OPPORTUNITY FINANCE NETWORK

Predatory Mortgage Lending and the Current Foreclosure Crisis:

Market Challenges and Opportunity Finance Responses

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—Disclaimer—

Information in this Innovation Guide is based on information gathered during the period specified. We cannot guarantee the validity of the opinions or the accuracy, reliability, or completeness of the information over time.

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Introduction

This Innovation Guide is intended for stakeholders in opportunity finance, affordable housing, and community development. The report begins with an overview of the opportunity finance industry and its role in responsible subprime lending, an explanation of the current credit mess, and a description of the general stages of the foreclosure prevention process. It follows with numerous examples of community development financial institution (CDFI) programs designed to help avert foreclosures or lessen the impact in communities hit with high foreclosure rates. The research for this Innovation Guide is by no means exhaustive and we anticipate there are numerous other CDFIs that could be included. Due to the investigative nature of the research, we do not attempt to quantify the impact that CDFIs are having within the current foreclosure crisis.

Methodology

To collect information for this Innovation Guide, Opportunity Finance Network posted an online survey on its website. We announced the survey on the Community Development Banking listserv and sent a notice to our members. The National Federation of Community Development Credit Unions also sent a notice to its members. The survey was posted from November 16, 2007 until December 31, 2007. We received a total of 37 complete responses to the survey. The survey was brief (16 questions), aiming to elicit a high response rate at the expense of more detailed program information.

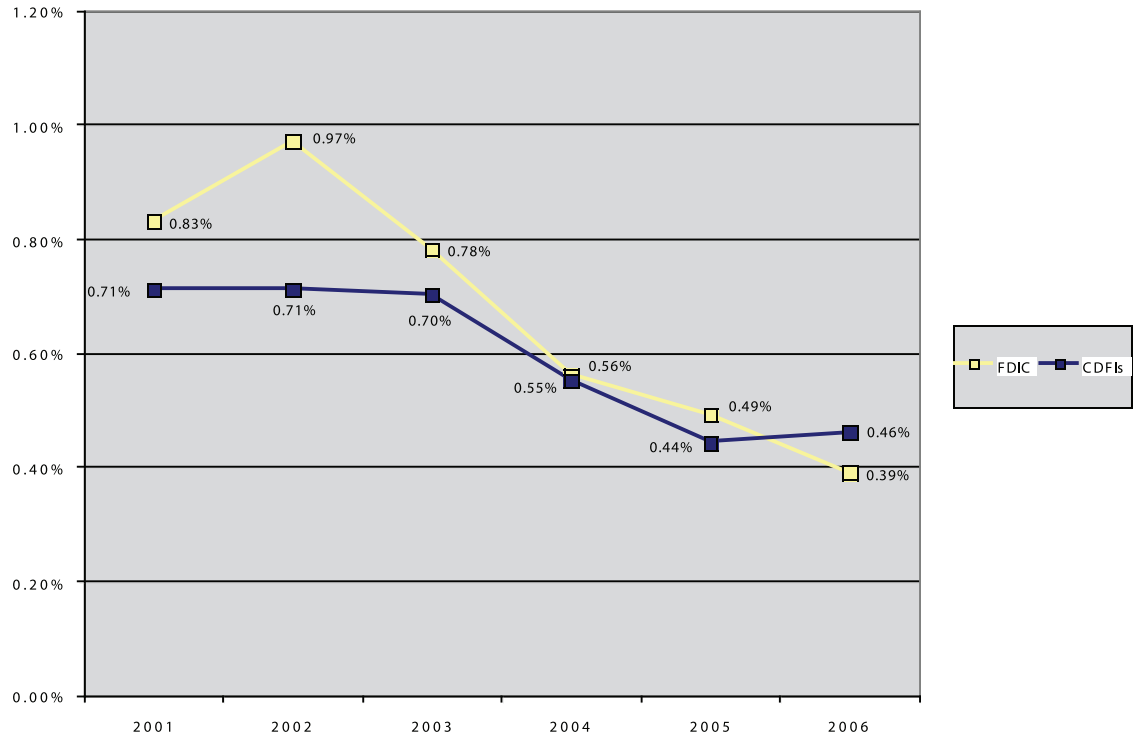
Opportunity Finance Network followed up with a subset of respondents with telephone interviews. In addition, we followed up with other CDFIs with relevant strategies who did not respond to the survey but with which we were familiar.

Opportunity Finance and Commercial Lenders in the Subprime Market

Opportunity finance helps people, markets, and communities just outside the margins of conventional finance join the economic mainstream and helps conventional finance to enter emerging opportunity markets. The opportunity finance industry comprises 801 certified CDFIs nationally,[1] as well as an estimated 200 non-certified CDFIs. There are four financial types of CDFI: loan funds, community development credit unions, community development banks, and community development venture capital funds. All are guided by a mission to serve low-income communities and individuals as well as a commitment to financial performance. Opportunity finance includes financing for homebuyers and homeowners, affordable housing and commercial real estate developers, community facilities and services, small businesses and microenterprises, and the consumer market.

Although opportunity finance serves less bankable, low-income, and subprime markets,[2] the industry maintains a lower average default rate than Federal Deposit Insurance Corporation (FDIC)-insured institutions. As shown in Figure 1, from 2001 through 2006, CDFIs had lower losses in five of the six years. Average loss rates over this period were 0.63% for CDFIs and 0.8% for FDIC-insured institutions. The industry has repeatedly demonstrated that these low-income and subprime markets are viable investment opportunities when responsible lending products are offered and coupled with technical assistance such as budgeting, pre and post loan education and counseling.

Figure 1: Loan Losses in CDFIs and FDIC Insured Commercial Lenders from 2001 to 2006



Source: CDFI Data Project, years 2004, 2005, and 2006 (unpublished), and FDIC - Statistics on Depository Institutions Report, Performance and Conditions Ratios.[3]

Please Note: FDIC figures do not include a large number of unregulated mortgage lenders from which much of the current subprime crisis stems.

[1] *As of June 1, 2008. Source: CDFI Fund.*

[2] *In 2005, 70% of CDFI customers were identified as low income, or 80% of area median income. Source: CDFI Data Project.*

[3] *Federal Deposit Insurance Corporation, Statistics on Depository Institutions. http://www2.fdic.gov/SDI/main4.asp.*

CDFI mortgage products include first and second purchase mortgages, secured and unsecured home improvement loans, and refinancing products. Mortgage products may be sold on the secondary market (often to Fannie Mae) or held in the CDFI's portfolio.[4] In 2005 alone, CDFIs reporting to the CDFI Data Project closed over 15,000 mortgages.[5] With CDFI loans comes education. CDFI homeownership programs work with clients to improve their credit, provide education on responsible and predatory mortgage products, and provide pre- and post-loan homeownership education and counseling. CDFI homeownership programs also work to preserve homeownership for individuals at risk of default or foreclosure, regardless of lender, through an array of services including loss mitigation counseling.

CDFIs encourage commercial lender participation in their markets. They typically do this by providing subordinate gap financing, guarantees, equity, and equity-like products, or by purchasing loans from commercial lenders. An example of a CDFI that has taken this kind of activity to scale is **Self-Help/The Center for Responsible Lending**, a North Carolina-based CDFI. Since 1998, Self-Help has been purchasing MyCommunityMortgage® loans (a Fannie Mae product) from banks. To encourage banks to lend deeper into their markets than they might otherwise do, Self-Help purchases only those MyCommunityMortgage® loans that meet three strict criteria: the borrower's credit score and income level are lower than the MyCommunityMortgage® maximums, and there is no mortgage insurance. Self-Help purchases the loans, holds on to the credit risk, and sells the loans to Fannie Mae. If the borrower defaults, Self-Help is required to purchase back the mortgage. Over the past ten years Self-Help has purchased about 50,000 MyCommunityMortgages® totaling more than $5 billion; the default rate on these loans has been only 0.64%.

The Current Crisis

By the late 1990s, several factors behind the subprime mortgage crisis were in place, including a new means to finance mortgages. The mortgage market had shifted from portfolio-based lending, where the lender held onto the mortgage through the life of the loan, to one with multiple players outside of the traditional lender and borrower, and without the requisite infrastructure to properly map who owns what. Under the new financing system, each mortgage is dissected based on risk, pooling similar slices into tranches, and the tranches sold on the bond market in mortgage backed securities. Trustee banks are responsible for overseeing each pool's operations to ensure that borrower payments reach investors; credit-rating agencies such as Moody's, Standard & Poor's, and Fitch are responsible for rating the risk of each security.

