Center for American Progress

# From Boom to Bust

## *Helping Families Prepare for the Rise in Subprime Mortgage Foreclosures*

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Progressive Ideas for a Strong, Just, and Free America

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## Introduction

Alarm bells are ringing loudly on Wall Street amid rising late payments and delinquencies on subprime home mortgages across the country, which are adding further worries to an already slowing economy and labor market.[1] The spike in foreclosures is delivering substantial losses to some home mortgage lenders, shaking investor confidence in the subprime loan market and possibly even prime home loan industry. A slumping housing market and the threat of higher mortgage payments are also raising fears that more homeowners will find themselves unable to service their mortgages or sell their homes, threatening mortgage lenders with further foreclosures and saddling homeowners with ruined credit ratings that cripple their ability to access loans in the future.[2]

All these worrisome trends are adding to concerns that an increase in home mortgage foreclosures could interact with other (sometimes related) macro-economic trends to further harm the broader U.S. economy, reducing the growth in incomes and job opportunities. Yet at the same time, a sad crisis is quietly unfolding for an untold number of families in neighborhoods across the country. Perhaps as many as 2.2 million families face the prospect of losing their homes in the coming years. This follows in the wake of more than 1.2 million foreclosure filings[3] in 2006, up 42 percent from 2005. That's one home mortgage foreclosure filing for every 92 households.[4]

Nor are the filings slowing down. The number of homeowners who entered into some stage of foreclosure in December 2006 was up 35 percent from December 2005 after a slight decrease in foreclosures in the late summer and fall of 2006.[5] At the same time, states all around the country are reporting an increase in foreclosures, with some states reporting as much as a 700 percent increase in 2006 over 2005.

A slowing housing market and sometimes dramatically higher mortgage payments almost guarantee that many more families will be unable to refinance their mortgages as they did during the housing boom.[6] Nor will many families be able to sell their homes for enough money to pay off their mortgages now that housing prices have gone down in many locations across the country. These trends suggest there are more foreclosures to come.

What's fueling these problems in the home-lending marketplace? The widespread use of non-traditional mortgage products such as hybrid adjustable-rate mortgages with complex interest rate terms and conditions—originally created for wealthy individuals with fluctuating incomes—were increasingly sold to middle- and lower-income families over the past 10 years amid the nationwide housing boom. These hybrid ARMs, which offer easy lending terms but the possibility of hefty rate increases in a few short years, were often peddled to less sophisticated consumers alongside minimal underwriting requirements that allowed many borrowers to purchase homes without assessing their ability to handle payments over the life of the mortgage. The result is that many such homeowners today are vulnerable to much higher mortgage payments than they were probably able to afford when the loans were originated.[7] The threat of higher payments is especially serious at a time when economic and employment growth is slowing and families' incomes may not rise as fast as they have in the past.

The problem is exacerbated in the subprime mortgage market, where borrowers generally have weaker credit histories, lower incomes, and fewer assets to support their loans, requiring them to pay higher interest rates than in the prime mortgage lending market. What's worse, many of these borrowers had to pay costly origination fees on their mortgages, which left them with little cash left to invest in their new homes or to service their mortgages when their adjustable interest rates rise.[8]

But it is not just poor credit that plagues borrowers in the subprime marketplace. Recent studies suggest that the growth of subprime borrowers with non-traditional loans is due to some lenders' use of unscrupulous and predatory practices. While it is difficult to assess the exact impact of predatory lending on the proliferation of these loans, the Center for Responsible Lending highlights certain trends that are common in the subprime market as evidence of predatory lending practices.

CRL cites the lack of solid underwriting documentation by lenders, which allowed many prospective homeowners to borrow well beyond their ability to service their debts, as well as costly up-front fees and pre-payment clauses that make it difficult for borrowers to refinance their mortgages.[9] Because of the combination of these lending practices and other factors, CRL estimates that one in five subprime loans originated over the last two years will end in foreclosure.[10]

That's a scary prospect for those homeowners who will see their dreams of homeownership dashed and the once-promising accumulation of wealth in their homes destroyed. Moreover, foreclosures tend to cascade across poorer communities where aspiring homeowners could only access subprime mortgage products, with detrimental long-term consequences for some communities. As foreclosure signs go up, lenders shy away from financing other properties in these neighborhoods, leading to a vicious downward spiral that can ruin neighborhood home values.

