Homeownership in a High-Cost Region

by Esther Schlorholtz

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A perfect storm is brewing in the home mortgage industry in eastern Massachusetts. Home prices are among the highest in the nation. Many buyers have borrowed heavily against their homes. When the Federal Reserve began raising rates in July 2004 and the prime rose from 4 percent to 8.25 percent within 24 months, homeowners with variable rates felt it immediately. Moreover, borrowers with adjustable rate mortgages are experiencing substantially higher costs as their rates re-set. Sales of new homes are slowing, and prices are softening.

Meanwhile, mortgage lenders unregulated by the Community Reinvestment Act (CRA) have aggressively marketed high-cost products, often in minority communities. African Americans and Latinos at every income level are five times more likely to get the costly loans than whites, and according to Home Mortgage Disclosure Act (HMDA) data for 2004, Boston's predominately minority neighborhoods were almost eight times more likely to get high-rate loans.

In 2005, both units in this Worcester duplex were purchased for $143,000 with SoftSecond loans. *Photograph by Greig Cranna, courtesy of the Massachusetts Housing Partnership.*

The storm is in its early stages. Foreclosure filings are up. Boston had 24 in 2004 and 60 in 2005. In the first four months of 2006 alone, according to city officials, Boston experienced another 60 foreclosures. The numbers are small compared with the city's nearly 1,700 foreclosures in 1992, but the trend is a concern. It took communities in the early 1990s years to recover from the foreclosures.

Mattapan, Roxbury, Dorchester, and Hyde Park have the highest foreclosure rates. These largely minority Boston neighborhoods also had the most high-cost loans (loans three percentage points or more above the comparable U.S. Treasury security of the same maturity).[1]

The Boston Globe Magazine recently correlated the growing percentage of high-cost loans in these neighborhoods with increasing foreclosures.[2] For example, Roxbury had more than 23 percent high-cost home-purchase loans in 2004, and in 2005 it had foreclosure petitions of 17 per 1,000 homes. Mattapan had almost 34 percent high-cost mortgages in 2004, and in 2005 it had foreclosure petitions of 15 percent.

According to the *Borrowing Trouble? VI* report, high-cost loans accounted for double-digit shares of all home-purchase lending in 17 suburban communities in Greater Boston. That includes Everett with 28 percent, Revere with 25 percent, Marlborough with 21 percent, and Randolph with 20 percent. Beyond Greater Boston, some of the high-cost loan shares were even higher—36 percent in Lawrence, 31 percent in Brockton, and 29 percent in Springfield.

Tackling the Challenge

What should we be doing to minimize the damage? Boston's Mayor Thomas Menino believes in intervening early—for example, by expanding the "Don't Borrow Trouble" campaign initiated by the Massachusetts Community & Banking Council (MCBC). Other municipal leaders are likely to follow suit. Banks are saying they will consider financing at-risk borrowers with fixed-rate products, but many borrowers will need public support.

Legislation has been proposed in Massachusetts that would require mortgage companies (largely headquartered out of state) to bear responsibilities like the ones that banks' assume under the Community Reinvestment Act, but it keeps getting delayed. The Massachusetts Division of Banks is carrying out fair-lending exams to ensure that these mortgage lenders are

In 1999, a Boston school custodian purchased a condominium in this Roslindale development for $135,000 with a SoftSecond loan. *Photograph by Greig Cranna, courtesy of the Massachusetts Housing Partnership.*

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not targeting minority-group populations with high-cost products. Additionally, expanded public-education initiatives are being proposed through MCBC, the Massachusetts Bankers Association, the Massachusetts Mortgage Bankers Association (MMBA), the Massachusetts Mortgage Association, and the Massachusetts Credit Union League. And the Federal Reserve Bank of Boston is coming out with a new consumer brochure, *True or False: Know Before You Go to Get a Mortgage*.[3]

Much more needs to be done, particularly to rein in predatory and fraudulent lending practices and to keep borrowers from taking out loans that they can't repay. Recently, MMBA proposed expanded licensing, monitoring, and education for mortgage brokers, a largely unregulated group, who are usually the first contact with homebuyers and whose fees increase with the size of a loan. Primarily because of a lack of state funding, the proposal was dropped.

