OCC released *Insights: Foreclosure Prevention; Improving Contact with Borrowers*, a document that introduces how banks, in conjunction with state and local governments, nonprofits and other key players, are approaching the issue of foreclosure and working to safeguard homeowners and their communities. www.occ.treas.gov/cdd/Foreclosure_Prevention_Insights.pdf

Ohio: Opportunity Loan Refinance Program

Ohio's Opportunity Loan Refinance Program, launched by the Ohio Housing Finance Agency (OHFA), aims to help borrowers refinance high-cost loans, offering a 30-year, fixed-rate loan and a 20-year, fixed-rate second mortgage. A unique aspect of this program is that the loans purchased by OHFA are bought through taxable bonds at no cost to the state's taxpayers. www.ohiohome.org/refinance/default.htm

The Reinvestment Fund

The Reinvestment Fund (TRF) is a national leader in the financing of neighborhood revitalization, with efforts focused across the Mid-Atlantic region. TRF's recent work includes studies on foreclosure filings in Delaware and Pennsylvania. www.trfund.org

SUMMARY OF STATE LENDING AND FORECLOSURE INTERVENTIONS

State	High-Cost Loan Law/Regulation	Foreclosure Intervention Law/Regulation	Broker Must Consider/Represent Interest of Borrowers when Recommending Mortgages (all states license mortgage brokers)	Statewide Consumer Education Campaign	Statewide Consumer Education Hotline	Statewide Foreclosure Task Force
Alabama						
Alaska				2005		
Arizona				2002	●	2007
Arkansas	2002 Arkansas Home Loan Protection Act 1340 (high-cost loan regulations)		●			
California	2002 California Covered Loan Law 4970 (high-cost loans, disclosure, counseling recommended, lower threshold than HOEPA, referral to counseling hotline)	2007 Department of Corporations Release No. 61-FS (notice to loan servicers)				2007
Colorado	2002 Colorado Consumer Equity Protection Act (high-cost loans, disclosure)	2007 HB 1322 (Mortgage Fraud Prevention Act)	●	2006		2006
Connecticut	2001 HB 6131; 2002 HB 5073 Connecticut Abusive Home Loan Lending Practices Act (high-cost loans)	CT Families – Refinancing Assistance		2005	●	2007
Delaware		2006 Emergency Mortgage Assistance Program (DEMAP)		2001	●	
District of Columbia	2002 Home Loan Protection Act Title 26A Ch 20 (high-cost loans, disclosures, counseling recommended)					
Florida	2002 Florida Fair Lending Act SB 2262 (high-cost loans, disclosure, counseling recommended)			2007	●	
Georgia	2002 Georgia Fair Lending Act HB 1361 (high-cost loans, counseling required, lower trigger than HOEPA)					
Hawaii		2007 HB 1306 HB 1336 (mortgage fraud against seniors)				
Idaho						
Illinois	2003 815 ILCS 137 High Risk Home Loan Act (high-cost loans, disclosure, counseling recommended, lower threshold than HOEPA)	2007 Mortgage Rescue Fraud Act		2004	●	2006
Indiana	2005 Home Loan Practices ("Article 9") (high-cost loans, disclosure, counseling recommended)	2007 SB 0390 Mortgage Rescue Fraud Law 2007 HB 1753 (counseling)		2006	●	2006
Iowa				2007	●	
Kansas	2000 Regulation of Agreements and Practices (16a-3-207) (high LTV loans, mentions counseling is available)					
Kentucky	2003 High-Cost Home Loan Law (high-cost loans, counseling recommended, disclosure) 2006 Predatory Lending Law			2005		
Louisiana						
Maine	2003 PL49 (high-cost loans, disclosure); 2007 Predatory Lending Law (counseling required)		●			
Maryland	2002 Maryland Covered Loan Law (high-cost loans, disclosure, counseling recommended at application, lower threshold than HOEPA)	2005 Foreclosure Counseling Services Law (mandates borrowers in foreclosure be referred to counseling); 2006 Lifeline Refinance Mortgage Program; 2007 Homeowners Preserving Equity (HOPE)		2005	●	2007
Massachusetts	2004 Predatory Home Loan Practices Act (high-cost loans, counseling required; lower triggers than HOEPA)	2007 Home Saver Foreclosure Prevention Program (foreclosure prevention loan fund)	●	2005	●	2006
Michigan	2002 Consumer Mortgage Protection Act (disclosure, counseling recommended at application, referred to counseling hotline)	2007 Adjustable-Rate Mortgage Program and Rescue Refinance Program		2006		2006
Minnesota	2002 Residential Mortgage Originator and Servicer Licensing Act (disclosure); 2007 Predatory Mortgage Practices (high-cost loan regulations)	2007 Foreclosure Prevention Loan Fund (funding for expanding counseling)	●	2003	●	2007