While policymakers examine the causes of the current crisis and consider legislative and policy-based solutions to prevent such a trend in the future, it is also critically important to consider ways to stem this rising tide of foreclosures. Given the crisis that may affect communities, policymakers should consider swiftly strengthening state and federal programs that help prevent home foreclosures.

While all states have homeownership and foreclosure prevention counseling, only a handful of states sponsor mortgage assistance programs that help qualifying families in danger of falling too far behind on their mortgage payments due to a sudden loss of income, illness or death in the family. Increased federal assistance could expand these programs and enhance those foreclosure prevention programs that do not provide loans. Among the steps policymakers should consider are:

- Federal grants to expand and enhance current mortgage assistance and foreclosure prevention programs and low-interest mortgage assistance to eligible borrowers.
- Federal funds to target key cities and states facing the highest risk of mass foreclosure.
- Provisions to ensure federal agencies assess the effectiveness of each program every three years.
- Strengthen programs that aid families while their mortgage contracts are renegotiated or the property is sold on the market so that the homeowners' credit ratings are salvaged, allowing for the possibility of future homeownership.

This paper details why the steps briefly outlined above would help ameliorate the current rise in foreclosures. The paper will first examine the causes of the crisis and then look at the structure of state-funded foreclosure prevention programs to illustrate how cost-effective federal support for these programs—particularly in key states—could help families facing foreclosure stay in their homes.

While foreclosures are sometimes unavoidable, it is in the best interests of our communities and overall economy to support those who have embraced homeownership and work to prevent foreclosure. After all, homeownership is an important step in the creation of stable and secure communities. Yet, homeownership is also a step that is especially difficult to take for those without access to traditional home lending products. When assets and wealth are better distributed and families are more financially secure, this, in turn, enhances opportunities for everyone and contributes to the country's overall economic security.

## Foreclosures in the Subprime Market

Until about a year ago, a virtuous circle defined the U.S. housing market. Rising house prices allowed mortgage lenders to make more loans and then sell some of those mortgages into the secondary marketplace, where eager investors at home and abroad snapped up these newly packaged mortgage-backed securities. Lenders, with money freed to provide more loans, pushed further in to the subprime market, where they looked for eager borrowers—knowing they could package these subprime mortgages into new mortgage-backed securities to sell anew on the subprime secondary market.

With home values ever on the rise over the past decade, and with secondary market investors ever eager to purchase high-yielding mortgage-backed securities, mortgage lenders in the United States helped the subprime market blossom.[11] By 2006, data indicate that 17 percent to 18 percent of mortgage-financed home purchases were made with subprime loans, a substantial portion of which were packaged into securities that did not require borrowers' proof of income.[12] Another estimate states that subprime loans account for 13 percent of *all* mortgages outstanding, or approximately $1.28 trillion.[13] While all consumers trapped in complicated and costly mortgages are at risk of foreclosure—especially if the costs of their loans increase much more rapidly than their incomes—subprime borrowers, because of limited loan alternatives and incomes, are particularly at risk.[14]

Although not all subprime loans threaten borrowers with future mortgage payment difficulties, many hybrid ARMs with exotic variable interest rates make borrowers increasingly vulnerable. These products include interest-only mortgages, "pick-a-payment" options that allow borrowers to decide what they can pay per month, initial fixed-rate mortgages that quickly convert to variable rates, and no-down-payment mortgages. Many of these hybrid ARMs also included hefty up-front fees that drained borrowers' savings and inhibited their ability to invest more equity in their new homes. This also means that struggling homeowners who need to sell their homes may be less likely to recover at least the value of the outstanding mortgage from the sale of their homes, especially when house prices are falling. In the end, borrowers are closer to the brink of foreclosure.

