A Study of
Residential Foreclosures in Texas

A report required by Section 2306.260 as established by HB 1582 of the 79th Regular Legislative Session

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EXECUTIVE SUMMARY

House Bill (HB) 1582 established the requirements of a study to examine mortgage foreclosure activity in Bexar, Cameron, Dallas, El Paso, Harris, and Travis Counties. HB 1582, the text of which is provided as Appendix A, required the study to evaluate the following issues:

"(1) the extent to which the terms of mortgages are related to the foreclosure rate and whether the terms could be offered in a manner to reduce the likelihood of foreclosures;
(2) the socioeconomic and geographic elements characterizing foreclosures;
(3) the securitization of mortgages in the secondary market and its effect on foreclosures;
(4) consumer education efforts to prevent foreclosures; and
(5) recommendations to reduce foreclosures and the foreclosure rate across this state."

For the purpose of this report, foreclosure is the borrower's actual loss of the home as the final result of a legal process that was preceded by borrower default on the loan. In Texas, there were 36,362 foreclosures reported between August 2005 and July 2006 by Foreclosure.com. To put this number in perspective, this represents 1.1% of the total estimated number of households in Texas with a mortgage.[1] It should be emphasized that default by a borrower does not always initiate the foreclosure process. Similarly, initiation of the foreclosure process does not always result in the loss of the home. At any point during the pre-foreclosure period, the borrower may be able to work with the lender to avoid the actual foreclosure. For example, according to the Foreclosure.com data, over the August 2005 through July 2006 time period, the monthly average number of actual foreclosed properties was only 26 percent of the active foreclosures -- homes in the pre-foreclosure process during the month.

State foreclosure process requirements and housing market conditions vary significantly. These issues can lead to a problematic comparison of the "foreclosure rates" of various areas if the number of pre-foreclosures is considered instead of number of actual foreclosures. Depending on the data source, the pre-foreclosure period can run from the time the lender files a public default notice up to the time when the property is sold at auction. State foreclosure proceeding notification requirements and the corresponding length of different stages of the pre-foreclosure period vary widely between the states. Longer time periods may create more opportunity for a home to be removed from the foreclosure process prior to sale at auction. Alternatively, longer time periods could allow the same property to enter and exit the pre-foreclosure process as the homeowner struggles to maintain payments on a loan they simply cannot afford. In either case, the number of pre-foreclosures and actual foreclosures will vary widely.

The housing market also affects the foreclosure rate in different areas. In states like California, Florida and Nevada, which have high home value appreciation rates, the numbers of properties sold at foreclosure is significantly less than the number of postings. Where home prices are increasing

[1] Foreclosure data is for the number of real estate owned (REO) properties which went through foreclosure sale and were purchased by the mortgage holder. While this activity is thought to represent most of the auction activity, the data does not report on properties that were purchased by third parties. It is also possible that in some instances, multiple notices may be posted for the same home as borrower default is resolved and then recurs. Mortgage data is the estimated number of mortgages provided by the 2004 American Community Survey.

rapidly, an owner can more easily sell a property in pre-foreclosure to cure the default, and perhaps even take away a profit. In states, like Texas, which have lower appreciation rates, owners typically cannot sell the property at a price that is high enough to fully cure a default.[2]

General Observations on Reasons for Foreclosure

At the most basic level, a borrower's inability to meet their monthly mortgage payments (default) is the direct cause of delinquency, which may or may not lead to foreclosure. Primary factors that contribute to such inability may be grouped into four broad categories.

- Changes in personal circumstances (such as job loss or other reduction in income, unanticipated major costs such as medical crises not covered by insurance) that adversely affect the ability to make what would have been otherwise manageable loan payments.
- Failure due to poor planning or lack of knowledge on how to carry out all of the responsibilities of being a homeowner. Such responsibilities would include such things as coping with changes in the loan structure (interest rate changes, balloon payments, etc.), increasing property taxes, insurance payments, and ongoing home maintenance costs.
- The borrower is a victim of unscrupulous or unlawful lending practices. For example, (1) property flipping, (2) loan churning, (3) excessive fees, (4) lending without regard to ability to repay, and (5) outright fraud and abuse. These activities are sometimes referred to as "predatory" which is distinctly different from "subprime" lending as discussed in more detail later in the Study.
- The borrower is either a perpetrator or a participant in fraudulent activities to qualify for a loan or to profit from the transaction.

Data that establishes why specific borrowers default on their mortgage loans and end up in foreclosure is not available from public sources. The foreclosure notices filed at the county clerk's office do not provide a reason for foreclosure or even, as a general rule, basic loan terms. Furthermore, the Committee lacked the financial or staffing resources to compile such data through surveys or other techniques. While the Study presents general information on possible causes of foreclosure garnered from existing national research, the absence of data on specific characteristics of Texas foreclosures precludes reaching even preliminary, factual conclusions about reasons for foreclosures in the Study's counties. Furthermore, the inclusion of information from other studies should not be interpreted as having full Committee concurrence with those studies' premises, methods, or findings.

While there is speculation as to major causes for defaults and, ultimately, foreclosures, such conclusions are generally not provable from public records. For example, to determine what caused loans to go into foreclosure, privacy concerns of the borrower have to be broached. One would have to contact each borrower directly to ask why they stopped making their loan payments. It would also be necessary to have access to each borrower's loan documentation, full mortgage application file, and ultimate lender's proprietary underwriting criteria. Furthermore, the person reviewing this information would need the underwriting expertise to fully understand the documentation and reach

[2] James Gaines, "Texas: Do We Have a Foreclosure Problem?" *Tierra Grande* (Real Estate Center at Texas A&M University) vol. 13, no. 1 (January 2006) http://recenter.tamu.edu/tgrande/vol13-1/1761.html (accessed August 17, 2006).

complex conclusions as to such issues as whether the borrower truly qualified under the lender's criteria and whether the borrower would have qualified for a more advantageous loan.

Study Organization and Findings

The study moves from a general discussion of the issue of foreclosure, to the specifics of the situation in Texas. Next, information is provided on current strategies for reducing foreclosures in Texas, including options for borrowers facing foreclosure and homebuyer education aimed at preventing foreclosure. This is followed by a review of legislative approaches from across the nation, and what is known about their effectiveness, including information on current laws in force in Texas. Finally, a brief set of conclusions regarding the state of knowledge concerning the problem of foreclosures in Texas is presented, along with specific recommendations for further research and enhancements to existing efforts to prevent foreclosures or assist those facing foreclosures to resolve their situations. A summary of the findings from each of these sections is below provided.

General Foreclosure Issues.

The main reasons for foreclosure, from the existing literature, include changes in personal financial circumstances, failure to understand or plan for mortgage obligations, or abusive lending practices. Existing information on causes comes primarily from studies done by the GSEs, and likely represents the area of the market least likely to include abusive lending practices. These studies find that changes in personal circumstances, often related to economic conditions, are the most important cause of foreclosures. Next, in terms of significance, is (non-mortgage) debt. Factors possibly related to the mortgage lending process are harder to identify. Evidence here is comprised primarily of examples of cases of particular abuse, along with information on changes in lending practices thought likely to make abuse more likely. This information highlights the potential for foreclosures to be brought on by lending practices but make it difficult to assess the scale of the problem overall. Some of these practices were addressed in Texas through legislation passed in the last session, but it is too soon to know the impact of these changes.

The Foreclosure Process in Texas.

The foreclosure process in Texas is relatively quick, straightforward, and simple compared that of many other states. It is a "power of sale" state and does not require a judicial foreclosure process, meaning that foreclosures can be handled without involving the courts. Other than to note that Texas has the shortest foreclosure processing period of all the states, no clear conclusions were drawn as to the impact of the length of the foreclosure period and the foreclosure rate. While Texas and Georgia have relatively short foreclosure periods and a higher foreclosure rate than many other states, there are other states with a comparable foreclosure rate and much longer foreclosure periods Indiana (251 days), Colorado (166 days), Michigan (90-425 days), Ohio (217 days), and Utah (138 days).

Analysis of Texas Foreclosures Activity.

This section presents results of our assessment of existing information on the magnitude of the problem in Texas, and in the six study counties. Researchers faced tremendous difficulty gathering loan-level information about foreclosures, preventing concrete conclusions from being drawn as to

causes. Instead, analysis of the characteristics of places in each county where high concentrations of foreclosures are found is presented to suggest areas for further research.

Common trends in the correlation between high foreclosure rates and certain demographic statistics can be identified across most of the counties included in this study. The exception, El Paso County, defied the pattern by not showing significantly strong trends in any of the demographic factors examined. High concentrations of minority populations correlated to higher foreclosure rates in all five counties other than El Paso. Also in a majority of the counties, clear trends were evident connecting residential foreclosure rates to lower income levels and greater use of higher rate loans. Further quantitative analysis, however, would be necessary to draw stronger conclusions about the implications of these correlations.

Options for Borrowers Facing Foreclosure.
Besides the obvious benefit of keeping households in their homes, for lenders and investors, foreclosure is an expensive process. Foreclosed properties sell for less than comparable properties in the applicable market area. Legal costs, insurance, taxes, property management, sales expenses, and unpaid interest income all cause lender losses to increase. This section of the report emphasizes the need to provide homebuyer education and counseling and to encourage borrowers to take full advantage of these resources.

Legislative Trends.
When comparing the legislative high-cost loan provisions in Texas to the most stringent guidelines in other states, there are several provisions that are addressed differently or not at all. Like other states, Texas has limits on refinancing low-rate home loans, restrictions and disclosure requirements with some high-cost loans, and licensing requirements for lenders and brokers. One provision offered at a less stringent level is the financing of insurance in conjunction with a home loan, which in some states is strictly prohibited. However, Texas law allows for the purchase of insurance in conjunction with a home loan if a notice “Insurance Notice to Applicant” is provided to each applicant. Additionally, while Texas disallows balloon payments, negative amortization, and prepayment penalties or “premiums” with some high-cost mortgage loans, in other states, these practices are strictly prohibited.

There is limited research on the impacts of some of these provisions, like increased homebuyer education on the rate of mortgage foreclosure. However, there is some consensus among researchers to substantiate that limiting the fees or additional costs rolled into the mortgage can help maintain an affordable mortgage. It is also difficult to assert how specific recommendations would impact the mortgage foreclosure rate in Texas; as there are many variables that impact lending practices. However, by examining best practices and those solutions that have worked well in other states, Texas can begin to tailor recommendations to meet the market needs.

Conclusions.
To analyze the number and location of foreclosures and to identify why those foreclosures occurred are two different matters. No reliable and demonstrable conclusions as to the causes of foreclosure activity in studied markets can be drawn from the publicly available data. Properties are foreclosed

upon because the borrower has gone into default and no alternative way to address this default has been agreed upon with the lender. Therefore, a useful understanding of the issue requires detailed understanding of matters for which publicly available information is not available: (1) Why did the borrower go into default and (2) what sort of efforts, if any, were made to explore an alternative resolution? Answering these questions would involve collecting a large body of private information, information that many borrowers would not want to share and many loan servicers do not even capture.

While there are findings supporting the conclusion that curtailment of income is a dominant cause of default for loans eligible for purchase by GSEs, any findings as to dominant causes for default with respect to subprime loans are anecdotal and not supported by publicly available information. All that can be concluded is that origination and foreclosure activity can, to a degree, be quantified and compared. Any causal connections or commonality between these activities cannot be determined or supported by publicly available data. To the extent that a high level of foreclosure activity may be detrimental to borrowers, lenders, investors, and even communities and economies, the collection of data so that causes and effects may be analyzed is a worthwhile objective.

Recommendations.

An obvious need is for additional Texas specific information on the causes of foreclosure, specifically information on factors that actually cause loan defaults. The Committee has identified two basic ways to obtain such information: funded academic research or the imposition of data collection requirements. The committee discussed the many administrative and monetary issues associated with the imposition of data collection requirements on the mortgage industry. From this discussion, it was noted that committee members had differing opinions as to the feasibility of imposing data collection requirements. On the other hand, members agreed that further detailed research is needed. Specifically, the committee recommends that a professional study of foreclosed properties within a Metropolitan Statistical Area be funded. This study must focus on causal factors of foreclosure in this part of the state from the perspective of the borrower, lender, mortgage originator, mortgage servicers, housing developers, secondary market representatives, industry oversight agencies, federal and state prosecutors, and consumer advocates. It is expected that this study will require original research at the level of the individual borrower – much of which would involve one-on-one interviews.

The Committee also recommends that the Legislature appropriate sufficient funds to:

- adequately fund enforcement of stronger fraud laws;
- expand multilingual educational efforts to make borrowers aware of opportunities to work out delinquencies. For example, public service announcements related to delinquencies and foreclosures, brochures describing options in the event of delinquency or default, internet website, and central call in number for borrowers in default; and
- provide support for expanding homebuyer education initiatives and of organizations to counsel borrowers in the foreclosure process.

INTRODUCTION

House Bill (HB) 1582 required the Texas Department of Housing and Community Affairs (TDHCA) to help coordinate a study (Study) to examine mortgage foreclosure activity in Bexar, Cameron, Dallas, El Paso, Harris, and Travis Counties. The text of the bill is provided as Appendix A.

As described by HB 1582, the Study was to discuss:

"(1) the extent to which the terms of mortgages are related to the foreclosure rate and whether the terms could be offered in a manner to reduce the likelihood of foreclosures;
(2) the socioeconomic and geographic elements characterizing foreclosures;
(3) the securitization of mortgages in the secondary market and its effect on foreclosures;
(4) consumer education efforts to prevent foreclosures; and
(5) recommendations to reduce foreclosures and the foreclosure rate across this state."

Advisory Committee

HB 1582 required the establishment of an advisory committee (Committee) with a wide ranging knowledge of lending, consumer advocacy, and housing issues to direct the focus of the Study. To ensure that the Committee had significant input on the final report, the Study's methodology and resulting findings required majority approval by the Committee. As provided for in HB 1582, the committee was comprised of the following:

- a representative of the Texas Housing Research Consortium at The University of Texas at Austin who served as the chair of the Committee,
- TDHCA's Executive Director or the Director's representative;
- Texas Savings and Mortgage Lending (SML) Commissioner or the Commissioner's representative;
- four members appointed by TDHCA who represent community and consumer interests; and
- four members appointed by SML who represent the mortgage lending industry.

An organizational meeting of the Committee was held on January 26, 2006, at the TDHCA Headquarters building in Austin. In addition to informal contact among various committee members (especially between the Chair and TDHCA staff) in the interim, subsequent official meetings of the Committee were held on August 4, 8, and 25. The Committee held a day long work session on September 15, 2006 to reach consensus and to approve the Study.

What Is A Foreclosure?

Foreclosure is often thought of as the time in which a loan is in default or is delinquent. For the purpose of this report, however, foreclosure is the borrower's actual loss of the home as the final result of a legal process that was preceded by borrower default on the loan. In Texas, there were 36,362 foreclosures reported between August 2005 and July 2006 by Foreclosure.com. To put this

number in perspective, this represents 1.1% of the total estimated number of households in Texas with a mortgage.[3]

It should be emphasized that default by a borrower does not always initiate the foreclosure process. Similarly, initiation of the foreclosure process does not always result in the loss of the home. This is an issue that can cause confusion if the comparison of "foreclosure rates" of various states or other areas are based on the number of pre-foreclosures instead of actual foreclosures. Depending on who is reporting the data, the pre-foreclosure period can run from the time the lender files a public default notice up to the time when the property is sold at auction. At any point during the pre-foreclosure period, the borrower may be able to work with the lender to avoid the actual foreclosure. The difference in the number of properties in the pre-foreclosure process and the number of foreclosed properties can be seen in August 2005 through July 2006 foreclosure data from Foreclosure.com. Over this time period, the monthly average number of actual foreclosed properties was only 26 percent of the homes in the pre-foreclosure process during the month.

Issues that Affect the Study of Foreclosures

At the most basic level, a borrower's inability to meet their monthly mortgage payments (default) is the direct cause of delinquency, which may or may not lead to foreclosure. Primary factors that contribute to such inability may be grouped into four broad categories.

- Changes in personal circumstances (such as job loss or other reduction in income, unanticipated major costs such as medical crises not covered by insurance) that adversely affect the ability to make what would have been otherwise manageable loan payments.
- Failure due to poor planning or lack of knowledge on how to carry out all of the responsibilities of being a homeowner. Such responsibilities would include such things as coping with changes in the loan structure (interest rate changes, balloon payments, etc.), increasing property taxes, insurance payments, and ongoing home maintenance costs.
- The borrower is a victim of unscrupulous or unlawful lending practices. For example, (1) property flipping, (2) loan churning, (3) excessive fees, (4) lending without regard to ability to repay, and (5) outright fraud and abuse. These activities are sometimes referred to as "predatory" which is distinctly different from "subprime" lending as discussed in more detail later in the Study.
- The borrower is either a perpetrator or a participant in fraudulent activities to qualify for a loan or to profit from the transaction.

As specified in HB 1582, "The extent to which the terms of mortgages are related to the foreclosure rate and whether the terms could be offered in a manner to reduce the likelihood of foreclosures" is a Study requirement. At the outset, it should be noted that data that establishes why specific borrowers default on their mortgage loans and end up in foreclosure is not available from public sources. The foreclosure notices filed at the county clerk's office do not provide a reason for

[3] Data is for the number of real estate owned (REO) properties which went through foreclosure sale and were purchased by the mortgage holder. While this activity is thought to represent most of the auction activity, the data does not report on properties that were purchased by third parties. It is also possible that in some instances, multiple notices may be posted for the same home as borrower default is resolved and then recurs. Mortgage data is the estimated number of mortgages provided by the 2004 American Community Survey.

foreclosure or even, as a general rule, basic loan terms. Furthermore, the Committee lacked the financial or staffing resources to compile such data through surveys or other techniques. While the Study will present general information on possible causes of foreclosure garnered from existing national research, the absence of data on specific characteristics of Texas foreclosures precludes reaching even preliminary, factual conclusions about reasons for foreclosures in the Study's counties. Furthermore, the inclusion of information from other studies should not be interpreted as having full Committee concurrence with those studies' premises, methods, or findings.

While there is speculation as to major causes for defaults and, ultimately, foreclosures, such conclusions are generally not provable from public records. For example, to determine what caused loans to go into foreclosure, privacy concerns of the borrower have to be broached. One would have to contact each borrower directly to ask why they stopped making their loan payments. It would also be necessary to have access to each borrower's loan documentation, full mortgage application file, and ultimate lender's proprietary underwriting criteria. Furthermore, the person reviewing this information would need the underwriting expertise to fully understand the documentation and reach complex conclusions as to such issues as whether the borrower truly qualified under the lender's criteria and whether the borrower would have qualified for a more advantageous loan.

Data Sources Used in the Study

Notwithstanding the above described limitations on the conduct of foreclosures studies, there is a large body of academic and commercial research which has a general relevance to the Study.

TDHCA was also able to obtain some mortgage loan and foreclosure location data which could be used to determine if there are any statistically significant correlations between foreclosure rates and other socio-economic characteristics within a Census tract. Information gathered from such analysis could help identify specific areas within communities that seem to have a high foreclosure rate and where additional research, consumer education, or marketing of more affordable loan products might be of value. As funding was not appropriated for the Study, the following sources of data used in the report were obtained by TDHCA or the Committee members at no or minimal cost.

Home Mortgage Disclosure Act (HMDA) Reported on 2004 Activity

The most comprehensive data source for general information on mortgage loans in Texas is HMDA data. HMDA data is loan-level data that includes information for each mortgage loan originated or denied by mortgage lenders that are legally required to report this information. Information reported includes loan purpose, loan amount, loan type, census tract, race of applicant, gender of applicant, annual income of applicant, and action taken on the loan. It should be noted, while HMDA does cover a substantial portion of all lending, not all loan originators are covered by HMDA requirements. Those not covered represent growing areas of the market.

Starting with data collected in 2004, lenders were required to report a defined interest rate spread on the loan when the APR of a loan, for first liens, is 3 points higher than the treasury rate at the time of the loan. This is reported as a number of points, to two decimal places. HMDA rate spread information on home purchase or refinance loans was used to quantify the relative level of these

loans in the Census tracts within each Study county. The observed level of higher rate loan activity could then be compared to the tract's foreclosure rate to see if tracts with higher cost lending activity also have higher foreclosure rates.

Two significant limitations on the use of this data in conjunction with an analysis of foreclosure rates should be noted.

- The most obvious issue is that HMDA data tracks newly originated loans, and foreclosure rate data is based chiefly on loans made in earlier (often much earlier) periods.
- The rate spread data will identify loans with higher fees (e.g., where the Treasury rate is 4.5 percent, the interest rate is 5.5 percent, and the APR is 7.6 percent) and appropriately structured subprime loans (e.g., where the treasury rate is 4.5 percent, the interest rate is 7.5 percent, and the APR is 7.6 percent). According to HMDA reporting requirements, both loans would reflect a spread of "3.1" reported for the data requirement, but, as the two preceding examples show, the meaning of this reported spread is unclear. Although the first example might be predatory because of high fees, this difference may also be caused by the borrower choosing to pay additional discount points to pay down the rate. The second example is more likely, but not certainly, a legitimate loan to a higher risk borrower that has been priced accordingly. Information on specific predatory practices tied to loans in a specific area will not be available without direct examination of a borrower's loan documentation. It should be clearly noted that while lower credit quality may translate into higher rate loans, which can lead to foreclosures, this is not predatory lending.

Information on Foreclosure Locations and Rates

There are a number of sources of foreclosure data in specific areas that are collected from county clerks or from lenders by independent companies. It should be noted that since collection of this type of data is not legally required, it does not have the same level of completeness or consistency as the HMDA data. Some of these third party sources market this information to persons who typically wish to monitor foreclosures often for the purpose of purchasing properties at foreclosure sales. Examples of the information that these companies collect include: location of properties involved in the foreclosure process, year of construction, size of the lot and structure, mortgage holder, value of the loan, outstanding balance, type of loan (FHA, VA, conventional, etc.), and time remaining on the loan.

The Study used quarterly foreclosure reporting data from 2004 to mid-2006 purchased from Foreclosure.com. Foreclosure.com data was used because the data covered a multi-year period for all six study counties, was relatively affordable, and could be obtained in a timely manner. Texas Real Estate Center at Texas A&M had also worked with this company as part of a report on foreclosure rates in Texas. The Foreclosure.com data is for properties acquired by the mortgage holder at the foreclosure sale. These properties are commonly known as other real estate owned (OREO) or real estate owned (REO) properties. It should be noted that the data does not report on properties that were purchased by third parties at foreclosure sales. It also does not include properties that went into the foreclosure process but had the default resolved prior to the foreclosure sale. This address level data was geocoded to the Census tract level so that summary information on the foreclosed properties could be compared to HMDA and decennial Census demographic data.

This allowed the demographic and lending activity characteristics of tracts where foreclosed loans were concentrated to be compared to other tracts where foreclosures were not as prevalent.

US Census Data

The 2000 Decennial Census provided information on the income, educational attainment, ability to speak English, and racial/ethnicity of the Census respondents residing in each Census tract. These factors were chosen as it was thought they might affect a household's ability to get a loan that was appropriate for them, understand the long term requirements of that loan, and have the financial wherewithal to maintain the home and make the mortgage payments over time.

Each state's number of households with a mortgage was obtained from the Census' 2004 American Community Survey. This data allowed for the number of households with a mortgage per foreclosure to be calculated for each state. This calculation allows the rate of foreclosures in Texas to be compared to other states. Obviously, the total number of foreclosures will depend in large part on the number of households with a mortgage in the state.

Study Structure

The study is organized to move from general discussion of the issue of foreclosure, to the specifics of the situation in Texas. Following presentation of evidence on the magnitude and nature of the problem in Texas, information is provided on current strategies for reducing foreclosures in Texas, including options for borrowers facing foreclosure and homebuyer education aimed at preventing foreclosure. This is followed by a review of legislative approaches in use around the country, and what is known about their effectiveness, including information on current laws in force in Texas. Finally, a brief set of conclusions regarding the state of knowledge concerning the problem of foreclosures in Texas is presented, along with specific recommendations for further research and enhancements to existing efforts to prevent foreclosures or assist those facing foreclosures to resolve their situations. More information on the purpose of each section is provided below.

- **General Foreclosure Issues**. This section provides a basic primer on the very complex and dynamic interaction that exists between consumer behavior, real estate law, economic forces, and a wide variety of supporting real estate and lending industries. Through a summary of other reports, the section describes issues other studies have identified as increasing the likelihood of borrower default and foreclosure. Because this general overview relies on observations made in other reports, the following two points should be emphasized.
  - This section contains research and conclusions from national studies and other relevant information sources as noted in citations. These observations are not specific findings of this Study or the Committee.
  - Existing studies highlight the importance of state or local context in determining which factors are most strongly linked to foreclosure in different locations. When possible, we incorporate information on the relevance for Texas of particular factors raised.
- **The Foreclosure Process in Texas**. This section describes Texas' specific legal requirements governing the process of foreclosure. It also provides an analysis of foreclosure data in affected markets covered by the Study, broken out by Census tract and correlated with selected socioeconomic data from the most recent decennial Census.

- **Analysis of Texas Foreclosures Activity.** This section presents results of our assessment of existing information on the magnitude of the problem in Texas, and in the six study counties. Researchers faced tremendous difficulty gathering loan-level information about foreclosures, preventing concrete conclusions from being drawn as to causes. Instead, analysis of the characteristics of places in each county where high concentrations of foreclosures are found is presented to suggest areas for further research.
- **Options for Borrowers Facing Foreclosure**. This section describes ways lenders may work with borrowers to reduce foreclosures and ultimately their associated losses. It also discusses other state, local, and non-profit programs that may help prevent foreclosures.
- **Homebuyer Education and Counseling**. This discusses ways that homebuyer education and counseling helps potential borrowers know how to identify and assess their borrowing options and, hopefully, avoid inappropriate loans. These activities also promote the value for borrowers to communicate with their servicer when circumstances change and their ability to pay the mortgage payments is strained.
- **Legislative Trends**. This section discusses pending and recent federal and state laws that considered or enacted to address some of the issues that the mortgage lending industry and mortgage borrowers are facing in a rapidly changing and highly complex lending environment. Many of these laws are of recent vintage: when possible, evidence is included as to the results of their enactment.
- **Recommendations**. This section presents the limited conclusions that can be drawn from our review of data on foreclosures trends in Texas and makes suggestions for future research aimed at investigating questions that arose from our review. In addition, the report recommends a strategy for gathering loan-level information on causes of foreclosure, needed to draw conclusions regarding the key causes of the problem in Texas. Emphasis is placed on suggesting strategies that are feasible for those most directly involved and most likely to be fruitful in yielding valuable information. Finally, recommendations are made for enhancements to current efforts.

GENERAL FORECLOSURE ISSUES

This section provides a basic primer on the very complex and dynamic interaction that exists between consumer behavior, real estate law, home price appreciation, economic forces, and various supporting real estate and lending industries. Through a summary of other reports, the section describes issues other studies have identified as increasing the likelihood of borrower default and foreclosure. Because this section relies on observations made in other reports, the following two points should be emphasized.

