COMMUNITY LAW CENTER

Lawyers for Neighborhoods

Good Morning Congresswoman Maloney, Senator Schumer, and members of the Joint Economic Committee. My name is Robert J. Strupp and I am the Director of Research and Policy at the Community Law Center based in Baltimore. I am honored to testify today concerning the impact of predatory lending and reverse redlining on low-income, minority, and senior borrowers and communities.

For over 22 years, the Community Law Center has been a leading voice in Baltimore for preventing and eradicating blight and returning vacant and abandoned property to productive use. The Community Law Center also seeks solutions to the predatory and deceptive real estate transactions that have caused foreclosures and that have led to many of the housing challenges facing communities throughout Maryland

Discriminatory practices in residential real estate are a well-documented blemish on our Country's history. It was not until 1962 that President Kennedy issued Executive Order # 11063 making Federal Housing Administration (FHA) and VA loans available to all Americans, without regard to race, color, creed, or national origin. Tragically, some homebuilders responded by no longer offering FHA and VA loans. Indeed, 5 years later, thirteen homebuilders—including three in Baltimore—were identified as violating the President's directive (See Michael L. Mark, *But Not Next Door*, Baltimore Neighborhoods, Inc, 2002, p. 20).

In 2000, at the behest of Senators Barbara Mikulski and Senator Paul Sarbanes, the United States Department of Housing and Urban Development (HUD) established the Baltimore City Flipping and Predatory Lending Task Force as a "laboratory" to develop creative solutions to the problems arising in Baltimore and nationwide from abuses in the FHA mortgage program, which was designed to help low-income families attain homeownership. The Community Law Center served as the staff for this Task Force. The Task Force was created to combat a number of residential real estate tactics that were hurting Baltimore's most vulnerable residents and neighborhoods. Relying on false and unsupportable appraisals, lenders originated FHA insured loans in amounts greatly exceeding the property's true value. Unsuspecting, trusting families aspiring to the American dream of homeownership were lured into purchasing shoddy, over-mortgaged properties that were too costly to repair and too overvalued to sell. As a result of these predatory practices, neighborhoods in the 1990s experienced rising foreclosures, bankruptcies, vacancies,, and neighborhood disintegration. The gravity of the foreclosure situation at the time is perhaps best demonstrated by the decision of the FHA to declare a moratorium on FHA foreclosures.

The Baltimore Task Force included representatives of HUD, FHA, Baltimore City Housing agencies, Fannie Mae, governmental officials, law enforcement agencies, housing counselors, consumer advocates, community leaders, and some of the regulated industries, including lenders and the real estate licensees.

As law enforcement heightened, responses to the mortgage fraud epidemic increased, and FHA loan requirements became more stringent, the abusive use of highly risky and exotic loan products to promote homeownership began to emerge.

The American obsession with homeownership at least since the administration of President Hoover. President Hoover initiated the Own Your Own Home Program, citing that "nothing [is] worse than increased tenancy and landlordism". Unfortunately, as homeownership grew, so did foreclosures: from 2% of commercial bank mortgages in 1922 to 11% by 1927. Following the Great Depression, the federal government established numerous initiatives to repair the mortgage markets and encourage homeownership. It created FHA to insure home loans and initiated the Federal National Mortgage Association (Fannie Mae) to purchase mortgages made by local banks. The federal government's regulation of the mortgage industry was born.

Homeownership requires sustainable, qualified borrowers. During the decade of the 1950s the FHA default rate increased fivefold. VA loans doubled during the same period. At the same time, the foreclosure rate on conventional mortgages remained nearly constant because non-government lenders maintained strict underwriting standards.