Of particular concern is the growth of two subprime ARM products, 2-28 and 3-27 ARMs, both of which include explosive payment shocks after the introductory, low-interest rate period expires in the second and third year of the ARM, respectively. Lenders are currently required to underwrite borrowers for the initial introductory rate, even though it may be clear that in many cases the borrower will be unable to afford the almost automatic payment increase built into the loan.

For borrowers with limited incomes, less time and resources for comprehensive financial education, and fewer loan options, the wrong loan can result in an unexpected increase in costs that tips the balance towards foreclosure. According to the most complete data on the subprime market from 2005, variable interest rate mortgages made up a substantial portion of all loan products, accounting for approximately 80 percent of subprime mortgage products.[15] While these loan products promised to ease the initial down payment and month-to-month payment burden, recent evidence indicates that loans were made to subprime borrowers who were likely never going to be able to afford to make the payments once the interest rates adjusted and payments increased.[16]

As the National Consumer Law Center notes, because non-traditional mortgage products and adjustable rate loans are made without adequate assessment of the borrower's ability to pay the loan, their particular features combined with their widespread use can present risks to the economy.[17] The substantial growth of interest-only and other hybrid ARMs during a period of low interest rates suggests that a rate increase could lead to a sudden payment increase, resulting in subsequent defaults and foreclosures. There is a particular risk of sudden payment hikes if income growth slows at the same time, as was the case throughout much of 2006. Even more worrisome is a spike in foreclosures in particular communities where many of these types of home loans were made. A series of foreclosures could have a significant impact on other borrowers, their families, and the local economy—turning what was a virtuous circle into an exceedingly vicious one.

Although data over the last year indicate there will be an increase in foreclosures in the coming months, there remains some debate about the cause, size, and impact of the crisis. In a recent report, the Office of the Comptroller of the Currency notes the rise in the number of foreclosures, pointing out that in nearly half the states the number has risen between 24 percent and 115 percent between 2001 and 2003—well before the recent concern over rising interest rates and the current housing slump.[18] The OCC study notes, however, that while no single loan type necessarily contributes to a rise in foreclosure rates, loans that include complex features, including high pre-payment penalty fees and low initial teaser rates that result in large balloon payments, combine to make particularly toxic situations for consumers with weak credit histories and limited financial resources.

In a 2005 study from the University of North Carolina-Chapel Hill, the authors similarly argue that loans with complicated features such as prepayment penalties and balloon payments are more likely to result in foreclosures than loans without these characteristics, and that families will suffer substantial losses in assets and wealth as a result of entering into them. Examining these trends in the subprime market, the Center for Responsible Lending estimates that 2.2 million borrowers will lose their homes and up to $164 billion of accumulated wealth in the foreclosure process.[19]

There is limited national data about the exact reasons borrowers go into foreclosure. A 2006 survey from a foreclosure prevention program in Minneapolis, however, reveals that loss of income and unemployment were the primary reasons borrowers faced foreclosure. Yet 20 percent of the borrowers surveyed faced foreclosure due to multiple refinances and predatory loan terms.[20] State-level foreclosure prevention counselors for programs in Minneapolis anticipate that changing loan terms will continue to contribute to borrowers seeking foreclosure prevention assistance.

Despite the differences of opinion about which kinds of loan features are behind the spike, the data indicate that foreclosure rates will continue to rise. In particular, African American and Hispanic borrowers are three times more likely to have a subprime loan than a white borrower, even when accounting for credit score.[21] Thus, a spike in foreclosures among subprime lenders will disproportionately affect minority and lower-income families and communities.

## Assessing the Impact of Foreclosures

In addition to advocates and policymakers, the mortgage industry has voiced concern about the spike in national foreclosures.[22] Foreclosure ruins a borrower's credit and homeownership potential, while a spike in foreclosures in a community can have long-term negative effects that are difficult to calculate. Each mortgage foreclosure carries with it legal and administrative costs that put a burden on borrowers and lenders. The Federal Reserve Bank of Chicago reports that the legal and administrative costs of foreclosure can mount to more than $50,000 for the lender alone.[23] Assuming CRL's 2.2 million estimate of forthcoming foreclosures, that is nearly $110 billion in related costs to lenders.