State	High-Cost Loan Law/Regulation	Foreclosure Intervention Law/Regulation	Broker Must Consider/Represent Interest of Borrowers when Recommending Mortgages (all states license mortgage brokers)	Statewide Consumer Education Campaign	Statewide Consumer Education Hotline	Statewide Foreclosure Task Force
Mississippi				2006		
Missouri		2007 Foreclosure Rescue Fraud				
Montana				2007	●	
Nebraska						
Nevada	2007 Predatory Lending Law (high-cost loan regulations)	2007 Predatory Lending Law (rescue fraud prevention)			proposed 2007	
New Hampshire		2007 Foreclosure Consultant Practices Act (rescue fraud prevention)				
New Jersey	2002 New Jersey Home Ownership Security Act (high-cost loans, disclosure, counseling required)	2007 New Jersey Home Ownership Preservation Refinance Program				
New Mexico	2003 Home Loan Protection Act (high-cost loans, lower threshold than HOEPA, disclosure, counseling recommended)			2004	●	2007
New York	2000 High-Cost Home Loan Law (lower threshold than HOEPA, disclosure, counseling recommended) (revised 2007)	2007 Home Equity Theft Prevention Act (rescue fraud); 2007 Keep the Dream refinance fund; 2007 HALT		2007		2007
North Carolina	1999 High-Cost Home Loan Law (high-cost loan regulations, counseling required)	2007 HB 1374 (consumer protections in loan servicing)	●	2001		
North Dakota						
Ohio	2002 HB 386 Sec. 1349.26 (high-cost loan regulations, disclosure); 2006 Homebuyer Protection Act	2007 Opportunity Loan Refinance Program	●	2005	●	2007
Oklahoma	2003 Home Ownership and Equity Protection Act (high-cost loan regulations, counseling recommended)			2006		
Oregon						
Pennsylvania	2001 Consumer Equity Protection Act (high-cost loans, counseling recommended, disclosures)	2007 Refinance to an Affordable Loan (REAL); Homeowner Equity Recovery Opportunity (HERO)				
Rhode Island	2006 Home Loan Protection Act (high-cost loan regulations, disclosure, counseling required, lower threshold than HOEPA)	2006 Madeline Walker Act (rescue fraud prevention)		2002		
South Carolina	2003 High-Cost and Consumer Home Loans Act (high-cost loan regulations, counseling required)		●	2002		
South Dakota						
Tennessee	2006 Home Loan Protection Act (high-cost loan regulations, counseling recommended, disclosure)					
Texas	2002 High-Cost Home Loan Law (high-cost loan regulations, counseling recommended, referral to counseling hotline)					
Utah	2004 High-Cost Home Loan Act (high-cost loan regulations, disclosure, counseling recommended)					
Vermont			●			
Virginia						2007
Washington						
West Virginia	2004 West Virginia Residential Mortgage Lender, Broker and Servicer Act (limits fees, requires counseling, strong provisions cover all loan types, protection against excessive fees and points, prepayment penalties, yield-spread premiums, includes remedies for violations)					
Wisconsin	2004 Responsible High-Cost Mortgage Lending Law (high-cost loan regulations, counseling recommended)			2007		
Wyoming						

SOURCE: Pew Center on the States, 2008, based on research by PolicyLab Consulting