In 1968, responding to the turmoil in our cities, FHA was empowered by Congress to insure loans that required down payments as low as $250. The unintended consequence was blockbusting; unscrupulous investors began to buy homes in changing neighborhoods, scaring homeowners to sell quick, and then these homes would be resold to low-income and minority families at inflated prices. By the early 1970s the consequences of these practices hit home, resulting in large numbers of mortgage defaults, a 500 count federal indictment involving 7,500 FHA insured homes in New York City neighborhoods, and previously stable neighborhoods collapsing as once optimistic homeowners, now in over their heads, walked away, leaving their homes to arsonists and other criminals.

The press for homeownership opportunities continued in the 1980s when Congress passed legislation requiring Fannie Mae and Freddie Mac to buy mortgages designed for low- and moderate-income households. The intent was noble: find a way to grow sustainable homeownership among American minorities. These efforts, however, failed to regard the borrower's underlying economic ability to sustain the mortgage and obligations of homeownership. Despite the fact that by the end of the 1990s homeownership reached 66% of all households, homeownership for low- and moderate-income households and young families was declining. The most creditworthy, were now homebuyers, leaving the biggest opportunity for mortgage expansion to be the field of lower-income families and refinancing. A Maryland mortgage lender predicted in a trade article that "low income borrowers are going to be our leading customers going into the 21st century."

Homeownership has been described as wealth building, a "forced savings plan," and is recognized as the largest purchase most Americans will ever make. Not only is homeownership important economically; it is important psychologically. A Baltimore study revealed that low-income homeowners had significantly higher levels of life satisfaction than similarly situated renters. (William M. Rohe & Michael A. Stegman, *The Effects of Homeownership on the Self-Esteem, Perceived Control, and Life Satisfaction of Low-Income People,* Journal of the American Planning Association 60 ,1994 pp173-184). No doubt, personal satisfaction with one's life leads to more stable households and communities.

Encouraging increased homeownership opportunities is not irresponsible, but it is wrong to equate legitimate, flexible lending standards with irresponsible underwriting. Low- and moderate-income communities need and ought to be given opportunities to access affordable credit. As we have learned, the loan products provided to borrowers were not affordable. Rather, they were money makers for the lending industry, so much so that premiums were paid based on the risk of the loan. The riskier the loan, the more a mortgage broker was paid, and the more Wall Street paid the originating bank. This feeding frenzy continued until, much like an over-stuffed animal, the entire system exploded.

What went wrong was the misuse of loan products not designed for fixed-income low- and moderate-income families, but intended for higher-compensated, self-employed borrowers with fluctuating incomes. Nevertheless, lenders were encouraged to utilize certain "tricks of the trade," such as the use of the NINA ("no income, no asset") loans. These loans are commonly referred to as "liar loans". As we know, in 2007, Freddie Mac stopped purchasing these loans. Although it is widely believed that borrowers deliberately took advantage of these products to be untruthful on their loan applications, the reality is that, time and again, it was the mortgage brokers and loan officers who inflated the borrower's income to qualify borrowers for loans they could not afford and to redirect them to the higher risk, more lucrative, and more expensive loans. Loan applications were frequently taken over the telephone and borrowers often did not see the documents until the closing. When borrowers spoke up, they were often told "not to worry," the information did not need to be verified. Many borrowers never even saw the misstatements until much later because they were rushed through the closing process without an opportunity to review, let alone comprehend, the documents. Today, as a result of these practices and the proliferation of predatory and subprime lending, numerous cities\confront abandoned, foreclosed, and unmaintained properties. For example, Baltimore and other municipalities have filed law suits against lenders for the economic devastation caused by lending practices and lack of property maintenance. As a result of foreclosures and the ensuing vacant houses, cities like Baltimore are losing tax revenue due to plummeting home values, but must continue to provide essential services. In addition, the rise in vacant properties increases the costs for rodent control, attracts squatters and drug dealers, and contributes to the overall decline of the community.

So, were minorities "targeted?" Was this reverse red-lining? Research conducted by the *Chicago Reporter* showed that African-Americans earning more than $100,000 a year were more than twice as likely to receive a high-cost loan than a white homeowner earning less than $35,000.