A spike in foreclosures can also create a domino effect in a single area, leading to a sharp depreciation in property values, decreased business investments, and lower tax revenues, which in turn affect the quality of schools and decreases nearby property values.[24] In a 2006 analysis of the impact of foreclosures in Chicago, for example, researchers Dan Immergluck and Geoff Smith of the Georgia Institute of Technology and the Woodstock Institute, respectively, estimate that each conventional foreclosure results in a 0.9 percent decline in nearby property values. The report estimates that for the city of Chicago, foreclosures between 1997 and 1998 reduced nearby property values by more than $598 million, for an average of $159,000 per foreclosure.[25]

Moreover, a foreclosed property that stays on the market too long may become vacant. When potential homebuyers see a cluster of homes either vacant or in foreclosure, it undermines investor confidence in an area. A study from the Homeownership Preservation Foundation estimates that the financial burden of an abandoned, foreclosed property can be more than $30,000 in city service protection, which is funded primarily by taxpayer money.[26] Multiple vacancies over a long period of time can spell economic disaster for communities and neighborhoods. Because subprime loans—which carry a higher default risk than prime loans—tend to be clustered geographically in lower-income, minority neighborhoods, these communities are particularly at risk.

The detrimental effects of a spike in foreclosures are likely to go beyond the communities directly affected by the increase. Specifically, lenders may curtail their willingness to provide loans to borrowers perceived to be "high risk," particularly minorities and small businesses—currently at greatest risk of default—as their own losses increase following a rise in defaults.[27]

There is already evidence that the recent spike in delinquencies and foreclosures is shaking investor confidence and slowing investment in the subprime market, the result of which could be less money for borrowers.[28] As subprime borrowers find themselves with limited loan options, some borrowers may turn to loans insured by the Federal Housing Administration, a government agency that helps families gain limited access to mortgage loans. However, an overall decrease in the private subprime market will result in decreased access to credit for home buyers—most likely to affect first-time and minority home buyers—and may result in a decreased number of home purchases, both of which are likely to harm local communities.

Out of concern for the potential rise in foreclosure rates and mortgage industry practices, federal regulators collaborated in September 2006 to issue an Interagency Guidance on non-traditional mortgage products—a set of instructions and principles to improve the quality of mortgage lenders' services to consumers. The Guidance called for improved disclosure, assessment, and underwriting practices for borrowers.[29]

Then, in early March of this year, federal regulators issued a preliminary draft of another Guidance in response to criticism that the earlier one did little to address the most complex hybrid ARM loans, such as 2-28s and 3-27s. In the new Guidance, federal regulators call on lenders to implement improved underwriting standards and improved assessment of a borrower's ability to comfortably cover payments during the life of the loan.

Although there is some hope that these Guidances will change industry practices and aid consumers in the future, they will do little to help those families currently trapped by unmanageable or predatory mortgage loans. For these families, short-term mortgage assistance programs may provide some relief.

## Using Innovative Resources to Prevent Foreclosure: State Mortgage Assistance Programs

Home loan providers, well aware of the costs of foreclosures on their own mortgage portfolios and on the broader mortgage lending environment, suggest that the first line of defense for borrowers on the brink of foreclosure is to approach the lender directly, explain the circumstances, and try to restructure the loan.[30] While lenders may be more willing to renegotiate the terms of the contract early in delinquency rather than face the costs of foreclosure, many non-traditional loans include high penalties and fees that can make it costly if not prohibitive to restructure or change the loan terms.

In addition, many families may not have the "know how" to approach the broker or lender directly, or instead fear that they risk losing their homes while they renegotiate the contracts. In such situations, a short-term loan combined with direct foreclosure counseling may be the best first-line defense against an abusive or complicated mortgage loan. In these cases, a foreclosure prevention program can be vital to aiding families.

In response to regional spikes in foreclosures, many states have already implemented various prevention programs. Using a combination of state appropriations and grants, some states have implemented one or a combination of three different types of programs: foreclosure counseling and loan renegotiation programs; legal aid programs; and mortgage assistance programs. Most programs combine counseling and loan negotiation with either mortgage assistance or legal aid.