Under this mortgage financing model, the broker/lender has little or no vested interest in the performance of mortgages nor are the brokers/lenders forced to underwrite responsibly as they are when they use Fannie Mae products. Unregulated mortgage companies flourished with this new financing mechanism, as did unscrupulous and predatory lending practices.[6] The Center for Responsible Lending identifies the seven signs of a predatory mortgage as:[7]

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[4] An example of a CDFI that offers a spectrum of mortgage products designed for less credit worthy borrowers which are held in its portfolio is Alternatives Federal Credit Union http://www.alternatives.org/homeloans.html.

[5] We estimate that the CDFI Data Project represents just over half of CDFIs nationally.

[6] As part of an investigation of the subprime-mortgage crisis, the Federal Bureau of Investigation has opened criminal inquiries into 14 mortgage lending companies focusing on securitization and insider trading. See: Perez, E. and Scannell, K. "FBI Launches Subprime Probe" The Wall Street Journal. January 30, 2008. http://online.wsj.com/article/SB120163969101526197.html?mod=hps_us_whats_news

[7] Common Abuses: Seven Signs of Predatory Lending. The Center for Responsible Lending. http://www.responsiblelending.org/issues/mortgage/sevensigns.html

- Excessive Fees
- Abusive Prepayment Penalties
- Kickbacks to Brokers (Yield Spread Premiums)
- Loan Flipping
- Unnecessary Products
- Mandatory Arbitration
- Steering & Targeting

Associated predatory strategies include over-valuing of properties, hidden fees, mortgages calculated according to stated income (40% of subprime loans),[8] lending more than the borrower could afford, single premium credit insurance, and predatory adjustable rate mortgages (ARMs).[9] These practices were used for purchase mortgages and particularly home equity loans as homeowner equity increased corresponding to higher real estate values. Mortgage brokers and some lenders targeted borrowers who lacked access to prime forms of credit but it was also the case that many borrowers with subprime loans would have been eligible for mortgages with better rates and terms.[10] Moreover, many prime borrowers were taking on jumbo mortgages with predatory aspects, such as artificially low teaser rates.[11]

CDFIs and other relevant stakeholders protested the rise of predatory mortgages and other types of predatory lending, such as payday loans. Freddie Mac's National campaign, "Don't Borrow Trouble," was launched in 2000 promoted by collaborative nonprofit and city efforts. In 2002, Self-Help, an aforementioned CDFI, launched the Center for Responsible Lending (CRL) to eliminate abusive financial practices on a national scale; meanwhile, CDFIs were devoting more resources toward education on recognizing and avoiding a predatory loan. Some states passed anti-predatory lending laws, usually with the help of the CRL and with the support of CDFI stakeholders but in January 2004 these laws were pre-empted by the Office of the Comptroller of the Currency, which exempted national banks and their affiliates from all state anti-predatory laws.[12] Subprime mortgage closings peaked from 2004 to 2006; through 2007 and 2008, interest rates on 1.8 million subprime-mortgages are scheduled to reset.[13]

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[8] Christie, Les. "Subprime loans defaulting even before resets." CNNMoney.com. February 20 2008 http://money.cnn.com/2008/02/20/real_estate/loans_failing_pre_resets/index.htm

[9] ARMs are not categorically predatory but they do leave borrowers open to rate shocks and a number of predatory ARM products have been very popular in subprime lending. The Center for Responsible Lending highlights exploding ARMs, in which an artificially low teaser rate resets to a high adjustable rate, and a Payment Option ARM, which results in negative amortization. According to the CRL 89% to 93% of subprime mortgages closed from 2004 to 2006 have exploding ARMs. CDFIs we spoke to did not readily distinguish between ARMs and predatory mortgages because most of the borrowers they see in trouble have these kinds of predatory ARMs and were not usually aware of the monthly payments that would be required.

[10] See Brooks, Rick, and Simon, Ruth. "Subprime Debacle Traps Even Very Credit-Worthy: As Housing Boomed, Industry Pushed Loans To a Broader Market." The Wall Street Journal. December 3, 2007 http://online.wsj.com/public/article/SB119662974358911035.html. We also heard anecdotal evidence supporting this finding from contributors to this report.

[11] A jumbo mortgage, also known as a nonconforming loan, is a mortgage above $417,000, the conventional loan limit set by Fannie Mae and Freddie Mac.

[12] According to the Center for Responsible Lending, roughly 50% of subprime mortgages were made from lenders unaffiliated with FDIC insured banks. For descriptions of anti-predatory lending law pre-emption, see Bagley, Nicholas "Subprime Safeguards We Needed" The Washington Post, Columns, January 25, 2008. http://www.washingtonpost.com/wp-dyn/content/article/2008/01/24/AR2008012402888.html and Spitzer, Eliot. "Predatory Lenders' Partner in Crime: How the Bush Administration Stopped the States From Stepping In to Help Consumers." The Washington Post, Columns. February 14, 2008. http://www.washingtonpost.com/wp-dyn/content/article/2008/02/13/AR2008021302783.html

[13] Joint Economic Committee special report, "Sheltering Neighborhoods from the Subprime Foreclosure Storm," 2007. http://jec.senate.gov/index.cfm?FuseAction=Reports.Reports&ContentRecord_id=c780213f-7e9c-9af9-761d-fd7e597b5cfe&Region_id=&Issue_id

Although the current economic situation is commonly referred to as "the subprime mortgage crisis", the opportunity finance industry views predatory lending, not subprime lending per se, as the primary cause of the fallout. The opportunity finance industry has demonstrated that low-income and subprime borrowers can manage credit responsibly when they are provided fairly priced financing. (See Figure 1.) Predatory mortgage products, overall, impose a higher risk for all borrowers regardless of income levels and credit score.[14] Predatory lending is termed such because of deceptive practices and systematic targeting of communities with low financial-literacy resulting in many borrowers not comprehending the terms and costs of their mortgage agreements.

The Center for Responsible Lending estimates that 2.2 million families have lost or will lose their homes as a result of abusive subprime mortgages closed from 1998 through 2006; this includes 20% of subprime mortgages made in 2005 and 2006.[15] As the predatory subprime mortgages head for trouble, a surfeit of houses on the market and high foreclosure rates have set off a downward spiral of decreasing sales prices and decreasing homeowner equity. Not since the Great Depression has a higher portion of Americans owed more on their mortgages than their homes are worth and the numbers are rising fast:[16] more than 10% of homeowners nationally are underwater, which is twice the number from a year ago.[17] Borrowers looking to refinance as rate resets and foreclosures loom face a tightening credit market and stricter underwriting standards.[18] Resulting shockwaves through financial markets have negatively impacted employment and other economic indicators, which in turn has affected the ability of borrowers with prime mortgages to make payments.[19]

[14] See "A Snapshot of the Subprime Market" for statistics on subprime and ARMs mortgages and foreclosures at the Center for Responsible Lending: http://www.responsiblelending.org/issues/mortgage/quick-references/a-snapshot-of-the-subprime.html

[15] Center for Responsible Lending: A Snapshot of the Subprime Market. http://www.responsiblelending.org/issues/mortgage/quick-references/a-snapshot-of-the-subprime.html

[16] Christie, Les. "Subprime loans defaulting even before resets." CNNMoney.com. February 20, 2008 http://money.cnn.com/2008/02/20/real_estate/loans_failing_pre_resets/index.htm

[17] Andrews, E, and Uchitelle, L. "Rescues for Homeowners in Debt" The New York Times. February 22, 2008. http://www.nytimes.com/2008/02/22/business/22homes.html?_r=1&hp&oref=slogin. "Underwater" means the mortgage balance outstanding is greater than the property is worth.