- This section contains research and conclusions from national studies and other relevant sources as noted in citations. These observations are not specific findings of this Study or the Committee and when taken out of context may not be meaningful.
- Existing studies highlight the importance of state or local context in determining which factors are most strongly linked to foreclosure in different communities. The Texas context may vary in ways that make it difficult to directly apply the findings of these studies. However, when possible, we incorporate information on the relevance for Texas of particular issues raised.

Borrower Reasons for Foreclosure

At the most basic level, a borrower's inability to meet their monthly mortgage payments (default) is the direct cause of delinquency, which may or may not lead to foreclosure. Primary factors that contribute to such inability may be grouped into four broad categories.

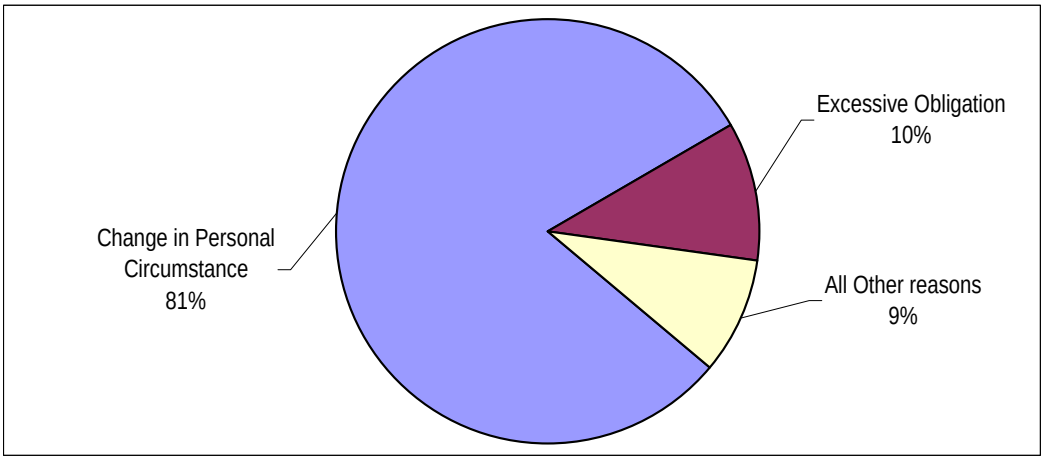
- Changes in personal circumstances (such as job loss or other reduction of income, unanticipated major costs such as medical crises not covered by insurance) that adversely affect the ability to make what would have been otherwise manageable loan payments.
- Failure due to poor planning or lack of knowledge on how to carry out all of the responsibilities of being a homeowner. Such responsibilities would include such things as coping with changes in the loan structure (interest rate changes, balloon payments, etc.), increasing property taxes, insurance payments, and ongoing home maintenance costs.
- The borrower is a victim of unscrupulous or unlawful lending practices. For example, (1) property flipping, (2) loan churning, (3) excessive fees, (4) lending without regard to ability to repay, and (5) outright fraud and abuse. These activities are sometimes referred to as "predatory" which is distinctly different from "subprime" lending as discussed in more detail later in the Study.
- The borrower is either a perpetrator or a participant in fraudulent activities to qualify for a loan or to profit from the transaction.

Based on a national sample of 53,608 Freddie Mac loans experiencing delinquency between 1999 and 2005, over 41 percent of borrowers cited unemployment or the curtailment of income as the reason for delinquency. Nearly 19 percent reported an illness in the family as the cause of default, and 10.3 percent indicated that excessive obligation was the cause.

Reported Reasons for Delinquency for Freddie Mac Borrowers 1999-2005[4]

Reason for Delinquency	Percentage
Unemployment or Curtailment of Income	41.5%
Illness in the Family	18.9%
Excessive Obligation*	10.3%
All Other Reasons	9.0%
Marital Difficulties	8.4%
Death in the Family	3.9%
Extreme Hardship	3.3%
Property Problem or Casualty Loss	2.1%
Inability To Sell or Rent Property	1.6%
Employment Transfer or Military Service	0.9%

*"Excessive obligation," includes credit cards, time payment purchases, larger and longer term auto loans (and auto leases), etc.



The Committee was able to obtain similar Texas-specific reason-for-default information for Federal Housing Administration loans made from 2000 through 2006. While the categorization of default reasons for the Freddie Mac and FHA data are not identical, the general ranking of reasons with "Unemployment or Curtailment of Income" as the top reason for default is similar.

Federal Housing Administration Default Reasons 2000-2006

Reason for Delinquency	Percentage
Unemployment or Curtailment of Income	32%
All Other Reasons	30%
Excessive Obligation	21%
Illness in the Family	7%
Marital Difficulties	6%
Death in the Family	2%
Inability To Sell or Rent Property	1%
Property Problem or Casualty Loss	0%
Employment Transfer or Military Service	0%

[4] Amy Crews Cutts, "Facts and Figures on New Mortgage Products," presentation at Protecting Consumers in the New Mortgage Marketplace - Federal Trade Commission Workshop, Washington, DC, May 24, 2006.

Changes in Personal Circumstance that Could Affect the Likelihood of Foreclosure

As can be seen by the chart above, over 80 percent of reasons for default in the survey of Freddie Mac loans can be characterized as changes in personal circumstance that are clearly not related to the form, amount, or borrower's understanding of the mortgage. Such changes would include unemployment or curtailment of income, illness in the family, marital difficulties, death in the family, property problem or casualty loss, extreme hardship, inability to sell or rent property, and employment transfer or military service.

Job loss or other financial strain is identified as the leading factor in default. Because of this, increasing unemployment rates and dips in the economy are of particular concern. Frank Nothaft, chief economist at Freddie Mac, has noted that, "if something should cause the economy to fall into a recession—for example, the price of oil jumps up to $100 per barrel and that leads to stagflation, with higher rates of unemployment—that will translate into further increases in default rates on all types of loan products."[5]

Marital difficulties also appear to be a significant factor in increasing the likelihood of default. Divorce can create loss of income and additional financial costs such as child support payments, legal fees, additional housing costs, or additional child care costs.

As reflected by the Freddie Mac and FHA data, the uninsured financial obligations related to illness in the family is a significant reason for delinquency. If an income-earning family member falls ill and is unable to work, or if the cost of medical care exceeds the household's free income, these households may become delinquent. In some cases, medical debts may even lead to foreclosure. Unpaid debt can reduce a borrower's credit rating, and thus trigger higher interest rates or less advantageous loan terms should the borrower need to refinance the mortgage or obtain other credit in the future.

"Excessive obligation," including credit cards, time payment purchases, larger and longer term auto loans (and auto leases), etc., was the leading factor in 10.3 percent of delinquencies. The proliferation of consumer debt is undoubtedly a significant contributor to the creation of an ever-growing class of precarious mortgage borrowers. It is further exacerbated by other factors that are, for the most part, beyond those borrowers' control, such as increasing property taxes, insurance costs, and utility costs. While most of these reasons for default could also be considered "changes in personal circumstance," some might be impacted by the terms of the loan the borrower is using. Therefore, it is broken out as a separate item for the purposes of this report.

In the survey, "All other reasons" was the catch-all for small categories. It included: servicing problems, payment adjustment, incarceration, payment dispute, abandonment of property, unable to contact borrower, fraud, energy or environment cost, transfer of ownership pending and any other reason that could not be identified. While this category includes reasons that may be

[5] Michael Murray, "Energy, Employment Top Mortgage Delinquency Concerns," *MBA News Link*, vol. 5 issue 128 (August 30, 2006) http://www.mortgagebankers.org/mbanewslink/issues/2006/08/30.asp#spot1 (accessed September 8, 2006).

related to the terms and structure of the loan (such as “payment adjustment” and “payment dispute”) there is no way to determine what portion of the category these items comprise.

Mortgage Related Issues that Could Affect the Likelihood of Foreclosure

An Overview of the Mortgage Process

In most cases, a homebuyer will take out a mortgage loan to purchase a home. This section discusses mortgage related issues that may affect the likelihood of foreclosure. Prior to discussion of those types of issues, it may be useful to describe some aspects of and players involved in the mortgage process.

The mortgage process involves many entities, only some of which are directly involved with the borrower. The following list provides an overview of terms related to and participants involved in the lending process. [6]

- **Borrower.** A person who has been approved to receive a loan and is then obligated to repay it and any additional fees according to the loan terms.*
- **Closing Agent.** The person or entity that coordinates the various closing activities, including the preparation and recordation of closing documents and the disbursement of funds. (May be referred to as an escrow agent or settlement agent in some jurisdictions.) Typically the closing is conducted by title companies, escrow companies or attorneys.*
- **Default.** The failure to make a scheduled payment or otherwise comply with the terms of a mortgage loan or other contract.*
- **Delinquency.** Failure to make a payment when it is due. The condition of a loan when a scheduled payment has not been received by the due date, but generally used to refer to a loan for which payment is 30 or more days past due.*
- **Foreclosure.** For the purpose of this report, foreclosure is the borrower’s actual loss of the home as the final result of a legal process that was preceded by borrower default on the loan.
- **Government Sponsored Enterprises (GSE).** Entities like Fannie Mae or Freddie Mac – public companies that operate under a federal charter. These entities do not lend money directly to consumers, but instead work to ensure that mortgage funds are available and affordable, by purchasing mortgage loans from institutions that lend directly to consumers.
- **Mortgage.** A loan to finance the purchase of real estate, for which the borrower pledges the real property as security for the repayment of the loan. The borrower gives the lender a lien on the property as collateral for the loan.*
- **Mortgage Broker.** A mortgage broker typically takes loan applications and may process loans, but generally does not use its own funds to close the loan. Mortgage brokers often act as independent contractors and not as an agent of the borrower or lender.*
- **Mortgagee**. The owner or holder of the debt.
- **Mortgage Insurance.** Insurance that protects lenders against losses caused by a borrower's default on a mortgage loan. Mortgage insurance typically is required if the borrower's down payment is less than 20% of the purchase price.*

[6] Definitions noted with asterisks come from http://www.mortgagecontent.net/content/fanniemae/FullGlossary/GlossaryH.html accessed 9/14/2006. Unless other wise noted, other definitions were developed by the Committee.

- **Real Estate Agents.** Most property is identified and purchased using a real estate agent. Sellers' agents generally represent the seller and list the property. Agents representing the buyer frequently recommend mortgage lenders and brokers to homebuyers. Sometimes they serve both as real estate agent and as mortgage broker, but they are required to provide disclosures of these dual roles.
- **Secondary Mortgage Market.** The secondary mortgage market pools loans that collateralize mortgage backed security instruments that are sold to investors.
- **Securitization.** The process of pooling real estate secured loans into mortgage backed securities.
- **Servicer.** A firm that performs loan-level administration functions or "servicing" functions, including collecting mortgage payments, paying the borrower's taxes and insurance and generally managing borrower escrow accounts.*
- **Subprime Lending.** Subprime lending is described as the practice of lenders charging higher interest rates compared to prime loan interest rates and a wider variety of terms in order to be compensated for accepting a greater level of risk in the transaction.
- **Predatory Lending.** This has been defined, at least in one context, as lenders "engaging in deception or fraud, manipulating the borrower through aggressive sales tactics, or taking unfair advantage of a borrower's lack of understanding of loan terms."[7]

The Impact of Nonconforming Mortgage Origination, Servicing, and Collection Processes

At one time, many mortgage lenders generally performed all lending functions themselves, including origination, funding, servicing, and holding the loan to maturity.[8] Because of this, lenders assumed the full risk of default and thus had a direct incentive to deny risky borrowers or find ways to mitigate those risks, such as requiring higher down payments.

With the advent of securitization, various entities were introduced, each handling a different aspect of the mortgage process. Instead of one entity handling the bulk of the process, a mortgage broker may work with the borrower, another company may originate the loan, another entity may purchase the loan and package it with other loans, other firms may sell the packaged loans to investors, another entity may hold the loans for the investor, a servicer will collect payments, and a special servicer may handle the foreclosure process.[9] With this separation of tasks, some or all of the credit risk may be shifted from the lender to other entities in the process.[10]

Some lenders control these risks more rigorously than others, such as requiring the use of specific underwriting criteria and programs and carefully selecting and monitoring those who can originate

[7] US Department of Housing and Urban Development and US Department of Treasury, *Curbing Predatory Home Mortgage Lending*, (Washington DC: US Department of Housing and Urban Development, 2000), 1, http://www.huduser.org/publications/pdf/treasrpt.pdf (accessed August 20, 2006).
[8] Kathleen Engel and Patricia McCoy, "Predatory Lending: What Does Wall Street Have to Do With It?" *Housing Policy Debate* (Fannie Mae Foundation) vol. 15, issue 3 (2004): 719, http://www.fanniemaefoundation.org/programs/hpd/pdf/hpd_1503_Engel.pdf (accessed August 17, 2006).
[9] Kurt Eggert, "Limited Abuse and Opportunism by Mortgage Servicers," *Housing Policy Debate* (Fannie Mae Foundation) vol. 15, issue 3 (2004): 771, http://www.fanniemaefoundation.org/programs/hpd/pdf/hpd_1503_Eggert.pdf (accessed August 17, 2006).
[10] Kathleen Engel and Patricia McCoy, "Predatory Lending: What Does Wall Street Have to Do With It?" 720.

their loans. Additionally, automated underwriting systems, such as Freddie Mac's Loan Prospector (LP), Fannie Mae's Desktop Underwriter (DU), Countrywide Home Loan's CLUES, provide necessary data on risk characteristics of loans being pooled for securitization. Almost all loan originators use one or more AUSs to determine the risk characteristics of a borrower and whether that borrower can be underwritten for a particular mortgage product that can be sold to the secondary market.[11] When the various participants in the origination process do not follow generally accepted, conforming industry practices, issues that may affect a borrower's ability to maintain their loan payments can arise.

Professional licensed mortgage brokers are able to offer consumers an overview of the mortgage lending process, access to the loan products of many lenders, and knowledge on a wide variety of available mortgage loan products. However, because mortgage brokers may work in the interest of themselves, the lender, or the borrower, lenders who do not select their brokers carefully and do not impose strict underwriting requirements and controls may find that they are acquiring and funding higher risk loans. For example, yield spread premiums or volume-based compensation, which are ways in which lenders pay brokers to originate loans for them, may create "reverse competition" because brokers have an incentive to deal with those lenders that pay the most premiums rather than those that deliver the most favorable terms for the borrower.[12]

A study of subprime loans originated between 1996 through 1999 found that loans originated through third-party originators, such as mortgage brokers, were more likely to default than loans originated through retail lending offices.[13] The study points out that the lenders bear the risk of mortgage default whereas third-party originators increasingly do not. The absence or reduction of this risk means that third-party originators may be more concerned about generating fees and points from the borrower, lender commissions, and yield spread premiums[14] and not necessarily the ability of the borrower to repay the loan. However, as noted above, lenders have addressed these types of concerns with varying degrees of effectiveness, with some lenders imposing more rigorous controls over the selection of their authorized originators and requiring strict underwriting programs.

For investors involved in the securitization process and concerned with the return on their investment, there are three main types of risk: credit, prepayment, and litigation risk.[15] The credit risk of a loan portfolio depends on the ability of the servicer to collect the principal, interest, and any costs. If these loans default and foreclose, investors will be at risk of losing part of their investment as the recovery that will result from the foreclosure and sale of the collateral will likely be insufficient to cover all of the principal, interest, and costs. Prepayment risk describes the possibility that the loans will be paid off before maturity, meaning that investors must reinvest their funds in an ever changing market where interest rate shifts and other conditions may make it difficult to secure a

[11] Fishbein and Woodall, *Exotic or Toxic*, 14
[12] Renaurt, "An Overview of the Predatory Mortgage Lending Process," 492.
[13] William Alexander et. al., *Some Loans are More Equal than Others: Third-Party Originations and Defaults in the Subprime Mortgage Industry*, (July 2001), 3, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=281233 (Accessed August 18, 2006).
[14] William Alexander et. al. *Some Loans are More Equal than Others*, 5.
[15] Kathleen Engel and Patricia McCoy, "Predatory Lending: What Does Wall Street Have to Do With It?" 720.

comparable return. Finally, litigation risk arises if the loans in the portfolio are made or documented improperly, thus leading to resolving actual or threatened lawsuits.

Because loan originators have the greatest access to full information on the borrower and the loan, they can, in theory, most accurately assess the risks for each loan. Identifying these risks, loan originators and holders have the potential to package riskier loans for sale in the secondary market.[16]

Although investors are concerned about risks, portfolios that contain loans with higher interest rates and prepayment penalties can also command higher prices on the secondary market.[17] This is because these portfolios have the potential to generate more income for investors because of the higher interest rate per loan, as well as the dissuasion of borrowers to refinance the loan and thus exit the portfolio because of the prepayment penalty. In addition, pricing, credit enhancements, legal obstacles, and other provisions reduce and diffuse much of the risk from these types of portfolios, thus giving investors little incentive to police against such lending practices.[18]

Abusive practices by some mortgage servicers, such as charging excessive and/or unearned fees, inappropriate or unnecessary force placing of insurance, and the poor oversight of escrow funds, can cause additional expenses for borrowers and may even contribute to an increased likelihood of default or foreclosure.[19] In 2003, the Federal Trade Commission and US Department of Housing and Urban Development announced settlements with Fairbanks Capital, one of the largest servicers of subprime mortgages.[20] Fairbanks Capital was charged with failing to post mortgage payments in a timely manner and then charging late fees, charging borrowers for insurance when borrowers already had insurance in place, collecting improper fees, and misrepresenting the mortgage amounts owed by borrowers. Some researchers contend that such opportunism by servicers is caused by the inability of borrowers to choose or control their mortgage servicers.[21] While most servicers place great value in their relationship with the customer because they are future repeat borrowers and buyers of other financial products, some servicers may be more concerned about their reputation with securitization entities and those using their services. For these servicers, the interest in their reputation with borrowers exists chiefly based on how it will affect the willingness of mortgage-backed securities issuers and trustees to select them.[22]

Possible Effects on Foreclosures from an Increasing Array of Mortgage Products

Today, there is an unprecedented and still increasing variety of mortgage products available to homebuyers. In the early 1990s, lenders were still offering mortgages at a single price to borrowers who met stringent credit history requirements and strict loan-to-value and debt-to-income ratios—

[16] Kathleen Engel and Patricia McCoy, "Predatory Lending: What Does Wall Street Have to Do With It?" 719.
[17] Renaurt, "An Overview of the Predatory Mortgage Lending Process," 492.
[18] Kathleen Engel and Patricia McCoy, "Predatory Lending: What Does Wall Street Have to Do With It?" 739.
[19] Eggert, "Limited Abuse and Opportunism by Mortgage Servicers," 756.
[20] Federal Trade Commission, "Fairbanks Capital Settles FTC and HUD Charges," http://www.ftc.gov/opa/2003/11/fairbanks.htm (accessed August 19, 2006).
[21] Eggert, "Limited Abuse and Opportunism by Mortgage Servicers," 767.
[22] Eggert, "Limited Abuse and Opportunism by Mortgage Servicers," 769.

this is no longer the case.[23] Borrowers can now access a variety of new loan products, including low or no down payment loans (or even loans in excess of the purchase price), various terms for adjustable rate mortgages (often qualifying at low "teaser" rates), interest-only and payment-option mortgages, "no documentation" or "low documentation" loans, and subprime loans that accept and price for lower credit quality. These products offer many households, who might not otherwise be able, an opportunity to become homeowners by increasing the affordability of loans and overcoming the first time homebuyers' down payment hurdle.

The growing use of these products has largely been driven by rapidly escalating real estate prices, because the lender's risk to originate to marginal borrowers is mitigated by rising asset values; technological advances that allow lenders to better analyze risk; a recent decline in mortgage refinancing due to rising interest rates; and the need for lenders to offer tempting products to compensate for the decline in business.[24] Other reasons believed to have increased the use of these products include the drive to increase homeownership rates; federal mandates for primary lenders (CRA), and GSE regulatory requirements. Another source noted that, in the "rush to gain customers during the housing boom, mortgage-makers lowered their lending standards."[25]

Some of the mortgage options described below afford the borrowers little, or even negative, equity in their homes. Studies have shown that the amount of equity in the home was statistically more significant than borrower or loan characteristics in determining the probable rate of default.[26] First American, a business information firm, found that 29 percent of loans closed in 2005 had zero or negative equity.[27]

The rise of non-traditional products seems to correspond to the rise in home prices.[28] The rise in home prices has fueled a need for more flexible mortgage products so that monthly payments remain affordable. However, at the same time, flexible products coupled with low interest rates have enabled buyers to purchase more expensive homes, thus increasing home prices, and thus attracting more buyers to utilize these products.

This section examines some of the newer mortgage options and discusses potential risks these features may present for borrowers.

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[23] Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 2005*, (2005), 16, http://www.jchs.harvard.edu/publications/markets/son2005/son2005.pdf (accessed August 19, 2006).
[24] Allen Fishbein and Patrick Woodall, *Exotic or Toxic? An Examination of the Non-Traditional Mortgage Market for Consumer and Lenders*, (Washington CD: Consumer Federation of America, May 2006), 14, http://www.consumerfed.org/pdfs/Exotic_Toxic_Mortgage_Report0506.pdf (accessed August 19, 2006).
[25] Jesse Eisinger, "Mortgage Market Begins to See Cracks as Subprime-Loan Problems Emerge," *Wall Street Journal*, August 30, 2006, http://online.wsj.com/article_email/SB115689403474748939-lMyQjAxMDE2NTM2MDgzOTA0Wj.html (accessed September 6, 2006).
[26] Capone, *Research Into Mortgage Default and Affordable Housing*, 3.
[27] Kenneth Harney, "Equity Percentage in Your Home: What Percentage?" *Realty Times*, February 27, 2006, http://realtytimes.com/rtnews/rtcpages/20060227_equity.htm (accessed August 20, 2006).
[28] Fishbein and Woodall, *Exotic or Toxic*, 14.

Low Down Payment and No Down Payment Mortgages

Traditionally, lenders required a significant down payment on a home. In 1990, 3 percent of conventional purchase loans had down payments of 5 percent or less—that number has since increased to about 16 to 17 percent.[29] Because borrowers who do put down less than 20 percent of the loan amount are generally required to buy private mortgage insurance, there is also a trend in offering first-lien mortgages that cover 80 percent of the home and then using piggyback second lien loans, typically with higher interest or adjustable rates, that cover the remaining balance. For the first half of 2005, it was estimated that 48 percent of homebuyers were utilizing piggyback loans.[30] In other cases, some lenders opt to charge a higher rate in lieu of requiring such insurance.

Studies have shown that low down payment mortgages have a statistically greater risk of default. A study of Freddie Mac-purchased loans originated between 1975 and 1983 and with defaults up to 1992 found that mortgages with a loan-to-value ratio between 91 and 95 percent had a default rate that was 50 percent higher that mortgages with loan-to-value ratios of 81 to 90 percent.[31] Another study on Freddie Mac loans originated in 1994 and tracked through 1996 found that mortgages with 5 percent down payments had a default rate that was two and a half times greater than standard loans made to lower-income borrowers while loans with 3 percent down payments (from borrowers and 2 percent down from other sources) had a default rate that was six times greater than standard loans.[32]

Borrowers making low or no down payment can be greatly affected if the housing market changes. Such borrowers may end up owing more than their homes are worth with even minor slumps in the real estate market.[33] If the personal financial situation of a borrower utilizing a low down payment mortgage deteriorates and the housing market in their area is stagnant or declines, this borrower would not have the option of selling their home to pay off the outstanding mortgage balance. Indeed, it has been identified that some borrowers may choose foreclosure if it is financially optimal for them, meaning that house prices or interest rates do not change during the delinquency period to make foreclosure unattractive.[34] The increasing availability of mortgage products for borrowers who have previously suffered foreclosures may contribute to borrowers making the decision to suffer foreclosure rather than attempting to negotiate or make adjustments to prevent it.

Adjustable Rate Mortgages

With fixed rate mortgages, the interest rate is set on the loan until maturity. With adjustable rate mortgages (ARMs), the interest rate on the loan may change up or down, typically adjusting annually based on some external index plus a stated margin. There are also "hybrid" ARMs, where the rate is

[29] Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 2005*, 17.
[30] Fishbein and Woodall, *Exotic or Toxic*, 12.
[31] Robert Van Order and Peter Zorn, "Income, Location, and Default: Some Implications for Community Lending," *Real Estate Economics*, vol. 28, issue 3 (2000), 393, http://www.areuea.org/publications/ree/articles/V28/REE.V28.3.2.PDF (accessed August 19, 2006).
[32] Michael Stamper, "Revisiting Targeted-Affordable Lending," Secondary Mortgage Markets, vol. 14, no. 3 (October 1997), 19, http://www.freddiemac.com/finance/smm/oct97/pdfs/stamper.pdf (accessed August 19, 2006).
[33] Fishbein and Woodall, *Exotic or Toxic*, 13.
[34] Ambrose and Capone, "Modeling the Conditional Probability of Foreclosure in the Context of Single-Family Mortgage Default Resolutions," 397.

fixed for the first three, five, seven, or ten years, after which the interest rate adjusts yearly.[35] These types of loans are represented by 3/1, 5/1, 7/1, and 10/1, where the first number is the fixed period, and the second number is the adjustment period thereafter. The use of ARMs has been climbing. The reasons for this increase include 1) the steep yield curve existing throughout much of the last several years caused rates for shorter durations to be significantly lower than long term durations, 2) lower monthly payments made mortgages more affordable, and 3) lower monthly payments allowed borrowers to qualify for larger loans. In 2004, 35 percent of conventional mortgage originations were ARMS, nearly double the share in 2003 (18 percent).[36]

ARMs are attractive for borrowers because they have lower initial monthly payments compared to traditional fixed rate mortgages, which can make homeownership more affordable.[37] Generally, the longer the adjustment period for an ARM, the closer its interest rate is to a fixed mortgage. Examining the mortgage rates for a fixed time in 2004, the payment on a $200,000 mortgage with a 10/1 ARM was 3 percent less than a fixed rate mortgage, whereas the payment with a one-year arm was 22 percent less.[38]

While homebuyers may be attracted to ARMs because of their lower initial payments, they may be unpleasantly surprised if interest rates rise and their mortgages adjust. For example, for a borrower with a 3/1 ARM and terms that specify that the interest rate can increase two percentage points at the first adjustment and two in subsequent years, limited to six points for the life of the loan, if the interest rate increased by two points each year, the borrowers monthly payment would increase by 126 percent after five years.[39] Furthermore, because some companies qualify borrowers based on the discounted first-year interest rate, borrowers who pushed the debt-to-income qualifying ratios will most likely have difficulty meeting their adjusted payments.[40]

For certain savvy borrowers, ARMs are a useful option for those who intend to sell or refinance prior to the adjustment period and understand the risks; unfortunately, there is evidence that not all borrowers are aware of the terms of these loans. A survey by the Consumer Federation of America found that lower income and minority borrowers were more likely to prefer ARMs, but were less likely to understand the risks.[41] The 2001 Survey of Consumer Finances, sponsored by the Federal Reserve Board, found that 35 percent of ARM borrowers did not know the value of the per-period cap on interest rate adjustments, 41 percent did not know the maximum interest rate that could be charged over the life of the loans, and 20 percent did not even know the interest rate at origination.[42]

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[35] J. Noel Fahey, "The Pluses and Minuses of Adjustable-Rate Mortgages," *Fannie Mae Papers*, vol. 3, issue 4 (December 2004), 1.
[36] Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 2005*, 16.
[37] "Option ARMS: Part One," The Quarterly Review of Interest Rate Risk, vol. 10, issue 2 (second quarter, 2005), 2, http://www.ots.treas.gov/docs/1/11520.pdf (accessed August 19, 2006).
[38] Fahey, "The Pluses and Minuses of Adjustable-Rate Mortgages," 4.
[39] Fahey, "The Pluses and Minuses of Adjustable-Rate Mortgages," 10.
[40] Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 2005*, 16.
[41] Fishbein and Woodall, *Exotic or Toxic*, 10.
[42] Brian Bucks and Karen Pence, *Do Homeowners Know Their House Values and Mortgage Terms?* (Federal Reserve Board of Governors, January 2006), 19, http://www.federalreserve.gov/pubs/feds/2006/200603/200603pap.pdf (accessed August 19, 2006).