Foreclosure prevention counseling programs exist throughout the country. In contrast, state-funded mortgage assistance or mortgage insurance programs were created by a handful of states, among them Pennsylvania and Minnesota, to prevent massive spikes in foreclosure rates and help families facing an income-related emergency. Such programs capitalize on state and local policymakers' detailed knowledge of what kind of adverse economic trends are most immediately affecting families, including unemployment due to factories moving offshore and company closings as well as more personal crises, such as medical emergencies or a death in the family.

While these mortgage assistance programs have helped many families, most were not created to aid families that were steered into unsuitable loans. Yet the structure of these programs could be adapted to help families caught in complex loans they did not understand upon origination and that they may no longer be able to afford when costs increase or incomes decline. An example of such a program is the Mortgage Foreclosure Prevention Program of Minneapolis/St. Paul, part of the larger Mortgage Foreclosure Prevention Network of Minnesota. It was created in 1991 to address a spike in foreclosures in lower-income neighborhoods due to economic underdevelopment. The program combines foreclosure prevention with mortgage assistance.

Under this program, borrowers must meet strict income eligibility requirements, live in particular areas of the city, and show evidence of an income-related loss while exhibiting a commitment to address the financial challenges. The program provides intensive foreclosure prevention counseling, including an assessment of long-term affordability, and direct advocacy with the lender in order to restructure the loan. If the lender denies the homeowner an affordable solution, the borrower may be eligible for financial assistance.

Since 1991, the program has helped 4,200 households receive foreclosure counseling and has helped a smaller subset receive mortgage assistance. In a 2005 study of the efficacy and cost-effectiveness of the program, approximately 60 percent of the households that had received services during the previous two years and reported on the status of their mortgages were current on their loans, both 12 months and 36 months after coming to the program.[31] Moreover, more than 70 percent of the households that received loans as part of the program's services were current on their loans 12 months after receiving program services.

Most homeowners who received services were able to reinstate their mortgages in approximately 9.5 months as well as pay back the loan. In the last two years, the rate of foreclosure faced by families served by the program has dropped from 11 percent to 6.8 percent. Researchers speculate this drop could be due to the fact that the growth of non-traditional loans offered to borrowers with no equity, combined with a state law that prohibits creditors from collecting deficiency judgments, has made lenders more willing to restructure the loan rather than initiate foreclosure and suffer a financial loss.[32] In 2007, out of concern for the growth of disadvantageous refinance loans, the city responded by increasing funding for counseling and mortgage assistance programs with the aim of reaching families trapped in unmanageable loans.[33]

Foreclosure prevention and mortgage assistance programs are invaluable tools in preventing foreclosure. But one drawback to such programs is that foreclosure prevention counselors are often forced to renegotiate the loan terms with predatory lenders who are rarely held responsible for steering borrowers towards high-cost and unsuitable loans. Thus, equally important for families and for changing the industry are programs that include legal aid services for victims of predation.

One organization offering such aid is South Brooklyn Legal Services in New York City, which provides legal counseling services to lower-income borrowers facing foreclosure due to predatory loans. The program assesses the suitability of the loan, determines if the lender purposefully steered the borrower towards a high-cost loan and, in some cases, initiates court proceedings against predatory lenders. With a modest budget of $450,000, in 2005 the program provided services to 254 borrowers in Brooklyn and helped some seek compensation through the courts.[34]

While foreclosure prevention programs save families' homes, legal aid services provide the necessary leverage to effectively curtail predatory lenders' practices. Other cities and states are trying similar methods to prevent foreclosure (see Table 1).

Still, state assistance programs have strict eligibility criteria, including specified income eligibility rules and a requirement that borrowers provide evidence that the impending foreclosure is not solely the result of financial mismanagement. These are difficult criteria to meet and not every family facing foreclosure will be able to participate in mortgage assistance or be able to access legal remedies.

At the same time, a foreclosure prevention program can provide helpful information to any borrower struggling to manage a loan. While state programs should not fund borrowers' poor financial decisions, low-interest loans to qualified borrowers who need time to either renegotiate the terms of the loan or sell the home could save many families and communities from the economic and personal crises that accompany foreclosure.

