Oral Testimony
Of

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On the topic
Of

Home Foreclosure: Will Voluntary Modifications Help Families Save Their Homes?

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Introduction

Good afternoon Mr. Chairman and other distinguished Members of the Committee. My name is James H. Carr and I am the Chief Operating Officer for the National Community Reinvestment Coalition. On behalf of our coalition, I am honored to speak with you today.

NCRC is an association of more than 600 community-based organizations that promotes access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities for America's working families. NCRC is also pleased to be a member of a new coalition of more than 200 consumer, civic, labor, and civil rights organizations – Americans for Financial Reform – that is working to cultivate integrity and accountability within the US financial system.

The Foreclosure and Economic Crises

Members of the Committee, the U.S. economy is mired in the worst economic crisis in more than a half century. And while few would conclude the current economic environment is comparable to the Great Depression, today's economy has earned its moniker, the Great Recession. Although we have suffered much already, the worst remains ahead of us.

The most dispiriting aspect of the current crisis is that we have yet to meaningfully address foreclosure crisis, the core problem that caused the financial system to implode and drove the economy into a ditch.

The current wave of foreclosures is largely rooted in toxic mortgage products originated between 2007 and 2008. This wave is being driven by rising unemployment and reduction in workers' hours. The more than 3 million jobs that have been lost since the start of this year, for example, translate into potentially 1.2 million additional foreclosures.

In fact, we are now experiencing a self-perpetuating cycle wherein (1) foreclosures drive down home values; (2) sinking home values erode bank assets and household wealth; (3) loss of wealth leads to lower consumer spending and less lending activity by banks; (4) this, in turn, leads to lower productivity; (5) decreased productivity creates more unemployment; and (6) more foreclosures. At this point the cycle is complete and self-reinforcing, as newly unemployed and under-employed homeowners face foreclosure when they cannot make mortgage payments.

The reality of this self-reinforcing and economically destructive cycle raises questions about the validity of many recent economic projections that suggest the economy is recovering. The financial services industry, for example, remains on life support despite recent positive earnings news.

A close look at the fine print and footnotes in the positive earnings reports of many large financial firms, for example, reveals that creative accounting has replaced innovative finance as a primary source of profits within the banking industry. Few of the reported earnings are a result of lending for and investments in tangible products and services for the American economy.

Not an Equal Opportunity Crisis

This is not an equal opportunity recession. Although the national unemployment rate is an uncomfortable 9.5 percent as of June, that rate for African Americans exceeds 15 percent, and for Latinos unemployment is approaching 13 percent. The unemployment rate for non-Hispanic whites, by comparison, remains under 9 percent.

Because African Americans and Latinos comparatively few savings, they are poorly positioned to survive a lengthy bout of unemployment. As a result, potentially millions of African-Americans and Latino households could find themselves falling out of the middle class by the time the economy recovers.

Moreover, African Americans and Latinos were targeted disproportionately for deceptive high cost loans. According to a study by the U.S. Department of Housing and Urban Development, subprime loans are five times more likely in African American communities than in white neighborhoods, and homeowners in high-income black areas are twice as likely as borrowers in lower-income white communities to have subprime loans.

The result is that blacks and Latinos are over-represented in the foreclosure statistics. African Americans, for example, have experienced a full three-percentage point drop in their homeownership rate since the crisis began.

Research by the National Community Reinvestment Coalition found that predatory lenders aimed their toxic products heavily at women of color. Because African-American children are more likely to reside in female-headed households, black children are also disproportionately harmed as a result of the foreclosure crisis and its attendant stresses.

Finally, in a separate NCRC study (The Broken Credit System, 2004), we found that after controlling for risk and housing market conditions, the portion of subprime refinance lending increased when the number of residents over the age of 65 increased in a neighborhood. If a borrower were a person of color, female, and a senior, she was the "perfect catch" for a predatory lender.

Fixing the Problems

In response to the magnitude and complexity of the current crisis, a three-fold response is essential.