[18] See Christie, Les. "Subprime loans defaulting even before resets." CNNMoney.com. February 20, 2008 http://money.cnn.com/2008/02/20/real_estate/loans_failing_pre_resets/index.htm

[19] Bajaj, Vikas., and Story, Louise. "Credit crisis hits prime borrowers: Even homeowners with good credit histories feeling pinch, analysts and data say." February 12, 2008. http://www.statesman.com/business/content/business/stories/personalfinance/02/12/0212credit.html

A number of agreements between lenders, legislators, and/or the White House attempt to curb foreclosures, including freezes on ARM rate hikes; Project Lifeline, an agreement by six of the major lenders to seek contact with homeowners who are 90 or more days into delinquency;[20] and FHA Secure, a federally insured refinancing product. On February 11, 2008, Countrywide Financial Corp. and housing advocacy group ACORN reached an agreement to formalize workout programs to help borrowers with all types of subprime loans avoid foreclosure.[21] To date, most strategies are criticized for being too limited in their scope and working for only a small percentage of borrowers. Although it is less expensive for a lender to waive prepayment penalties, freeze rate rises, and/or modify loans, there appears to be reluctance to commit the necessary resources to loan modifications for delinquent borrowers. Lenders argue that commitments to investors restrict them from making loan modifications; however, the cost of modifying loans compared to the cost of an equivalent number of foreclosures is likely far less.[22]

Through the crisis, CDFI's have shifted resources from the purchase and rehab market to damage control for victims of predatory lending. In many cases, CDFI counselors who formerly spent 10% to 20% of their time on foreclosure prevention now commit 70% to 90% of their time. New curricula and products have been implemented to address demand, including

- **Loss mitigation counseling with lenders,**
- **Refinancing and other credit solutions where appropriate,**
- **Advocacy at the state and federal level, and**
- **Strategies to mitigate the impact in neighborhoods heavily hit by foreclosures.**

The challenge for CDFIs is the quickly changing environment. As credit markets tighten, market conditions weaken and the number impacted by the crisis increases, products designed a year ago are relevant to fewer borrowers today. CDFI must anticipate a moving target when they are designing products and services if they are to maintain relevance.

[20] Paletta, D. and Hagerty, J.R. "Lenders Step Up Effort to Avert Foreclosures." The Wall Street Journal. February 12, 2008. http://biz.yahoo.com/wallstreet/080212/sb120276908653960265_id.html?.v=6

[21] Raj, J.R."Countrywide Financial, Acorn reach subprime agreement" Reuters. February 11, 2008. http://news.yahoo.com/s/nm/20080211/us_nm/countrywide_acorn_dc_1

[22] Foreclosures in declining markets are a financial burden to the lender.

An Essential Framework for Foreclosure Prevention

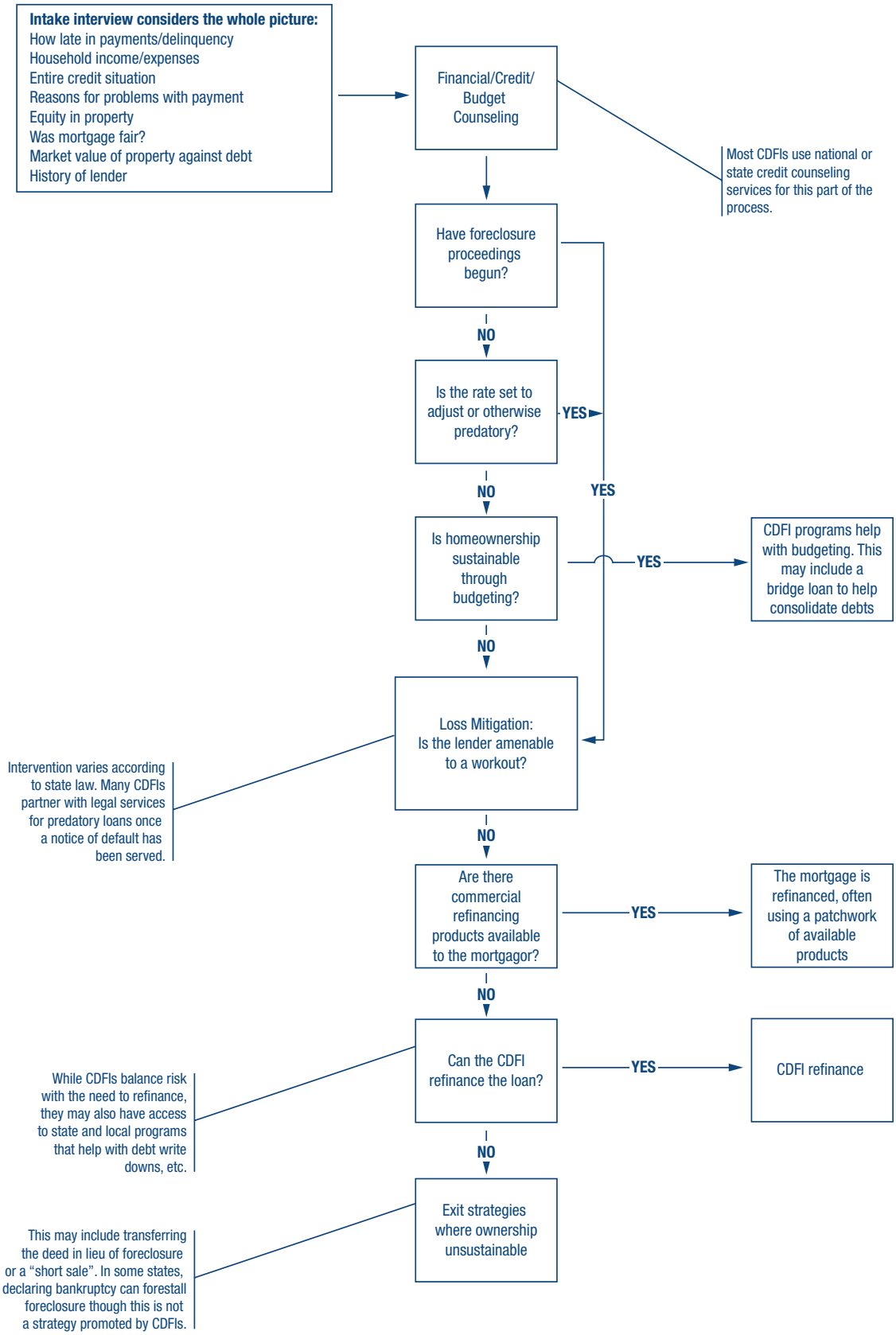
Borrowers with troubled mortgages go through a number of stages before succumbing to foreclosure and there is a corresponding logic to strategies for averting foreclosure or mitigating the impact on a borrower who cannot avoid foreclosure. While this varies according to several factors relevant to state foreclosure laws some stages are consistent nationally. A delinquent borrower will receive a notice of default anywhere from 30-90 days into delinquency and a notice of foreclosure after 90 days or longer. There are a host of considerations that determine the outcome of whether or not the borrower can avoid foreclosure. These include:

- Is the borrower already in default?
- If so, has the borrower been attempting to make payments even if the payments are inadequate (good faith payments)?
- Is the mortgage predatory?
- Is the rate set to adjust or has it already adjusted?
- Could the borrower manage if the mortgage had been a responsible one or did they borrow beyond their means?
- Has the borrower's situation changed since they took out the mortgage?
- Is the current value of the home less than the purchase mortgage amount? If so, was the original appraisal inflated?

In all foreclosure prevention programs, the first step after intake is usually credit counseling. The CDFI will work out a budget with the borrower to see whether they can afford their mortgage payments under current circumstances and in the case of an ARM, when their interest rate increases.[23] The flow chart below provides a general framework for how most programs work.

[23] Increasingly, CDFIs are utilizing national credit-counseling providers for this component of services.

Figure 2: A Foreclosure Prevention Framework



By and large, the earlier in the process the borrower connects with a foreclosure prevention program, the brighter their outcome. Specifically, if they wait until delinquency or until they have received a notice of default, their options will be fewer. However, as the credit market tightens and values and home equity decrease, the outlook for all borrowers having trouble making mortgage payments looks bleaker.

Working with a delinquent borrower is labor and resource intensive. As one contributor to this research put it, "In regular [purchase] mortgage lending it's easy to stratify people. You can serve a lot of people in a short time. But every situation in foreclosure prevention is unique. I've been working with one gentleman for ten months with still no outcome."

CDFI Strategies Addressing Foreclosures

This section breaks out CDFI strategies into seven categories: marketing, Loss Mitigation: Repayment Plans and Workouts, Legal Intervention, Refinance Ready or Debt Consolidation Loans, CDFI Debt Writedown, Refinancing, and Maintaining Value in Areas with High Foreclosure Rates. Within each category, we highlight programs that offer innovative strategies or provide a context for the significant challenges CDFIs and others facing in addressing the current crisis.

Marketing

The success of any kind of workout or refinancing is very largely determined by the stage in which a borrower seeks help. Because a borrower's chance of holding onto their home diminishes sharply the further into default they fall, an effective marketing strategy targeting borrowers before they get into trouble is crucial.