Including a provision for families trapped in predatory loans also requires a strong definition of predation. While states should be given the leeway to determine how best to define predatory loan terms, there are many existing examples of instances in which it is clear that borrowers were misled into accepting loan products they did not understand.

Examples of predatory practices include complex loans sold to older consumers, limited English speaking borrowers, or borrowers with limited access to financial advice and education. In such cases, there is evidence that lenders misinformed consumers about the terms and total cost of the loan in order to encourage the loan purchase.[35] There are also plenty of examples of lenders steering borrowers towards subprime loans when they could have been eligible for a lower-cost prime loan, or of lenders assessing borrowers' ability to pay an initial teaser introductory interest rate without assessing borrowers' ability to pay the rate-adjusted loan. Lenders have also encouraged borrowers to purchase complex, high-cost loans, the terms of which may not be clear at the loan origination, and charged excessively high interest rates and fees.[36]

The Government Accountability Office highlights additional signs of predatory lending practices, including: lack of clear disclosure of additional fees and interest; encouraging borrowers to refinance loans with a loan that is disadvantageous to the borrower; and inflating property appraisals as well as doctoring loan applications and settlement documents to reflect a particular level of income.[37] All of these conditions can be assessed when considering whether or not a loan is predatory.

Where there are clear signs of predation, borrowers should be protected from the built-in loan fees as well as the administrative and legal fees that accompany foreclosure filings that frustrate the loan renegotiation process. In cases of predation, lenders should either forgive or cover these additional costs.

### Table 1: Select State Foreclosure Prevention Programs

| Program and Location | Administrative Oversight and Program Cost | Eligibility Criterion | Type of Relief and Loan | Number of Homes Saved |
|---|---|---|---|---|
| **Pennsylvania's Homeowner's Emergency Assistance Program (HEMAP) Pennsylvania–created in 1983** | Administered by the PA Housing Finance Agency; funding through state appropriations; $4.4 million to run the program in 2007; 74% of loan disbursement comes from loan repayment. | a. Must prove residency and financial loss through no fault of the applicant<br>b. The loan is secured by an additional mortgage on the threatened property | a. Loan amount based on mortgage rate payment<br>b. Once the loan is granted, homeowners have 24 months of mortgage coverage | Since 1983, the program has saved 37,100 homes from foreclosing and has received 145,500 loan applications |
| **MassHousing: Homeownership and Mortgage Insurance Program** | Created in 1966 by state legislation as a self-supporting organization to enhance affordable renting and home ownership throughout the state of MA.<br>Provides low cost mortgage insurance for lower income home buyers that protects against job loss, disability and death in the family. | **To qualify for a loan, and insurance coverage:**<br>a. Must be a first time home buyer unless buying in the greater Boston area<br>b. Strict income and purchase price limits<br>c. Minimum down payment of 3% of the purchase price for a MassAdvantage loan<br>d. Must take a longer home buyer's counseling course if down payment is less than 5% or if you are buying a multi-family home | a. Low interest rate loans<br>c. Provides up to $2,000 a month for six months if the borrower becomes unemployed or faces another emergency | Saved 3,000 homes from foreclosure since 2004 |
| **North Carolina's Home Protection Pilot Program (HPP) and Loan Fund–created in 2005** | State legislature implemented the program in response to mass lay-offs and a spike in state-wide foreclosures; $1.75 million in initial administrative cost and loan money | a. Job loss must be due to "rapidly changing economic conditions"<br>b. The borrower must have had good credit before the foreclosure<br>c. Reasonable expectation that the worker will another job | a. Loan is not given to the homeowner but to the lender<br>b. Lender is charged 0% interest and has 15 years to pay back the loan<br>c. Average loan is $9,000, equaling about $45 a month for 15 years | Since 2005, the Program has saved 150 homes from foreclosing. 230 homeowners have applied for the program |
| **Minneapolis Mortgage Foreclosure Prevention Program (MFPP)–created in 1991** | Funded by city of Minneapolis, MN Housing Finance Agency, and the Family Housing Fund; $1.6 million in initial administrative and loan costs. | a. Resident of North or Northeast Minneapolis<br>b. Strict income requirements<br>c. Express commitment to solving the problem | a. Foreclosure counseling;<br>b. Advocacy with the lender;<br>c. Affordability assessment<br>d. Credit restoration<br>e. If the lender denies the homeowner an affordable work out solution, the homeowner may be eligible for a loan. | Counseled nearly 5000 households since 1991; foreclosure successfully prevented for 64% of borrowers; 283 deferred loans originated to date |
| **South Brooklyn Legal Services: The Foreclosure Prevention Project** | Created in 1995; Administered by South Brooklyn Legal Services, funded through federal and state money; $500,000 in 2007 administrative costs | a. Anyone facing foreclosure<br>b. Victim of predatory lending scheme | a. Legal representation for homeowners facing foreclosure due to abusive and illegal lending practices<br>b. Home mortgage counseling for low and moderate income homeowners | In the last two years, the program has provided 498 borrowers with consumer counseling and legal aid services |