NOTE: As of January 31, 2008

Subprime Lending: Sowing the Seeds of a Foreclosure Crisis

The subprime market was intended to provide home loans for people with impaired or limited credit histories. In addition to lower incomes and blemished credit, borrowers who received subprime loans may have had unstable income, savings or employment and a high level of debt relative to their income. However, there is evidence that many families who received subprime mortgages could have qualified for less expensive mainstream loans but were instead “steered” into accepting higher-cost subprime loans. In fact, one study of Freddie Mac that securitized loans found that one in five subprime loan holders could have received a prime mortgage.⁵⁴

In a short time, subprime mortgages grew from a small niche market to a major component of home financing. From 1994 through 2006, the subprime home loan market grew from \$35 billion to more than \$600 billion and reached a 23 percent share of the mortgage market.⁵⁵ The majority of subprime lending has been in the form of refinance loans rather than purchase mortgages to buy homes. Subprime loans also typically have higher interest rates and fees than found in prime loans, and subprime loans are more likely to include prepayment penalties and broker fees (known as “yield-spread premiums”).

During the late 1990s, widespread abusive lending practices emerged in the subprime market. The primary abusive practices involved equity stripping—that is, charging homeowners exorbitant fees or selling borrowers such unnecessary products as single-premium credit insurance on refinanced mortgages. By financing these additional charges as part of the new loan, unscrupulous lenders were able to disguise these excessive costs. Further, these loans

typically came with costly prepayment penalties, which mean that homeowners have to pay thousands of dollars to close the abusive loan.

During the past several years, a number of states moved to pass laws that address equity-stripping practices. Research assessing these laws has shown them to be highly successful in cutting excessive costs for consumers without hindering borrowers’ access to credit. In addition, the leadership shown by states helped encourage the adoption of some best practices by responsible lenders and leaders in the mortgage industry. For example, single-premium credit insurance virtually disappeared from the market, upfront fees declined and prepayment penalties became less costly, on average, and lasted for a shorter period of time.

In spite of these successes, problems in subprime lending were not completely eliminated. Prepayment penalties continued to be imposed on 70 percent of all subprime loans, and many other predatory practices stayed in place and still occur in the market. These practices include steering (which occurs when lenders push market borrowers into a subprime mortgage even when they could qualify for a prime loan), yield-spread premiums (fees to brokers for selling loans with higher interest rates than the borrowers qualified for), and loan “flipping” (which occurs when a lender refinances a loan without providing any net tangible benefit to the homeowner).

In addition, a second generation of subprime lending abuses emerged in 2004 and dominated the market in 2005 and 2006. These predatory practices included high-risk loan products that typically began with a low introductory “teaser” interest rate that increased sharply after two years and failed to account for escrows for required taxes and insurance. The very design of

these loans, which were marketed to borrowers who could not afford these mortgages, has forced struggling homeowners to refinance to avoid unmanageable payments, in effect defeating the prohibition against flipping that many states instituted previously.