CDFIs operate on tight budgets and so look for affordable outreach strategies. Many foreclosure prevention programs receive referrals from the national HOPE NOW Alliance.[24] The weakness with this approach is that most HOPE NOW referrals are already delinquent. We found two CDFIs that stand out in how they approach marketing. Both programs have implemented collaborative strategies that help spread costs across participating entities and both programs use available data to reach out to borrowers before they fall into default. Both programs are based in Chicago and collaborate with City departments.

Chicago Neighborhood Housing Services (Chicago NHS)

The Homeownership Preservation Initiative (HOPI) is a collaborative effort that includes the City of Chicago, Chicago NHS, The Credit Counseling Resource Center (CCRC), and major Chicago lenders. The program started in 2003 to address a rapid rise in foreclosure filings in the city of Chicago, with a three-year goal of providing counseling to 3,000 households. Chicago NHS has been making outreach efforts in the target neighborhoods since 1997, when it realized that 10% of households in some of these neighborhoods were in danger of foreclosure.

The HOPI marketing strategy included 25,000 postcards, sent by the City to targeted ZIP codes to promote counseling. Other marketing included public service announcements, media events,

[24] HOPE NOW is an alliance that includes the Housing Preservation Foundation and NeighborWorks® America that has a hotline and referral to NeighborWorks® centers for face-to-face counseling.

and bus and subway advertisements. In January 2004, the collaborative launched a telephone service through which callers could access counseling using Chicago's non-emergency "311". Chicago NHS also reached out in neighborhoods where it has an office presence and has sent direct mailings to homes facing ARM resets.

Over the period of January 2004 to July 2005, well before the current subprime crisis, approximately 1,300 individuals from the City of Chicago received telephone counseling. Another 800 came to Chicago NHS seeking face-to-face counseling for their mortgage problems. Most of these clients were already delinquent. In 2007, Chicago NHS reached out to target neighborhoods with another mailing and saw 450 people in their workshops on foreclosure prevention and nearly 2,000 in face-to-face counseling. Among households targeted prior to ARM resets, 60% to 70% who engage with the program engage prior to delinquency. In 2008, among all clients, roughly 60% have a good chance of keeping their homes.

ShoreBank is a regulated bank and certified CDFI with more than $2.1 billion in assets. With the high number of subprime ARMs set to reset in their target market, ShoreBank identified 10,000 homeowners within the 25 low-moderate income Chicago neighborhoods it serves whose subprime ARMs were set to adjust in the next 12 to 18 months and who fall between 60% to 100% of area median income. ShoreBank targeted direct mail to these homeowners to promote their Rescue Loan Program. This program offers fixed-rate refinancing and new purchase loans. In addition, it offers free workshops and seminars that aim to help borrowers better understand mortgages and the home buying process. These presentations have become a valuable source of leads and business referrals, helping ShoreBank to loan more than $10 million to over 50 homeowners during the first three months of the program's operation.

Loss Mitigation: Repayment Plans and Workouts

Foreclosure prevention counselors generally try to mediate between the borrower and the lender's loss mitigation officer to prevent foreclosure. For most programs, a decent loan modification on an otherwise unaffordable mortgage is considered an excellent outcome. A loan modification is a permanent change to the loan agreement with the current lender that alters one or more terms of the loan such as lowering the interest rate or increasing the length of the loan term. In some cases, the modification may include a reduction in principal (for example, forgiving delinquent payments). A loan modification is intended to be a long-term solution to a troubled loan.

Forebearance, the temporary cessation or reduction of loan payments and the principle behind a repayment plan, is not a long-term solution unless it is combined with a loan modification; otherwise the borrower will be in the same position at the end of the forebearance period as they were when they started. The borrower would then enter a repayment agreement wherein the lender agrees to accept partial repayment of delinquent amounts with each monthly payment. This type of repayment plan is not a realistic solution for a borrower who cannot make even the regular monthly payment.

Many lenders have publicized that they are willing to work with delinquent borrowers and, indeed, it would appear within their interests. Under lender ownership, the "real estate owned property (REO)" must be quickly turned over and typically sells far below the appraised value; lenders stand to lose far more from a foreclosure than from a loan modification. However, lender loss mitigation is far more often around repayment plans than loan modifications and foreclosure

is still a far more common occurrence than an effective modification. The Center for Responsible Lending reports that for every loss mitigation effort made by a lender, seven times as many foreclosures are initiated; for subprime ARMs, the ratio is 13 to one.[25] One finding asserts that 29% of 400,000 foreclosures in the 3rd quarter of 2007 were on borrowers who had gone through the loan mitigation process with the lender but still could not make their payments. Loss mitigation should address the factors that made the loan unaffordable in the first place; modifications that contain permanent adjustments, not temporary ones, will result in a more positive outcome.

Foreclosure prevention programs agree that the loss mitigation process is far more effective when a third party who knows the process is involved. One contributor to this research reported that, "Borrowers say there's a huge difference when we're on the phone with the lender."

Barriers to Loss Mitigation

Effective loss mitigation requires determination on the part of the borrower and/or lender/servicer. The borrower may call the lender/servicer[26] numerous times and still receive no response; one contributor to this research offered the anecdote of a lender's loss-mitigation specialist whose voice mailbox was consistently full. Another said that it often requires 45 days of repeated efforts to receive an initial response from a loss mitigation officer. While it is in the interests of most lenders to restructure a loan rather than foreclosure, particularly if the property is in a soft market, most servicers are overwhelmed with the number of calls they are currently receiving and do not have the capacity to manage them.

Delineations between the collections department and the loss mitigation department at most lenders are not conducive to a happy outcome for the delinquent borrower. A borrower who is delinquent or heading towards delinquency deals with the collections department, which has no incentive or is not authorized to negotiate a repayment plan or modification. It is not until the borrower has received a notice of default that they are put through to the loss mitigation department and given the opportunity to negotiate. The problem with this model is that the further into default a borrower slides, the less likely it is they will escape foreclosure. As experience with individual lenders grows and information is shared among foreclosure prevention programs, we now see foreclosure prevention counselors helping borrowers circumvent the lender's intended service structure and going directly to the loss mitigation departments before they reach foreclosure proceedings.[27]

Another barrier to loan modifications is the inability of lenders to identify who holds the notes for mortgage that were divided into tranches, repackaged, and sold as mortgage-backed securities. There is not yet a standard supporting infrastructure of documentation for these securities, making it difficult if not impossible to map them to the underlying loans. Lenders have also argued that modifying loans may make bring litigation from the investors.

[25] Voluntary Loan Modifications Fall Far Short: Foreclosure Crisis Will Continue Unabated without Court-Supervised Modifications. Center for Responsible Lending Issue Brief. January 30, 2008. http://www.responsiblelending.org/pdfs/paulson-brief-final.pdf

[26] There was some anecdotal consensus among contributors to this research on which lenders were unresponsive and which ones were willing to negotiate a workout or repayment plan.

[27] This website provides a list of direct loss mitigation division numbers for major lenders: http://www.loansafe.org/forum/showthread.php?t=133

At present, the only debt that a bankruptcy court cannot modify is a first mortgage. This creates a disincentive for lenders to modify the loan. The Center for Responsible Lending has been pushing a provision for "judicial modifications" that would allow bankruptcy courts to write down a loan to the current appraised value of the property. Lenders would also have more of an incentive to modify loans if this provision was passed. The Center for Responsible Lending projects that such a provision could prevent 600,000 foreclosures.

Finally, stated income mortgages, popular among the self-employed, are more difficult to modify because verifying borrower income may take several months of tracking, during which time the borrower is heading further into delinquency.[28]

Examples of Loss Mitigation Programs

We highlight in detail here just two CDFIs that offer loss mitigation services, although all of the CDFIs highlighted in this report offer loss mitigation services directly or through partners. Both examples highlight the challenges of loss mitigation. A notable difference between the two programs is that the first highlighted, the Housing Partnership of Northeast Florida, has been offering foreclosure prevention since 2004, and the latter, Community Housing Resources, Inc., only implemented its foreclosure prevention program in 2008.

Other CDFIs of note for loss mitigation include the **NeighborWorks® Housing Services of New York** for how it educates customers in loss mitigation, the **Parodneck Foundation** for its work with senior citizens, and **Chicago Neighborhood Housing Services** for the collaborative approach it has taken toward loss mitigation.