Today largely unregulated, out-of-state lenders are the primary source for mortgages in Boston. In 1990, local banks and credit unions controlled nearly 80 percent of the city's home mortgage market, but now they are down to 22 percent.[4] Nevertheless, Massachusetts banks make loans to lower-income and minority groups that outperform out-of-state companies' loans.

Solid, well-performing loans for low- and moderate-income borrowers are the result of good lending products and responsible lenders working with the state, municipalities, and not-for-profit organizations. The loans have predictable, stable monthly payments, and the payments are manageable for borrowers. Almost 40 banks and credit unions now originate loans under the SoftSecond Loan Program, administered by the Massachusetts Housing Partnership.[5]

The Borrower

It is important that borrowers understand the homebuying process and know where to get help if they run into difficulties. Every borrower obtaining financing through the SoftSecond Program must undergo prepurchase counseling and, prior to loan closing, must authorize foreclosure intervention by nonprofit organizations. The program is limited to first-time home buyers earning 100 percent of the area median income or less.[6]

Lenders offering SoftSecond loans issue two loans, one at 75 percent loan-to-value that is a conventional loan but issued at a somewhat below-market rate. The lender also provides a second mortgage at the same below-market rate. The borrower pays no principal on the second mortgage until the 11th year, and public resources may subsidize the interest payment for low-income borrowers. If there is an interest subsidy, it is phased out between years six and 10. Borrowers do not have to pay private mortgage insurance, and although a 3 percent down payment is required, some of that can be a gift or grant.

Since 1990, the SoftSecond Program has helped more than 8,700 low- and moderate-income first-time homebuyers, making it the state's most successful mortgage product for this group. In SoftSecond's 16 years of operation, there have been only 30 foreclosures. Astonishingly, there was only one foreclosure in 2004, three in 2005, and none in the first six months of 2006.

Even a small bank can be successful with SoftSecond loans. Boston Private Bank, which joined the program in 1996, had about $300 million in net assets at that time. Now a $2.2 billion full-service commercial bank, it has originated SoftSecond loans totaling more than $96 million since 2000. It has never experienced any losses with the program, demonstrating that a bank can do well while doing good.

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For more than 15 years, MCBC has been the forum that has enabled the banks, public officials, and community organizations to collaborate on the credit and financial needs of lower-income people and neighborhoods. It has monitored the success of the SoftSecond Program and has developed improvements to benefit both lenders and borrowers.

Through such partnerships, increased public awareness, and leadership by government officials, nonprofit organizations and lenders will weather this storm. And if the legislature can bring CRA-like responsibilities to all mortgage lenders and can require continuing education and improved monitoring of mortgage brokers, Massachusetts will be way ahead.

Better regulatory oversight in all areas, but especially in fair lending, can ensure that minority-group borrowers and other vulnerable populations are not targeted unfairly by unscrupulous lenders and brokers. Programs to create educated homebuyers and interventions to prevent foreclosures can also help those who are most at risk. Finally, products that promote long-term stability in homeownership—products that work for both the lender and the borrower—will be good for the community overall.

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Endnotes

[1] These results are reported in an analysis prepared for the Massachusetts Community & Banking Council (MCBC) by Jim Campen of the Gaston Institute at UMass Boston, *Borrowing Trouble? VI: High Cost Mortgage Lending in Greater Boston*, 2004, March 2006.

[2] *The Boston Globe Magazine*, April 2, 2006.

[3] See www.bos.frb.org/consumer/consumer pubs.htm.

[4] Reported in an analysis prepared for MCBC by Jim Campen, *Changing Patterns XII: Mortgage Lending to Traditionally Underserved Borrowers and Neighborhoods in Greater Boston 1990-2004*, January 2006.

[5] Jim Campen and Tom Callahan, "SoftSecond Program Celebrates 10 Years," *Communities & Banking*, spring 2001, 15.

[6] MassHousing's programs are similarly innovative and can reach higher-income populations, up to 135 percent of the area median income. The programs fill a gap for higher-income minorities (more than $91,000 per year) who find fewer options. For example, in 2004, in spite of high earnings, upper-income African Americans received almost 45 percent of their home-purchase loans as high-cost loans. In contrast, only about 5 percent of upper-income whites did, according to the *Borrowing Trouble? VI* report. Meanwhile, upper-income Latinos received 42 percent of their home-purchase loans as high-cost loans.