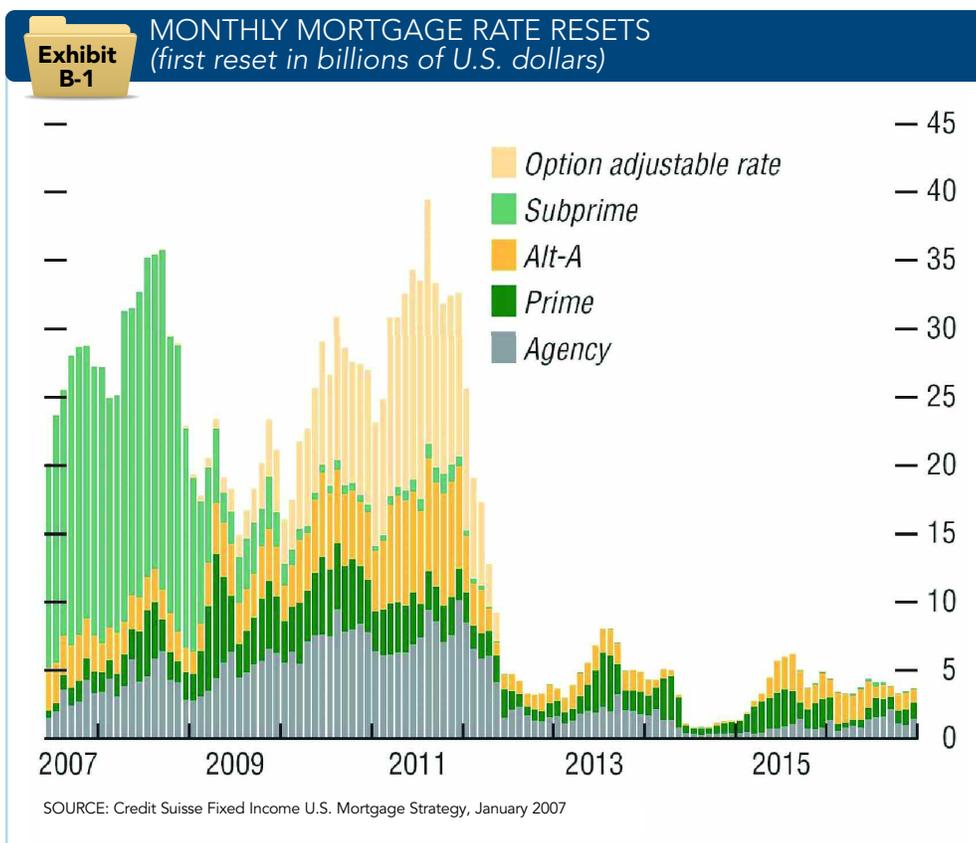
Add to this mix a historically strong housing market from 2002 to 2006, where prices in many areas exceeded sustainable levels. Record volumes of loans were pushed through the mortgage lending system, with real estate markets promoting homes as an investment with rapid double-digit returns. Exacerbating these conditions were subprime loans combined with adjustable-rate mortgages (ARMs), loans with teaser rates and even negative repayment of principal, loan applications with no documentation of ability to repay, and overly aggressive real estate appraisers and loan brokers.

Borrowers were routinely told that if all else failed they could simply refinance their loans. But when home prices stopped rising at record rates, many borrowers found they owed more than their homes were worth.

Although media attention has focused on current borrowers with adjustable-rate loans that will reset to higher rates after an introductory period (creating so-called payment shocks and likely more foreclosures), the bulk of these resets are predicted to occur in 2008 and 2009. The problems of the mortgage market are just beginning; it could take up to five years for the process to unwind and recover.

As Exhibit B-1 shows, a large share of these subprime rate resets will occur throughout 2008, peaking in October. Massive foreclosures are also expected to arise from the large numbers of another product, the payment option ARMs,

which are also facing significant payment resets. Studies have shown that, particularly as originators who lacked experience in making these loans entered the fray in a significant way, many of these payment option ARMs were originated with lax underwriting standards—even though the majority of them are not subprime loans.⁵⁶ Exhibit B-1 shows a spike in payment option ARM resets between 2009 and 2011, just after the 2008 spike in subprime hybrid ARM resets.



Understanding the Foreclosure Process

When a consumer acquires a mortgage loan on a home, the lender receives a security interest in the property. This allows the lender to start foreclosure proceedings if the borrower fails to pay the loan according to its stated terms. While a borrower is technically in “default” on the loan after missing even one payment, the reality is that many lenders wait until the loan is seriously past due (three missed payments—also called a “90-day delinquency”—with a fourth payment due) before declaring the loan in default and beginning the foreclosure process.

The foreclosure process varies according to state law, but typically lasts five to 18 months. Initially, borrowers have a period of time (called the reinstatement period) during which they have the right to “cure” their default. The reinstatement period typically lasts three to four months, although it can be as short as 21 days, as in Texas, or as long as six to 12 months.

Borrowers may cure a default in several ways:

- They may bring their account current by paying the past due balance on their loan, including late charges and other fees assessed by the lender.
- They may renegotiate the terms of their loan with the lender.
- They may pay off their loan by refinancing the loan with another lender.
- They may sell the property to pay off the current loan (if the home is worth more than the mortgage).
- Or they may voluntarily convey the property back to the lender through a deed-in-lieu of foreclosure.