## Expanding Mortgage Assistance Programs

Local foreclosure prevention and loan restructuring programs today can help only a limited number of borrowers due to budgetary and size restrictions, but there is no reason they couldn't be expanded to serve a greater number of borrowers. Combining the best features of these current programs with low-interest loan assistance and substantive legal aid tools for families is the best defense against the threat of mounting foreclosures. Expanding current state programs and adding additional programs in key cities and states could help save countless homes and communities.

The federal government has a role to play in helping families facing foreclosure by increasing funding and support. In those states where these programs do not exist or could be enhanced, the federal government should encourage their creation by promising new funding and support. Such an expanded program could include the following features:

- A federal grant of $25 million[38] to expand and enhance current mortgage assistance and foreclosure prevention programs to include public awareness campaigns, robust foreclosure prevention counseling, legal aid services, and low-interest mortgage assistance to eligible borrowers.
- Additional federal funds to target key cities and states facing the highest risk of mass foreclosure in order to strengthen existing programs and add loan renegotiation, mortgage assistance, and legal aid services to those programs where they do not exist.
- All funds granted should include provisions that require programs and agencies to assess the structure and effectiveness of each program. This assessment should be submitted every three years to a federal agency responsible for evaluating all programs' effectiveness.
- Federal and state housing agencies should emphasize that the focus of these programs is to aid families while the mortgage contract is renegotiated or the property is sold on the market. While homeowners may not be able to save their homes, programs may be able to salvage families' credit, allowing for the possibility of future loan access and home ownership.

The aim of foreclosure prevention programs is to protect families and communities from a dramatic rise in foreclosures. Comprehensive programs targeting the most vulnerable homeowners that include foreclosure prevention counseling and loan renegotiation, legal services and short-term assistance, will aid many families facing an increase in payment and the threat of foreclosure.

While there is some cost associated with expanding mortgage assistance programs, it is far less than the related costs that lenders, borrowers, and communities will face with mounting foreclosures. One way to fund the expansion of state programs is to include a small fee for foreclosure prevention programs during a new home purchase. A small, nominal fee paid by new homeowners provides protection for individual homeowners facing foreclosure and provides a source to continue to fund foreclosure prevention programs.[39]

Even better, state-based data indicate that once an initial anti-foreclosure loan fund is created, the pay-back rate on such loans is high enough that interest earnings and principal repayments on theses loans help provide the money necessary to originate new loans. In Pennsylvania, for example, 74 percent of new loans originated from the fund come from previous loan repayments. After an initial investment, then, these types of foreclosure loan programs may be able to cover much of their operating costs themselves, leaving states to find funding for administrative and programmatic costs that could be paid through a "new home purchase" fee as described above. Such a funding mechanism also reinforces the important point that multiple foreclosures affects families and communities and everyone should contribute to curb their increase.