The **Housing Partnership of Northeast Florida** is a NeighborWorks® member and has been working predominantly with delinquent borrowers that are referred to them by a number sources including the HOPE Hotline.[29] Within their loss mitigation division, less than 10% of clients negotiate a modification and about 70% of this 10% (7%) are successful in that they have avoided further delinquency. Richard Paige of the Housing Partnership says that to modify a loan , the lender usually requires the borrower to pay at least two or three past-due payments but many that come to the program seeking help are already six months delinquent and the requirement is unrealistic. Many mortgage holders heading into delinquency treat it as an all-or-nothing proposition. If they fall behind they just stop paying, which is not a good platform for a workout.

Worcester Community Housing Resources, Inc. (WCHR). WCHR seems to be reaching delinquent borrowers slightly earlier in the delinquency timeline, perhaps due to the proactive stance that the Massachusetts state agencies have taken to prevent foreclosures. Fifty-five to 60% of clients seen in January were pursuing a loan modification. As of early May, most were still waiting for responses from their lenders.

WCHR is a CDFI loan fund that coordinates with two other nonprofits to staff the NeighborWorks® HomeOwnership Center of Worcester, though not a NeighborWorks® member itself. This is one of three such NeighborWorks® HomeOwnership Centers nationally. The HomeOwnership Center offers a host of NeighborWorks® education and counseling services, including a foreclosure triage class. Counselors help participants develop a budget before the class and then educate participants on where they are in terms of foreclosure and their options moving forward, and provide individual follow up. Instructors educate the participants on how to approach their lender for a modification and assist where they can make a difference.

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[28] According to the Center for Responsible Lending, 43% to 50% of subprime mortgages closed from 2004 to 2006 were approved without fully documenting income.

[29] An initiative of the Homeownership Preservation Foundation, the HOPE Hotline was implemented in 2005. NeighborWorks® Members with foreclosure prevention services receive the bulk of the referrals.

To date, all homeowner that have come to the Center have been referred by the national HOPE Hotline. This is expected to change because the three nonprofits that staff the Center are coordinating efforts to do their own marketing and outreach based largely on a database of ARMs set to adjust. January 2008 was the Center's first month of operation; it served 40 clients that month. Most were at least two months delinquent at intake and the majority had an ARM. After program counseling, roughly 55-60% were pursuing a loan modification; 10% to 15% were pursuing refinancing with one of several products provided by other lenders; the remaining 25% either faced bankruptcy or a short sale.[30]

The HomeOwnership Center works with all levels of income and does minimal work with investment property mortgages. According to Miguel Rivera, Director of Lending at WCHR, the majority of borrowers that come to the Center hoping to avoid foreclosure are at or above 80% of area median income and out of the 2,300 ARM resets in Worcester, more than half are single-family homes. This points to the reality that subprime mortgages are not just affecting low-income households.

Legal Intervention

Legal services are primarily used in foreclosure prevention to:[31]

- **Negotiate a loan modification.**
- **Provide legal representation to borrowers in the few states where foreclosure requires court involvement.**
- **Use bankruptcy laws to temporarily halt foreclosure and/or eviction, which also varies by state law. By and large, CDFIs do not recommend Chapter 13 as a means to prevent foreclosure but do advise borrowers on their options.**

Although foreclosure laws vary by state, legal intervention in foreclosure prevention appears to be fairly consistent across states in the programs we examined. In most cases, legal services are only involved once the servicer has given notice of foreclosure proceedings against the borrower. Most CDFIs with foreclosure prevention programs partner with local nonprofit legal services, such as Legal Aid, rather than providing the services directly. Legal Aid centers typically work with low-income individuals and in partnering with these programs some CDFIs have found that only a percentage of their clients are eligible for these services. The Institute for Foreclosure Legal Assistance (IFLA) is a collaborative effort involving the Center for Responsible Lending that supports groups that provide legal representation to borrowers facing foreclosure due to abusive lending practices. Other consumer and nonprofit law centers, such as the National Consumer Law Center, are offering affordable training to foreclosure prevention programs.

[30] A short sale is the sale of a property for less than the mortgage balance outstanding. The sale proceeds go to the lender who agrees to accept the proceeds as payment in full for the outstanding balance and release the owner from further responsibility. A short sale is an alternative to foreclosure.

[31] RealtyTrac® provides a breakout of state laws affecting foreclosure, "Foreclosure Laws and Procedures By State." at http://www.realtytrac.com/foreclosure-laws/foreclosure-laws-comparison.asp. See ACORN (Association of Community Organizations for Reform Now) for updates on state laws. http://www.acorn.org/index.php?id=736

Contributors to this research reported that very few cases actually go to court unless the state requires the lender to sue the borrower to foreclose. Some courts in states with judicial foreclosure, notably Ohio and Florida, are requiring that lenders prove property title ownership before foreclosure can proceed. The challenged lenders have not been able to produce the title because the securities are not mapped to the underlying loans.[32] This has allowed borrowers in default to retain their property, at least temporarily. There is also anecdotal evidence that in judicial foreclosure states, the foreclosure process takes longer, around 16 months, so there is more time to avoid foreclosure. There are also a growing number of actions brought by state attorneys general to prevent subprime lenders from selling loans.[33]

Since 2002, **Baltimore Community Lending's (BCL)** Homeowner Emergency Loan Program (HELP) has offered a comprehensive approach to borrowers in and nearing default or foreclosure who are victims of predatory lending or have an ARM reset. More than 90% of **Baltimore Community Lending**'s HELP clients are pre-screened referrals from housing counseling agencies. BCL's Executive Director, Ruth Louie said that, "These borrowers have little trust of lenders and the counselors have proven to be the right entity to refer them to HELP." HELP services include counseling and education; intervention with existing mortgage lenders, including legal intervention as needed; an affordable mortgage refinance and emergency repair loan fund; and write-down grants to assist eligible homeowners achieve an affordable refinance loan. HELP was early among the CDFI responses to predatory mortgage lending, in part because Baltimore suffered from predatory mortgage lending earlier and more acutely than most other cities. Since inception, Baltimore HELP has provided foreclosure prevention services to more than 238 families.

Legal assistance is provided by Civil Justice, a Maryland network of lawyers serving low- and moderate-income individuals. If the lawyer sees a potential case for legal action they will pursue legal action with the client or refer the client to BCL. BCL also has cross referrals with another nonprofit housing developer with a legal division. It has always been BCL's intent to allow the legal partners to gather information from these homeowners and establish a body of cases for a potential class action or individual action. Five of these families have received partial debt forgiveness due to legal intervention in the amount of $12,842.

Santa Cruz Community Ventures/Santa Cruz Community Credit Union (SCCV) is setting up a legal clinic for foreclosure prevention with the Watsonville Law Center under their collaborative program, the Economic Justice Project. The legal component is one strategy of SCCV's three-pronged approach to foreclosure prevention; the other two components are community education and housing counseling. The first legal clinic was scheduled for March 11, 2008 with three volunteer lawyers. Attendees must fall below 250% of the poverty level. SCCV envisages that the legal assistance will help participants in foreclosure negotiate a workout or repayment plan.

[32] See Morgenson, Gretchen. 2007 "Foreclosures Hit a Snag for Lenders." New York Times. November 15. http://www.nytimes.com/2007/11/15/business/15lend.html?_r=1&oref=slogin

[33] Blanton, Kimberley. "Subprime lender sued under predator law: AG accuses Fremont of 'worst practices'" The Boston Globe. October 6, 2007. http://boston.com/business/globe/articles/2007/10/06/subprime_lender_sued_under_predator_law/

The Housing Partnership of Northeast Florida works with Jacksonville Area Legal Aid and refers directly anyone who has received a notice of default, which is roughly 50% of the CDFI's clients. Jacksonville Area Legal Aid has reportedly had a 100% success rate challenging servicers on the title of the mortgage.

Another CDFI loan fund, the **Northwest Ohio Development Agency (NODA)**, is discussing the issue of mediation with judges in their district. Under the plan, the local courts would hire a part-time magistrate to work with the lenders.

Refinance Ready or Debt Consolidation Loans

As the foreclosure crisis deepens and borrowers become less able to handle debt, any type of lending aimed at foreclosure prevention has become more difficult; however, debt consolidation is still useful when a borrower is having trouble making payments due to a number of high-interest loans outstanding, such as payday loans, credit card debt, and car payments.

The Housing Partnership of Northeast Florida has a refinance ready loan with a term of 36 months designed to bring the borrower current and address delinquencies that prevent them from being eligible to refinance their mortgage. Currently, eligibility for these loans is very low as most of the recent program participants have been deep in delinquency when they arrive at the program.