If the default is not cured by the end of the reinstatement period, a lender typically will proceed with foreclosure as permitted under state law. Although the exact process may vary, the lender generally sells the property through a public auction or private sale and uses the proceeds to cover the amount owed on the mortgage. In most states, the lender also has the right to pursue a borrower’s other financial assets to mitigate any default-related losses.

Endnotes

- ¹ Mark Zandi, Chief Economist and Co-Founder, Moody's Economy.com, 2008, "Monetary Policy and the State of the Economy," Testimony Before the U.S. House Financial Services Committee (February 26, 2008).
- ² More details on their methodology can be found in the appendix of the *Losing Ground* report at <<http://www.responsiblelending.org/pdfs/foreclosure-paper-report-2-17.pdf>>.
- ³ Based on Center for Responsible Lending, *Subprime Spillover: Foreclosures Cost Neighbors \$202 Billion; 40.6 Million Homes Lose \$5,000 on Average*, CRL Issue Brief, <http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html> (accessed January 25, 2008). (Revised and updated February 28, 2008). See Exhibit 1.
- ⁴ Mortgage Bankers Association, *National Delinquency Survey* (March 2008).
- ⁵ Ibid.
- ⁶ Based on Center for Responsible Lending, *Subprime Spillover: Foreclosures Cost Neighbors \$202 Billion; 40.6 Million Homes Lose \$5,000 on Average*, CRL Issue Brief, <http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html> (accessed January 25, 2008). (Revised and updated February 28, 2008). See Exhibit 1.
- ⁷ Global Insight, *The Mortgage Crisis: Economic and Fiscal Implications for Metro Area* (Lexington, MA: Global Insight, November 26, 2007).
- ⁸ Mortgage Bankers Association, *National Delinquency Survey* (March 2008).
- ⁹ Center for Responsible Lending, *Subprime Spillover: Foreclosures Cost Neighbors \$202 Billion; 40.6 Million Homes Lose \$5,000 on Average*, CRL Issue Brief, <http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html> (accessed January 25, 2008). (Revised and updated February 28, 2008). See Exhibit 1.
- ¹⁰ Mortgage Bankers Association, *National Delinquency Survey* (March 2008).
- ¹¹ Craig Focardi, *Servicing Default Management: An Overview of the Process and Underlying Technology*, Research Note No. 033-13C (TowerGroup, November 15, 2002).
- ¹² If Ohio expands its commitment, as it is considering doing, the total dollar amount of publicly supported mortgage refinance funds could exceed \$800 million.
- ¹³ Mortgage Bankers Association, *National Delinquency Survey* (March 2008).
- ¹⁴ RealtyTrac, *2007 U.S. Foreclosure Report* (January 29, 2008), <http://www.realtytrac.com/ContentManagement/prcssrelease.aspx?ChannelID=9&ItemID=3988&acctn=64847> (accessed January 29, 2008).
- ¹⁵ Charles E. Schumer, *Sheltering Neighborhoods from the Subprime Foreclosure Storm* (Special Report by the Joint Economic Committee, 2007), <http://jec.senate.gov/Documents/Reports/subprime11apr2007revised.pdf> (accessed November 29, 2007).
- ¹⁶ Ellen Schloemer, Wei Li, Keith Ernst, and Kathleen Keest, *Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners* (Center for Responsible Lending, December 2006), <http://www.responsiblelending.org/issues/mortgage/research/page.jsp?itemID=31217189> (accessed December 1, 2007).