It is estimated that more than $200 billion in ARMs will adjust in 2006 and more than $1 trillion will adjust in 2007.[43] In order to avoid rising interest rates at adjustment, borrowers with ARMS may decide to refinance into a fixed rate mortgage. However, if these borrowers have loans with prepayment penalties or if their financial situations have deteriorated, they end up owing additional money or even end up with a higher interest rate. ARMs currently have a higher delinquency and foreclosure rate compared to fixed rate loans,[44] and given the increased interest rates over the last few years they are more likely to have problems in the near future.

It should be noted that ARMs appear to comprise a small portion of the loan market in Texas. For example, of the 4,326,555 Federal Housing Administration loans made between 2000 and 2006, only 102,416 (2 percent) were ARMs.

Interest-Only and Payment-Option Mortgages

Interest-only loans and payment-option mortgages are forms of ARMs, where the borrower pays only the interest on the mortgage or chooses a fixed payment amount for a set period of time. Because these loans have reduced payments at the beginning of the loan term, the monthly payments will increase after the deferral period when borrowers begin to also pay principal. LoanPerformance reported that nearly a third of all home purchase originations in 2004 were interest-only mortgages.[45]

Consumer Federation of America analyzed a database of 100,000 mortgages originated between January and October 2005 in an attempt to identify borrowers electing interest-only or payment-option mortgages.[46] The analysis identified 8.1 percent of loans were interest-only and 2.3 percent were payment option with the following characteristics: 50.4 percent earned more than $72,000 a year; African Americans were 30.4 percent more likely to receive payment-options mortgages; only 1 percent of payment-option borrowers had a loan-to-value ratio above 95 percent whereas 21.5 percent of interest-only borrowers had ratios that high (both compared to 23.4 percent for all borrowers in the sample); and 53.8 percent of payment-option borrowers had credit scores below 700, compared to 38.6 percent of interest-only borrowers and 48.2 percent of all borrowers.

As with other ARMs, these loans are a good option for borrowers who intend to sell or refinance during the principal deferment period. However, borrowers who do not sell or refinance, and who do not experience an increase in income to cover the increased payments, may find themselves faced with default. Furthermore, if the borrower only makes the minimum payment on a payment-option loan, the mortgage will negatively amortize because the difference will be added to the mortgage balance.[47] While some borrowers may not be concerned about this because of rising home values, these borrowers may be unable to switch to a different loan product if housing prices were to drop.

[43] Fishbein and Woodall, *Exotic or Toxic*, 11.
[44] "Delinquency and Foreclosure Trends for Fixed vs. ARM Loans," *The Market Pulse* (LoanPerformance) March 2006, 12, http://www.loanperformance.com/market_pulse/default.aspx (accessed August 19, 2006).
[45] Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 2005*, 17.
[46] Fishbein and Woodall, *Exotic or Toxic*, 22.
[47] "Option ARMS: Part One," 4.

A recent annual filing by Washington Mutual acknowledged that it improperly measured debt-to-income ratios for borrowers obtaining option ARMs in 2004 and through October 2005.[48] As interest rates rose during that time, these borrowers were qualified based on ratios calculated using an interest rate that was lower than the prevailing rates at the time. Because of this, these borrowers have higher than average mortgage obligations compared to their income and thus may be more susceptible to energy cost spikes and property tax increases, in addition to an upwardly adjusting interest rate when the ARM resets.

Subprime Loans

Subprime lending is described as the practice of lenders charging higher interest rates compared to prime loan interest rates in order to be compensated for accepting a greater level of risk in the transaction because of the lower credit quality of the borrower. Subsequently, the subprime market offers individuals with poor credit histories, high debt-to-income ratios, less financial documentation, or other application limitations with the opportunity to secure mortgage credit.[49]

Perhaps the foremost factor in mortgage underwriting is the evaluation of an applicant's credit report to determine how he or she has traditionally managed credit. A credit report is a record of an individual's credit and includes information about credit history, account statuses, credit card account listings, credit inquiries, and public-record items such as bankruptcies, foreclosures, or accounts in collection.

Experian, Equifax, and Trans Union are the three main credit bureaus that collect information on individual consumer credit habits. In their reports, credit information is divided into five sections: potentially negative items, accounts in good standing, requests for credit history, personal information, and a personal statement, which is an explanation of any credit information that an individual may elect to add to the report.

Through the comparison of personal credit factors to historical credit data, individuals receive a credit score that numerically quantifies future credit risk. Because the basic mathematical model for this score was originally developed by Fair Isaac and Company, it is commonly referred to as a FICO score. The top FICO score is 850, and credit risk increases as a score decreases. FICO estimates that 20 percent of the general population has a score below 620, 20 percent scores between 620 and 690, 20 percent between 690 and 745, and the remaining percentage has scores over 745.[50] According to Experian's National Score Index[51], as of August 2006, Texas has the lowest average credit score in the nation at 648.

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[48] Jesse Eisinger, "Mortgage Market Begins to See Cracks as Subprime-Loan Problems Emerge."

[49] James Carr and Lopa Kolluri, "Predatory Lending: an Overview," *Financial Services in Distressed Communities: Issues and Answers*, (Washington DC: Fannie Mae Foundation, August 2001), 35, http://www.fanniemaefoundation.org/programs/financial.PDF (accessed August 20, 2006).

[50] Fair Issac and Company, "Understanding Your Credit Score," 6, http://www.fairisaac.com/NR/rdonlyres/6F127C6D-E5D2-4EB3-B0CC-A0BD3FE00D94/0/UnderstandCreditScoreBklt.pdf (accessed August 23, 2006).

[51] Experian, "National Score Index," http://www.nationalscoreindex.com/USScore.aspx (accessed August 23, 2006).

Average Credit Score, by State

Rank	State	Credit Score	Rank	State	Credit Score	Rank	State	Credit Score
1	South Dakota	709	19	New York	685	37	Florida	672
2	Vermont	707	20	Oregon	685	38	Indiana	672
3	Minnesota	706	21	Washington	685	39	Alabama	670
4	North Dakota	706	22	Maryland	684	40	Alaska	670
5	Montana	704	23	Utah	684	41	Colorado	670
6	New Hampshire	703	24	Idaho	683	42	Arkansas	667
7	Massachusetts	702	25	Illinois	682	43	Mississippi	667
8	Maine	699	26	Delaware	680	44	Oklahoma	664
9	Iowa	697	27	Kansas	680	45	North Carolina	663
10	Connecticut	695	28	Ohio	680	46	South Carolina	663
11	Wisconsin	695	29	Missouri	678	47	Georgia	662
12	Nebraska	694	30	Michigan	677	48	Louisiana	662
13	Rhode Island	693	31	West Virginia	676	49	New Mexico	660
14	Pennsylvania	692	32	**US**	675	50	Arizona	659
15	New Jersey	691	33	Kentucky	674	51	Nevada	654
16	Hawaii	690	34	Tennessee	674	52	**Texas**	648
17	Virginia	689	35	District of Columbia	673			
18	Wyoming	689	36	California	672			

Source: Experian's National Score Index

With lower average credit scores, it is likely that a greater proportion of Texas households may be qualifying for mortgage loans at higher interest rates than households in states with higher than average credit scores. If these borrowers had better credit scores, they probably would have qualified for loans with a lower monthly payment. The resulting savings could provide these borrowers with an extra cushion against unforeseen expenses and financial difficulties.

Using a sample of loans that were originated between January 1996 and June 1997, Freddie Mac commissioned a survey to investigate the characteristics of subprime borrowers.[52] Of the 4,342 sampled, 54.6 had a subprime purchase, refinance, or second mortgage, while the rest were prime. The survey found that 25 percent of subprime borrowers paid more than two points at closing, whereas 10.1 percent of prime borrowers paid more than two points. With regard to credit scores, only 12.5 percent of subprime borrowers had credit scores of over 680 compared to 70.5 percent of prime borrowers. This type of evidence seems to support the claim that some borrowers are receiving subprime loans when they could have qualified for prime rates: Freddie Mac reports that this figure may be as high as 35 percent while Fannie Mae estimates the figure to be closer to 50 percent.[53]

The survey also found that subprime borrowers tended to be older and less educated. Subprime borrowers generally "had a harder time getting a loan, were less in control of their finances, and more likely to experience life disruptions."[54] Furthermore, subprime borrowers were less informed about mortgage options; searched for loan approvals and low payments, rather than a low interest

[52] Howard Lax, et. al., "Subprime Lending: An Investigation of Economic Efficiency," Housing Policy Debate (Fannie Mae) vol. 15 issue 3 (2004), 535, http://www.fanniemaefoundation.org/programs/hpd/pdf/hpd_1503_Lax.pdf (Accessed August 21, 2006).
[53] Carr and Kolluri, "Predatory Lending: an Overview," 37,
[54] Lax, "Subprime Lending," 550.

rate; were more likely to use fringe financial services, and were six times more likely than prime borrowers to respond to advertisements or phone calls offering guaranteed approvals.

Various studies have concluded that minorities receive a disproportionate amount of subprime loans. An examination of 2004 HMDA data found that African Americans were 30 percent more likely to receive a higher rate subprime loan than white borrowers, even after controlling for differences in risk.[55] Hispanic borrowers purchasing homes were 29 to 142 percent more likely to receive a subprime loan with a higher rate, depending on whether the loan was an ARM and contained a prepayment penalty.[56] This trend appears to be continuing, with an analysis by the Federal Reserve of the 2005 HMDA data indicating that 54.7 percent of black borrowers paid a higher-than-typical interest rate on home mortgages.[57] For Hispanics, 46.1 percent paid more than typical for their mortgages last year. This can be compared to only 17.2 percent of whites paying higher interest for their home mortgages last year.

The report indicated that for all borrowers, incidents of higher priced mortgages increased significantly from 24.6 percent in 2005 compared with 11.5 percent in 2004. Cited reasons for these increases included higher mortgage rates in general and increasing rates for popular adjustable-rate mortgages. Also it appeared that some borrowers who were stretching to purchase a home used creative financing, like higher-priced piggyback loans.

While subprime loans can serve a portion of the community that may not otherwise be able to receive mortgage credit, there are more risks involved. Subprime loans foreclose at higher rates than prime loans. In the third quarter of 2003, less than 1 percent of prime loans were in the process of foreclosure compared to over 6 percent of subprime loans.[58] Fair Isaac and Company estimates that about 10 percent of all households have credit scores under 580, but that they are expected to account for over 42 percent of defaults.[59] This foreclosure risk can be attributed to lending to borrowers who may not have control over their finances. For example, those with higher debt-to-income ratios may not be able to survive a financial setback.

Predatory Lending

Predatory lending is perhaps the most controversial issue implicated with any study relating to possible legislation of the mortgage industry. It is also one of the hardest issues to define and quantify.

Predatory lending has been defined, at least in one context, as lenders “engaging in deception or fraud, manipulating the borrower through aggressive sales tactics, or taking unfair advantage of a

[55] Debbie Gruenstein Bocian, Keith Ernst, and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, (Center for Responsible Lending, May 2006), 3, http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf (accessed August 21, 2006).
[56] Bocian et. al., *Unfair Lending*, 4.
[57] “Report: Blacks and Hispanics pay more for mortgages,” DallasNews.com, September 8, 2006.
[58] Renaurt, “An Overview of the Predatory Mortgage Lending Process,” 479.
[59] Capone, *Research Into Mortgage Default and Affordable Housing*, 10.

borrower's lack of understanding about loan terms."[60] Four main categories of abuses[61] emerged out of testimony at predatory lending forums organized by the US Department of Housing and Urban Development and the US Department of Treasury:

- Loan Flipping: repeated, successive refinancings that often include high fees and penalties.
- Excessive Fees: "packed" fees included in loan amount unknown to borrower.
- Lending without Regard of Ability to Repay: lending often based on home equity rather than borrowers income and ability to make payments.
- Outright Fraud and Abuse: deceptive and/or highly aggressive sales tactics.

Predatory lenders may use aggressive sales tactics to attract potential borrowers. Such techniques may include door-to-door solicitation, direct telephone marketing, direct mailings, or local advertisements to pursue people with limited educations and/or people with considerable equity in their homes.[62]

Any loan that does not take into account the borrower's ability to pay or includes excessive fees, or any lender that engages in frequent loan flipping that adds fees and penalties has the strong potential to lead to default and foreclosure for the borrower. It should also be noted that any loan can exhibit predatory or abusive characteristics at some point during the life of the loan. In the case of mortgage servicing, "a predatory loan can be serviced fairly and a fair loan can be serviced abusively."[63]

A number of states have passed legislation in an attempt to curb these types of practices. For further discussion of such laws, please see the legislation section of this document. A 2006 Center for Responsible Lending (CRL) study that examined 6 million subprime mortgage loans made from 1998 to 2004 found that, in states with anti-predatory lending laws that exceed federal protections, borrowers received loans with less abusive terms, borrowers paid the same or lower interest rates for subprime mortgages, and there was no significant effect on subprime mortgage volume compared to states without anti-predatory lending laws.[64]

In 2001, Senate Bill 1581 was enacted (77th Legislature, regular session), which added Chapter 343, "Home Loans" to the Texas Finance Code. Subchapter C of this section, which pertains to "High-Cost Home Loans," refers to a loan that (1) has a principal amount equal to or less than the maximum conventional loan amount established by Fannie Mae; (2) is not a reverse mortgage or open-end account; and (3) is a credit transaction where (a) the annual interest rate exceeds the Treasury yield by more than 8 percent for first lien loans (10 percent for second lien loans) or (b) has total points and fees that exceed 8 percent of the loan amount or $400 (whichever is greater). For

[60] US Department of Housing and Urban Development and US Department of Treasury, *Curbing Predatory Home Mortgage Lending*, (Washington DC: US Department of Housing and Urban Development, 2000), 1, http://www.huduser.org/publications/pdf/treasrpt.pdf (accessed August 20, 2006).
[61] HUD, *Curbing Predatory Home Mortgage Lending*, 21-22.
[62] James Carr and Lopa Kolluri, "Predatory Lending: an Overview," 32-33.
[63] Eggert, "Limited Abuse and Opportunism by Mortgage Servicers," 756.
[64] Wei Li and Keith Ernst, *The Best Value in the Subprime Market: State Predatory Lending Reforms*, (Center for Responsible Lending, February 2006), 2-3, http://www.responsiblelending.org/pdfs/rr010-State_Effects-0206.pdf (accessed September 6, 2006).

these high-cost loans, there are restrictions on balloon payments, negative amortization, and prepayment penalties, as well as restrictions on the lenders ability to make a high-cost loan to a consumer without regard to the borrower's current and future ability to repay the loan. Please refer to the appendix for the full text of this legislation.

Effective January 1, 2006, Fannie Mae's single family loan limit for first mortgages was $417,000.[65] For August 1, 2006, the daily treasury yield curve rate for a 30 year maturity was 5.07 percent.[66] When considering a $125,000 mortgage, in order for the mortgage to be covered under Chapter 343 of the Texas Finance Code, the loan would need to have either an interest rate higher than 13.07 percent or have points and fees (not including down payment) of more than $10,000.

A good overview of both the predatory lending issues and the level of effort required to analyze the lending characteristics of specific foreclosed properties may be found in a report entitled *The Effect of Concentrated Subprime Lending on a Community of New Single-Family Homes in San Antonio, TX - A Case Study*.[67] This report studied a San Antonio subdivision that experienced a high number of foreclosures before construction of the subdivision had been completed. It discusses the impact of many of the lending practices, when not used appropriately, that appear to increase the likely hood of foreclosure: high-risk ARM home loans, high loan to value ratios, irresponsible and deceptive lending practices (such as the provision of obscured or incomplete tax information), and not providing borrowers with knowledge required to make informed decisions.

General Observations on Reasons for Foreclosure

From the existing literature, it appears the main reasons for foreclosure include changes in personal financial circumstances, failure to understand or plan for mortgage obligations, or abusive lending practices. Existing information on causes comes primarily from studies done by the GSEs, and likely represents the area of the market least likely to include abusive lending practices. These studies find that changes in personal circumstances, often related to economic conditions, are the most important cause of foreclosures. Next, in terms of significance, is (non-mortgage) debt. Factors possibly related to the mortgage lending process are harder to identify. Evidence here is comprised primarily of examples of cases of particular abuse, along with information on changes in lending practices thought likely to make abuse more likely. This information highlights the potential for foreclosures to be brought on by lending practices but make it difficult to assess the scale of the problem overall. Some of these practices were addressed in Texas through legislation passed in the last session, but it is too soon to know the impact of these changes.

[65] Fannie Mae, "2006 Single-Family Loan Limits," http://www.fanniemae.com/aboutfm/loanlimits.jhtml (accessed August 20, 2006).
[66] US Department of Treasury Office of Debt Management, "Daily Treasury Yield Curve Rates," http://www.treas.gov/offices/domestic-finance/debt-management/interest-rate/yield.shtml (accessed August 20, 2006).
[67] Olivia Yu, Ph.D, *The Effect of Concentrated Subprime Lending on a Community of New Single-Family Homes in San Antonio, TX - A Case Study*, *A Report to Fannie Mae*, Department of Criminal Justice at the University of Texas at San Antonio, May 5, 2005.

THE FORECLOSURE PROCESS IN TEXAS

Texas Foreclosure Laws

During the closing of a home sale, the homebuyer executes a deed of trust, which gives the trustee a power of sale with respect to the property being purchased to secure performance of the mortgage loan. This deed of trust outlines the foreclosure process, should the borrower default on the loan. Unless there is a conflict with Texas law or no written process for the loan, a foreclosure that complies with the procedure outlined in the deed of trust is valid.[68]

Section 51.002 of the Texas Property Code describes the steps in the foreclosure process as codified in Texas law. If the deed of trust has requirements above and beyond the minimum requirements outlines in this section of the Property Code, those additional requirements must be exactly followed in order for the foreclosure to be valid.[69]

According to §51.002, if the borrower is delinquent in making a payment, the lender must then notify the borrower by certified mail that he or she has 20 days to cure the delinquency. If the borrower fails to cure the delinquency after proper notice, the trustee is then permitted to use the "power of sale" provision conferred by the deed of trust to begin the foreclosure process for the benefit of the lender. This process begins with the lender giving 21-day advance notice of the intent to sell the property by (1) mailing the default notice to the borrower by certified mail, (2) posting the default notice on the county courthouse door, and (3) filing the default notice with the county clerk. If the borrower is unable to cure the default within the 21 days, the property is sold at the county courthouse at a public auction held on the first Tuesday of the month following the expiration of the 21-day period.

The mortgage loan note secured by the deed of trust typically will include an acceleration clause, which allows the lender to require the full balance of the mortgage (principal, interest, penalties and certain costs), and not just the amount in arrears, should the borrower default.[70] The power of sale provision enables the trustee to sell the property at auction for the benefit of the holder of the mortgage loan, the proceeds of that sale being applied to the balance of the mortgage. After the sale, there is no right to redemption in Texas.[71]

At the sale, any party may bid on the property, and typically the lender will bid on the property up to what is owed by the borrower on the mortgage.[72] If the foreclosure sale does not generate sufficient funds to repay the full amount of the deficient mortgage, the lender typically has the ability to pursue a deficiency suit, seeking to obtain a judgment against the borrower to recover

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[68]Judon Fambrough, *A Homeowner's Rights Under Foreclosure* (Real Estate Center at Texas A&M University, September 2005), 1, https://recenter.tamu.edu/pdf/825.pdf (accessed August 17, 2006).
[69] Fambrough, *A Homeowner's Rights Under Foreclosure,* 2.
[70] Fambrough, *A Homeowner's Rights Under Foreclosure,* 1.
[71] Fambrough, *A Homeowner's Rights Under Foreclosure,* 3.
[72] James Gaines, "Texas: Do We Have a Foreclosure Problem?" *Tierra Grande* (Real Estate Center at Texas A&M University) vol. 13, no. 1 (January 2006) http://recenter.tamu.edu/tgrande/vol13-1/1761.html (accessed August 17, 2006).

the remaining loss, within two years of the foreclosure sale.[73] However, in practice, lenders rarely pursue deficiency judgments because borrowers in foreclosure typically have few resources, thus making the pursuit of a judgment a waste of the lender's resources.[74]

The Committee would like to emphasize that a Texas homeowner would rarely face a foreclosure 41 days after a default. It is in the borrower and lender's interest to work together to resolve the problem through a process other than foreclosure. For example, Freddie Mac typically works for 120 days with a delinquent borrower before referral to an attorney for foreclosure. Generally that would be 150 days from the due date of the last payment installment. Freddie Mac's attorney-managed foreclosure process in Texas takes an average of 95 days, if cases where bankruptcy, probate, or other processes that can extend the period are excluded. For Freddie Mac, the average Texas timeline is 245 days from the default event to foreclosure. In 2006 Freddie Mac instituted a new program to pay attorneys an incentive fee to provide a workout in favor of the borrower, rather than foreclose. However, the program is too new to measure results.

Length of the Foreclosure Period

The foreclosure process in Texas is relatively quick, straightforward, and simple compared that of many other states. It is a "power of sale" state and does not require a judicial foreclosure process, meaning that foreclosures can be handled without involving the courts. One source estimates that on average, judicial foreclosures take 148 days longer than nonjudicial foreclosures. The state with the longest foreclosure process, Maine, uses a judicial process that takes 300 days longer than Texas, which has the shortest foreclosure process.[75] In addition to Texas, 28 other states allow a "simpler, quicker, and cheaper nonjudicial" power-of-sale foreclosure option, whereas 21 states require a judicial process. As can be seen by these numbers a few states use both methods.

The following table compares the length of the foreclosure period to the foreclosure rate. It uses information on foreclosures from the third quarter of 2005 through the second quarter 2006 and information on foreclosure laws from Realty.com.[76] The table shows the number of households with a mortgage[77] divided by the average monthly foreclosure rate. This number provides a better comparison of the foreclosure rate than just the total number of foreclosures as obviously Texas will have more foreclosures than much smaller states.

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[73] Fambrough, *A Homeowner's Rights Under Foreclosure,* 4.

[74] Karen Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit* (Board of Governors of the Federal Reserve System, May 2003), 6, http://www.federalreserve.gov/pubs/feds/2003/200316/200316pap.pdf (accessed August 17, 2006).

[75] Karen Pence, *Foreclosing on Opportunity,* 5.

[76] The foreclosure data is from Foreclosure.com and represents the number of real estate owned (REO) properties which went through foreclosure sale and were purchased by the mortgage holder. It should be noted that the data does not report on properties that were purchased by third parties at foreclosure. It also does not include properties where the foreclosure process was initiated but not carried out because the default was resolved prior to the foreclosure.

[77] Census' 2004 American Community Survey.

Other than to note that Texas had the reported shortest foreclosure processing period of all the states, from a cursory examination of the data, no clear conclusions can be drawn as to the impact of the length of the foreclosure period and the foreclosure rate. While Texas and Georgia have relatively short foreclosure periods and a higher foreclosure rate than many other states, there are other states with a comparable foreclosure rate and much longer foreclosure periods Indiana (251 days), Colorado (166 days), Michigan (90-425 days), Ohio (217 days), and Utah (138 days).

Estimated Foreclosure Timelines by U.S. State

Total days to sale or expiration of redemption period from receipt of notice by borrower.

State	Judicial	Nonjudicial	# of Households w/ a Mortgage per Foreclosure	Foreclosure Rate (Ranking high to low)
Alabama		49-74	1,841	16
Alaska		105-108	7,138	37
Arizona		N/A	7,251	39
Arkansas		80	1,766	15
California		117	16,368	49
Colorado		166	919	3
Connecticut	160		12,207	46
Delaware	170-210		5,415	33
Florida	135		11,539	44
Georgia	37		795	2
Hawaii	220		136,626	50
Idaho		150	3,494	26
Illinois	300		2,463	23
Indiana	251		752	1
Iowa	160		2,037	17
Kansas	N/A		1,573	13
Kentucky	147		1,735	14
Louisiana	180		4,311	29
Maine	240		7,708	40
Maryland	46		6,982	36
Massachusetts	75		11,727	45
Michigan		90-425	921	4
Minnesota		270-280	2,771	24
Mississippi		90	2,408	22
Missouri		60	1,266	10
Montana		150	5,173	32
Nebraska	142	111	2,096	18
Nevada		116	4,686	30
New Hampshire		59	10,187	43
New Jersey	270		9,814	42
New Mexico	180		2,162	19
New York	355		3,888	27

State	Judicial	Nonjudicial	# of Households w/ a Mortgage per Foreclosure	Foreclosure Rate (Ranking high to low)
North Carolina	150	120	1,314	11
North Dakota	150		6,350	35
Ohio	217		930	5
Oklahoma	156		1,408	12
Oregon		150	4,688	31
Pennsylvania	270		2,324	21
Rhode Island		74	13,518	48
South Carolina	180		1,123	9
South Dakota	150		3,930	28
Tennessee		40-50	1,061	8
Texas		**21**	**1,050**	**6**
Utah		138	1,056	7
Vermont	275		12,722	47
Virginia		45	8,949	41
Washington		135	7,160	38
West Virginia		120	2,221	20
Wisconsin	290		3,250	25
Wyoming		60	5,721	34

One school of thought holds that borrowers who are subject to lengthier foreclosure processes may have more time to resolve the default or be able to live in their home longer before being evicted.[78] In Texas, where the entire process from delinquency to foreclosure sale can potentially take as little as 41 days, borrowers who do not work with lenders to implement loss mitigation arrangements have very little time until foreclosure proceedings are complete. For states like California, where the process can take as long as 120 days,[79] borrowers may have a greater opportunity to contact their lender as well as remedy the financial issue that caused the initial payment lapse. For example, in a favorable market where home values were appreciating and sales were occurring quickly, this time period could have afforded the borrower the option to resell the home and avoid foreclosure, and, in some instances, even enable the borrower to exit with a profit.