The **Opportunities Credit Union's** Individual Development Account (IDA) Debt Reduction Program provides matching funds to borrowers to write down debts in order to make mortgage payments more affordable. Many CDFI credit unions and some microenterprise programs have similar IDA programs.

CDFI Debt Writedown

Negative homeowner equity results from a mortgage based on an inflated appraisal value or from a drop in home value. The percentage of homeowners with zero or negative equity in their home is expected to rise in coming months with an estimated peak of around 25% in the West, 20% in the Midwest, and 15% nationally.[34]

Writedown grants reduce the principal owed, making refinancing with a responsible mortgage a more viable option for borrowers with negative equity. Since CDFIs are not in the business of making grants, any CDFI implementing a grant writedown program requires a source of grant capital and these programs usually result from a partnership with housing authorities, state agencies, and/or HUD.

Baltimore Community Lending's (BCL) Homeowner Emergency Loan Program (HELP) has utilized $916,000 of HUD grant funds exclusively as forgivable loans to eligible low- and moderate-income homeowners to remedy predatory mortgages through the reduction of delinquency. Thirty-nine of the 41 families BCL has refinanced have required mortgage

[34] Andrews, E, and Uchitelle, L. "Rescues for Homeowners in Debt" The New York Times. February 22, 2008. http://www.nytimes.com/2008/02/22/business/22homes.html?_r=1&hp&oref=slogin

writedowns. The maximum writedown per borrower is $30,000, which is incorporated into the refinancing.[35]

The funds are provided as a lien against the property that decreases by 20% every year. After five years the writedown grant is forgiven. The borrower is not allowed to sell or refinance the house (i.e. to recapture the writedown) during this 5-year period unless the refinance results in a lower mortgage payment and there is no cash paid out to the borrower at closing. If the home is sold or the borrower receives a cash-out payment at refinancing, they must repay an appropriate portion of the writedown.

CDFI Refinancing

Due to a tightening credit market, negative home equity, and other market factors, refinancing has fast become a less viable means to curb foreclosures. Issues for CDFIs creating and implementing a refinancing product include:

- Should the CDFI develop a product to hold in its portfolio or sell on the secondary market, or use a combination of first and second mortgages, perhaps keeping the second in their portfolio? Most CDFI loan funds and credit unions are not capitalized for their own mortgage product so they typically rely on secondary mortgage products, at least for the first mortgage. CDFIs with member deposits such as credit unions and banks have greater capacity to hold mortgages in their portfolios.

- Loan-to-Value (LtV). With decreasing and over-appraised values, providing an LtV that will be appropriate to the borrower is a concern. CDFIs tend to be accommodating eligible borrowers with LtVs of 100% to 105%, sometimes with a second mortgage. While the need for a higher LtV refinance grows, the number eligible for a higher LtV is falling.

- Who is eligible? CDFIs work almost exclusively with owner-occupiers in terms of housing loans unless the loan is to an affordable housing developer. Some programs only work with borrowers holding a predatory mortgage, some work with rate resets specifically, and many will only work with borrowers who are low-moderate income, or below 120% area median income. Most programs we spoke with are elastic on income when it comes to foreclosure prevention compared with other services.

Through writing this report, OFN became familiar with at least 17 CDFIs offering or in the process of offering refinancing. These CDFIs include:

- Alternatives Federal Credit Union
- ASI Federal Credit Union
- Baltimore Community Lending
- Coastal Enterprises, Inc
- Cooperative Federal (Syracuse Cooperative Federal Credit Union)
- El Futuro Credit Union
- FAHE Inc.
- Housing Partnership of Northeast Florida
- Neighborhood Housing Services of Chicago
- Neighborhood Housing Services of New York City
- Neighborhood Housing Services of Phoenix
- Northwest Ohio Development Agency
- O.U.R. Federal Credit Union
- Opportunities Credit Union – using FHA secure
- Self-Help
- ShoreBank
- Worcester Community Housing Resources, Inc.

[35] See a description of Baltimore Community Lending's refinancing product under the section titled "Refinancing."

Based on the spectrum of foreclosure prevention strategies CDFIs offer, refinancing is one of the least likely outcomes for a borrower in default. There are, however, one or two notable exceptions that have successfully engaged borrowers prior to delinquency when refinancing is a more viable option.

All of the products we looked at were priced at about prime plus 1-1.5% fixed for 30 to 40 years. Some products drop after a fixed time of zero-delinquency on payments. In general, CDFIs continue to service the loans they originate through the life of the loan.

ShoreBank[36] created the Rescue Loan Program for borrowers 90 days or less delinquent on their mortgage, who have fair to decent credit, and who fall between 60% to 100% of the area median income.[37] Shorebank stands out among the CDFIs highlighted in this section because it is perhaps the only one to pursue refinancing as the primary option, as opposed to loss mitigation with the current lender.

It was important to ShoreBank that they hold on to the refinanced loan and service it through its life so the lender remains accountable. The bank's High Yield Savings Account was launched simultaneously to help fund the newly refinanced mortgages in the Rescue Loan program. The online account enables consumers looking for a competitive rate of interest on their money to also be available to receive a social return on their investment. ShoreBank estimates they have gained nearly 500 new deposit customers from across the country through their high-yield savings program and have raised nearly $9 million in new deposits.

Through its high-profile marketing campaign, ShoreBank is targeting borrowers before the interest rate resets and before they become too delinquent, which accounts for their very high refinancing rate against applications. To alleviate the problem of negative equity in a declining market, Shorebank utilizes a guarantee provided by the Illinois State Treasury. By the close of January, 2008, ShoreBank had successfully refinanced approximately 60 of 76 refinancing applications with dozens more in the pipeline. On average, it has taken only 12 to 14 days to process an application.

Another Chicago program offering refinancing is **Neighborhood Housing Services of Chicago (Chicago NHS).**[38] Chicago NHS finances all mortgage lending, including refinancing, through a privately-placed mortgage-backed certificate it organized with a number of Chicago banks. The banks committed to purchasing $100 million of a mortgage warehouse line over three years. Chicago NHS is currently in the second iteration of this financing process with $65 million in certificates. Currently, roughly 50% to 60% of certificates represent refinancings but this amount was up to 65% of loans closed in the last quarter.

When homeowners have negative equity in their homes, Chicago NHS negotiates with the lender to reduce the principal. In 2008, Chicago NHS is finding lenders more amenable to writing off $20,000 to $30,000 as opposed to losing $60,000 at foreclosure. Many of the homes being refinanced received inflated appraisals at purchase. Many are in substandard condition so Chicago NHS couples the refinancing with rehab loans with LtVs of up to 115% or the projected value of the rehabbed unit through a second lien on the property.

[36] Also Highlighted under Marketing

[37] See a description of Shorebank's Rescue Loan Program at the Chicago Federal Reserve: http://www.chicagofed.org/community_development/files/pnv_remar08_web_shorebank_rescue_loan_program.pdf

[38] Also highlighted in the Marketing section.

$20,000 to $30,000 as opposed to losing $60,000 at foreclosure. Many of the homes being refinanced received inflated appraisals at purchase. Many are in substandard condition so Chicago NHS couples the refinancing with rehab loans with LtVs of up to 115% or the projected value of the rehabbed unit through a second lien on the property.

To date, Chicago NHS has helped at least 270 families keep their homes. For about 75% of these families, loss mitigation was the solution and the other 25% were refinanced by Chicago NHS, usually combined with a reduction in the original mortgage. The program does not have impact figures for those counseled on the telephone.

The following three refinancing products were designed by loan funds in collaboration with Fannie Mae as Fannie Mae pilot programs. One contributor to this research commented that Fannie Mae no longer has the appetite for this type of individualized program; nor did we come across Fannie Mae pilot products that had been tested then applied more broadly. However, Fannie Mae has continued to purchase the piloted products.

Most clients at **Baltimore Community Lending**'s[39] Homeowner Emergency Loan Program (HELP) are delinquent on their loans when they arrive at the program but not yet in the foreclosure process. Some are facing an ARM reset in a few months, while others are struggling to make monthly payments on loans they really couldn't afford but were steered into by mortgage brokers. The original program goal was to refinance 30 families. To date, HELP has refinanced 41 families totaling $2.7 million in loans including rehabilitation assistance. Only one of these loans has defaulted.