- ¹⁷ This pattern generally holds true with few exceptions. First, states where foreclosures are rooted in weakened job markets rather than in subprime mortgages—such as Ohio, Michigan and Indiana—have higher default rates than the proportion of subprime loans in the market suggests. Second, some states with high rates of subprime lending, such as California, have lower default rates than might be expected. Perhaps the lower default rates can be explained by strong housing market values that have resulted in high levels of resale and refinancing. Also, as seen in Exhibit 1, the delinquency rates for subprime loans are many times larger than prime loans. Subprime ARMs have even higher rates of delinquency.
- ¹⁸ Christopher L. Cagan, *Mortgage Payment Reset: The Issue and Impact* (First American CoreLogic, March 19, 2007), http://www.loanperformance.com/infocenter/whitepaper/FARES_resets_whitepaper_021406.pdf (accessed December 1, 2007).
- ¹⁹ Ibid.
- ²⁰ Craig Focardi, *Servicing Default Management: An Overview of the Process and Underlying Technology*, Research Note No. 033-13C (TowerGroup, November 15, 2002).
- ²¹ Center for Responsible Lending, *Subprime Spillover: Foreclosures Cost Neighbors \$202 Billion; 40.6 Million Homes Lose \$5,000 on Average*, CRL Issue Brief, <http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html> (accessed January 25, 2008). (Revised data updated February 28, 2008). See Exhibit 1.
- ²² William Apgar, Mark Duda, and Rochelle Nawrocki Gorey, *The Municipal Cost of Foreclosures: A Chicago Case Study*, Housing Finance Policy Research Paper Number 2005-1 (Minneapolis, MN: Homeownership Preservation Foundation, February 27, 2005).
- ²³ Ibid.
- ²⁴ Global Insight, *The Mortgage Crisis: Economic and Fiscal Implications for Metro Areas* (Lexington, MA: Global Insight, November 26, 2007).
- ²⁵ David Evans, *Public School Funds Hit by SIV Debts Hidden in Investment Pools*, Bloomberg News (Nov 15, 2007), <http://www.bloomberg.com/apps/news?pid=20601170&refer=home&sid=aYEOAghQ5IUA> (accessed January 25, 2008).
- ²⁶ Global Insight, *The Mortgage Crisis: Economic and Fiscal Implications for Metro Area* (Lexington, MA: Global Insight, November 26, 2007).
- ²⁷ William Apgar, Mark Duda, Bruce Gottschall, Rochelle Nawrocki Gorey, and Angie Marks, *Preserving Homeownership: Community-Development Implications of the New Mortgage Market* (Prepared by Neighborhood Housing Services of Chicago, March 25, 2004), <http://www.nhschicago.org>. See also Larry Cordell, *Innovative Servicing Technology: Smart Enough to Sustain Homeownership Gains?* (Research Institute for Housing America, Conference on Housing Opportunity: Will Technology Expand Housing Opportunity, 2001). See also Amy Cutts and Richard K. Green, *Innovative Servicing Technology: Smart Enough to Keep People in their Homes*, paper presented at Harvard University Joint Center for Housing Studies Symposium: Building Assets Building Communities (Cambridge, MA: Harvard University Joint Center for Housing Studies, 2003). See also J. Michael Collins “Exploring the Design of Financial Counseling for Mortgage Borrowers in Default,” *Journal of Family and Economic Issues* 28(2):207-226.
- ²⁸ J. Michael Collins “Exploring the Design of Financial Counseling for Mortgage Borrowers in Default,” *Journal of Family and Economic Issues* 28(2):207-226. See also Larry Cordell, *Innovative Servicing Technology: Smart Enough to Sustain Homeownership Gains?* (Research Institute for Housing America, Conference on Housing Opportunity: Will Technology Expand Housing Opportunity, 2001).
- ²⁹ Nevada proposed a hotline in 2007; the state is considering the recommendation.