A counter opinion on the affect of the foreclosure period length is that longer foreclosure processes may actually increase the probability of default. Borrowers in states that have long foreclosure periods have more opportunities to reinstate, but the extended period of "free rent" also makes it attractive for borrowers to allow the home to proceed to foreclosure.[80] A study of FHA-insured mortgages reporting default in years 1988 through 1994 found that as the time in

[78] Kurt Eggert, "Limited Abuse and Opportunism by Mortgage Servicers,"771.

[79] Gaines, "Texas: Do We Have a Foreclosure Problem?"

[80] Brent Ambrose and Charles Capone, "Modeling the Conditional Probability of Foreclosure in the Context of Single-Family Mortgage Default Resolutions," *Real Estate Economics* (American Real Estate and Urban Economics Association) vol. 26, issue 3 (1998): 405, http://www.areuea.org/publications/ree/articles/V26/REE.V26.3.2.PDF (accessed August 17, 2006).

default rose, the probability of foreclosure rose and the probability of reinstatement and property sale declined.[81] A longer default period can accumulate greater arrearages and thus impede reinstatement. However, it should be noted that this study sampled loans that were originated and in default prior to a 1996 congressional directive that empowered FHA to offer and pursue loss mitigation options with borrowers in default.[82]

While lengthy foreclosure processes and other legal factors such as redemption rights may provide more time and flexibility for homebuyers experiencing financial difficulties, research suggests that they also increase lender costs, which may, in turn, either reduce the supply of mortgage credit in these areas or increase costs to borrowers at the time of loan origination.[83] Thus, lenders prefer a shorter timeframe. If foreclosure is delayed, lenders lose money as the borrower does not make payments because the loan balance rises and therefore the equity in the home decreases.[84] For example, delaying the foreclosure process on a $100,000 mortgage by 16 months can increase lender costs by over $13,500.[85]

[81] Amborse and Capone, "Modeling the Conditional Probability of Foreclosure," 422.

[82] Charles Capone, *Research Into Mortgage Default and Affordable Housing: A Primer* (LISC, March 2002), 14, http://www.lisc.org/content/publications/detail/906 (accessed August 17, 2006).

[83] Karen Pence, *Foreclosing on Opportunity,* 28.

84 Eggert,, "Limited Abuse and Opportunism by Mortgage Servicers," 771.

85 Karen Pence, Foreclosing on Opportunity, 5.

ANALYSIS OF TEXAS FORECLOSURE ACTIVITY

This section presents results of our assessment of existing information on the magnitude of the problem in Texas, and in the six study counties. Researchers faced tremendous difficulty gathering loan-level information about foreclosures, preventing concrete conclusions from being drawn as to causes. Instead, analysis of the characteristics of places, in each county, where high concentrations of foreclosures are found is presented to suggest areas for further research.

Texas as Compared to the Nation and Other States

The following table shows the total foreclosures, average monthly foreclosures, and the rate of foreclosure for each state.[86] This data indicates that Texas leads the nation in terms of the total number of foreclosures. However, its rank is slightly lower (6th) in terms of the number of households with a mortgage to each foreclosure.

Foreclosure Statistics by State July 2005 - June 2006 (Sorted by Foreclosure Rate)

Rank	State	Total Foreclosures	Average Monthly # of Foreclosures	# of Households with A Mortgage Per Average Monthly # of Foreclosures
1	Indiana	19,103	1,592	752
2	Georgia	23,858	1,988	795
3	Colorado	12,846	1,071	919
4	Michigan	25,751	2,146	921
5	Ohio	27,415	2,285	930
6	**Texas**	**36,362**	**3,030**	**1,050**
7	Utah	4,650	388	1,056
8	Tennessee	11,763	980	1,061
9	South Carolina	7,914	660	1,123
10	Missouri	10,272	856	1,266
11	North Carolina	13,825	1,152	1,314
12	Oklahoma	4,646	387	1,408
13	Kansas	3,644	304	1,573
14	Kentucky	4,872	406	1,735
15	Arkansas	2,874	240	1,766
16	Alabama	5,076	423	1,841
17	Iowa	3,126	261	2,037
18	Nebraska	1,698	142	2,096
19	New Mexico	1,685	140	2,162
20	West Virginia	1,477	123	2,221
21	Pennsylvania	11,174	931	2,324
22	Mississippi	2,197	183	2,408
23	Illinois	10,843	904	2,463
24	Minnesota	4,728	394	2,771
25	Wisconsin	3,771	314	3,250

86 The foreclosure data is from Foreclosure.com and represents the number of real estate owned (REO) properties which went through foreclosure sale and were purchased by the mortgage holder. It should be noted that the data does not report on properties that were purchased by third parties at foreclosure. It also does not include properties where the foreclosure process was initiated but not carried out because the default was resolved prior to the foreclosure.

Rank	State	Total Foreclosures	Average Monthly # of Foreclosures	# of Households with A Mortgage Per Average Monthly # of Foreclosures
26	Idaho	884	74	3,494
27	New York	7,930	661	3,888
28	South Dakota	362	30	3,930
29	Louisiana	1,796	150	4,311
30	Nevada	1,036	86	4,686
31	Oregon	1,624	135	4,688
32	Montana	335	28	5,173
33	Delaware	341	28	5,415
34	Wyoming	179	15	5,721
35	North Dakota	181	15	6,350
36	Maryland	1,879	157	6,982
37	Alaska	175	15	7,138
38	Washington	1,922	160	7,160
39	Arizona	1,736	145	7,251
40	Maine	386	32	7,708
41	Virginia	1,924	160	8,949
42	New Jersey	1,854	155	9,814
43	New Hampshire	292	24	10,187
44	Florida	3,270	273	11,539
45	Massachusetts	1,143	95	11,727
46	Connecticut	641	53	12,207
47	Vermont	118	10	12,722
48	Rhode Island	161	13	13,518
49	California	3,850	321	16,368
50	Hawaii	15	1	136,626

A suggested reason as to why Texas might have a higher foreclosure rate than some other states is related to the rate of appreciation of home values. In a report by James Gaines of the Texas Real Estate Center, this issue is concisely described.

> *"In the high-appreciation states of California, Florida and Nevada, properties actually sold at foreclosure number significantly less than postings. The principal reason is fairly simple. In states with rapidly increasing home prices, an owner served with a default notice and foreclosure posting can easily sell the property and cure the default, probably at a profit. In states with less appreciation, such as Texas, owners typically do not have the opportunity to sell the property at a high enough price to cure a default.*
>
> *This discrepancy may also reflect the fact that many homes are being purchased by first-time homebuyers who qualify for loans based on initially lower interest rates and more liberal underwriting criteria applied by aggressive lenders. Many people are able to acquire a loan and buy a house but are unable to keep up with payments on the loan because of high property taxes, insurance costs, maintenance and other normal homeownership costs for which they are not prepared. Higher numbers of foreclosures in states like Texas probably*

indicate easier home credit and the owner's inability to sell the property on default because of low rates of home price appreciation."[87]

Foreclosure Rates in the Study Counties

It should be emphasized that the observations of this study related to foreclosure rates and associated characteristics apply specifically to the six study counties, Bexar, Cameron, Dallas, El Paso, Harris, Travis. These counties comprised approximately 46 percent of the total Texas foreclosures. The following table provides county level foreclosure statistics for the six Study counties. As with the national data, the data is from Foreclosure.com and covers REO foreclosure activity. Due to differences in the data that was available at the county level, the time period covered June 2005 through May 2006.

Foreclosures for Study Counties[88]

Rank	County	Total Foreclosures	Average Monthly # of Foreclosures	# of Households with A Mortgage Per Average Monthly # of Foreclosures
1	Dallas	6,107	509	539
2	Cameron	354	30	800
3	Harris	6,119	510	828
4	Bexar	2,440	203	897
5	Travis	1,195	100	1,093
6	El Paso	476	40	1,861
	Total for Study Counties	16,691	1,391	780

One clear indication from the data is that the foreclosure rates vary widely across the counties. Dallas had the highest foreclosure rate in terms of households with a mortgage. El Paso's foreclosure rate was more than three times lower.

Census Tract Level Foreclosure Analysis

From the preceding section on General Foreclosure Issues, it is clear that economic conditions, illness, and divorce are strongly related to foreclosures. Beyond that, it becomes harder to make strong statements about which factors are most likely to be related to foreclosure in a particular place. Without individual loan data, we are unable to tease out what happened in each case for each county. In the absence of this information, we developed an exploratory strategy for assessing possible factors behind foreclosures—factors that can be investigated further in other research.

Through use of census data and data available under the HMDA (described earlier), we were able to explore whether particular areas of the city were more or less likely to contain foreclosed

[87] James Gaines, "Texas: Do We Have a Foreclosure Problem?" *Tierra Grande* (Real Estate Center at Texas A&M University) vol. 13, no. 1 (January 2006) http://recenter.tamu.edu/tgrande/vol13-1/1761.html (accessed August 17, 2006).
[88] The foreclosure data is from Foreclosure.com data set used for this Study.

properties. Rather than an examination of individual outcomes, this section presents evidence about places and communities. Results here are simply trends. More sophisticated quantitative analysis would be necessary to draw stronger conclusions about the strength of correlations between the amount of foreclosures in a community (e.g., census tract) and any particular demographic feature of that area, as well as of interrelationship among any of these factors.

We looked at the relationship between the concentration of foreclosures in a particular census tract and tract-level measures of educational attainment, income, minority population, linguistic isolation of non-English speakers and share of local loans with rates well above conventional levels. Interpretation of any apparent relationships should proceed with care, due to the fact that we are considering averages for an area rather than examining the characteristics of individuals within each area.

Nonetheless, as a first step in the process of investigating the issue of foreclosure, these maps and statistics can be used to suggest areas for further research or policy discussion. For example, counties where foreclosures are concentrated in areas characterized by very low average incomes and a high concentration of high rate loans may indicate a problem with subprime lending. It would not be possible, however, to draw any conclusions about whether lending practices were abusive in any way. Similarly, counties where foreclosures are concentrated in areas characterized by a high degree of linguistic isolation of residents, or low average levels of educational attainment, may indicate a problem with poor understanding of loan options or terms. Again, further investigation would be needed to assess what is really going on. But with these maps and data, some starting points for each county can be suggested.

A more detailed discussion of each demographic factor that the Study evaluated is below provided. For each factor, the observed relationship between the percentage of foreclosures and percentage of mortgages within prescribed quartiles of tracts within each county is established.

Foreclosure Concentrations

This measure shows the concentration of foreclosures reported between 1/1/2002 and 6/30/2006 in each tract. Each county's tract concentration ratios, as represented by the ratio of each tract's number of foreclosures to its number of mortgages, were divided into quartiles to categorize the tract's foreclosure level as being very low through very high. The number of foreclosures and mortgages within each tract were then totaled to determine the relative level of foreclosure activity in each category of tract.

Each of the Study counties showed that tracts which are characterized as having a “very high” foreclosure rate have a much higher percentage of the county’s foreclosures than the county’s mortgages as a group. The higher percentage of foreclosures occurring in tracts with “very high” foreclosure rates indicates that the foreclosures are more concentrated in certain tracts as opposed to being spread equally across each county.

Linguistic Isolation

This measure shows the tract level concentration of households which have difficulty speaking English. Each county's tract concentration ratios, as represented by each tract's ratio of linguistically isolated households to its total number of households, were divided into quartiles to categorize the tract's linguistic isolation level as being very low through very high. The number of foreclosures and mortgages within each tract were then totaled to determine the relative level of foreclosure activity in each category of tract. A linguistically isolated household is one in which no member 14 years old and over (1) speaks only English or (2) speaks a non-English language and speaks English very well." In other words all members 14 years old and over have at least some difficulty with English. This factor was chosen for evaluation because it was thought that the ability to understand English could affect the ability to understand key aspects of the loan process if the verbal description of the loan and written documentation was not provided in the primary language of the borrower.

With the exception of Bexar and Travis Counties, differences between the foreclosure distribution across the linguistic isolation categories was not significantly different. However, in these two counties, a higher rate of foreclosures appears to have occurred in “high” and “very high” linguistic isolation tracts. Cameron County showed a slightly higher proportion of mortgages being in tracts that could be categorized as having a “high” level of linguistic isolation.

Educational Attainment

This measure shows the concentration of persons in each tract who have a lower level of educational attainment. Each county's tract concentration ratios, as represented by each tract's number of persons without a high school degree by its total number of persons, were divided into quartiles to categorize the tract's number of persons with a low level of education as being very low through very high. The number of foreclosures and mortgages within each tract were then totaled to determine the relative level of foreclosure activity in each category of tract. As was the case with linguistic isolation, this factor was chosen for analysis because it was thought that a Borrower’s level of education could affect the ability to understand key aspects of the loan process.

The relationship between education and foreclosure rates is unclear. Two of the counties, El Paso and Harris, showed differences between the percentage of foreclosure and percentage of mortgages in tracts that were categorized as having a “very low” and “low” level of persons without a high school diploma. However, this ratio remained fairly equal for the other two categories. Bexar, Dallas, and Travis showed a fairly noticeable trend that the foreclosure rate increased with the rate of persons without a diploma. Cameron County only showed a very slight variance between the percentage of foreclosures and percentage of mortgages in the tracts where the percentage of persons without a high school diploma was categorized as “high.”

Income Level

This measure shows the concentration of households in each tract with a comparatively low income. Each county's tract concentration ratios, as represented by each tract's owner occupied median household income divided by the county's median household income, were divided into quartiles to categorize the tract's relative level of low income households as being very low through very high. The number of foreclosures and mortgages within each tract were then totaled to determine the relative level of foreclosure activity in each category of tract. This factor was chosen for evaluation because it was thought that borrowers in lower income tracts would have fewer resources available to help them through the life events that cause foreclosure as described in the section on General Foreclosure issues.

As was the case with educational attainment, the relationship between the level of tract household income and foreclosure rates is unclear. Cameron and Harris Counties did not show very significant differences between the foreclosure distribution and the mortgage distribution across the income categories. Harris and El Paso counties showed a higher percentage of foreclosures as compared to the percentage of mortgages at the “high” tract income level. Bexar, Dallas, and Travis Counties showed increasing percentages of foreclosure activity as compared to the percentage of mortgages across the board as the tract household income decreased.

Minority Population

This measure shows the relative concentration of non-"White" households in each tract. Each county's tract concentration ratios, as represented by each tract's non-"White" households divided by the total number of households, were divided into quartiles to categorize the tract's relative level of minority population as very low through very high. The number of foreclosures and mortgages within each tract were then totaled to determine the relative level of foreclosure activity in each category of tract. This factor was chosen for analysis because existing research indicates that minorities have lower incomes, educational attainment, and higher use of higher rate loans. These are three of the other factors that are being evaluated in this section of the Study.

Across all of the study counties, the level of foreclosure activity was higher in tracts that were categorized as having “high” or “very high” minority populations.

Higher Rate Loan Activity

This measure shows the concentration of loans where the spread between the annual percentage rate (APR) on the loan and the rate on treasury securities with comparable maturity periods exceeds the applicable rate by more than 3 percent. Each county's tract concentration ratios, as represented by each tract high rate spread loans divided by the total number of originated loans, were divided into quartiles to categorize the tract's relative level of high rate loans as being very low through very high. The number of foreclosures and mortgages within each tract were then totaled to determine the relative level of foreclosure activity in each category of tract. This factor

was chosen for evaluation as this might be a general indicator of the relative use of subprime and newer loan products as discussed in the General Foreclosure Issues section.

As was the case with race, across all of the study counties, the level of foreclosure activity was higher in tracts that were categorized as having "high" or "very high" levels of high rate loans. In Bexar, Dallas, Harris, and Travis counties this factor showed the highest relative concentration of foreclosure activity in these two categories. For example, in Travis County 78 percent of the foreclosure occurred in "high" or "very high" tracts as compared to only 45 percent of the county's mortgages being in these tracts.

Census Tract Analysis for Each Study County

The following series of tables and corresponding maps describe the relationship between each demographic factor and the relative percentage of foreclosures and percentage of mortgages for each of the prescribed quartiles.

Bexar County

According to the 2005-06 data, the monthly average of foreclosures in Bexar County equaled one for every 897 mortgages held in the county. This is higher than the rate for Texas as a whole, which stood at one foreclosure for every 1,050 mortgages.

Tract Level Analysis

Analysis of the census tract level was drawn from the 2002-06 data. Absent information on the characteristics of individual borrowers or their loans, it is difficult to draw conclusions about the relative importance of various possible causes for the rate or distribution of foreclosures. However, analysis of census and HMDA data for Bexar County tracts revealed a number of genuine trends.

Census tracts where foreclosures were most concentrated were:

- More likely to have high numbers of linguistically isolated residents. Tracts in which at least 6% of the population was linguistically isolated accounted for 44% of foreclosures but only 31% of mortgages.
- More likely to have high numbers of residents without a high school diploma. Tracts where at least 20% of residents did not graduate accounted for 49% of foreclosures but only 32% of mortgages in the county.
- More likely to have average incomes below the regional median. Tracts with average incomes below 89% of regional median accounted for 50% of foreclosures but only 32% of mortgages in the county.
- More likely to be minority neighborhoods. Tracts where minorities' share of the population was above 68% accounted for 54% of foreclosures but only 35% of mortgages. Conversely, tracts where minorities comprised less than 44% of the population contained 36% of all mortgages but only 18% of foreclosures.

- More likely to include households whose loans are characterized as higher rate. Tracts where at least 24% of loans were high rate loans accounted for 52% of foreclosures but only 38% of mortgages.

Of the 272 total tracts in Bexar County, the following 67 comprised the quartile of tracts with the highest concentrations of foreclosed properties:

Tract FIPS Code	Estimated Total # of Mortgages in 2004	Total # of Foreclosures 2004-2006	Tract Foreclosure Rate (Mortgages/ Foreclosure)
48029110600	124	8	15.5
48029110700	58	4	14.5
48029110800	37	2	18.5
48029120502	497	33	15.1
48029121205	325	19	17.1
48029121403	361	28	12.9
48029121404	304	16	19.0
48029121506	839	58	14.5
48029121508	697	60	11.6
48029121802	784	67	11.7
48029130100	259	25	10.4
48029130200	153	14	10.9
48029130300	255	30	8.5
48029130400	661	45	14.7
48029130500	271	43	6.3
48029130600	292	56	5.2
48029130700	102	10	10.2
48029130800	314	25	12.6
48029130900	305	27	11.3
48029131000	819	47	17.4
48029131100	273	34	8.0
48029131400	863	49	17.6
48029131501	1714	208	8.2
48029131502	1253	68	18.4
48029131607	1512	79	19.1
48029140300	301	15	20.1
48029140600	239	15	15.9
48029140800	651	33	19.7
48029141000	276	25	11.0
48029141200	889	53	16.8
48029141600	330	53	6.2
48029141800	214	11	19.5
48029150600	370	21	17.6
48029150700	506	25	20.2
48029151700	876	47	18.6
48029151900	181	12	15.1
48029152100	226	22	10.3
48029152200	259	82	3.2
48029160400	457	27	16.9
48029161200	179	10	17.9
48029161301	873	66	13.2
48029161502	854	57	15.0
48029161600	402	25	16.1
48029170300	344	22	15.6
48029170401	284	17	16.7
48029170500	424	26	16.3
48029170800	81	4	20.3
48029170900	210	14	15.0
48029171300	698	38	18.4
48029171400	695	56	12.4
48029171500	622	35	17.8
48029171600	639	39	16.4
48029171700	884	44	20.1
48029171801	578	35	16.5
48029171902	7	13	0.5
48029171907	1158	68	17.0
48029171908	1333	136	9.8
48029171912	1102	59	18.7
48029172002	132	7	18.9
48029180300	474	31	15.3
48029180504	377	31	12.2
48029181003	12	8	1.5
48029181401	425	23	18.5
48029181402	6	2	3.0
48029181715	1441	72	20.0
48029181716	1578	81	19.5
48029190100	219	14	15.6
Quartile Averages	**481.0**	**57.9**	**7.9**

Bexar County

County Level of Foreclosures		Total Tracts	Total # of Foreclosures	Total # of Mortgages	Foreclosures/ Mortgages
All Tracts		272	6,040	182,291	3.3%

Tract Level of Foreclosures[1]

	Quartile Break Points	# of Tracts/ Quartile	# of Foreclosures	# of Mortgages	Foreclosures/ Mortgages	% of Foreclosures	% of Mortgages
Very Low	<2%	68	475	50,946	0.9%	8%	28%
Low	2%<>3%	69	1,402	56,759	2.5%	23%	31%
High	3%<>5%	68	1,634	39,708	4.1%	27%	22%
Very High	>5%	67	2,529	34,878	7.3%	42%	19%

Tract Level of Linguistic Isolation[2]

Very Low	<3%	69	1,692	77,928	2.2%	28%	43%
Low	3%<>6%	67	1,741	48,530	3.6%	29%	27%
High	6%<>13%	69	1,544	32,333	4.8%	26%	18%
Very High	>13%	67	1,063	23,500	4.5%	18%	13%

Tract Level of Persons without a High School Diploma[3]

Very Low	<8%	68	1,177	71,076	1.7%	19%	39%
Low	8%<>20%	68	1,957	53,289	3.7%	32%	29%
High	20%<>42%	68	1,728	33,916	5.1%	29%	19%
Very High	>42%	68	1,178	24,010	4.9%	20%	13%

Tract Relative Income Level[4]

High	>125%	68	1,174	72,085	1.6%	19%	40%
Moderate	89%<>125%	68	1,840	51,285	3.6%	30%	28%
Low	67%<>89%	68	1,875	37,030	5.1%	31%	20%
Very Low	<67%	68	1,151	21,891	5.3%	19%	12%

Tract Minority Population[5]

Very Low	<44%	68	1,064	65,014	1.6%	18%	36%
Low	44%<>68%	68	1,738	53,439	3.3%	29%	29%
High	68%<>88%	68	1,971	38,753	5.1%	33%	21%
Very High	>88%	68	1,267	25,085	5.1%	21%	14%

Tract Level of Higher Rate Loan Activity[6]

Very Low	<12%	68	888	55,833	1.6%	15%	31%
Low	12%<>24%	68	2,007	58,470	3.4%	33%	32%
High	24%<>36%	68	1,709	39,654	4.3%	28%	22%
Very High	>36%	68	1,436	28,334	5.1%	24%	16%

Sources:

[1]Foreclosure.com data set.

[2]Table P20. HOUSEHOLD LANGUAGE BY LINGUISTIC ISOLATION [14], Universe: Households, Data Set: Census 2000 Summary File 3 (SF 3) – Sample Data

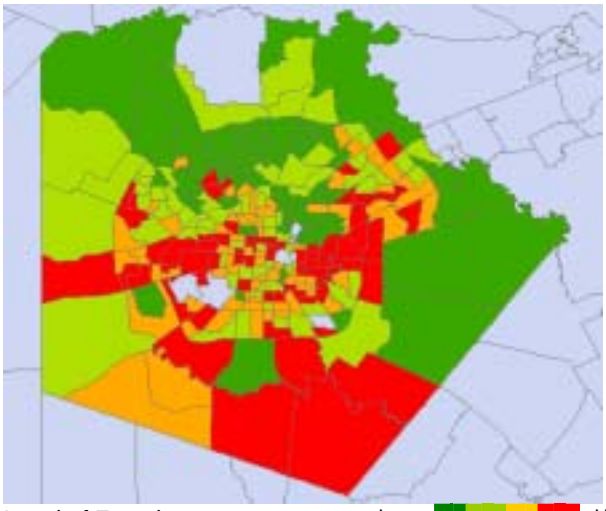
[3]Table P37. Sex by educational attainment for the population 25 years and over [35], 2000 Census

[4]Table HCT12. MEDIAN HOUSEHOLD INCOME IN 1999 (DOLLARS) BY TENURE [3], Universe: Occupied housing units, Data Set: Census 2000 Summary File 3 (SF 3) – Sample Data

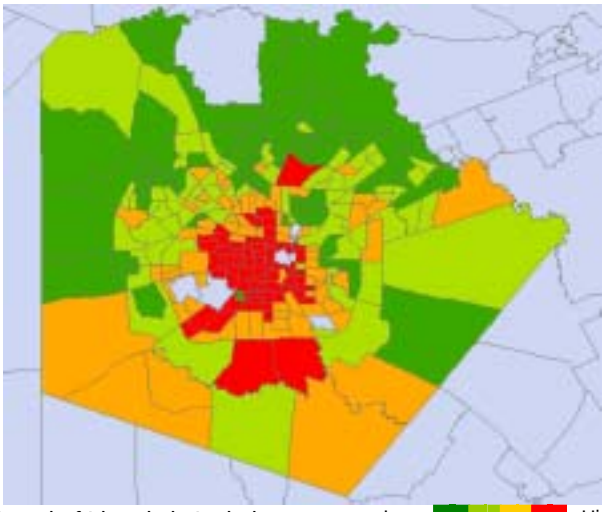
[5]Table P8. HISPANIC OR LATINO BY RACE [17], Universe: Total population, Data Set: Census 2000 Summary File 1 (SF 1) 100-Percent Data

[6]2005 Home Mortgage Disclosure Act Data

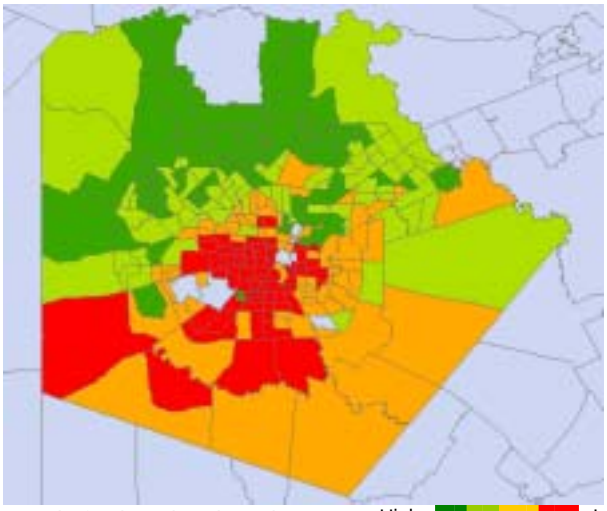
Bexar County Tract Characteristics



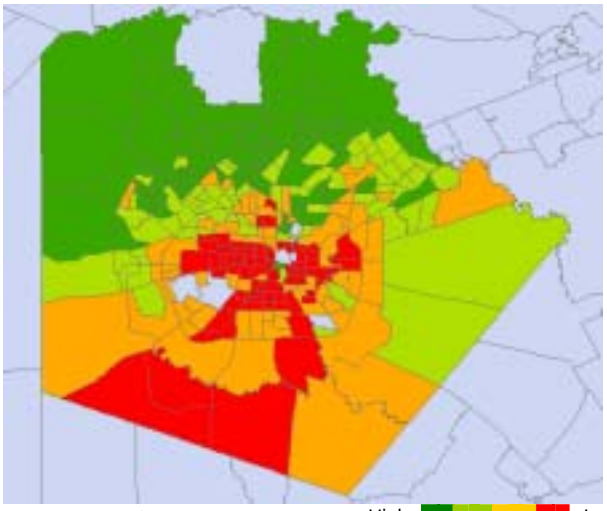
Level of Foreclosures Low High



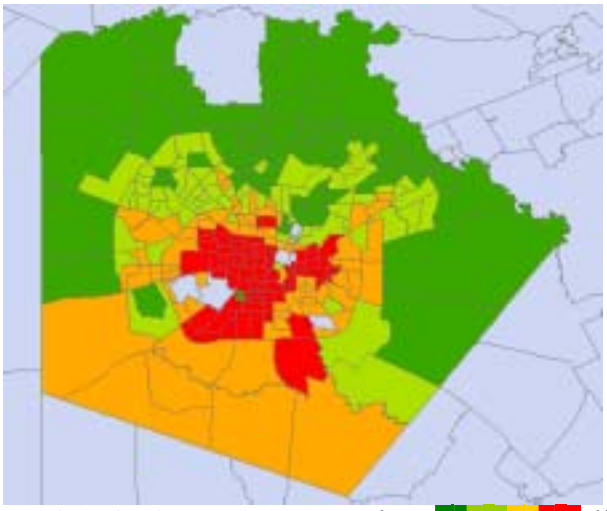
Level of Linguistic Isolation Low High



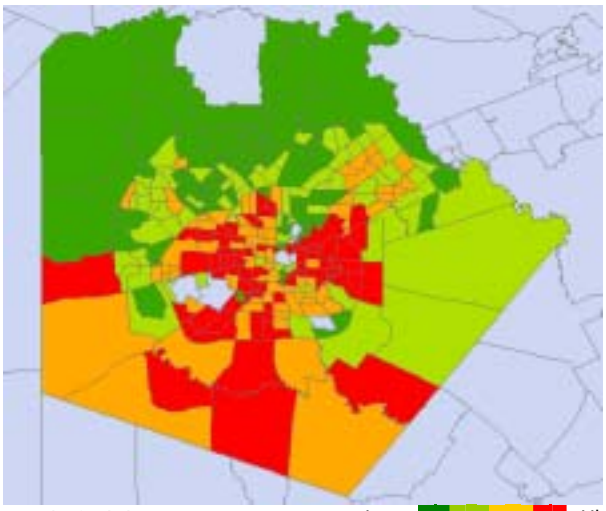
Level of Educational Attainment High Low



Income Level High Low



Level of Minority Population Low High



Level of Higher Rate Loans Low High

Cameron County

According to the 2005-06 data, the monthly average of foreclosures in Cameron County equaled one for every 800 mortgages held in the county. This is much higher than the rate for Texas as a whole, which stood at one foreclosure for every 1,050 mortgages. Compared to the other five counties examined, Cameron County had the second highest rate of foreclosure during the study period (2005-06), behind only Dallas County.