The New York *Times* reported in-depth on the impact of foreclosures in the Baltimore community of Belair-Edison. The Community Law Center researches the real estate transactions in this community and provides findings to the local housing counselors to reach out to at-risk homeowners. This partnership has enabled Belair-Edison residents the opportunity to successfully obtain sustainable loan modifications and avoid foreclosure.

The *Times* article highlighted a study conducted by The Reinvestment Fund, showing that over a 4-year period (2003-2007), nearly half of the houses foreclosed on were owned by women. The National Association of Realtors reported that 40% of all home sales in 2006 were to single female buyers. The National Community Reinvestment Coalition (NCRC) determined that nearly half of these 2006 female purchases utilized subprime mortgages.

The Consumer Federation of America reported that women were 32% more likely to receive a subprime loan than men, even though male/female credit scores are comparable. The Consumer Federation of America also determined that, among high income borrowers, African-American women were five times more likely to receive subprime loans than white men. There has been considerable research conducted by NCRC, the Federal Reserve, and others to support the conclusion that minorities received a disproportionate number of subprime loans, even after controlling for creditworthiness. (i.e., see Paul S. Calem, Kevin Gillen & Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, 29 Journal of Real Estate Fin. & Econ. 393 (2004); Paul S. Calem, Jonathan E. Hershaff & Susan M. Wachter, *Neighborhood Patterns of Subprime Lennding: Eviidence from Disparate Cities,* 15 Housing Policy Debate 603 (2004)).

The mortgage crisis is felt by the senior population as well. Equity is often a senior's largest if not only asset for retirement. The devaluation of home prices severely impacts this population, delays retirement, impacts employment opportunities for the next generation, and thwarts the ability of seniors to use reverse mortgage products to supplement fixed-income elderly homeowners. According to AARP research, 28% of all delinquencies and foreclosures at the end of 2007 were on loans held by older Americans. Older African Americans and Hispanics had higher foreclosure rates than older whites. Another frightening trend highlighted by Harvard's Joint Center for Housing Studies is that today more older Americans are carrying a mortgage. Twenty years ago, 34% of Americans over 50 had a mortgage. Today, according to the study, 53% of older Americans have a mortgage. Combined with the fact that millions of elderly homeowners devote more than 50% of their income to pay for housing, this presents a troubling picture. Research indicates that some of the most financially vulnerable members of our society, such as the elderly and poor, are being hit particularly hard by the housing crisis.

Returning to Baltimore, since 2000, over 30,000 homes went into foreclosure, roughly 13% of all city households. As noted, these foreclosures have caused the city lost tax revenue, lower home values, increased crime and added expenditure for essential services and property maintenance—including rodent control and the need to board up and secure these homes from squatters and other misuse. In January 2008, Baltimore filed a complaint against Wells Fargo Bank seeking damages for the economic injuries brought upon the city's minority neighborhoods as a result of Wells Fargo's deceptive lending practices. .

Where do we go now? The FHA response a decade ago in Baltimore is worth a closer look. A national foreclosure moratorium may be the bold but necessary next step in resolving the foreclosure crisis. Although foreclosures are said to have dipped slightly in May, one in every 398 households with loans received a foreclosure filing. Filings, which include notices of default and auctions, were reported on 321,480 properties last month.

Congress alluded to a national foreclosure moratorium in the Helping Families Save Their Homes Act of 2009, Title IV § 401(a): "It is the sense of the Congress that mortgage holders, institutions, and mortgage servicers should not initiate a foreclosure proceeding or a foreclosure sale on any homeowner until . . . foreclosure mitigation provisions have been implemented and determined to be operational . . ." This provision is unfortunately not binding, but it points to Congress's recognition that a national foreclosure moratorium would give borrowers time to research and apply to loan modification programs and give lenders time to build the capacity necessary to handle the increased volume of loan modification requests.