- ³⁰ See note 12.
- ³¹ Previous studies suggested that counseling programs had greater efficacy. However, today's subprime loan terms and the decline of housing values have made post-purchase counseling more challenging.
- ³² Brothers Redevelopment, Inc., *The Colorado Foreclosure Prevention Hotline, 2007 Status Report*. Unpublished memo. (2007).
- ³³ Ibid.
- ³⁴ Ohio Foreclosure Prevention Task Force, *Ohio Foreclosure Prevention Task Force Combined List of Recommendations* (September 11, 2007), www.bricker.com/legalservices/industry/bank/ftfrecc.pdf (accessed December 1, 2007).
- ³⁵ HOPE NOW Alliance, *NOW: Support & Guidance for Homeowners*, Alliance Statement (October 2007), <http://www.hopenow.com> (accessed January 25, 2008).
- ³⁶ State Foreclosure Prevention Working Group, *Analysis of Subprime Mortgage Servicing Performance*, Data Report No. 1 (February 2008), <http://www.csbs.org/Content/NavigationMenu/Home/StateForeclosurePreventionWorkGroupDataReport.pdf> (accessed February 25, 2008).
- ³⁷ Pennsylvania Housing Finance Agency, *Pennsylvania Foreclosure Prevention Act 91 of 1983—Homeowners' Emergency Mortgage Assistance Program (HEMAP)*, <http://www.phfa.org/consumers/homeowners/hemap.aspx> (accessed December 1, 2007).
- ³⁸ Ohio has two "funds" to assist delinquent borrowers. The first is the "Ohio Rescue Fund" for NeighborWorks organizations, which disburse grants of up to \$3,000 to help delinquent borrowers catch up on their mortgages. The second fund, the Opportunity Loan Refinance fund, operated by the OFHA, has been less successful due to strict underwriting requirements. The task force advised OHFA to expand its guidelines.
- ³⁹ Equity stripping, which is a predatory practice employed by unscrupulous individuals, is designed to identify vulnerable homeowners who have substantial equity in their property with the goal of "stripping" the equity in their property. These equity strippers attempt to obtain title to the property—at below market value, as part of the terms to the transaction—and quickly attempt to rid themselves of any interest the homeowner has so the property can be sold and the equity captured.
- ⁴⁰ Paul Leonard, California Office Director, Center for Responsible Lending, 2007, "Preserving the American Dream: Legislative Recommendations to Protect Future Borrowers in California," Testimony before the California Senate Banking Committee (August 21, 2007); See also Mortgage Asset Research Institute, Inc. 2006. *Eighth Periodic Mortgage Fraud Case Report to Mortgage Bankers Association*, <URL: <http://www.mari-inc.com/pdfs/mba/MBA8thCaseRpt.pdf> (accessed April 2007); Global Structured Finance Outlook, 2007: Economic and Sector-by Sector Analysis, Fitch Ratings Credit Policy, (December 11, 2006), p. 21.
- ⁴¹ Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, The 2006 HMDA Data. *Federal Reserve Bulletin* (December 21, 2007), 23, <http://www.federalreserve.gov/pubs/bulletin/default.htm> (accessed Dec. 1, 2007).
- ⁴² Debbie Gruenstein Bocian, Keith S. Ernst, and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages* (Center for Responsible Lending, May 31, 2006), http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf (accessed Dec. 1, 2007).
- ⁴³ J. Michael Collins, "Exploring the Design of Financial Counseling for Mortgage Borrowers in Default," *Journal of Family and Economic Issues* 28(2):207-226.
- ⁴⁴ State of New York Banking Department, "HALT – Halt Abusive Lending Transactions & Mortgage Fraud: About HALT," Consumer Help and Information, <http://www.banking.state.ny.us/cshaltnews.htm> (accessed January 25, 2008).