Tract Level Analysis

Analysis of the census tract level was drawn from the 2002-06 data. Absent information on the characteristics of individual borrowers or their loans, it is difficult to draw conclusions about the relative importance of various possible causes for the rate or distribution of foreclosures. However, analysis of census and HMDA data for Cameron County census tracts revealed a number of genuine trends.

Census tracts where foreclosures were most concentrated were:

- More likely to have high numbers of linguistically isolated residents. Tracts in which at least 20% of the population was linguistically isolated accounted for 38% of foreclosures but only 30% of mortgages.
- More likely to have high numbers of residents without a high school diploma. Tracts where at least 47% of residents did not graduate accounted for 47% of foreclosures but only 32% of mortgages in the county.
- More likely to be minority neighborhoods. Tracts where minorities' share of the population was above 90% accounted for 41% of foreclosures but only 34% of mortgages.

There was no apparent relationship between foreclosures and the relative income level of a neighborhood or higher rate loan activity.

Of the 86 total tracts in Cameron County, the following 22 comprised the quartile of tracts with the highest concentrations of foreclosed properties:

Tract FIPS Code	Estimated Total # of Mortgages in 2004	Total # of Foreclosures 2004-2006	Tract Fore-closure Rate (Mortgages/ Foreclosure)
48061010601	649	26	25.0
48061010800	489	22	22.2
48061011500	238	16	14.9
48061011700	419	19	22.1
48061011901	408	18	22.7
48061012607	199	26	7.7
48061012608	294	17	17.3
48061012610	25	12	2.1
48061012611	146	6	24.3
48061013002	233	11	21.2
48061013203	110	8	13.8
48061013206	95	6	15.8
48061013207	70	12	5.8
48061013208	45	2	22.5
48061013304	246	14	17.6
48061013306	138	6	23.0
48061013308	190	15	12.7
48061013309	177	12	14.8
48061013401	108	5	21.6
48061013801	32	2	16.0
48061013901	105	6	17.5
48061014100	232	12	19.3
Quartile Averages	**211.3**	**12.4**	**17.3**

Cameron County

County Level of Foreclosures		Total Tracts	Total # of Foreclosures	Total # of Mortgages	Foreclosures/ Mortgages
All Tracts		86	706	23,611	3.0%

Tract Level of Foreclosures [1]

	Quartile Break Points	# of Tracts/ Quartile	# of Foreclosures	# of Mortgages	Foreclosures/ Mortgages	% of Foreclosures	% of Mortgages
Very Low	<2%	22	43	4,274	1.0%	6%	18%
Low	2%<>3%	21	151	7,131	2.1%	21%	30%
High	3%<>4%	21	239	7,558	3.2%	34%	32%
Very High	>4%	22	273	4,648	5.9%	39%	20%

Tract Level of Linguistic Isolation[2]

Very Low	<14%	22	222	8,465	2.6%	31%	36%
Low	14%<>20%	21	215	7,998	2.7%	30%	34%
High	20%<>29%	22	185	4,341	4.3%	26%	18%
Very High	>29%	21	84	2,807	3.0%	12%	12%

Tract Level of Persons without a High School Diploma[3]

Very Low	<33%	22	269	9,682	2.8%	38%	41%
Low	33%<>47%	21	178	6,356	2.8%	25%	27%
High	47%<>59%	21	160	4,601	3.5%	23%	19%
Very High	>59%	22	99	2,972	3.3%	14%	13%

Tract Relative Income Level[4]

High	>126%	22	231	7,945	2.9%	33%	34%
Moderate	93%<>126%	21	226	7,924	2.9%	32%	34%
Low	76%<>93%	21	178	4,903	3.6%	25%	21%
Very Low	<76%	22	71	2,839	2.5%	10%	12%

Tract Level of Minority Population[5]

Very Low	<81%	22	247	9,162	2.7%	35%	39%
Low	81%<>90%	21	170	6,246	2.7%	24%	26%
High	90%<>96%	21	155	4,565	3.4%	22%	19%
Very High	>96%	22	134	3,638	3.7%	19%	15%

Tract Level of Higher Rate Loan Activity[6]

Very Low	<27%	22	226	8,425	2.7%	32%	36%
Low	27%<>36%	21	195	6,668	2.9%	28%	28%
High	36%<>49%	21	167	4,435	3.8%	24%	19%
Very High	>49%	22	118	4,083	2.9%	17%	17%

Sources:

[1]Foreclosure.com data set.

[2]Table P20. HOUSEHOLD LANGUAGE BY LINGUISTIC ISOLATION [14], Universe: Households, Data Set: Census 2000 Summary File 3 (SF 3) – Sample Data

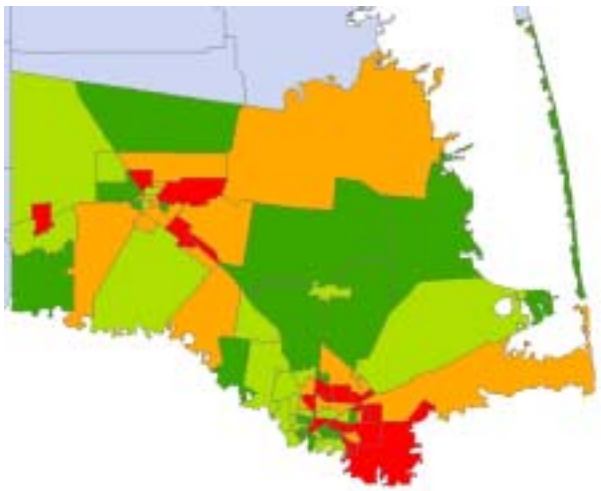
[3]Table P37. Sex by educational attainment for the population 25 years and over [35], 2000 Census

[4]Table HCT12. MEDIAN HOUSEHOLD INCOME IN 1999 (DOLLARS) BY TENURE [3], Universe: Occupied housing units, Data Set: Census 2000 Summary File 3 (SF 3) – Sample Data

[5]Table P8. HISPANIC OR LATINO BY RACE [17], Universe: Total population, Data Set: Census 2000 Summary File 1 (SF 1) 100-Percent Data

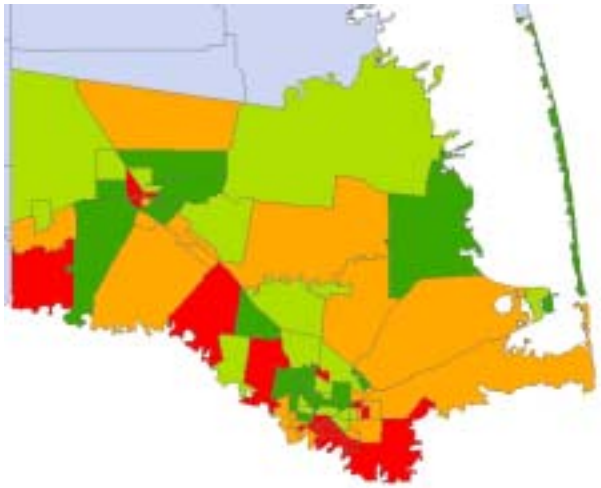
[6]2005 Home Mortgage Disclosure Act Data

Cameron County Tract Characteristics



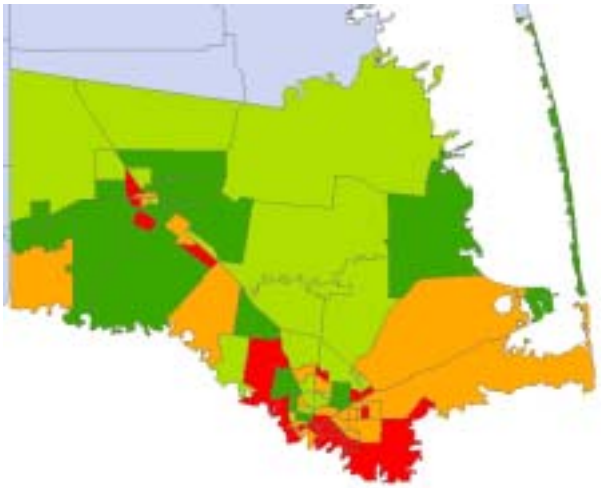
Level of Foreclosures Low High

Level of Linguistic Isolation Low High

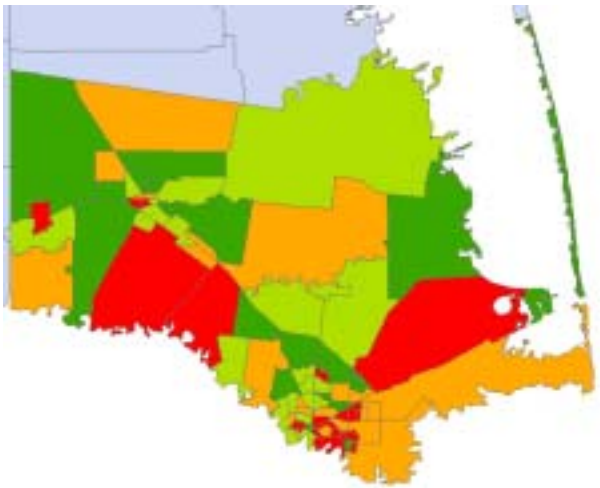


Level of Educational Attainment High Low

Income Level High Low



Level of Minority Population Low High



Level of Higher Rate Loans Low High

Dallas County

According to the 2005-06 data, the monthly average of foreclosures in Dallas County equaled one for every 539 mortgages held in the county. This is much higher than the rate for Texas as a whole, which stood at one foreclosure for every 1,050 mortgages. Compared to the other five counties examined, Dallas County had the highest rate of foreclosure during the study period (2005-06)—more than three times the rate found in El Paso County.

Tract Level Analysis

Analysis of the census tract level was drawn from the 2002-06 data. Absent information on the characteristics of individual borrowers or their loans, it is difficult to draw conclusions about the relative importance of various possible causes for the rate or distribution of foreclosures. However, analysis of census and HMDA data for Dallas County tracts revealed a number of genuine trends.

Census tracts where foreclosures were most concentrated were:

- More likely to have high numbers of residents without a high school diploma. Tracts where at least 22% of residents did not graduate accounted for 46% of foreclosures but only 33% of mortgages in the county.
- More likely to have average incomes below the regional median. Tracts with average incomes below 93% of regional median accounted for 50% of foreclosures but only 36% of mortgages in the county.
- More likely to be minority neighborhoods. Tracts where minorities' share of the population was above 53% accounted for 51% of foreclosures but only 36% of mortgages. Conversely, tracts where minorities comprised less than 34% of the population contained 36% of all mortgages but only 20% of foreclosures.
- More likely to include households whose loans are characterized as higher rate. Tracts where at least 24% of loans were high rate loans accounted for 69% of foreclosures, but only 47% of mortgages.

There was no apparent relationship between foreclosures and the linguistic isolation of a neighborhood.

Of the 466 total tracts in Dallas County, the following 116 comprised the quartile of tracts with the highest concentrations of foreclosed properties:

Tract FIPS Code	Estimated Total # of Mortgages in 2004	Total # of Foreclosures 2004-2006	Tract Foreclosure Rate (Mortgages/ Foreclosure)
48113000500	102	18	5.7
48113000900	131	16	8.2
48113001002	217	19	11.4
48113001301	192	26	7.4
48113001502	75	27	2.8
48113002000	129	12	10.8
48113002200	8	9	0.9
48113002701	65	11	5.9
48113002702	57	25	2.3
48113003201	7	2	3.5
48113003300	6	2	3.0
48113003500	90	26	3.5
48113003700	227	40	5.7
48113003800	176	29	6.1
48113003901	64	17	3.8
48113003902	112	29	3.9
48113004000	81	16	5.1
48113004100	41	4	10.3
48113004300	98	9	10.9
48113004900	286	48	6.0
48113005200	410	44	9.3
48113005500	346	50	6.9
48113005700	397	76	5.2
48113005901	676	84	8.0
48113006002	153	18	8.5
48113006100	473	46	10.3
48113007806	8	10	0.8
48113007811	214	34	6.3
48113007815	61	25	2.4
48113007816	87	29	3.0
48113007905	23	7	3.3
48113008603	53	5	10.6
48113008701	275	46	6.0
48113008703	250	31	8.1
48113008704	220	25	8.8
48113008705	83	8	10.4
48113008801	285	38	7.5
48113008802	579	73	7.9
48113008900	174	23	7.6
48113009000	715	72	9.9
48113009101	535	45	11.9
48113009104	444	38	11.7
48113009201	818	78	10.5
48113009804	18	5	3.6
48113010101	137	16	8.6
48113010601	193	20	9.7
48113010901	193	17	11.4
48113011104	662	73	9.1
48113011105	449	41	11.0
48113011300	758	80	9.5
48113011401	211	43	4.9
48113011402	74	12	6.2
48113011602	332	37	9.0
48113011701	802	72	11.1
48113011702	560	54	10.4
48113011800	980	104	9.4
48113011900	1383	158	8.8
48113012000	518	66	7.8
48113012100	631	80	7.9
48113012206	751	80	9.4
48113012207	692	92	7.5
48113012211	226	26	8.7
48113012500	1018	98	10.4
48113012602	559	53	10.5
48113013612	105	17	6.2
48113014112	81	8	10.1
48113014114	9	1	9.0
48113014502	281	36	7.8
48113014901	76	9	8.4
48113015205	351	38	9.2
48113015900	125	11	11.4
48113016100	167	22	7.6
48113016509	985	91	10.8
48113016510	1448	139	10.4
48113016511	985	108	9.1
48113016514	1493	146	10.2
48113016516	648	59	11.0
48113016517	714	61	11.7
48113016606	1354	160	8.5
48113016610	880	123	7.2
48113016611	1045	116	9.0
48113016612	1729	229	7.6
48113016614	2332	340	6.9
48113016615	971	123	7.9
48113016616	742	143	5.2
48113016618	543	71	7.6
48113016619	344	31	11.1
48113016620	1156	143	8.1
48113016701	721	107	6.7
48113016703	277	27	10.3

Tract FIPS Code	Estimated Total # of Mortgages in 2004	Total # of Foreclosures 2004-2006	Tract Foreclosure Rate (Mortgages/ Foreclosure)
48113016704	876	77	11.4
48113016705	767	89	8.6
48113016803	672	96	7.0
48113016804	1110	108	10.3
48113016903	280	38	7.4
48113017001	385	39	9.9
48113017003	914	101	9.0
48113017004	200	27	7.4
48113017101	450	55	8.2
48113017102	538	70	7.7
48113017201	392	69	5.7
48113017202	795	75	10.6
48113017301	797	96	8.3
48113017306	925	88	10.5
48113017602	554	61	9.1
48113017603	1463	224	6.5
48113017604	362	52	7.0
48113017703	458	57	8.0
48113017806	562	73	7.7
48113017900	654	84	7.8
48113018105	862	77	11.2
48113018127	455	40	11.4
48113018206	562	64	8.8
48113018401	543	48	11.3
48113018503	50	25	2.0
48113019209	16	7	2.3
Quartile Averages	**481.0**	**57.9**	**7.9**

Dallas County

County Level of Foreclosures		Total Tracts	Total # of Foreclosures	Total # of Mortgages	Foreclosures/ Mortgages
All Tracts		466	15,406	274,509	5.6%

Tract Level of Foreclosures [1]

	Quartile Break Points	# of Tracts/ Quartile	# of Foreclosures	# of Mortgages	Foreclosures/ Mortgages	% of Foreclosures	% of Mortgages
Very Low	<3%	117	854	66,782	1.3%	6%	24%
Low	3%<>5%	116	2,794	73,933	3.8%	18%	27%
High	5%<>8%	117	5,042	78,000	6.5%	33%	28%
Very High	>8%	116	6,716	55,794	12.0%	44%	20%

Tract Level of Linguistic Isolation[2]

Very Low	<2%	117	5,241	92,600	5.7%	34%	34%
Low	2%<>5%	116	4,140	82,090	5.0%	27%	30%
High	5%<>13%	116	3,692	59,930	6.2%	24%	22%
Very High	>13%	117	2,333	39,889	5.8%	15%	15%

Tract Level of Persons without a High School Diploma[3]

Very Low	<9%	117	3,098	94,655	3.3%	20%	34%
Low	9%<>22%	116	5,273	87,047	6.1%	34%	32%
High	22%<>42%	116	4,402	56,226	7.8%	29%	20%
Very High	>42%	117	2,633	36,581	7.2%	17%	13%

Tract Relative Income Level[4]

High	>123%	117	2,333	86,571	2.7%	15%	32%
Moderate	93%<>123%	116	5,362	89,808	6.0%	35%	33%
Low	70%<>93%	116	4,599	62,220	7.4%	30%	23%
Very Low	<70%	117	3,112	35,910	8.7%	20%	13%

Tract Minority Population[5]

Very Low	<34%	117	3,142	98,577	3.2%	20%	36%
Low	34%<>53%	116	4,448	79,341	5.6%	29%	29%
High	53%<>79%	116	4,283	53,731	8.0%	28%	20%
Very High	>79%	117	3,533	42,860	8.2%	23%	16%

Tract Level of Higher Rate Loan Activity[6]

Very Low	<13%	117	1,282	66,864	1.9%	8%	24%
Low	13%<>24%	116	3,480	77,090	4.5%	23%	28%
High	24%<>34%	117	5,385	71,734	7.5%	35%	26%
Very High	>34%	116	5,259	58,821	8.9%	34%	21%

Sources:

[1]Foreclosure.com data set.

[2]Table P20. HOUSEHOLD LANGUAGE BY LINGUISTIC ISOLATION [14], Universe: Households, Data Set: Census 2000 Summary File 3 (SF 3) – Sample Data

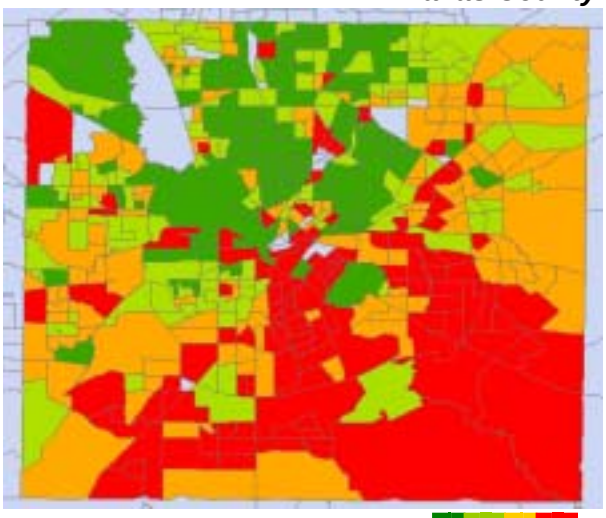
[3]Table P37. Sex by educational attainment for the population 25 years and over [35], 2000 Census

[4]Table HCT12. MEDIAN HOUSEHOLD INCOME IN 1999 (DOLLARS) BY TENURE [3], Universe: Occupied housing units, Data Set: Census 2000 Summary File 3 (SF 3) – Sample Data

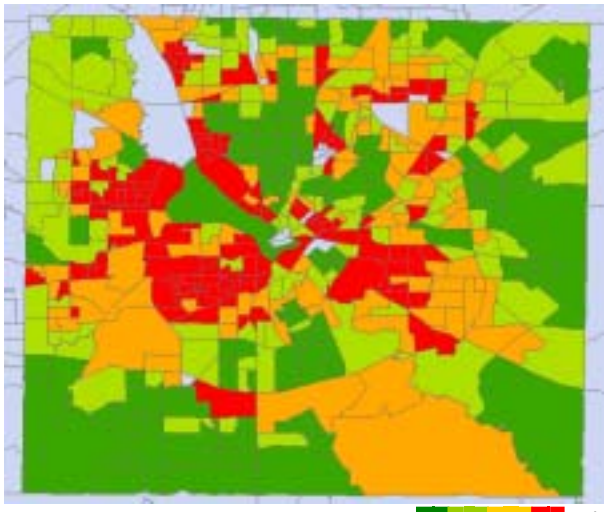
[5]Table P8. HISPANIC OR LATINO BY RACE [17], Universe: Total population, Data Set: Census 2000 Summary File 1 (SF 1) 100-Percent Data

[6]2005 Home Mortgage Disclosure Act Data

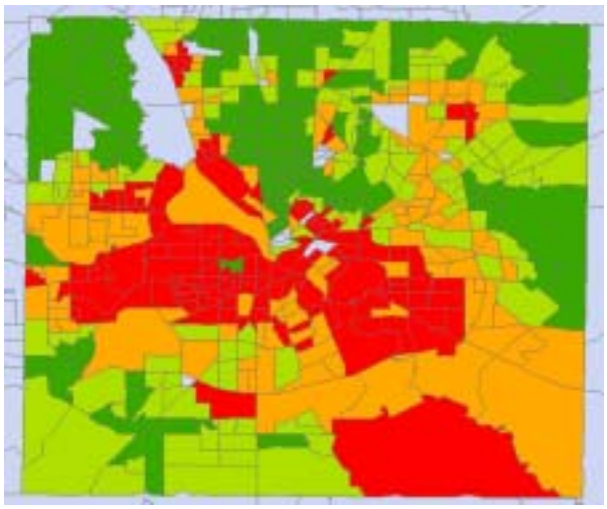
Dallas County Tract Characteristics



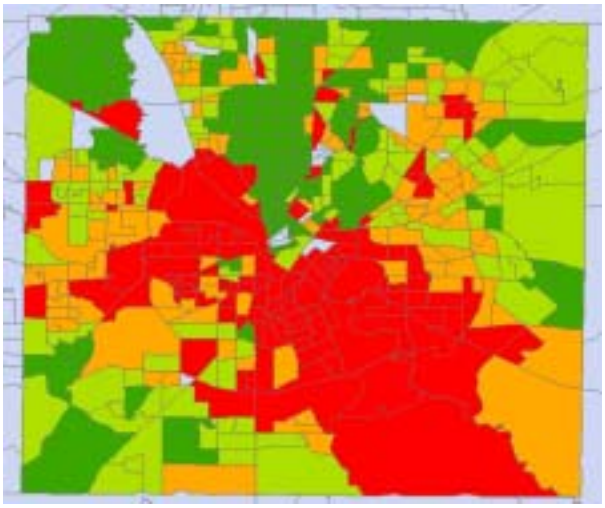
Level of Foreclosures Low High



Level of Linguistic Isolation Low High

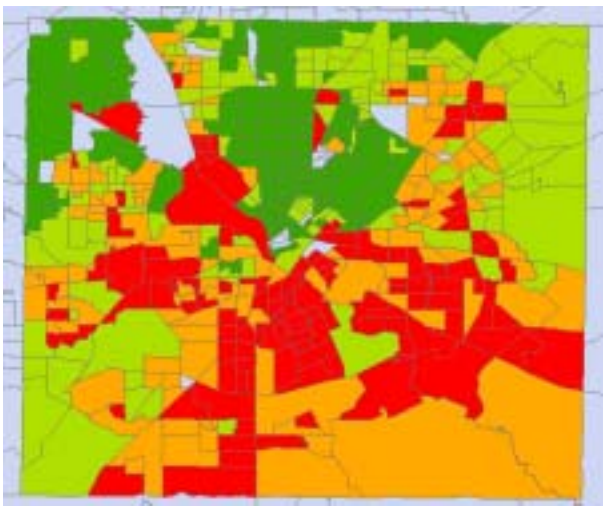


Level of Educational Attainment High Low



Income Level High Low

Level of Minority Population Low High



Level of Higher Rate Loans Low High

El Paso County

According to the 2005-06 data, the monthly average of foreclosures in El Paso County equaled one for every 1,861 mortgages held in the county. This is much lower than the rate for Texas as a whole, which stood at one foreclosure for every 1,050 mortgages. Compared to the other five counties examined, El Paso County had the lowest rate of foreclosure during the study period (2005-06).

Tract Level Analysis

Analysis of the census tract level was drawn from the 2002-06 data. Absent information on the characteristics of individual borrowers or their loans, it is difficult to draw conclusions about the relative importance of various possible causes for the rate or distribution of foreclosures. Unlike the other counties included in this study, analysis of census and HMDA data for El Paso County census tracts revealed few trends. There was no apparent relationship between foreclosures and linguistic isolation, the level of persons without a high school diploma, relative income level, minority population, or higher rate loan activity.