1. Stem the Rising Tide of Foreclosures

The new “Home Affordable Modification Program” (or HAMP) is the most comprehensive plan to date to address the foreclosure crisis.

Features that make the President’s plan superior to any similar programs to date include:

(1) The government shares the cost of writing down loans to be affordable for borrowers;

(2) Loan modifications are designed to make loans affordable over the long-term;

(3) Borrowers do not have to become delinquent in order to receive assistance;

(4) Second liens can also be modified as part of the plan (more than half subprime loans); and

(5) Servicers are provided financial incentives to encourage their participation; and (bankruptcy protection is proposed as a stick to encourage participation.

These are key and critical program elements missing from previous efforts. But there remain challenges.

Challenges with the program include:

(1) Principal balances on loans that are severely underwater are not bought down or eliminated to improve loan affordability. Forbearance of principal, accompanied with balloon payments due on sale of transfer of property, codifies predatory or discriminatory loan features. This is a critical weakness in HAMP because many loans have experienced negative amortization since they were originated, because they were originated at grossly inflated prices. Loans that are deeply upside down are more at risk of foreclosure even if the payments are made affordable.

(2) The program is voluntary for some institutions, and for all, is administratively cumbersome, time-consuming, and inconsistently administered (including failure to fully appraise consumers' financial situations to ensure the modifications is sustainable from borrower's financial perspective; and

(3) Unemployment-induced foreclosures are not adequately addressed. Borrowers facing a loss of income before or after a modification are not fully protected and foreclosure needlessly continues to be the trigger for costly evictions. This latter practice of evicting borrowers who have been foreclosed upon further drives down home prices for neighboring homeowners and positions additional properties for foreclosure.

Finally, the program would benefit greatly from more transparent data on loan modification outcomes so as to allow for a more immediate analysis of the program's performance and the need for possible further refinements.

The Administration has thus far been aggressive about responding to program weaknesses and tightening guidelines to improve performance. But as HAMP's performance thus far bears out, the program remains far from meeting the foreclosure prevention needs demanded by the magnitude of the crisis. The best estimates to date are that 50,000 loans have been modified since the program was launched earlier this year. This compares with an estimated 7 million foreclosures predicted for this year and next by Moody's Economy.com.

It is clear that a more robust response is needed.

A "new" vintage Great Depression era Homeowners Loan Corporation (HOLC) is warranted. The new entity would more aggressively pursue loan modifications using exceptional powers, such as eminent domain, to secure toxic loan products from investors and modify as many loans as possible to make them affordable and sustainable. Loans would be purchased at a reasonable discount (between current market value and face value). Discounts secured through the purchase process would be applied to modify the loans. This process would greatly reduce the cost to taxpayers of loan modification.

The new HOLC could also be useful to address unemployment-driven foreclosures. HOLC could take possession of properties and structure foreclosure moratoria based on workers' unemployment benefits. During that period, mortgage payments could be greatly reduced.

Under certain circumstances, borrowers might be allowed to remain in their homes at no cost (for a limited time. This arrangement in many instances would benefit the borrower, their community and investor since vacant and abandoned properties harm all parties and do not benefit anyone. The foreclosure loss severity rate on homes financed with subprime loans is now approaching 65 percent.

Reform of the bankruptcy code is also warranted. It was proposed as part of the President's Home Affordable Modification Program and should be reintroduced and passed into law.

Currently, bankruptcy courts can modify repayment terms on the outstanding debt on a luxury yacht or investment property, but not the family home. This disparity in treatment is unfair, inequitable, and serves no legitimate public policy goal. Furthermore, expanded bankruptcy protection could address as much as 30 percent of loans heading to foreclosure and at no cost to the American taxpayer.

2. Rebuild Communities Harmed by the Crisis

Certain communities have borne a disproportionate share of the damage and pain wrought by the foreclosure and economic crises, and should therefore be targeted for priority allocation of economic recovery funding. These acutely suffering communities are characterized by a convergence of three factors:

1. Significantly higher levels of unemployment;
2. Significantly greater concentrations of foreclosures; and
3. Historically under-funded, inferior, or poorly maintained infrastructure.