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- ⁴⁶ Center for Responsible Lending, *Subprime Spillover: Foreclosures Cost Neighbors \$202 Billion; 40.6 Million Homes Lose \$5,000 on Average*, CRL Issue Brief, <http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html> (accessed January 25, 2008). (Revised and data updated February 28, 2008). See Exhibit 1.
- ⁴⁷ "New Law Gives Foreclosure Notice to Help Renters," *Chicago Daily Southtown* (August 31, 2007).
- ⁴⁸ Edmund L. Andrews and Louis Uchitelle, "Rescues for Homeowners in Debt Weighed," *New York Times* (February 22, 2008), <http://www.nytimes.com/2008/02/22/business/22homes.html?pagewanted=1&ei=5070&en=19b585b57f24e19f&ex=1204347600&emc=eta1>. For more information about FHA Secure see http://portal.hud.gov/portal/page?_pageid=33,717446&_dad=portal&_schema=PORTAL.
- See also Department of Housing and Urban Development, Federal Housing Commission, Mortgage Letter 2007-11 (September 5, 2007), available at <http://portal.hud.gov/fha/reference/ml2007/07-11ml.doc>
- ⁴⁹ HOPE NOW Alliance, *NOW: Support & Guidance for Homeowners*, Alliance Statement (October 2007), <http://www.hopenow.com> (accessed January 25, 2008).
- ⁵⁰ "More Than 200,000 Letters Sent to At-Risk Homeowners: Alliance Urges Borrowers to Get Help Now," HOPE NOW Alliance press release (October 31, 2007).
- ⁵¹ Jay Brinkman. *An Examination of Mortgage Foreclosures, Modifications, Repayment Plans and Other Loss Mitigation Activities in the Third Quarter of 2007*. See also *HOPE NOW: Number of Homeowners Helped Rapidly Rising*, press release by Hope Now Alliance (January 18, 2008).
- ⁵² American Securitization Forum, *Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans, Executive Summary* (December 6, 2007), 33-34, <http://www.americansecuritization.com/uploadedFiles/FinalASFStatementonStreamlinedServicingProcedures.pdf> (accessed December 1, 2007).
- ⁵³ IFLA was launched with a \$15 million grant from the investment management firm Paulson & Co. Inc. IFLA provides funding and training to organizations that help homeowners negotiate alternatives to foreclosure. The majority of IFLA's funds will be given in the form of grants in 10 or more states to support direct legal assistance to borrowers, to fight foreclosure, predatory lending and abusive loan practices. IFLA will do this primarily by providing money to top nonprofit legal-aid groups and law school clinics.
- ⁵⁴ Mike Hudson and E. Scott Reckard, "More Homeowners with Good Credit Getting Stuck in Higher-Rate Loans," *Los Angeles Times*, p. A-1 (October 24, 2005). For most types of subprime loans, African-American and Latino borrowers are more likely to be given a higher-cost loan even after controlling for legitimate risk factors. See also Debbie Gruenstein Bocian, Keith S. Ernst, and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages* (Center for Responsible Lending, May 31, 2006), http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf (accessed Dec. 1, 2007). See also Darryl E. Getter, "Consumer Credit Risk and Pricing," *Journal of Consumer Affairs* (June 22, 2006); Howard Lax, Michael Manti, Paul Raca, and Peter Zorn, "Subprime Lending: An Investigation of Economic Efficiency," *Housing Policy Debate* 15(3):533-571.

- ⁵⁵ Based on origination volume statistics published regularly by *Inside Mortgage Finance*.
- ⁵⁶ See e.g. Office of the Comptroller of the Currency, National Credit Committee, *Survey of Credit Underwriting Practices 2005*. By the industry's own admission, underwriting standards in the subprime market have become extremely loose in recent years, and analysts have cited this laxness as a key driver in foreclosures. The Office of The Comptroller of Currency (OCC) survey of credit underwriting practices found a "clear trend toward easing of underwriting standards as banks stretch for volume and yield," and the agency commented that "ambitious growth goals in a highly competitive market can create an environment that fosters imprudent credit decisions. See also Fitch Ratings, 2007 Global Structured Finance Outlook: Economic and Sector-by-Sector Analysis (December 11, 2006); See also *Structured Finance: U.S. Subprime RMBS in Structured Finance CDOs*, FITCH RATINGS CREDIT POLICY (New York, N.Y), August 21, 2006, at 4 (noting that "loans underwritten using less than full documentation standards comprise more than 50 percent of the subprime sector..." "Low doc" and "no doc" loans originally were intended for use with the limited category of borrowers who are self-employed or whose incomes are otherwise legitimately not reported on a W-2 tax form, but lenders have increasingly used these loans to obscure violations of sound underwriting practices); See also Vikas Bajaj and Louise Story, *Mortgage Crisis Spreads Beyond Subprime Loans*, New York Times (February 12, 2008). See also Ruth Simon, *Option ARMs: Next Weakling. Fall in Home Prices, Rise in Loan Values Force Foreclosures*, Wall Street Journal (December 22, 2007) (citing recent study from Merrill Lynch that states 'Merrill Lynch economists called option ARMs "ticking time bombs" that will start "ticking louder next year.")