The Baltimore Partnership Office of Fannie Mae, prior to closing, was actively involved in developing the HELP refinance product, and agreed to purchase the loans.[40] BCL funds a first mortgage refinance loan, sometimes including funds for rehabilitation. BCL also funds rehab/repair loans on a second lien. Fannie Mae has maintained its partnership with HELP and purchases the loans after closing or once repairs are completed. HELP has sold 36 loans (totaling $2.2 million) to Fannie Mae, holding only those HELP loans that do not meet the criteria for sale.

BCL now offers a second refinance product, Lifeline Refinance Loan, as an approved lender with the Maryland Community Development Administration. This product offers up to 100% financing at low interest rates for homeowners with resetting ARM loans. HELP sells the loans to the MCDA. Foundation grants are used to assist HELP borrowers with closing costs and to help HELP's operating expenses.

Northwest Ohio Development Agency (NODA)[41] is a small loan fund serving Lucas County, Ohio. NODA's predatory lending remediation program, Restoring the Dream, offers refinancing along with other foreclosure prevention services for borrowers with predatory mortgages. NODA negotiated its first mortgage product with Fannie Mae in 2003 through Fannie Mae's Chicago office. A conventional lender refinances the first mortgage, which Fannie Mae then purchases, while NODA supplies the second mortgage and holds it in their portfolio. The total loan package may be as high as 110% of the appraised value. The local banks have been very supportive of the product.

[39] Described in more detail under Legal Intervention and also highlighted in CDFI Debt Writedown

[40] We heard that Fannie Mae through its regional offices had negotiated 21 such products for pilot programs.

[41] Also highlighted under Legal Intervention

Applicants to Restoring the Dream are divided into two streams according to the borrower's credit before they closed their mortgage. The first stream is for borrowers whose credit was good at the time of the predatory loan; borrowers in this stream are eligible to try for a refinance through the program immediately. The second stream is for borrowers whose credit was poor before the predatory mortgage. In this case, NODA will refinance after a period of six months during which time the borrower must meet certain requirements, including counseling and regular monthly mortgage payments. If the borrower cannot afford the full monthly mortgage payment, NODA and the borrower agree on an affordable amount. If the lender is moving ahead with foreclosure and not accepting payments, the borrower makes the payments to NODA, which deposits them into an escrow account. The deposits go toward purchase of a home following foreclosure. If the borrower misses a payment, they are required to start over. If they miss two months, they are expelled from the program and NODA returns any deposited funds. During the six-month trial period, the borrower cannot voluntarily increase their debt or be subject to collections or charge offs individually over $220 or $1000 combined and existing charge offs cannot be lien threats. NODA will accept a debt to income ratio of up to 45% for their refinancing product.

In Ohio, a borrower facing foreclosure can live in the home until the lender sells the property through a Sheriff Sale. Tiffany Zinn, NODA's Chief Operating Officer, says that the lender is not eager to sell a foreclosed home where values have significantly depreciated and roughly 50% of homes that receive notice of foreclosure do not ultimately foreclose. Tiffany said that in several cases the borrower has repurchased the home for a lower rate using the escrowed funds.

NODA screens about 15 applicants a week for their refinancing program. The vast majority does not qualify for services in the program because they are not in NODA's service area, they have title issues, their loan is worth more than the home, their debt ratio exceeds program guidelines, or the loan is not predatory. When the client is eligible for refinancing, Zinn says, it is relatively easy to convince a lender to drop prepayment penalties. In addition, when the property is re-appraised, if the current market value is less than the mortgage outstanding, NODA helps the borrower negotiate a lower payoff the borrower can afford. If negotiation efforts fail, NODA advises clients to contact an attorney.

NODA has only one staff member available for housing counseling. Although NODA offers many other counseling services, the counselor now spends 75% of her time on foreclosure prevention. Recently NODA and a local television station broadcast a story about a first time homebuyer just to let people know that it is still okay to buy a home and that it can be done the right way.

By December 30, 2007, NODA had remediated a total of 46 loans: 24 loans were modified and 23 refinanced, bringing a cumulative $2.37 million in benefits to consumers and an average reduction in monthly payments of $231.

The Housing Partnership of Northeast Florida's[42] Mortgage Recovery Loan Program began in late 2005 before the coming foreclosure crisis was widely acknowledged outside of socially responsible lending advocates and nonprofit housing groups. The Fannie Mae pilot loan program offers the option of up to a $2,000 loan to bring the borrower current and address delinquencies that prevented them from being refinance eligible. The Housing Partnership finances the loans

[42] Also highlighted under Loss Mitigation, Legal Intervention, and Refinancing Ready and Debt Consolidation Loans.

The Mortgage Recovery Loan eligibility criteria include the following:

- Must demonstrate foreclosure potential;
- The owner-occupier must have income below 120% of the area median household income;
- The borrower should be making good faith attempts to remain current on their mortgage; and
- The borrower's current mortgage has at least two of the seven hallmarks of a predatory mortgage (which the vast majority does).

Richard Paige, The Housing Partnership's VP of Lending Services, estimated that roughly 98% of program clients are not eligible for a lending solution because by the time they seek assistance they are not able to handle more debt. Others who may be eligible have issues that make it difficult. Richard sees refinancing as a more relevant solution in 2005 when massive delinquencies were not the issue they are today. He notes the changing nature of the foreclosure crisis saying that,

> "In 2005, 95% of the people who came to us were victims of predatory lending. Now there's an increase in demand for our services but the portion with predatory mortgages is only about 70%-75%...25% are families that may be five to seven years into conventional, fixed-rate mortgages but have recently been laid off and [are] now working in a lower-paying job that doesn't allow them to keep up with payments. Because of the reduction in home values, they still owe more than the house is worth so are very difficult to refinance. Jacksonville wasn't a speculative market like Tampa or Miami. People bought homes because they saw the prices going up quickly."

To date,[43] The Housing Partnership has closed six Mortgage Recovery loans. One performed perfectly, two performed well with some delinquencies, two have run into problems and the Housing Partnership has brought them back in for counseling; the sixth is not doing well at all and is close to foreclosure.

Another line of secondary market products popular among CDFIs and NeighborWorks® affiliates come from the Neighborhood Housing Services of America. The Federation of Appalachian Housing Enterprises Inc. (FAHE) is a loan fund serving four states in central Appalachia. Through more than 40 nonprofit members, such as housing authorities, community housing developers, and community action agencies, FAHE offers refinancing with a Neighborhood Housing Services of America (NHSA) purchase/refinancing product. FAHE sells the loans to NHSA with full recourse for the life of the loan. FAHE has an accompanying loan loss reserve to purchase loans back from NHSA. The loan to value maximum is 95%, although most of the refinances that FAHE originates are 90% or less.

Appalachia has not seen the kinds of predatory and unaffordable mortgage lending apparent in other markets. Jim King, FAHE's executive director, says that predatory loans in Appalachia are more often associated with rent-to-own schemes and manufactured housing. There is also a cultural reluctance to take out home equity loans. As of March 7, 2007, FAHE had 70 loans in the pipeline but only seven were for refinancing.

[43] As of January 30, 2008

Worcester Community Housing Resources, Inc.[44] with other service providers and stakeholders is involved in a collaborative effort with the State Attorney General's Office and the Massachusetts Housing Authority to offer refinancing. The NeighborWorks® HomeOwnership Center of Worcester, in which WCHR is a partner and the primary lender, has been identified as one of ten state-approved foreclosure prevention centers. However, the State's nonprofit mortgage-broker license exemption, under which WCHR currently lends, has been eliminated since the subprime crisis escalated and all mortgage lenders have come under tighter state regulation. As one of the State's foreclosure prevention centers, WCHR will be eligible to use the State's Home Saver refinancing product, a 40-year amortized mortgage. The maximum loan to value for a Home Saver mortgage is 105% of the current appraised value of the property. To mitigate the affects of deflating values, the State is trying to negotiate in a situation whereby if the difference between the mortgage and current appraised value was, for example $30,000 or less, the existing lender would provide a second mortgage for this difference with a 0% deferred payment most likely due on resale or refinancing. This would be offered in conjunction with the Home Saver refinancing product.

Maintaining Value in Areas with High Foreclosure Rates

As more homes with unaffordable mortgages are put on the market or foreclose, and housing supply outweighs demand, all housing values decline. Moreover, many foreclosed homes remain vacant and further devalue the surrounding area. Lenders holding the titles of foreclosed homes have not volunteered to maintain the properties though there are examples of cities, such as Boston and Buffalo, suing lenders to force property maintenance. CDFIs working to mitigate the negative impact of high foreclosures in their target communities are primarily involved in lending to nonprofits that purchase and rehab the foreclosed homes, which are then sold or rented affordably.