Channeling dollars to the individuals and communities that need them most will immediately stimulate the economy and save and create jobs. Families that live on the edge of survival will pour these recovery dollars immediately back into the economy through spending on groceries, medicine, clothing, child care, energy, transportation, and other basic necessities. Prioritizing areas hardest hit by widespread unemployment and mounting foreclosures would more directly help stabilize the housing market and steady falling home prices that continue to undermine the strength of US financial institutions. Finally, investing in areas most in need of infrastructure improvements would provide a needed enhancement of the quality of life in communities long-neglected.

3. Refocus Financial System Regulation on the Interests of Consumers

Many blame the foreclosure crisis on a claim that financial institutions sought to improve homeownership among unqualified low- and moderate-income, and minority households.
This assertion has no basis in fact or logic.

According to the Federal Reserve Board, only 6 percent of high-cost subprime loans to low- and moderate-income households were covered by CRA regulation. And, the Center for Responsible Lending finds that less than 10 percent of subprime loans were for first-time homeownership.

In fact, it was failure to regulate adequately the U.S. mortgage markets that allowed deceptive, reckless, and irresponsible lending to grow unchecked until eventually it overwhelmed the financial system.

Almost every institutional actor in home mortgage finance process played a role. Comprehensive anti-predatory lending legislation should be enacted immediately. Such legislation should apply mortgage-related consumer protections to all of the institutional players in the mortgage market including banks, brokers, mortgage companies, appraisers, servicers, investment banks, credit rating agencies, hedge funds, and other financial entities.

Expansion of the Community Reinvestment Act (CRA) is also essential to bringing safe and sound lending to struggling families and communities.

Inasmuch as nearly 95 percent of problematic subprime loans were originated by non-CRA covered institutions, the time to bring more financial firms under the regulatory umbrella of CRA.

Moreover, today roughly 97 percent of banks pass their CRA exams. Yet, more than 40 million households are only marginally connected to mainstream financial institutions and more than 9 million are completely unbanked. The time has also come to increase enforcement of CRA on existing covered institutions, including eliminating the loopholes, exceptions, and special preferences that allow banks to exclude major shares of their business operations from coverage.

The CRA ratings system is also in need of refinement to provide more meaningful CRA grades, and improve data collection and analysis, and inclusion of race as an explicit factor in CRA exams are also long overdue.

A final component of comprehensive financial regulatory reform is the establishment of a Consumer Financial Protection Agency. President Obama’s regulator reform proposal calls for the creation of such an agency, and Congress should pass that into law. The imperative is clear for a regulatory body that puts consumers ahead of special banking interests. The reality of the mortgage market is that as soon as one predatory practice is eliminated, another takes its place.

Today, for example, the Mortgage Asset Research Institute estimates that mortgage-related fraud is more prevalent now than it was at the height of the lending boom. The proposed Consumer Financial Protection Agency would have the authority to investigate and take action against existing and future unfair and irresponsible lending practices as they evolve. And it would create rules that make financially predatory practices harder to introduce in the markets.

Conclusion

In the words of Nobel Prize-winning economist Joseph Stiglitz, the financial system discovered there was money at the bottom of the wealth pyramid and it did everything it could to ensure that it did not remain there. Stated otherwise, the business model for many financial institutions was to strip consumers of their wealth rather than build and improve their financial security.

Ironically, most solutions to date have focused on rewarding the financial firms (and their executives) that created this crisis. But in spite of more than $12.8 trillion of financial support in the form of loans, investment, and guarantees, this approach is not working because consumers continue to struggle in a virtual sea of deceptive mortgage debt and a financial system that remains unaccountable to the American public.

Now is the time to shift the focus away from Wall Street and onto Main Street by addressing, in a broader manner, the growing foreclosure crisis and its contagion effects on national home prices and the overall economy. This includes introducing a more robust foreclosure mitigation program, focusing recovery dollars on the communities most negatively impacted by the crisis, and enacting strong consumer protections against deceptive and reckless lending practices.

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