Of the 122 total tracts in El Paso County, the following 31 comprised the quartile of tracts with the highest concentrations of foreclosed properties:

Tract FIPS Code	Estimated Total # of Mortgages in 2004	Total # of Foreclosures 2004-2006	Tract Foreclosure Rate (Mortgages/ Foreclosure)
48141000109	553	29	19.1
48141000110	344	13	26.5
48141000203	896	37	24.2
48141000204	675	19	35.5
48141001001	235	17	13.8
48141001203	55	2	27.5
48141001700	17	1	17.0
48141002000	17	1	17.0
48141002300	318	13	24.5
48141002400	247	8	30.9
48141002500	602	17	35.4
48141002600	172	7	24.6
48141002800	36	2	18.0
48141002900	40	3	13.3
48141003401	330	11	30.0
48141003602	129	5	25.8
48141003701	334	11	30.4
48141003702	322	14	23.0
48141010203	223	9	24.8
48141010207	350	27	13.0
48141010309	977	36	27.1
48141010310	351	11	31.9
48141010311	1114	49	22.7
48141010313	3148	144	21.9
48141010315	340	15	22.7
48141010318	362	11	32.9
48141010319	35	1	35.0
48141010320	2178	64	34.0
48141010321	2566	75	34.2
48141010402	174	5	34.8
48141010504	30	1	30.0
Quartile Averages	**553.9**	**21.2**	**25.9**

El Paso County

County Level of Foreclosures		Total Tracts	Total # of Foreclosures	Total # of Mortgages	Foreclosures/ Mortgages
All Tracts		122	1,547	73,832	2.1%

Tract Level of Foreclosures [1]

	Quartile Break Points	# of Tracts/ Quartile	# of Foreclosures	# of Mortgages	Foreclosures/ Mortgages	% of Foreclosures	% of Mortgages
Very Low	<1%	32	133	15,013	0.9%	9%	20%
Low	1%<>2%	29	273	19,378	1.4%	18%	26%
High	2%<>3%	30	483	22,271	2.2%	31%	30%
Very High	>3%	31	658	17,170	3.8%	43%	23%

Tract Level of Linguistic Isolation[2]

Very Low	<10%	31	481	27,538	1.7%	31%	37%
Low	10%<>18%	30	634	26,571	2.4%	41%	36%
High	18%<>26%	30	272	12,804	2.1%	18%	17%
Very High	>26%	31	160	6,919	2.3%	10%	9%

Tract Level of Persons without a High School Diploma[3]

Very Low	<19%	31	488	30,358	1.6%	32%	41%
Low	19%<>40%	30	618	22,465	2.8%	40%	30%
High	40%<>51%	30	313	14,313	2.2%	20%	19%
Very High	>51%	31	128	6,696	1.9%	8%	9%

Tract Relative Income Level[4]

High	>124%	31	494	31,335	1.6%	32%	42%
Moderate	86%<>124%	30	613	23,659	2.6%	40%	32%
Low	71%<>86%	30	280	12,133	2.3%	18%	16%
Very Low	<71%	31	160	6,705	2.4%	10%	9%

Tract Minority Population[5]

Very Low	<74%	31	436	26,194	1.7%	28%	35%
Low	74%<>89%	30	457	20,493	2.2%	30%	28%
High	89%<>95%	30	494	18,228	2.7%	32%	25%
Very High	>95%	31	160	8,917	1.8%	10%	12%

Tract Level of Higher Rate Loan Activity[6]

Very Low	<18%	31	606	27,804	2.2%	39%	38%
Low	18%<>28%	30	423	20,563	2.1%	27%	28%
High	28%<>38%	30	338	15,580	2.2%	22%	21%
Very High	>38%	31	180	9,885	1.8%	12%	13%

Sources:

[1]Foreclosure.com data set.

[2]Table P20. HOUSEHOLD LANGUAGE BY LINGUISTIC ISOLATION [14], Universe: Households, Data Set: Census 2000 Summary File 3 (SF 3) – Sample Data

[3]Table P37. Sex by educational attainment for the population 25 years and over [35], 2000 Census

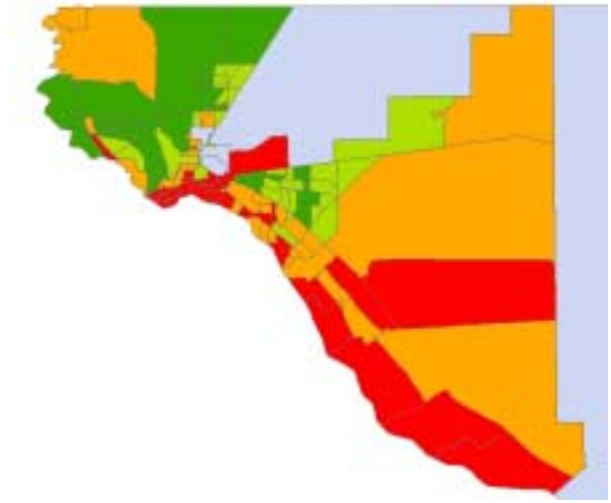
[4]Table HCT12. MEDIAN HOUSEHOLD INCOME IN 1999 (DOLLARS) BY TENURE [3], Universe: Occupied housing units, Data Set: Census 2000 Summary File 3 (SF 3) – Sample Data

[5]Table P8. HISPANIC OR LATINO BY RACE [17], Universe: Total population, Data Set: Census 2000 Summary File 1 (SF 1) 100-Percent Data

[6]2005 Home Mortgage Disclosure Act Data

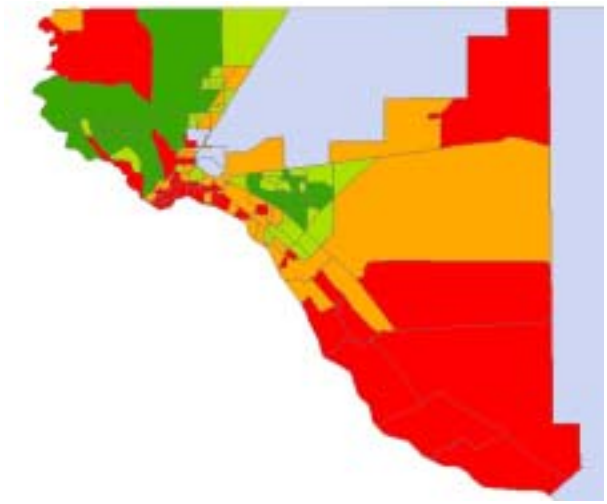
El Paso County Tract Characteristics

Level of Foreclosures Low High



Level of Linguistic Isolation Low High

Level of Educational Attainment High Low



Income Level High Low

Level of Minority Population Low High

Level of Higher Rate Loans Low High

Harris County

According to the 2005-06 data, the monthly average of foreclosures in Harris County equaled one for every 828 mortgages held in the county. This is higher than the rate for Texas as a whole, which stood at one foreclosure for every 1,050 mortgages. Compared to the other five counties examined, Harris County had the third highest rate of foreclosure during the study period (2005-06), behind Dallas and Cameron counties.

Tract Level Analysis

Analysis of the census tract level was drawn from the 2002-06 data. Absent information on the characteristics of individual borrowers or their loans, it is difficult to draw conclusions about the relative importance of various possible causes for the rate or distribution of foreclosures. However analysis of census and HMDA data for Harris County census tracts revealed a number of genuine trends.

Census tracts where foreclosures were most concentrated were:

- More likely to have average incomes below the regional median. Tracts with average incomes below 87% of regional median accounted for 35% of foreclosures but only 29% of mortgages in the county.
- More likely to be minority neighborhoods. Tracts where minorities' share of the population was above 60% accounted for 42% of foreclosures but only 33% of mortgages. Conversely, tracts where minorities comprised less than 30% of the population contained 38% of all mortgages but only 27% of foreclosures.
- More likely to include households whose loans are characterized as higher rate. Tracts where at least 27% of loans were high rate loans accounted for 57% of foreclosures, but only 41% of mortgages.

There was no strong relationship between foreclosures and a neighborhood's degree of linguistic isolation or level of high school dropouts.

Of the 626 total tracts in Harris County, the following 157 comprise the quartile of tracts with the highest concentrations of foreclosed properties:

Tract FIPS Code	Estimated Total # of Mortgages in 2004	Total # of Foreclosures 2004-2006	Tract Foreclosure Rate (Mortgages/ Foreclosure)
48201210200	21	2	10.5
48201210800	98	14	7.0
48201210900	35	3	11.7
48201211000	118	6	19.7
48201211100	188	16	11.8
48201211200	125	8	15.6
48201211300	152	13	11.7
48201211400	105	6	17.5
48201211800	19	3	6.3
48201212100	354	16	22.1
48201222700	106	9	11.8
48201230200	335	22	15.2
48201230300	119	8	14.9
48201230400	142	16	8.9
48201230600	165	14	11.8
48201231200	590	42	14.0
48201231400	246	20	12.3
48201231500	315	15	21.0
48201232000	428	25	17.1
48201232100	190	11	17.3
48201232200	322	17	18.9
48201232300	996	72	13.8
48201232400	1896	87	21.8
48201232700	700	54	13.0
48201233600	119	24	5.0
48201240300	297	38	7.8
48201240400	552	127	4.3
48201240500	42	11	3.8
48201240700	741	65	11.4
48201240900	2103	131	16.1
48201241000	1444	83	17.4
48201241100	3196	183	17.5
48201241200	1171	54	21.7
48201250200	480	40	12.0
48201250300	1486	99	15.0
48201250400	2076	103	20.2
48201251600	511	29	17.6
48201251700	884	46	19.2
48201251800	143	12	11.9
48201251900	1964	121	16.2
48201252000	296	15	19.7
48201252100	169	14	12.1
48201252300	2315	159	14.6
48201252500	219	11	19.9
48201252600	365	28	13.0
48201252800	422	30	14.1
48201253300	535	54	9.9
48201253400	105	14	7.5
48201253700	531	26	20.4
48201254200	312	14	22.3
48201310200	18	6	3.0
48201310500	186	9	20.7
48201310900	177	10	17.7
48201312000	173	8	21.6
48201312200	74	13	5.7
48201312300	59	10	5.9
48201312400	39	12	3.3
48201312500	147	19	7.7
48201312600	149	26	5.7
48201312700	135	49	2.8
48201312800	31	4	7.8
48201312900	256	44	5.8
48201313000	160	19	8.4
48201313300	255	13	19.6
48201313500	230	13	17.7
48201313600	229	18	12.7
48201313800	115	12	9.6
48201320800	261	13	20.1
48201321100	317	19	16.7
48201321300	221	13	17.0
48201321500	99	8	12.4
48201322100	309	16	19.3
48201322600	790	38	20.8
48201322800	703	47	15.0
48201322900	343	23	14.9
48201323000	186	10	18.6
48201323300	187	17	11.0
48201323800	1003	46	21.8
48201330800	445	49	9.1
48201330900	273	13	21.0
48201331100	134	20	6.7
48201331200	126	13	9.7
48201331300	357	26	13.7
48201331400	7	2	3.5
48201331700	429	26	16.5
48201331800	241	16	15.1
48201331900	374	20	18.7
48201332000	366	19	19.3
48201332100	264	14	18.9
48201333100	173	11	15.7

Tract FIPS Code	Estimated Total # of Mortgages in 2004	Total # of Foreclosures 2004-2006	Tract Foreclosure Rate (Mortgages/ Foreclosure)
48201341100	68	6	11.3
48201341700	494	26	19.0
48201343500	364	26	14.0
48201350500	795	38	20.9
48201410100	39	3	13.0
48201410300	110	8	13.8
48201410600	37	8	4.6
48201411100	511	45	11.4
48201421300	15	1	15.0
48201421500	56	5	11.2
48201422200	90	7	12.9
48201422300	830	64	13.0
48201423100	11	2	5.5
48201423300	1101	51	21.6
48201423600	1514	82	18.5
48201431900	65	19	3.4
48201432000	199	10	19.9
48201432100	186	11	16.9
48201432800	107	8	13.4
48201433500	171	10	17.1
48201433600	13	4	3.3
48201452000	442	25	17.7
48201452200	28	4	7.0
48201452700	811	37	21.9
48201453200	279	17	16.4
48201453700	906	46	19.7
48201454000	936	67	14.0
48201454200	929	42	22.1
48201454300	1919	98	19.6
48201510100	66	14	4.7
48201510600	204	16	12.8
48201511500	834	52	16.0
48201530100	165	9	18.3
48201530300	75	9	8.3
48201530600	182	9	20.2
48201532000	530	35	15.1
48201532600	1025	76	13.5
48201532700	700	49	14.3
48201532800	470	22	21.4
48201533000	51	6	8.5
48201533100	1175	87	13.5
48201533600	188	9	20.9
48201541300	1526	77	19.8
48201541400	992	55	18.0
48201541700	345	16	21.6
48201542000	1815	87	20.9
48201542100	2240	180	12.4
48201542200	960	84	11.4
48201542300	1880	115	16.3
48201542900	1347	70	19.2
48201543000	807	62	13.0
48201550400	1281	119	10.8
48201550600	2465	148	16.7
48201550800	493	36	13.7
48201550900	1327	66	20.1
48201551000	401	21	19.1
48201551100	1143	101	11.3
48201553000	1939	106	18.3
48201553100	956	52	18.4
48201553200	616	28	22.0
48201553900	1825	84	21.7
48201554800	859	39	22.0
48201555100	863	42	20.5
48201555200	788	40	19.7
48201555300	906	74	12.2
48201555400	779	43	18.1
48201555800	436	58	7.5
Quartile Averages	**560.3**	**36.7**	**14.5**

Harris County

County Level of Foreclosures		Total Tracts	Total # of Foreclosures	Total # of Mortgages	Foreclosures/ Mortgages
All Tracts		626	12,689	422,134	3.0%

Tract Level of Foreclosures [1]

	Quartile Break Points	# of Tracts/ Quartile	# of Foreclosures	# of Mortgages	Foreclosures/ Mortgages	% of Foreclosures	% of Mortgages
Very Low	<1%	157	709	103,503	0.7%	6%	25%
Low	1%<>3%	157	2,494	125,038	2.0%	20%	30%
High	3%<>4%	155	3,726	105,629	3.5%	29%	25%
Very High	>4%	157	5,760	87,964	6.5%	45%	21%

Tract Level of Linguistic Isolation[2]

Very Low	<3%	157	3,779	148,300	2.5%	30%	35%
Low	3%<>6%	156	3,980	118,756	3.4%	31%	28%
High	6%<>15%	156	3,160	90,442	3.5%	25%	21%
Very High	>15%	157	1,770	64,636	2.7%	14%	15%

Tract Level of Persons without a High School Diploma[3]

Very Low	<10%	157	2,968	161,840	1.8%	23%	38%
Low	10%<>25%	156	5,114	128,158	4.0%	40%	30%
High	25%<>42%	156	3,085	83,435	3.7%	24%	20%
Very High	>42%	157	1,522	48,701	3.1%	12%	12%

Tract Income Level[4]

High	>119%	156	2,976	162,858	1.8%	23%	39%
Moderate	87%<>119%	157	5,306	136,900	3.9%	42%	32%
Low	64%<>87%	156	2,776	79,827	3.5%	22%	19%
Very Low	<64%	157	1,631	42,549	3.8%	13%	10%

Tract Minority Population[5]

Very Low	<30%	157	3,436	160,654	2.1%	27%	38%
Low	30%<>60%	156	3,838	120,683	3.2%	30%	29%
High	60%<>86%	156	3,355	89,063	3.8%	26%	21%
Very High	>86%	157	2,060	51,734	4.0%	16%	12%

Tract Level of Higher Rate Loan Activity[6]

Very Low	<14%	157	1,683	121,655	1.4%	13%	29%
Low	14%<>27%	156	3,840	127,524	3.0%	30%	30%
High	27%<>40%	156	4,759	112,730	4.2%	38%	27%
Very High	>40	157	2,407	60,225	4.0%	19%	14%

Sources:

[1]Foreclosure.com data set.

[2]Table P20. HOUSEHOLD LANGUAGE BY LINGUISTIC ISOLATION [14], Universe: Households, Data Set: Census 2000 Summary File 3 (SF 3) – Sample Data

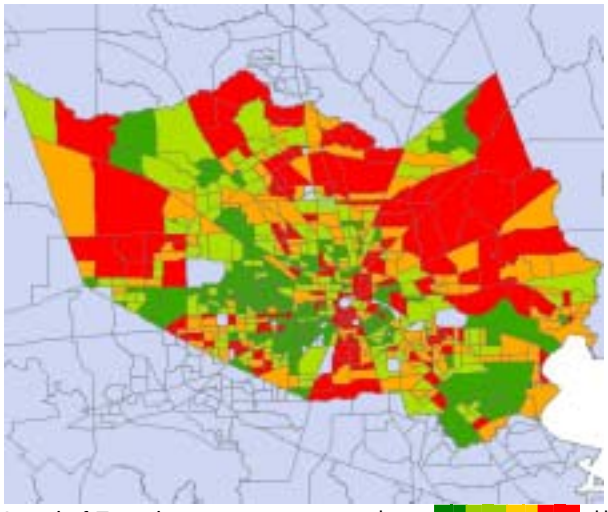
[3]Table P37. Sex by educational attainment for the population 25 years and over [35], 2000 Census

[4]Table HCT12. MEDIAN HOUSEHOLD INCOME IN 1999 (DOLLARS) BY TENURE [3], Universe: Occupied housing units, Data Set: Census 2000 Summary File 3 (SF 3) – Sample Data

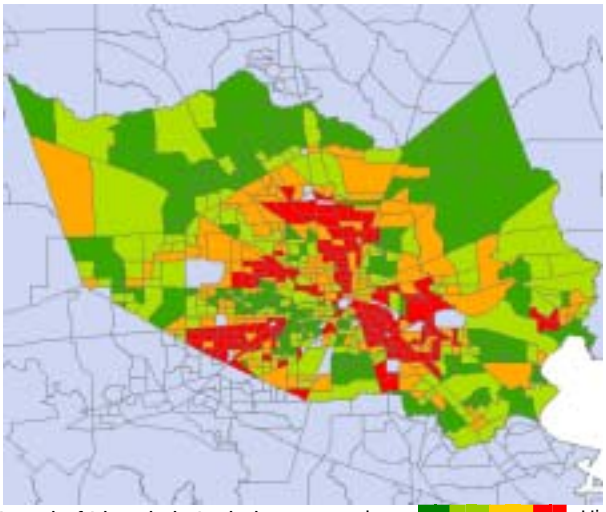
[5]Table P8. HISPANIC OR LATINO BY RACE [17], Universe: Total population, Data Set: Census 2000 Summary File 1 (SF 1) 100-Percent Data

[6]2005 Home Mortgage Disclosure Act Data

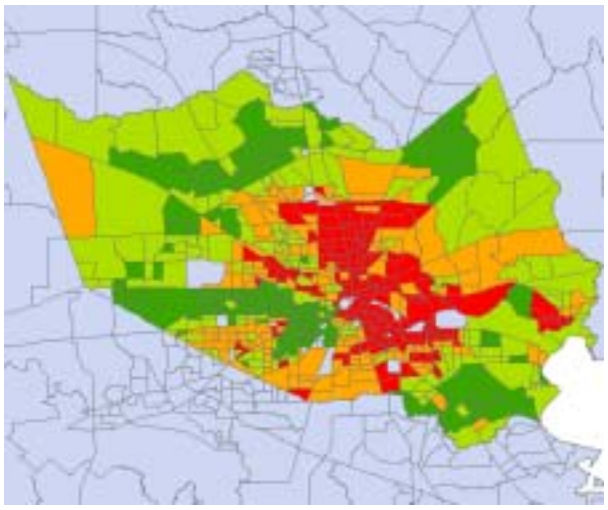
Harris County Tract Characteristics



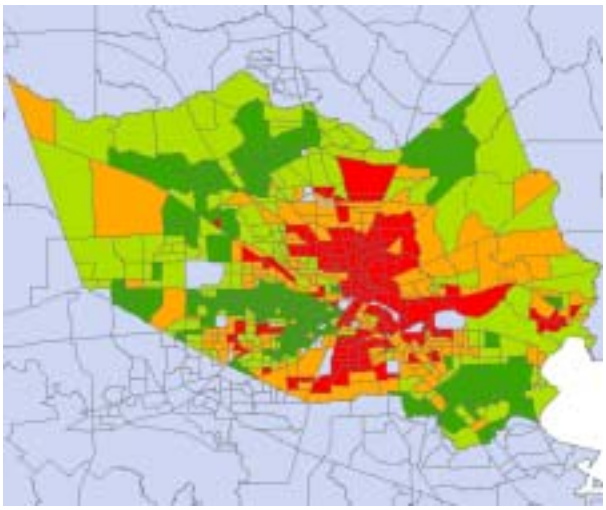
Level of Foreclosures Low High



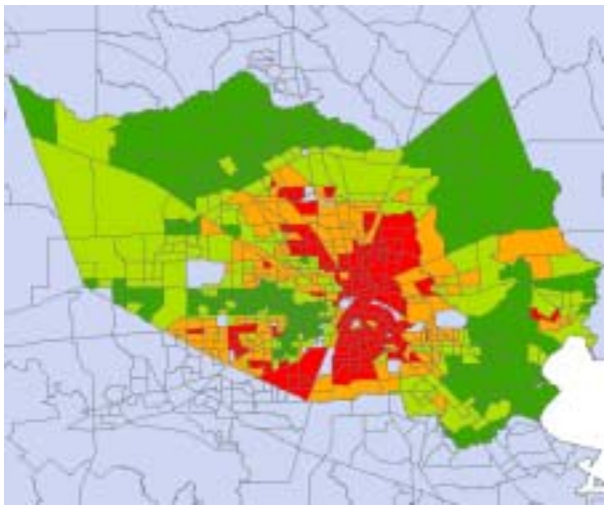
Level of Linguistic Isolation Low High



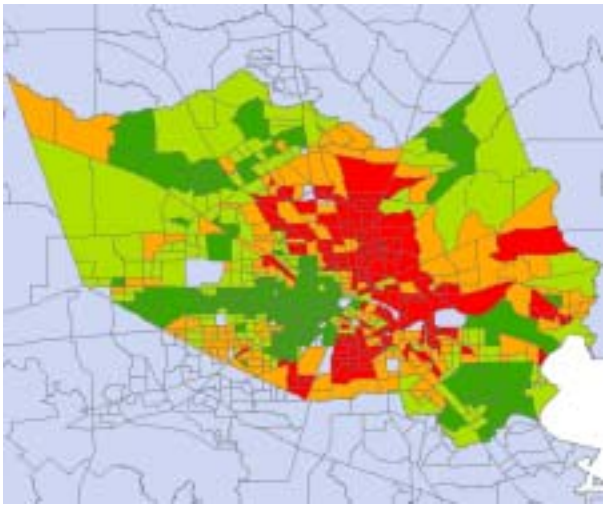
Level of Educational Attainment High Low



Income Level High Low



Level of Minority Population Low High



Level of Higher Rate Loans Low High

Travis County

According to the 2005-06 data, the monthly average of foreclosures in Travis County equaled one for every 1,093 mortgages held in the county. This is lower than the rate for Texas as a whole, which stood at one foreclosure for every 1,050 mortgages. Compared to the other five counties examined, Travis County had the second lowest rate of foreclosure during the study period (2005-06).

Tract Level Analysis

Analysis of the census tract level was drawn from the 2002-06 data. Absent information on the characteristics of individual borrowers or their loans, it is difficult to draw conclusions about the relative importance of various possible causes for the rate or distribution of foreclosures. However, analysis of census and HMDA data for Travis County census tracts revealed a number of general trends.

Census tracts where foreclosures were most concentrated were:

- More likely to have high numbers of linguistically isolated residents. Tracts in which at least 4% of the population was linguistically isolated accounted for 50% of foreclosures but only 30% of mortgages.
- More likely to have high numbers of residents without a high school diploma. Tracts where at least 10% of residents did not graduate accounted for 61% of foreclosures but only 35% of mortgages in the county.
- More likely to have average incomes below the regional median. Tracts with average incomes below 92% of regional median accounted for 55% of foreclosures but only 33% of mortgages in the county.
- More likely to be minority neighborhoods. Tracts where minorities' share of the population was above 38% accounted for 70% of foreclosures but only 41% of mortgages. Conversely, tracts where minorities comprised less than 21% of the population contained 35% of all mortgages but only 14% of foreclosures.
- More likely to include households whose loans are characterized as higher rate. Tracts where at least 10% of loans were high rate loans accounted for 78% of foreclosures, but only 45% of mortgages.

Of the 177 total tracts in Travis County, the following 44 comprise the quartile of tracts with the highest concentrations of foreclosed properties:

Tract FIPS Code	Estimated Total # of Mortgages in 2004	Total # of Foreclosures 2004-2006	Tract Foreclosure Rate (Mortgages/ Foreclosure)
48453000203	7	1	7.0
48453000603	16	1	16.0
48453000801	99	6	16.5
48453000802	156	11	14.2
48453001100	35	2	17.5
48453001742	437	24	18.2
48453001753	20	1	20.0
48453001767	1427	141	10.1
48453001806	167	14	11.9
48453001812	115	8	14.4
48453001819	202	20	10.1
48453001820	315	18	17.5
48453001821	646	40	16.2
48453001822	475	29	16.4
48453001823	419	37	11.3
48453001833	726	40	18.2
48453001835	889	57	15.6
48453001836	4363	238	18.3
48453001837	1600	84	19.0
48453001840	928	119	7.8
48453001841	1364	74	18.4
48453001849	9	1	9.0
48453002107	485	36	13.5
48453002109	359	37	9.7
48453002110	245	37	6.6
48453002202	483	93	5.2
48453002205	597	79	7.6
48453002206	904	150	6.0
48453002307	253	26	9.7
48453002310	98	10	9.8
48453002313	114	15	7.6
48453002314	24	3	8.0
48453002315	27	4	6.8
48453002316	14	5	2.8
48453002403	363	19	19.1
48453002409	564	30	18.8
48453002410	233	20	11.7
48453002411	436	40	10.9
48453002413	227	28	8.1
48453002416	715	69	10.4
48453002417	984	78	12.6
48453002418	932	65	14.3
48453002419	12	5	2.4
48453002420	1210	103	11.7
Quartile Averages	**538.5**	**43.6**	**12.2**

Travis County

County Level of Foreclosures		Total Tracts	Total # of Foreclosures	Total # of Mortgages	Foreclosures/ Mortgages
All Tracts		177	3,327	108,848	3.1%

Tract Level of Foreclosures [1]

	Quartile Break Points	# of Tracts/ Quartile	# of Foreclosures	# of Mortgages	Foreclosures/ Mortgages	% of Foreclosures	% of Mortgages
Very Low	<1%	45	140	32,009	0.4%	4%	29%
Low	1%<>2%	44	434	29,154	1.5%	13%	27%
High	2%<>5%	44	835	23,991	3.5%	25%	22%
Very High	>5%	44	1,918	23,694	8.1%	58%	22%

Tract Level of Households with Linguistic Isolation[2]

Very Low	<2%	45	477	35,368	1.3%	14%	32%
Low	2%<>4%	45	1,211	40,710	3.0%	36%	37%
High	4%<>9%	43	851	19,506	4.4%	26%	18%
Very High	>9%	44	788	13,264	5.9%	24%	12%

Tract Level of Persons without a High School Diploma[3]

Very Low	<3%	45	332	35,643	0.9%	10%	33%
Low	3%<>10%	44	978	35,137	2.8%	29%	32%
High	10%<>24%	44	894	22,636	4.0%	27%	21%
Very High	>24%	44	1,123	15,432	7.3%	34%	14%

Level of Household Income[4]

High	>116%	44	422	40,384	1.0%	13%	37%
Moderate	92%<>116%	44	1,065	32,943	3.2%	32%	30%
Low	71%<>92%	44	1,001	21,466	4.7%	30%	20%
Very Low	<71%	45	839	14,055	6.0%	25%	13%

Tract Minority Population[5]

Very Low	<21%	44	476	37,768	1.3%	14%	35%
Low	21%<>38%	44	521	26,468	2.0%	16%	24%
High	38%<>63%	44	1,318	28,339	4.7%	40%	26%
Very High	>63%	45	1,012	16,273	6.2%	30%	15%

Tract Level of Higher Rate Loan Activity[6]

Very Low	<5%	45	223	29,201	0.8%	7%	27%
Low	5%<>10%	45	500	29,901	1.7%	15%	27%
High	10%<>17%	43	1,463	32,899	4.5%	44%	30%
Very High	>17%	44	1,141	16,847	6.8%	34%	15%

Sources:

[1]Foreclosure.com data set.