For several years now, Funding Partners for Housing Solutions has been providing lines of credit to CDCs and housing authorities to purchase foreclosed properties in Colorado. In 2007, Funding Partners spearheaded a purchase-resale initiative, The Foreclosure Reset Program, that will dovetail with the Colorado Foreclosure Hotline and other participating agencies. As of early May 2008, the Reset Program is in final planning. Under the proposed model, CDCs and housing authorities would negotiate purchase agreements with the current homeowner, followed by a short-sale negotiation with the mortgage servicer for the delinquent note.[45] The CDC/Authority would finance purchase of the delinquent note through a line of credit issued by a consortium of CDFIs including Funding Partners, and the Mile High Community Loan Fund (also Colorado based). The CDC/Authority will hold title to the property. Referrals to the program would come from the Colorado Foreclosure Hotline.

[44] Also highlighted for their work in Loss Mitigation.

[45] Joe Rowan of Funding Partners says they work with many lenders who cannot modify notes while satisfying investor requirements but who do have room to negotiate a short sale. The Denver Branch of the Federal Reserve is working with relevant lenders and stakeholders to coordinate the process for negotiating short sales.

The "owner" could continue residing in the property as a tenant and work towards repurchase of the property with a responsible mortgage and appropriate homeownership counseling. When homeownership is not a viable option, tenancy would be maintained with the participating CDC/authority as the owner.

As the CDC/Authority reaches its credit maximum, as established by the partner CDFI, the lines of credit would be purchased by the Colorado Housing Finance Authority and secured by a senior deed of trust and guaranteed by the CDC/Authority. The Finance Authority will hold on to the mortgages for up to seven years, sufficient time for the occupant to achieve re-purchase capacity or determination by the agency to maintain the property in their own inventory.

After a mortgage has reached seven years with the housing finance authority, the tenant may purchase the property. Some of the participating nonprofit agents will incorporate properties into existing land trusts, where they can remain permanently affordable. The housing finance authority has indicated an appetite of $30 million to $50 million. The initial pilot will most likely top out at $5 million to 10 million in lending authority, with additional commitments predicated upon performance and market demand.

The Greater New Haven Community Loan Fund is working collaboratively with other agencies and the City of New Haven to finance the acquisition of foreclosed properties and working with neighborhood CDCs and other local groups to sell them to homeowners with responsible mortgages or to responsible landlords who will provide affordable rental housing. The Loan Fund is trying to build a collaborative structure within the City to have a comprehensive response to the problem, from counseling of those with problem mortgages through neighborhood preservation activities.

The Community Redevelopment Loan and Investment Fund of Atlanta is looking at a similar strategy to the Greater New Haven Loan Fund with their developer affiliate. The CDFI's developer affiliate is to identify a neighborhood in Atlanta (with local CDC support) and apply an acquisition and rehabilitation strategy for 20 – 25 homes initially. The developer affiliate will then rent for a couple of years and then sell with the hope that many of the renters would ultimately become the respective homeowners. The CDFI would provide the seed acquisition and rehab capital and leverage additional funding.

An example of a community revitalization tool that provides incentive for homebuyers to purchase property and remain in an area is Home Value Protection. Since 2002 **Home HeadQuarters**, a CDFI loan fund and NeighborWorks affiliate, has offered protection against decreasing home values for owner-occupants in Syracuse, New York, through their Home Value Protection (HVP) program. HPV coverage requires a one-time fee, which is 1.5% the appraised value of the home; however, participating households can select the amount of the value they wish to cover, ranging from 50% to 150% of the appraised value. Any decline in value is based upon indexed price declines in the zip code at the time of sale compared to zip values at the time of coverage. Should zip prices have declined at the time of sale, HVP pays deficit based on the percentage of the property value covered. By using an index of zip values rather than the individual property, the strategy does not discourage investment in protected properties and pays even if the home with the covered value sells at a profit. The HVP contract has purchase amount restrictions and requires a minimum of three years ownership and residence in the home; breaches to this requirement on a case-by-case basis. While the program essentially offers insurance against declines in home value, the term "insurance" cannot be applied to the product due to state law.

Home HeadQuarters was part of a group that conceived of the program and though a public-private partnership had the pilot up and running within a year. NeighborWorks America®, provided support for planning and implementation of the product. The Syracuse Neighborhood Initiative, through Congressman Jim Walsh, provided $5 million in funds as a capital reserve. The Yale School of Management and others helped with program planning and HUD provided seed capital for the pilot. Other partners included Freddie Mac, HSBC, Real Liquidity LLC, and FleetBank, who in 2003 offered to pay the 1.5% premium for their borrowers who were eligible for the protection.

HVP was featured in a 2004 Wall Street Journal article. At the time, HVP had protected $4.7 million in property values across 67 properties was protected. Today, the program protects around $11 million in property values. HVP has also spurred discussion of similar programs at Freddie Mac and Fannie Mae.

Home HeadQuarter's marketing and resource development manager, Karen Schroeder, said that while local homeowners and realtors seem interested in HVP, sales have remained consistently flat for the product and there is in fact more interest from academics and governments in other markets than homebuyers and owners in Syracuse. Fortunately, Syracuse real estate, in recent history, has experienced stabilization rather than the boom-bust cycle apparent in so many markets. No holder of HVP has ever needed to be reimbursed for a decline in value upon sale of their home. The foreclosures Home HeadQuarters is seeing in the area are due in large part to job loss and medical expenses, which is typical in this market, as well as the foreclosure of homes in outer-ring areas purchased with adjustable rate mortgages. In this stable market, Home HeadQuarters is seeing steady demand for its homeowner education classes, purchase and home improvement lending products. The CDFI is developing its own mortgage products as tightening credit prevents their borrowers from eligibility for the secondary market ones.

Conclusion

The recent dramatic increase in the number of American households facing foreclosure, subsequent fall in home values, and tightening credit markets create an untenable situation. Not only does it affect households facing foreclosure but neighborhoods, investors, and individual consumers face new risks. The fallout, which is expected to continue for several years, has sent a resounding shudder through the US economy and-indeed-world financial markets.

The immediate challenge of foreclosure prevention to scale could be alleviated through incentives and/or requiring lenders/investors to be more amenable to debt writedowns on mortgages and freezing rates before they increase. These lenders could also be required or provided with incentives to devote adequate resources to their loss mitigation divisions in order to decrease the current bottleneck of servicing homeowners approaching foreclosure. Judicial modifications of first mortgages to the current appraised value of the property would also go a long way to alleviating the situation.

[46] Nasaw, Daniel. "For Some Home Buyers, a Nice Hedge." Wall Street Journal. February 3, 2004. www.nw.org/network/comstrat/homeEquity/documents/SyracuseHomeEquityProtectionProgram.pdf

Foreclosure prevention programs, such as those highlighted in this paper, require more resources in the form of direct funding and/or partners in order to market services, set up networking infrastructure, and to continue providing relevant and responsible refinancing and purchase products. Purchase products are vital so that foreclosed homes may be quickly taken off the market.

Programs that are building strategies to preserve property values in areas with high foreclosure rates while producing affordable housing require resources as well as commitments from public and private partners to see their strategies successfully implemented. While many programs, such as those highlighted in the section of this paper titled "Maintaining Value in Areas with High Foreclosure Rates," have closed in on such strategies, the key challenge is securing enough reasonable capital to maximize impact. The key challenge for the developer is securing small amounts of subsidy required to rehab the properties before making them available for affordable rental or sale. Again, the public-private partnerships and additional resources can multiply the impact of strategies that may be otherwise untenable.

There are at least two scale strategies for retaining property values and creating affordable housing currently under investigation. Some larger CDFIs are looking at financing the bulk purchase of Real Estate owned (REO) properties at a highly-reduced rate. In addition, hedge funds have approached large several large CDFIs to partner on the cut-rate purchase of poorly performing mortgage-backed securities. Either strategy presents an unprecedented opportunity for producing subsidy-free affordable housing.

While the current housing and financial meltdown has caused great hardship to a large number of Americans, the crisis has put housing, lending, and how financial markets work front and center on the national agenda. This is a crucial and ideal time to set the direction of housing and lending policy moving forward and to make investments that will not only stabilize the housing and financial markets but also bring greater equity to wealth-building opportunities for all income levels and set them in a direction that multiplies the investment long into the future.

Notes

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