Moreover, there is already a model in place to better streamline federal and state foreclosure prevention programs. The NeighborWorks Center for Foreclosure Solutions, an initiative of NeighborWorks America—a national non-profit organization funded by Congress to support home ownership and community development—works with national non-profit, mortgage, and insurance organizations to help build the technical capacity of foreclosure counselors and carry out public awareness campaigns. In addition, the Center works with states and cities facing high rates of foreclosure to build the capacity of foreclosure prevention programs.[40]

The Center also operates a national hotline for borrowers facing foreclosure who are looking for further assistance and resources. Expanded federal support for foreclosure programs ensures that NeighborWorks has robust state and local programs to which they can refer families facing foreclosure. These types of programs will be absolutely critical to aiding families as they weather this current foreclosure crisis.

But they cannot take the place of comprehensive legislative and policy-based efforts aimed at curbing predatory lenders and aiding families facing unexpected crises to create sustainable pathways for homeownership. Most mortgage assistance programs were not created to help families victimized by predatory lending, but there is no reason why their eligibility criteria and structure couldn't be altered to help borrowers trapped by an unsuitable loan. A robust mortgage assistance program administered by states and municipalities and designed to aid families facing unexpected economic crises, including an unexpected rise in foreclosure rates, could go a long way in aiding families and softening the coming foreclosure crisis.

Combining the features of foreclosure prevention counseling with legal advocacy and short-term loan assistance is a powerful defense against potential foreclosures. Implementing such a policy, combined with ongoing policy-based efforts, is a comprehensive strategy and a modest investment to help families save their homes and communities while creating pathways for homeownership and asset-development for families throughout the country.

# Endnotes


1 Ruth Simon et al., "Home Lenders Cut the Flow of Risky Loans, Default Fears Draining Subprime Pool, Adding to Pressure on Prices," *The Wall Street Journal*, February 26, 2007; Peter Thal, et al., "HSBC ousts U.S. Pair Amid Mounting Subprime Woes," *Financial Times*, February 23, 2007; "Why Investors Get Caught in the Subprime Trap," *The Wall Street Journal*, February 22, 2007, at C1.

2 "How Expansions Die: Credit Cracks in the Economic Foundation," Editorial, *The Wall Street Journal*, February 17, 2007.

3 It is important to note that while not every "foreclosure filing" will end in actual foreclosure, a filing indicates a borrower is significantly behind in monthly loan payments. Data of completed foreclosures between 1998 and 2000 indicate that nearly 60 percent of foreclosure filings resulted in foreclosure. State-level data from Minnesota indicate that early intervention on behalf of the borrower can prevent foreclosure, strengthening the case for foreclosure prevention. Further, a foreclosure filing can result in substantial legal fees, a drain for low-income earners and funds that could go towards the cost of the home.

4 *Consumer Bankruptcy News*, "More than 1.2 Million Foreclosures Reported in 2006," February 15, 2007; Reuters, "Foreclosures surge 42 percent in 2006," CNNMoney.com, January 25, 2007, available at http://money.cnn.com/2007/01/25/real_estate/bc.usa.economy.housing.foreclosures.reut/index.htm?postversion=2007012508.

5 "Foreclosure Rates Up in December," *RealtyTrac*, January 16, 2007; Christie Les, "Foreclosure Rates Up in December: Lower Lending Standards and Softening Markets Contribute to Continued Trouble for Homeowners," CNNMoney.com, January 17, 2007, available at http://money.cnn.com/2007/01/16/real_estate/December_foreclosures_up_from_2005/index.htm?postversion=200701171.

6 Christian Weller, *The End of the Great American Housing Boom*, Center for American Progress, Washington, D.C., December 2006; Ellen Schloemer, et al., *Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners*, Center for Responsible Lending, December 2006; "Nightmare Mortgages," *BusinessWeek*, September 11, 2006.

7 Non-traditional, also known as "alternative," "exotic" and "unhealthy" loans, include a number of different kinds of products. These include interest-only loans, "pick-a-payment" options, and "Zero Points" limited-to-no-down-payment options, a short introductory period of a fixed rate followed by ARM terms. To see more examples of these loans, see "World Savings, World Loan Features," available at http://www.worldsavings.com/servlet/wsavings/loans-new/residential-loans.html?place=WeLoLoEH1809.

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