[2]Table P20. HOUSEHOLD LANGUAGE BY LINGUISTIC ISOLATION [14], Universe: Households, Data Set: Census 2000 Summary File 3 (SF 3) – Sample Data

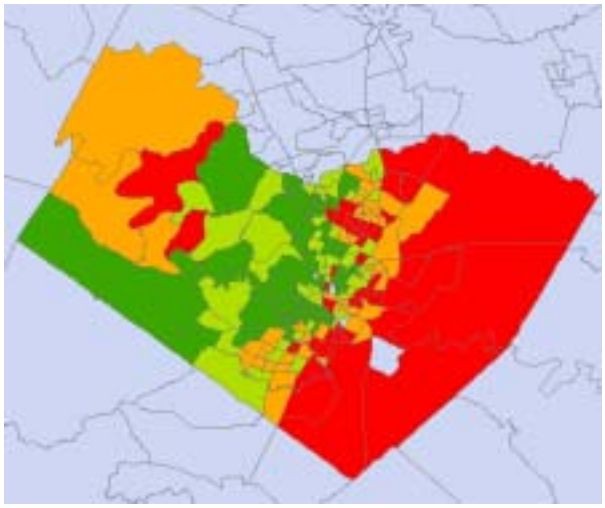
[3]Table P37. Sex by educational attainment for the population 25 years and over [35], 2000 Census

[4]Table HCT12. MEDIAN HOUSEHOLD INCOME IN 1999 (DOLLARS) BY TENURE [3], Universe: Occupied housing units, Data Set: Census 2000 Summary File 3 (SF 3) – Sample Data

[5]Table P8. HISPANIC OR LATINO BY RACE [17], Universe: Total population, Data Set: Census 2000 Summary File 1 (SF 1) 100-Percent Data

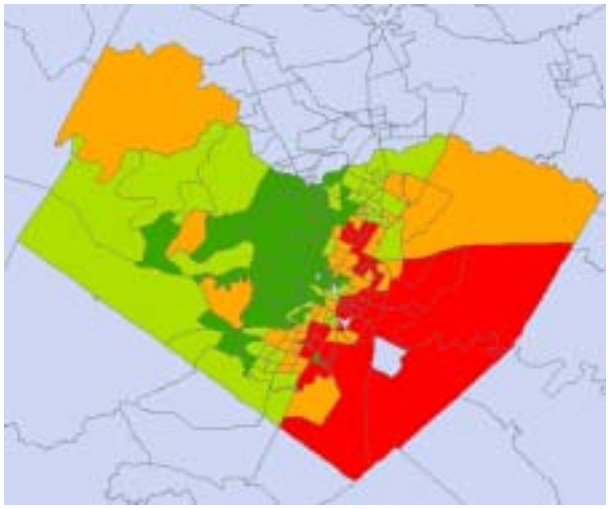
[6]2005 Home Mortgage Disclosure Act Data

Travis County Tract Characteristics



Level of Foreclosures Low High

Level of Linguistic Isolation Low High



Level of Educational Attainment High Low

Income Level High Low

Level of Minority Population Low High

Level of Higher Rate Loans Low High

Summary

Common trends in the correlation between high foreclosure rates and certain demographic statistics can be identified across most of the counties included in this study. The exception, El Paso County, defied the pattern by not showing significantly strong trends in any of the demographic factors examined. High concentrations of minority populations correlated to higher foreclosure rates in all five counties other than El Paso. Also in a majority of the counties, clear trends were evident connecting residential foreclosure rates to lower income levels and greater use of higher rate loans. Further quantitative analysis, however, would be necessary to draw stronger conclusions about the implications of these correlations.

OPTIONS FOR BORROWERS FACING FORECLOSURE

Benefits of Mitigation Strategies

In 1991, Fannie Mae released a servicer bulletin laying out various options that servicers could use in order to avoid foreclosure with defaulted borrowers, promising to reimburse them for their efforts; in 1994, Freddie Mac began offering options and in 1996, FHA was directed by Congress to do the same.[89] These bulletins and directives were the start of the loss mitigation movement by the mortgage industry to help borrowers avoid foreclosure.

Besides the obvious benefit of keeping households in their homes, for lenders and investors, foreclosure is an expensive process. On average, foreclosed properties sell for between 5 and 10 percent less than comparable properties in the applicable market area, and with the added legal costs, property management, sales expenses, and unpaid interest income, losses can easily exceed 25 percent of the mortgage balance.[90] Insurance and taxes are also significant costs in the foreclosure process.

Loss Mitigation Options

There are various types of loss mitigation options offered by lenders. The following general information can be found in Capone 2002[91] and Capone and Metz 2003.[92]

Common Loss Mitigation Options

Special Forbearance	Loan Modification	Partial Claim	Pre-foreclosure (Short) Sales	Deed-in-Lieu of Foreclosure
Extended payment plan worked out with the servicer to repay accumulated arrearages. Plan can last up to 18 months and works well for borrowers with temporary financial difficulties.	A no-cost refinance where the loan terms and interest rate may be modified. Works well when interest rates are low because arrearages can be added to the mortgage balance, rewritten for 30 years, and still lower the monthly mortgage payment.	Used with FHA mortgages. FHA pays the amount in arrears to the servicer to make the borrower current. Borrower commits to reimbursing FHA when the property is sold, should there be equity in the property.	Normal home sale process where the investor and the borrower split losses on the sale. Borrowers typically can pay back their share of the loss interest free. FHA and VA loans do not require loss sharing.	Borrower signs over the title to the investor rather than having the home foreclosed. Borrower may be offered a cash payment, while investor avoids time and expense of foreclosure proceedings.

[89] Capone, *Research Into Mortgage Default and Affordable Housing*, 14.
[90] Charles Capone and Albert Metz, "Mortgage Default and Default Resolutions: Their Impact on Communities," (Presentation at the Federal Reserve Bank of Chicago Conference on Sustainable Community Development, Washington, DC, March 27, 2003), 3, http://www.chicagofed.org/cedric/files/2003_conf_paper_session2_capone.pdf (accessed August 20, 2006).
[91] Capone, *Research Into Mortgage Default and Affordable Housing*, 15.
[92] Capone and Metz, "Mortgage Default and Default Resolutions," 6-8.

For a more detailed example of loss mitigation options, see Freddie Mac's loss mitigation efforts at: http://www.nw.org/network/neighborworksprogs/foreclosuresolutions/default.asp . As can be seen by the following differences from the above chart, these options vary from lender to lender.

- For "Loan Modification" Freddie Mac can extend the loan amortization beyond 30 years.
- For a 'short' sale, Freddie Mac may take all the loss and the borrower takes none.

As a result of loss mitigation techniques, numerous foreclosures have been avoided. An analysis of FHA loans defaulting between the first quarter of 1998 and the second quarter of 2002 found that, of 498,917 total defaults that were not cured by borrowers, 58.1 percent arrived at a workout option and 41.9 percent ended in foreclosure.[93] In 1999, 60.6 percent of defaults ended in foreclosure, whereas in 2001, only 22.3 percent ended in foreclosure. Another study of FHA loans originated between 1988 and 1993 and studied through 1995 found that 49.5 percent of borrowers with high loan-to-value ratios were able to reinstate the mortgage.[94] Of these, only 45.6 percent did not default again within the study period.

A study of 148,050 loans owned by Freddie Mac that entered into default between January and September of 2001 and tracked for 18 months found that 90 percent of 60-day delinquent loans that started repayment plans cured within the 18-month timeframe compared with 73 percent of 90-day delinquent loans and 61 percent of 120-day delinquent loans.[95] This suggests that lenders and borrowers initiating loss mitigation options earlier in the default process results in higher foreclosure prevention rates. The importance of early intervention in preventing foreclosures should be emphasized.

Interaction between the Delinquent Borrower and Lender

In the late 1990s, automated credit scoring servicing tools emerged in order to (1) identify delinquent loans that are more likely to benefit from early intervention, (2) identify delinquent loans that are more likely to create a loss without an intervention, and (3) underwrite delinquent loans for a workout.[96] Currently, servicing scoring tools are used for over 80 percent of mortgages, and they enable lenders to target and contact troubled borrowers earlier in the process, which reduces the time and cost of lost mitigation. Such tools, such as Freddie Mac's Early Indicator and Workout Prospector, "have greatly increased the chances that a delinquent borrower will have the option of a home retention workout, and that a workout will be offered earlier in the process."[97]

[93] Capone and Metz, "Mortgage Default and Default Resolutions," 26.
[94] Ambrose and Capone, "Modeling the Conditional Probability of Foreclosure in the Context of Single-Family Mortgage Default Resolutions," 410.
[95] Amy Crews Cutts and Richard K. Green "Innovative Servicing Technology: Smart Enough to Keep People in Their Houses?" in Building Assets, Building Credit: Creating Wealth in Low-Income Communities, Nicolas P. Retsinas and Eric S. Belsky, eds. 2005, Washington, DC: JCHS/Brookings Press., 368. Footnote 8 is page 363; footnote 9 is page 365..
[96] Cutts and Green, Innovative Service Technology, 363.
[97] Cutts and Green, Innovative Service Technology, 365.

It must be emphasized that loss mitigation and foreclosure prevention options will work only if the borrower is aware of the option and participates in the program. In August 2005, Freddie Mac and Roper Public Affairs surveyed 2,031 borrowers to compare the behavior of delinquent borrowers and borrowers in good standing.[98] Of all delinquent borrowers, 61 percent were unaware of workout options, but 92 percent of delinquent borrowers would have contacted their lender if they were aware of the options. The survey found 75 percent of delinquent borrowers were contacted by their mortgage lender, but 31 percent had not contacted their lender. Of those borrowers who did not contact their lender, 20 percent said there was no reason to do so, 17 percent said that they could resolve the situation on their own, and 8 percent said there was nothing the lender could do. Another 7 percent did not have the money to pay, 6 percent claimed that they never had difficulty paying their mortgage, 11 percent were embarrassed or scared, and 5 percent did not know whom to call. The study also found that of borrowers in good standing, 73 percent were unaware of workout options. Finally, the survey also showed that only 38 percent of delinquent borrowers were aware that they could talk to a counseling agency, but 74 percent said that they would likely use a counseling agency. Among the options considered, this item had the largest 'knowledge gap', which demonstrates the greatest opportunity for consumer education. This suggests that all borrowers may benefit from additional information regarding default and foreclosure avoidance options as well as expanded outreach efforts by lenders and organizations offering services.

State, Local, and Non-Profit Assistance Programs

In addition to options offered by servicers, some states have developed programs to help homeowners avoid foreclosure. The State of Pennsylvania offers the Homeowner's Emergency Mortgage Assistance Program (HEMAP), which assists borrowers facing foreclosure because of a financial hardship that is not of their causing and who can demonstrate that they can resume normal mortgage payments at the conclusion of the assistance period.[99] Through this program, homeowners can receive loans to bring delinquent payments current and may be eligible to receive assistance for up to 24 months. Depending on their income, households are then required to pay up to 40 percent of their net monthly income toward housing payments, including the HEMAP payment. For households that are required to pay interest on the loan, the rate is 9 percent. Some non-profits also can offer "rescue" loans in some predatory loan situations.

While this type of program can save the homes of borrowers facing foreclosure due to a sudden one-time event, it may not address the situations of borrowers facing such ongoing issues as upwardly adjusting interest rates, rising property taxes, or rising insurance costs. Borrowers with ARMs that are ready to adjust may not be able to demonstrate that they can assume normal

[98] Freddie Mac, *Foreclosure Avoidance Research*, (Freddie Mac, 2005) http://www.freddiemac.com/service/msp/pdf/foreclosure_avoidance_dec2005.pdf (accessed September 6, 2006).
[99] 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 August 20, 2006).

mortgage payments at the conclusion of the assistance period, and thus may not be good candidates for such a program.

Many nonprofit organizations and credit counseling agencies are also available to help borrowers understand the foreclosure process and develop avoidance plans. Successful post-purchase education and foreclosure intervention programs include seven key components: (1) community and industry outreach; (2) client intake and problem assessment; (3) financial counseling, including budget and debt management counseling; (4) additional assistance, including legal and financial assistance; (5) negotiation with loan servicers; (6) refinancing education and assistance; and (7) program evaluation and assessment.[100]

In 2005, the City of Dallas initiated the Dallas Home Ownership Preservation Enterprise, which is a partnership of local nonprofits, consumer credit counseling agencies, financial institutions, the City of Dallas, HUD, and other governmental entities, aimed at providing education and assistance to homebuyers facing foreclosure.[101] Through a partnership with Homeownership Preservation Foundation to offer a toll-free counseling hotline, callers are connected with HUD-certified credit counselors who help homeowners develop an action plan, act as an intermediary between the borrower and the lender, and help them access other services such as legal and employment assistance or face-to-face counseling through a community organization. In its first month of operation, the hotline received over 1,200 calls and counseled nearly 400 homeowners—instantly surpassing the program's 12-month goal of counseling 250 homeowners.

The Homeownership Preservation Foundation (HPF) is a nonprofit organization that partners with local governments, other nonprofit organizations, borrowers, and mortgage lenders and servicers to deliver homeownership preservation programs.[102] There is more information on the HPF at: http://www.nw.org/network/neighborworksprogs/foreclosuresolutions/default.asp . The hotline is available nationwide, and since January 2006, calls to the hotline have increased 61 percent to 140 per day.[103] Approximately 40 percent of these callers are having trouble with ARMs.

Additionally, Freddie Mac has developed a training for nonprofits called, "Alternatives to Foreclosure for Housing Counselors." Information on this program is available at http://www.freddiemac.com/learn/counselor/#af.

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[100] Christi Baker, *Essential Components of Port-Purchase Program Models*, (KnowledgePlex, July 2004), 3, http://content.knowledgeplex.org/kp2/cache/documents/42018.doc (accessed September 6, 2006).
[101] Christopher Morton, "Preserving Hard-Fought Gains: How Communities are Battling the Rise in Foreclosures," Housing Facts and Findings (Fannie Mae Foundation) vol. 8, issue 2 (2006) http://www.fanniemaefoundation.org/programs/hff/v8i2-preserving.shtml (accessed September 6, 2006).
[102] Homeownership Preservation Foundation, "Empowering Homeowners and Creating Opportunity," http://www.hpfonline.org/Profile.htm (accessed September 6, 2006).
[103] Noelle Knox, "Can't Pay? Talk to Mortgage Lender," USA Today, August 24, 2006, http://www.usatoday.com/money/perfi/housing/2006-08-24-mym-mortgage_x.htm (accessed September 6, 2006).

Rescue Scams

A troubling development in the foreclosure prevention business is the rise in "rescue" scams. These scams typically come in one of three forms: (1) where the rescuer charges excessive fees for phone calls or paperwork the homeowner could easily have performed them self, (2) "bailout" schemes where the owner surrenders title to the rescuer with the belief that he or she can stay in the home and buy it back later, and (3) "bait and switch" tactics where the owner does not realize that they surrendered ownership of the home.[104] To employ such scams successfully, rescuers use the following strategies: saturation marketing, building "trust" with the owners, keeping the owner uninformed about the process, fraud, "affinity" marketing, preying on the desperation of owners in foreclosure, and targeting borrowers with a lack of economic education.[105]

For example, borrowers who do not speak English as a primary language can present an enhanced opportunity for victimization. It may be easier to build trust if the perpetrator speaks the borrower's language. The borrower may also be apprehensive of working with the lender or servicer directly because these entities are who they owe money to, they have less experience with banking institutions in general, or the lender or servicers may not have agents that speak the borrower's language.

[104] Steve Tripoli and Elizabeth Renuart, *Dreams Foreclosed: The Rampant Theft of Americans' Homes Through Equity-Stripping Foreclosure Rescue Scams*, (Boston, MA: National Consumer Law Center, June 2005), 8, http://www.consumerlaw.org/news/ForeclosureReportFinal.pdf (accessed August 20, 2006).
[105] Tripoli and Renaurt, *Dreams Foreclosed*, 10.

HOMEBUYER EDUCATION AND COUNSELING

A recurring theme in this report is the need for borrower's to make informed decisions. When borrowers enter into loans that they do not fully understand or they do not fully realize all of the implications of being a homeowner, the likelihood that they will encounter financial difficulties in the future related to their homeownership increase. Homebuyer education and counseling can be a valuable tool in educating potential homebuyers about the costs and benefits of owning a home and available loan products. For the purpose of this report, these activities will be referred to as homebuyer education whether they occur in a classroom setting or in the form of one-on-one counseling. These activities can indirectly affect default rates by convincing some borrowers that home ownership may not be their best choice.[106] For those who do proceed with a home purchase, evidence has shown that pre-purchase homebuyer education counseling can reduce delinquencies. However, without more training opportunities and funding programs for local counseling agencies, the needs of all homebuyers will not be met. It is estimated that 120,000 to 150,000 individuals receive pre-purchase education through HUD programs, which is only a fraction of the one million lower income households becoming first time homebuyers each year.[107]

Research on Homebuyer Education

A study of nearly 40,000 Freddie Mac affordable lending loans originated between the third quarter of 1993 and the third quarter of 1998 (tracking through the second quarter of 2000) found that borrowers receiving counseling had an average 19 percent lower delinquency rate.[108] This study also found that the counseling method had a profound effect on rates: borrowers receiving individual counseling had a 34 percent reduction in delinquencies, borrowers receiving classroom education had a 26 percent reduction, home study participants demonstrated a 21 percent reduction, and there was no evidence that telephone counseling mitigated risk.

A study tracking over 11,000 clients that received credit counseling during a five-month period in 1997 found the counseling provided greatest benefits for those clients with the lowest credit scores.[109] Borrowers with credit scores in the 10th and lowest percentile experienced a net 36.3 point increase in credit scores over the three-year period following the counseling. Borrowers in the lowest percentiles also experienced a decrease in the number of accounts holding a balance, decrease in total debt balances, and a reduction in the number of delinquencies. Interestingly, the study also found that borrowers with scores in the 90th percentile actually had their scores decline, most debts increase, and had an increase in delinquencies. The authors of the study attribute this to the presumption that for borrowers with higher incomes, the prediction of a serious financial crisis may have triggered the choice to seek counseling, and the crisis still affected their financial situation.[110]

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[106] Capone and Metz, "Mortgage Default and Default Resolutions," 5.
[107] Collins, *Pursuing the American Dream*, 32-33.
[108] Abdighani Hirad and Peter Zorn, "A Little Knowledge is a Good Thing" in Low-Income Homeownership: Examining the Unexamined Goal, Nicolas P. Retsinas and Eric S. Belsky, eds. 2002, Washington, DC: JCHS/Brookings Press. Page 146.
[109] Gregory Elliehausen, E. Christopher Lundquist, and Michael Staten, *The Impact of Credit Counseling in Subsequent Borrower Credit Usage and Payment Behavior*, (January 2003), 43, http://www.chicagofed.org/cedric/files/2003_conf_paper_session1_staten.pdf (accessed August 21, 2006).
[110] Elliehausen, Lundquist, and Staten, *The Impact of Credit Counseling in Subsequent Borrower Credit Usage and Payment Behavior*, 44.

Homebuyer Education Standards

Currently, there are few universal standards regarding homebuyer education. Agencies that are certified or approved by different oversight organizations or who provide education for certain loan products have different requirements. Education requirements of select programs are described below.

- The US Department of Housing and Urban Development (HUD), which also releases funding for counseling agencies, has specific requirements. There are four main requirements for housing counseling approval: the agency must be a nonprofit, the agency must have successfully administered a counseling program for at least one year, the agency must have functioned in the area it intends to serve for at least one year, and the agency must have sufficient resources to implement its counseling activities.[111] HUD also requires that housing counseling agencies have a plan and services that meet HUD's definition contained in the HUD Housing Counseling Program Handbook, 7610.1.[112]
- Fannie Mae affordable lending products that require homebuyer education have different requirements. Homebuyer education fulfilling Fannie Mae loan requirements may be provided by a lender, counseling agency, or mortgage insurance company, and must cover the following topics: "preparing for homeownership, shopping for a home, obtaining a mortgage, loan closing, and life as a homeowner."[113]
- NeighborWorks America, which was established by Congress in 1978 as the "Neighborhood Reinvestment Corporation," is currently developing national curriculum and certification standards for homeownership education and counseling through its NeighborWorks Center for Homeownership Education and Counseling.[114] These standards include the provision of a minimum of eight hours of group education with individual follow-up sessions; certified trainers; and a core curriculum that includes buyer readiness, community involvement, budgeting, credit, financing a home, selecting a home, maintaining a home, finances, and foreclosure prevention.[115]

Cost of Homebuyer Education

The costs of providing homebuyer education vary according to the length, personalization, and content of the course. As a general estimate, homeownership classes and counseling can cost $100 to $300 per client.[116] NeighborWorks America estimates that, for homebuyers who need only eight hours of group training and are "near ready" to purchase a home, the cost per customer amounts to $456, while for those homebuyers with credit issues and who need more individualized counseling, the cost is $1,008.[117]

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111 HUD, "Housing Counseling Approval Information," December 2005, http://www.hud.gov/offices/hsg/sfh/hcc/hccprof13.cfm (accessed August 21, 2006).

112 HUD, *Application for Approval as a Housing Counseling Agency*, form HUD-9900, http://www.hudclips.org/sub_nonhud/html/pdfforms/9900.pdf (accessed August 21, 2006).

113 Fannie Mae, "Home Buyer Education Policies," http://www.efanniemae.com/is/hcounselors/homebuyered.jsp (accessed August 21, 2006).

114 NeighborWorks America, "NeighborWorks Center for Homeownership Education and Counseling," http://www.nw.org/network/training/homeownership/aboutNCHEC.asp, (accessed August 21, 2006).

115 NeighborWorks America, *Homebuyer Education Methods: Training the Trainer* (Washington DC: NeighborWorks Training Institute workbook, 2005), Tab 2, page 4.

116 Michael Collins, *Pursuing the American Dream: Homeownership and the Role of Federal Housing Policy* (Neighborhood Reinvestment Corporation, March 2002), 32, http://www.nw.org/network/pubs/studies/documents/pursuingAmDreamCollins2002.pdf (accessed August 21, 2006).

117 NeighborWorks America, *Homebuyer Education Methods,* Tab 3, page 4.

Because many homebuyers lack the financial means to pay for a class, or may choose not to attend if they consider the class to be expensive, homebuyer education providers need to locate other means of financial support. HUD funds housing counseling agencies through the Housing Counseling Programs yearly notice of funding availability. For fiscal year 2005, $23,593,332 in national and regional housing counseling grants and $18,070,668 in state and local grants were awarded.[118] In Texas, one organization received $780,000 through the national and regional funding allocation, while eight organizations received $762,127 through the state and regional allocation—which is an average of approximately $95,000 per organization. Using the cost per participant estimates above, these eight local organizations would be able to serve approximately 95 to 200 customers per year with their HUD funding awards.

Examples of State Homebuyer Education Initiatives

Chapter 2306.253 of the Texas Government Code requires that TDHCA develop and implement a statewide homebuyer education program. In response to this mandate, TDHCA has developed a training and certification program for nonprofits interested in providing homebuyer education in their communities. To ensure uniform quality of the homebuyer education provided throughout the state, TDHCA contracts with NeighborWorks America to teach local nonprofit organizations the principles and applications of comprehensive pre- and post-purchase homebuyer education. In 2006, TDHCA's $70,000 budget for the program funded two "Train the Trainer" five-day certification workshops for new providers and four days of continuing education classes. The Department also secures sponsors to cover meeting space and other additional costs so that participants' expenses are minimized. Certification classes can accommodate up to 40 participants each, and 30 spaces are available in the continuing education classes. Classes are frequently oversubscribed. Currently, a provider's certification with TDHCA does not expire, but providers are encouraged to obtain continuing education.

TDHCA surveys certified providers each year for updated information on their classes offered, the number of classes offered, and number of individuals educated. Of 136 active organizations (employing 188 certified individuals) currently providing homebuyer education, they have offered 1,522 classes, educated 16,485 households, and counseled 4,194 families experiencing default or foreclosure in 2005.

In addition to training classes, states such as Kentucky reimburse counseling agencies for their services. Through the Kentucky Housing Corporation Homeownership Counseling Program, approved counseling agencies may receive up to $370 per individual client counseled, $400 per two-hour homebuyer class, and $600 per five-hour homebuyer class.[119] Kentucky currently has 39 approved housing counseling agencies.[120] If each of these organizations counsel only one individual per month and offer just one two-hour and one five-hour class per month, the state housing agency's reimbursement to local agencies will total nearly $650,000 a year.

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[118] HUD, "Housing Counseling Grantees for Fiscal Year 2005," http://www.hud.gov/content/releases/statebystate05.pdf (accessed August 21, 2006).

[119] Kentucky Housing Corporation, "Homeownership Counseling Program Memorandum of Agreement for Housing ownership Counseling Services," i-ii, http://www.kyhousing.org/uploadedfiles/Homeownership/Education/HCP%20Contract.pdf (accessed August 21, 2006).

[120] Kentucky Housing Corporation, "KHC's List of Approved Counselors," http://www.kyhousing.org/CounselorList.asp?sec=57&County=All (accessed August 21, 2006).

LEGISLATIVE TRENDS RELATED TO FORECLOSURE PREVENTION

This section discusses federal and state laws that have been considered or enacted to address some of the issues that the mortgage lending industry and mortgage borrowers are facing in a rapidly changing and highly complex lending environment. Most often this legislation can be categorized as "responsible lending" or "predatory lending" provisions. As was the case with the "General Foreclosure Issues" section, this information is provided as a primer to show what other governmental bodies are doing to address what are perceived as inappropriate mortgage lending practices, including some practices that may lead to increase defaults and, resultantly, foreclosures.

The causal link between subprime loans or predatory lending practices and a high rate of foreclosure is not definitive. While offering legislative remedies to predatory lending practices may decrease foreclosure rates in some areas, it is difficult to establish the level of effectiveness given the limited data available on types of mortgages in Texas. It should be noted that the legislative approaches provided in this section should not be perceived as proposed courses of action for the State of Texas. A number of these laws have been passed fairly recently. Both time and research will be needed to identify and assess the long term implications of imposing such legal requirements.

The information in this section is primarily derived from cross-referencing the findings of two major sources of ongoing research tracking state predatory lending/mortgage foreclosure laws.

- The National Council of State Legislatures (NCSL) a bipartisan organization serving state legislatures and staff throughout the United States, is tracking "Predatory Mortgage Lending" as an issue area by examining legislation that targets four areas including (1) loan "flipping" or the refinancing of loans with diminishing, tangible return for the consumer; (2) financing of excessive fees or the adding of fees, points, and other penalties so payments at the end of the loan term are significantly higher; (3) "asset-based" or "equity-lending," which lends to consumers based on accumulated assets rather "income-based" lending, based on the consumers ability to repay; and (4) outright fraud and abuse by lenders.
- The Center for Responsible Lending's (CRL's) website tracks national and state legislative trends addressing "predatory" or "high-cost" loans. Unlike NCSL, the Center for Responsible Lending attempts to evaluate the relative strength of state legislation by comparing the specific provision of the laws against the standards established by HOEPA over a decade ago. The Study does not evaluate the strength/weakness of individual state provisions compared to federal HOEPA legislation, but it will use the typology created by the Center's research to help frame the discussion on the types of provisions found in state legislation.

Information obtained from both sources was also supplemented with staff research on legislative bills presented in over 25 states and the District of Columbia.

Responsible Lending Legislation that Has Been Proposed at the Federal Level

During the 109th Congress, 1st Session, the following four pieces of legislation were introduced to address specific lending provisions and practices in an attempt to decrease the level of mortgage foreclosures. While none of this legislation was adopted, the proposals demonstrate some national

concerns regarding high mortgage foreclosure rates and remedies that have been suggested to address the problems.

The "Prevention of Predatory Lending Through Education Act" (HR 200)
Introduced on January 4, 2005; referred to the Committee on Financial Services
This legislation would have enabled the US Department of Housing and Urban Development (HUD) to distribute grants for counseling and homebuyer education programs and establish a toll-free number for predatory lending complaints. The three main tenets of the consumer education component included (1) the authorization of grant program for education targeting "those most vulnerable to being taken advantage of by predatory and unscrupulous lending practices relating to home loans,"[121] focused on the various components of high-cost mortgages; (2) counseling programs for current and prospective homeowners regarding lending practices; and (3) referral services for those activities. The bill would also have established a predatory lending advisory council to establish the operation of the toll-free number, advise HUD regarding the distribution/selection of grant amounts, and study defaults and foreclosures in the US.

The "Prohibit Predatory Lending Act" (HR 1182)
Introduced on March 9, 2005; referred to the Committee on Financial Services
This legislation would have amended the "Truth in Lending Act of 1968" by adjusting rates, fees, and charges in relation to certain mortgages; amend existing requirements to include new provisions regarding prepayment penalties, balloon payments, and the consumer's ability to repay; introduce additional requirements (such as pre-loan counseling) for certain mortgages; and provide additional protections for home loans, such as a provision against "flipping" a mortgage and prohibiting the financing of single premium credit insurance with a consumer's principal dwelling.

The "Responsible Lending Act" (HR 1295)
Introduced on March 15, 2005; referred to the Committee on Financial Services
A stated purpose of this legislation was "to protect consumers against unfair and deceptive practices in connection with higher cost mortgage transactions."[122] This was to be accomplished by addressing loan practices through several major sections including amending civil remedies under existing law; creating nationally uniform lending standards; addressing mortgage servicing; establishing minimum standards for licensing of mortgage brokers; enhancing real estate appraisal standards and their oversight; and, like other legislation, addressing homebuyer education by creating consumer counseling requirements and procedures; establishing an Office of Housing Counseling; and offering grants for housing counseling assistance.

The "Predatory Mortgage Lending Practices Reduction Act" (HR 1994)
Introduced on April 28, 2005; referred to the Committee on Financial Services
This legislation focused on lender reforms through the following five major tenets: (1) additional certification requirements for mortgage lenders and brokers, including certified training with regard to subprime lending; (2) amending current lender requirements for high-cost mortgages by requiring a

[121] US Congress. House. *Prevention of Predatory Lending Through Education Act,* HR 200, 109th Cong., 1st Session.
[122] US Congress. House. Mortgage Lending Improvements and Uniform National Standards Act, HR 1295, 109th Cong., 1st Session.

"Best Practices Plan," instituting a good faith resolution of complaints provision, prohibiting charges not previously disclosed, and establishing a plain description and disclosure requirement; (3) establishing "unfair and deceptive acts and practices," to provide for rulemaking proceedings, compliance enforcement, and penalties for "unfair or deceptive acts or practices"; (4) prohibiting certain arbitration clauses, including those clauses imposed on consumers without their consent; and (5) offering grants to community development corporations for predatory lending education.

Examples of State Responsible Lending Legislation

In 1994, Congress passed the Home Ownership and Equity Protection Act (HOEPA) to provide consumer protections from predatory lending practices that often lead to foreclosure. Twelve years later, 29 states are addressing these same concerns by establishing legislation to curb abusive lending practices to aid consumers with gaining improved access to homeownership without risk of mortgage foreclosure or long-term financial problems. In examining state legislation, the definitions used for "predatory lending" and "high-cost loans" are as varied as the remedies to address them.

According to NCSL, as of January 3, 2006, there are 37 states (including the District of Columbia) with legislation targeting predatory lending practices.[123] In addition to these states, CRL identifies six additional states that have at minimum a statute addressing a component of lending practices. This report indicated that there were eight states that did not have any legislation or which had insufficient information available regarding statutes to protect against predatory lending practices, including Alabama, Delaware, Hawaii, North Dakota, Oregon, South Dakota, and Wyoming.

NCSL's information indicated that between 2001 and 2005, 2003 was a peak year for passing predatory lending legislation with 29 states successfully passing such legislation. In 2004, only 10 pieces of legislation were passed. In 2005, the decline continued with only eight pieces of legislation being passed, including HB 955 and HB 1582 in Texas.

In 2006, four states enacted predatory lending legislation. This legislation was the Ohio Homebuyer's Protection Act of 2006, the Tennessee Home Protection Act of 2006, the Rhode Island Home Loan Protection Act of 2006, California Senate Bill 1609 and Assembly Bill 790

Of the three laws, the Ohio Homebuyer's Protection Act of 2006 appears to be the most comprehensive. It prohibited a real estate appraisal for a mortgage loan without state certification/licensure and modifying existing mortgage broker/loan officer law to include the disclosure of information, prohibited acts, and educational requirements (including pre-licensure examination). Additionally, this act created a Consumer Education Finance Board to investigate homebuyer education practices and annually report with recommendation of efforts to improve financial literacy in the state and makes other changes to mortgage lending practices including restrictions on flipping or the financing of high-cost fees. Most importantly, this legislation required cooperation among several state agencies to institute reform.

[123] National Conference of State Legislatures, "Predatory Mortgage Lending," http://www.ncsl.org/programs/banking/predlend_intro.htm (accessed July 13, 2006).

The legislation of Rhode Island and Tennessee focused more strongly on consumer protections. The State of Rhode Island's "Home Loan Protection Act" instituted reforms based on recommendations of the Legislative Commission that studied mortgage lending practices during years 2004 and 2005. Specifically, the act prohibits activities such as flipping, encouraging default, financing of points and fees, and other practices contributing to high-cost loans. Tennessee's Home Loan Protection Act of 2006, offers similar consumer protections including flipping and the calculating or financing of fees, but specifically excludes reverse mortgage transactions from the definition of a "home loan," barring these transactions from receiving the same consumer protection provisions as conventional home loans and reinforcing the support toward income-based rather than equity-based lending.

In September 2006, legislation to specifically curb "predatory" and "fraudulent" lending was passed the California Senate and Assembly and was approved by the Governor. Senate Bill 1609 offers protections for seniors who wish to borrow against their home equity through the use of reverse mortgages. The law requires such borrowers to meet with a HUD-approved counselor, the loan documents would have to be in the same language in which negotiations were made, and a borrower could not be required to purchase an annuity as a loan condition. Under Assembly Bill 790, lenders who misrepresent their education or other qualifications could temporarily or permanently lose their license. Both measures were unopposed and enjoyed broad support.[124]

Characteristics of State Responsible Lending Legislation

The state legislatures have implemented a wide variety of approaches to address predatory lending in their respective states. Some states (Illinois, Louisiana, Rhode Island, South Carolina, Utah, and Virginia) have started the process by commissioning a study to define the scope of the problem and recommend long-term solutions. In the case of Rhode Island, the study began with a series of town hall meetings throughout the state to discuss issues affecting local communities. Other states (Alaska, Idaho, Iowa, Kansas, and Vermont) have opted to initiate change through individual statutes that address a particular factor such as the Legal Rate of Interest addressed by Alaska Statute AS 45.45.010.

Despite these varied approaches, there appear to be four common areas addressed by states including (1) amending allowable loan provisions or additional costs that may be financed as a part of the mortgage; (2) increasing consumer awareness through homebuyer education programs; (3) creating collaboration among the various agencies and stakeholder groups to work toward solvency; and (4) providing civil and other legal remedies (such as mandatory disclosure document language) to consumers affected by high-cost mortgage loans.

In its "State Legislative Scorecard," CRL categorizes recommended changes to allowable loan provisions into six major categories including covered loan provisions, points and fees protections,

[124] Jason Green, "Bills Targeting 'Predatory' Lending Practices Head to Governor," Palo Alto Daily News (California), September 1, 2006

prepayment penalty restrictions, flipping, high-cost protections, and high-cost remedies. Following are definitions of each type as provided on CRL's website:[125]

- Covered Loans: "Types of mortgages covered under the statute. Strong provisions include all loan types such as conventional, government-insured, and open-end."
- Points and Fees: "Protections against excessive points and fees. Strong provisions avoid loopholes for subprime prepayment penalties and yield spread premiums while providing protection at a lower threshold."
- Prepayment Penalty: "Restrictions on subprime pre-payment penalties. Strong provisions restrict the term amount of allowable pre-payment penalties."
- Flipping: "Protection against flipping (harmful refinance loans). Strong provisions prohibit flipping that has not net benefit to the borrower on all home loans."
- High-Cost Protections: "High-cost loan protections. Strong provisions allow homeowners to defend against foreclosure without exception."
- High-Cost Remedies: "Remedies for violations of high-cost loan protections. Strong provisions allow homeowners to defend against foreclosure, without exception."

In addition to identifying legislation found under each type of provision, CRL evaluates the strength of each provision in its respective category by comparing its requirements with the standards established by HOEPA as the baseline for comparison. Of those states examined, New Mexico's Home Loan Protection Act (2003) is identified as having the strongest legislation, followed by the states of North Carolina (often considered a lead case study regarding predatory lending legislation) and West Virginia.[126] Some of the states identified as having the weakest provisions after the passage of HOEPA include California, Colorado, Louisiana, Nevada, Oklahoma, Pennsylvania, and Utah.[127]

To try to identify recurring provisions provided in state legislation, TDHCA staff reviewed key bills affecting predatory lending in the following 23 states and the District of Columbia.[128] Alaska, Arkansas, California, Colorado, District of Columbia, Georgia, Kentucky, Louisiana, Massachusetts, Michigan, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, North Dakota, Oregon, Rhode Island, South Dakota, Tennessee, Utah, Virginia, and Wisconsin.

Examples of commonly used provisions included the following type prohibitions or requirements.

- Prohibiting the financing of any life or health insurance or any payments (directly or indirectly) for any debt cancellation relating to the mortgage
- Requiring training, certification, licensing, and continuing education of mortgage lenders and brokers
- Requiring homebuyer education class for some or all loans and require proof at loan closing
- Providing additional restrictions on certain loans, defined as "covered" loans including requiring certain disclosures as provided in statute

[125] Center for Responsible Lending, "Mortgage Lending", http://www.responsiblelending.org/issues/mortgage/statelaws.html (accessed July 13, 2006)
[126] Center for Responsible Lending, "Mortgage Lending."
[127] Center for Responsible Lending, "Mortgage Lending."
[128] The identification of states was by random selection.

- Decreasing or eliminating the amount of points and fees (including late payment fees) which can be financed as a part of the mortgage loan
- Prohibiting the "flipping" of a home loan; defined as either refinancing a low-interest special, subsidized, or government sponsored loans or as a loan that does not produce a tangible net benefit for the consumer
- Prohibiting the encouragement or recommending of defaulting on an existing loan prior to and in connection with closing of a home loan that refinances any portion of the existing debt
- Limiting creditors from charging fees for modifying or amending existing home loans
- Prohibiting pre-payment penalty provisions
- Prohibiting mandatory arbitration clauses that limit the ability of the borrower to seek relief through judicial processes
- Prohibiting or limiting additional "high-cost" loan provisions including balloon payments call provisions, negative amortization, and increased interest rates.
- Limiting on provisions which allow the use of loan proceeds to be used toward home improvement contracts or multiple payments consolidated and paid in advance

In addition to these regulatory provisions, several states include enforcement provisions for deliberate violation of lending requirements including additional rights to actual, statutory, or punitive damages and provisions with prescribed methods of correcting unintentional violations.

Texas Legislation

Compared to other states, CRL does not identify Texas as having the strongest or weakest lending provisions. For example, in comparison to California, another high population state, Texas is identified as having stronger high-cost loan provisions.[129]

The following Texas laws are similar to the examples of legislation used by other states that works to control practices that could lead to an increased chance of foreclosure.

- Prohibiting the financing of any life or health insurance or any payments (directly or indirectly) for any debt cancellation relating to the mortgage.
  - Similar Texas citations were not found
- Requiring training, certification, licensing, and continuing education of mortgage lenders and brokers
  - Real Estate License Act, Chapter 1101, Texas Occupation Code
  - Section 156.201 et seq, Texas Finance Code [Mortgage Broker License and Loan Officer License]
- Requiring homebuyer education class for some or all loans and require proof at loan closing
  - Reverse Mortgages: Sec. 50(k)(6), Article XVI, Texas Constitution
  - Section 343.102(a)(1)-(2), Texas Finance Code
- Providing additional restrictions on certain loans, defined as "covered" loans including requiring certain disclosures as provided in statute

[129] Center for Responsible Lending, "Mortgage Lending", http://www.responsiblelending.org/issues/mortgage/statelaws.html (accessed July 13, 2006)

  - Home Equity Loans: Sections 50(a)(6)(M)(i)-(ii) [1-day Preclosing disclosures on terms, fees and charges], 50(a)(6)(Q) [12 day notice], 50(g), 50(h), and 50(k)(6), Article XVI, Texas Constitution
- Decreasing or eliminating the amount of points and fees (including late payment fees) which can be financed as a part of the mortgage loan
  - Similar Texas citations were not found.
- Prohibiting the "flipping" of a home loan; defined as either refinancing a low-interest special, subsidized, or government sponsored loans or as a loan that does not produce a tangible net benefit for the consumer
  - Section 343.101(b), Texas Finance Code [refinancing before 7 years prohibited unless certain conditions apply]
- Prohibiting the encouragement or recommending of defaulting on an existing loan prior to and in connection with closing of a home loan that refinances any portion of the existing debt
  - Similar Texas citations were not found.
- Limiting creditors from charging fees for modifying or amending existing home loans
  - Similar Texas citations were not found.
- Prohibiting pre-payment penalty provisions
  - Residential Homestead: 12% limit, Section 302.102, Texas Finance Code
  - Secondary Mortgage Loans (interest rate in excess of 10% not secured by single family residential property): Chapter 342, Subchapter G, Texas Finance Code and 7 TAC Sec. 1.70(b)
  - Manufactured Homes: Chapter 347, Texas Finance Code
  - Home Equity Loans: Texas Constitution, Art. XVI, Section 50(a)(6)(Q) and (G)
  - Contracts for Deeds: Chapter 5, Subchapter D, Texas Property Code
  - High Cost Home Loans: Section 343.205, Texas Finance Code
- Prohibiting mandatory arbitration clauses that limit the ability of the borrower to seek relief through judicial processes
  - Similar Texas citations were not found.
- Prohibiting or limiting additional "high-cost" loan provisions including balloon payments call provisions, negative amortization, and increased interest rates.
  - Home Equity Loans: Sections 50(a)(6)(L) and 50(t)(8), Article XVI, Texas Constitution
- Limiting on provisions which allow the use of loan proceeds to be used toward home improvement contracts or multiple payments consolidated and paid in advance
  - See the sections on Home Equity Laws and Reverse Mortgage Laws in the Texas Constitution.

Legislative Trend Summary

When comparing the legislative high-cost loan provisions in Texas to the most stringent guidelines in other states, there are several provisions that are addressed differently or not at all. Like other states, Texas has limits on refinancing low-rate home loans, restrictions and disclosure requirements with some high-cost loans, and licensing requirements for lenders and brokers. One provision offered at a less stringent level is the financing of insurance in conjunction with a home loan, which in some states is strictly prohibited. However, Texas law allows for the purchase of insurance in

conjunction with a home loan if a notice “Insurance Notice to Applicant” is provided to each applicant. Additionally, while Texas disallows balloon payments, negative amortization, and prepayment penalties or “premiums” with some high-cost mortgage loans, in other states, these practices are strictly prohibited.

It should be noted that there is limited research on the impacts of some of these provisions, like increased homebuyer education on the rate of mortgage foreclosure. However, there is some consensus among researchers to substantiate that limiting the fees or additional costs rolled into the mortgage can assist in maintaining an affordable mortgage. In the case of Texas, it is also difficult to assert how specific recommendations would positively impact the mortgage foreclosure rate; there are too many variables impacting mortgage lending practices in the state. However, by examining best practices and those solutions that have worked well in other states, Texas can begin to tailor recommendations to meet the market needs.

CONCLUSIONS

Any causal connections or commonality between these activities in the Study's counties cannot be determined or supported by publicly available data. To the extent that a high level of foreclosure activity may be detrimental to borrowers, lenders, investors, and even communities and economies, the collection of data so that causes and effects may be analyzed is a worthwhile objective.

To analyze the number and location of foreclosures and to identify why those foreclosures occurred are two different matters. The reason that the property securing a mortgage loan is foreclosed is because the borrower has gone into default and no alternative way to address this default has been agreed upon. Therefore, a useful understanding of the issue requires detailed understanding of matters for which publicly available information is not available: (1) Why did the borrower go into default and (2) what sort of efforts, if any, were made to explore an alternative resolution?

To ascertain why borrowers go into default is complex. Reaching valid answers based on empirical data would involve collecting a large body of private information, information that many borrowers would not want to share and many loan servicers do not even capture, and being able to correlate that data to the mortgage market and its components. While some significant participants in the mortgage market may have developed views as to the likely causes for their particular borrowers to have defaulted, their conclusions, even if true, may not hold for the Texas mortgage market as a whole. For example, the Roper survey (as discussed on page 69 of this report) defined reasons for foreclosure for a small sample of defaulted loans from Freddie Mac's portfolio. That loan sample may or may not be directly relevant to the foreclosures in the Study area.

In the case of the relationship between subprime loans and foreclosures, many questions still remain unanswerable with existing data. Examples of these questions are: Were the factors that led to default foreseeable when the loans were originated? Were the originators knowingly placing borrowers in loans where there was a known substantial likelihood of default? If so, was this being done because the loan purchasers and securitizers had defined these to be acceptable parameters of risk? Or were some originators acting in their own interest, likely to the detriment of borrower and investor alike? The Committee was unable to find any publicly available data to answer these important questions.

All that can be concluded is that origination and foreclosure activity can, to a degree, be quantified and compared. Common trends in the correlation between high foreclosure rates and certain demographic statistics can be identified across most of the counties included in this study. The exception, El Paso County, defied the pattern by not showing significantly strong trends in any of the demographic factors examined. High concentrations of minority populations correlated to higher foreclosure rates in all five counties other than El Paso. Also in a majority of the counties, clear trends were evident connecting residential foreclosure rates to lower income levels and greater use of higher rate loans. Further quantitative analysis, however, would be necessary to draw stronger conclusions about the implications of these correlations.

RECOMMENDATIONS

An obvious need is for additional Texas specific information on the causes of foreclosure, specifically information on factors that actually cause loan defaults. The Committee has identified two basic ways to obtain such information: funded academic research or the imposition of data collection requirements. The committee discussed the many administrative and monetary issues associated with the imposition of data collection requirements on the mortgage industry and members had differing opinions as to the feasibility of imposing data collection requirements.

On the other hand, the members agreed that further detailed research is needed. Specifically, the committee recommends that a professional study of foreclosed properties within a Metropolitan Statistical Area be funded. This study must focus on causal factors of foreclosure in this part of the state from the perspective of the borrower, lender, mortgage originator, mortgage servicers, housing developers, secondary market representatives, industry oversight agencies, federal and state prosecutors, and consumer advocates. It is expected that this study will require original research at the level of the individual borrower – much of which would involve one-on-one interviews. *The Effect of Concentrated Subprime Lending on a Community of New Single-Family Homes in San Antonio, TX - A Case Study* provides an example of a methodology for conducting this type of research.[130] This report studied a San Antonio subdivision that experienced a high number of foreclosures before construction of the subdivision had been completed. The report used purchased data sets, reviews of county records, interviews of borrowers, analysis of demographic and lending data, review of loan documents, and other labor intensive research methods.

The Committee also recommends that the Legislature appropriate sufficient funds to:

- adequately fund enforcement of stronger fraud laws;
- expand multilingual educational efforts to make borrowers aware of opportunities to work out delinquencies. For example, public service announcements related to delinquencies and foreclosures, brochures describing options in the event of delinquency or default, internet website, and central call in number for borrowers in default; and
- provide support for expanding homebuyer education initiatives and of organizations to counsel borrowers in the foreclosure process.

[130] Olivia Yu, Ph.D, *The Effect of Concentrated Subprime Lending on a Community of New Single-Family Homes in San Antonio, TX - A Case Study*, *A Report to Fannie Mae*, Department of Criminal Justice at the University of Texas at San Antonio, May 5, 2005.

APPENDIX A. HOUSE BILL 1582

AN ACT
relating to a study of residential foreclosures in certain counties.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF TEXAS:
SECTION 1. Subchapter K, Chapter 2306, Government Code, is amended by adding Section 2306.260 to read as follows:
Sec. 2306.260. STUDY REGARDING RESIDENTIAL FORECLOSURES.
(a) The department shall conduct a study to examine mortgage foreclosure rates in Bexar, Cameron, Dallas, El Paso, Harris, and Travis Counties and shall establish an advisory committee to direct the focus of the study. The advisory committee shall be composed of:

(1) the director or the director's representative;
(2) the savings and loan commissioner or the commissioner's representative;
(3) four members appointed by the director who represent community and consumer interests;
(4) four members appointed by the savings and loan commissioner who represent the mortgage lending industry; and
(5) a representative of the Texas Housing Research Consortium at The University of Texas at Austin.

(b) The representative of the Texas Housing Research Consortium at The University of Texas at Austin serves as chair of the advisory committee.
(c) The advisory committee established under Subsection (a) shall address the following topics in the study:

(1) the extent to which the terms of mortgages are related to the foreclosure rate and whether the terms could be offered in a manner to reduce the likelihood of foreclosures;
(2) the socioeconomic and geographic elements characterizing foreclosures;
(3) the securitization of mortgages in the secondary market and its effect on foreclosures;
(4) consumer education efforts to prevent foreclosures; and
(5) recommendations to reduce foreclosures and the foreclosure rate across this state.

(d) The advisory committee shall determine the methodology to be used in conducting the study. The methodology used to study the topics listed in Subsections (c)(1), (2), and (3) must include a statistically significant sample size.
(e) All findings of the advisory committee must be approved by a majority of the members of the advisory committee.
(f) To obtain information to conduct the study, the department may contract with appropriate organizations, public or private institutions of higher education, and entities with
experience in conducting real estate or mortgage research. All state agencies, boards, commissions, and institutions of higher education shall comply with requests from the department for
information or assistance in conducting the study.
(g) All information used to conduct the study must be accessible to the department, the Savings and Loan Department, and the legislature. The department shall prepare a consolidated
analysis and recapitulation of the information used to conduct the study and shall make the analysis and recapitulation available to the public. The department shall ensure that the analysis and

recapitulation of the information used to conduct the study contain only aggregate data and do not contain data specific to any mortgage.
(h) Except as provided by other law, private, confidential, and privileged information obtained for the production of any public reports is the property of the parties to the mortgage and is
not subject to the disclosure provisions of Chapter 552.
(i) The department shall report to the governor, the lieutenant governor, and the speaker of the house of representatives on the study and its results not later than September 1, 2006.
(j) To conduct the study, the department may use money available under Section 1372.006(a-1), and the department or advisory committee may seek and accept grants and donations.
(k) This section expires February 1, 2007.

SECTION 2. Section 1372.006, Government Code, is amended by adding Subsection (a-1) to read as follows:
(a-1) In addition to being used in the affordable housing research and information program under Section 2306.259, money transferred to the Texas Department of Housing and Community
Affairs may be used by the department to conduct the study regarding residential foreclosures, as provided by Section 2306.260. This subsection expires February 1, 2007.

SECTION 3. This Act takes effect immediately if it receives a vote of two-thirds of all the members elected to each house, as provided by Section 39, Article III, Texas Constitution. If this Act does not receive the vote necessary for immediate effect, this Act takes effect September 1, 2005.

APPENDIX B. FORECLOSURE STUDY MEMBERS

The persons listed below are the members of the Committee created by HB 1582.

Committee Chair

Elizabeth Mueller
Texas Housing Research Consortium
c/o University of Texas at Austin
School of Architecture

Committee Members

Tommy Bastian (SML appointee)
Barrett Burke Wilson Castle Daffin & Fappier, L.L.P.

Steven A. Carriker (TDHCA appointee)
Executive Director
Texas Association of Community Developments Corporations

Robert Doggett (TDHCA appointee)
Texas Rio Grande Legal Aid

Joe Farr (SML appointee)

Tim Hathaway (SML appointee)
Freddie Mac

Maria King (SML appointee)
President
Texas Association of Mortgage Brokers

Benny McMahan (TDHCA appointee)
Chief Executive Officer
Texas Association of Realtors

Kathy Mitchell (TDHCA appointee)
Consumers Union

Danny Payne
Commissioner
Texas Department of Savings and Mortgage Lending Commissioner

Stephen Schottman, Team Lead, Research and Planning
TDHCA Division of Policy and Public Affairs