

SAN DIEGO REINVESTMENT TASK FORCE

Analysis and Response to Foreclosures in Low-Moderate Income Communities of San Diego

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Sub-Committee Report

Bob Adelizzi
Lynn Hastings
Wendell French
George Harris III
Jim Schmidt
Venus Molina

Technical Assistance By
Steve Bouton
Schahrazad Berkland

Jim Bliesner
Reinvestment Director

ANALYSIS AND RESPONSE TO FORECLOSURES IN LOW AND MODERATE INCOME COMMUNITIES OF SAN DIEGO.

Preface

The San Diego Reinvestment Task Force (RTF) is charged with the responsibility of “monitoring lending practices and developing strategies for reinvestment”. It was formed by City Council and County Board resolution in 1977. Its specific concern is private lending and credit policies and practices in low and moderate-income communities as defined by the Community Reinvestment Act. The RTF, as a practice attempts to regularly examine available data in these communities to identify strengths and weaknesses related to economic health and to propose responses in the case of disinvestment. The RTF has evolved as a close partnership between government, lenders and the community with a sound record of success and effectiveness.

The RTF received testimony in June of 2005 regarding the impending foreclosure problem and in its three-year work plan, approved in April of 2006, directed staff to undertake further analysis and develop a strategy for response to the evidence. The RTF contracted with Steve Bouton and Associates to do a study mapping the incidents of home loan foreclosures as compared to sub prime home loans. **(ATT 1)** The research showed that communities that were predominantly ethnic and or low-income experienced higher levels of both sub prime loans and foreclosures. The research illustrated that the volume of foreclosures was and will be coterminous with the volume of sub prime loans and that the lending peak was reached in 2006. At that time it was projected that the cycle of foreclosures would last through 2009.

Over the past four months (May-August, 2007) the RTF has used its regular monthly meeting to hear evidence related to the current state of affairs with the foreclosure environment as well as to work through a sub committee to do a summary review of 1) current conditions, 2) possible causes, 3) remediation.

The source of capital for most sub-prime and the majority of predatory loans have come from unregulated mortgage lenders.**(ATT 2)** Some of those have established linkages (as subsidiaries) with major lenders while most do not. Investors have provided initial capital and long-term capital has been provided by resale of mortgages into the secondary

markets through securities. A major buyer of sub prime securities has been Fannie Mae and Freddie Mac. Other major buyers and subsequently lenders leading in foreclosures include investors and banks from Germany (Deutsche bank), France (BNP Paribas), China and Japan. Loan servicing for unregulated lenders is being done by regulated, mainstream lenders such as Countrywide and Wells Fargo) The California. Department of Corporations licenses mortgage banks to make home loans in the state but does not regularly monitor their rates or locations as required by federal bank regulators.. On a national level, several Wall Street investment firms have been negatively affected by their reliance on securitizing and leveraging financial obligations resulting in neutral or sell recommendations from market analysts. This in turn has had an ongoing negative effect on US and foreign markets.

Proposed remediation is focused on pending federal and state legislation and the need for key provisions and conditions. The need for regulations related to mortgage brokers and bankers is central to future restrictions on predatory lending. The third level of remediation is related to increased capacity of local organizations to assist residents in avoiding foreclosure. Finally the recommendations address the need to diminish the negative impacts of foreclosures on the quality of life of San Diego neighborhoods.

Background

The mortgage market has dramatically changed. Thirty years ago regulated financial institutions originated, serviced and held in their portfolio primarily 30 year fixed rate loans repaid with equal monthly-amortized payments. Their underwriting standards were as inflexible as the mortgage product itself.

In the ensuing years, the components of the business of originating, servicing, and investing were separated. A plethora of new products were introduced. Freddie and FNMA became the principal investor for so-called "conforming" mortgages. The mortgage security became a global financial product. Wall Street "sliced and diced" mortgages to offer investors the opportunity to purchase securities with different interest and credit risk characteristics that matched their unique investment criteria. A giant new industry was created. This "reengineering" of the mortgage transformed the mortgage into a commodity and created a greater demand for the product as a financial instrument."

Independent mortgage originators are paid significant fees to originate mortgages regardless of how the mortgage performs (no incentive to originate high quality loans and they often received additional incentives to originate loans with higher spreads --sub prime loans).

Mortgage service companies bear interest rate and credit risk. When interest rates change they risk losing their portfolios as borrowers refinance. Generally, they are more profitable servicing performing loans that do not require individual treatment thus creating a disincentive to counsel and work with borrowers. Often their loan-servicing contract restricts their ability to work with borrowers.

Creative and complex loan products became increasingly more risky and esoteric as low interest rates and excess global capital created a huge appetite for these products. This created a market for "sub prime loans"--higher risk loans with bigger spreads.

Although borrowers had greater access to credit, they didn't understand these new loan products they were sold. They focused on the availability of funds with affordable initial payments often at low "teaser" rates. They ignored or didn't understand that when these loans "reset" at higher rates they were unaffordable.

There was a large increase in the number of non-traditional mortgage originators, loan serving entities and investors who flocked to this new industry. Many of the new originators were often untrained, unprofessional and unscrupulous. They often targeted markets and borrowers to originate loans that paid the highest commissions. Often the borrower didn't need or understand the loan they received.

The regulatory and supervisory structure for this new industry was inadequate and unprepared. This new system worked well as long as housing demand was strong and prices continued to increase enabling consumers to either refinance or sell their homes. However, as in every strong market there is a leveling. The music has stopped. Investors will lose money, some businesses that service loans will go out of business, and the number of mortgage originators will decline and many homeowners will lose their homes and their credit rating.

Impacts on Communities

While the following events impact all communities and neighborhoods, they bear more heavily on low/moderate income communities where the foreclosure rates will be higher due to lower family incomes and predatory lending practices. Significant numbers of foreclosures are occurring and will continue for at least the next two years particularly in the more vulnerable low-income communities.

Spreads increase for mortgage debt as investors reassess the securities they own. This "flight to quality" will make capital more costly for all mortgage borrowers but particularly for low-income higher risk borrowers. Property values will decline as consumers have more difficulty selling existing homes and foreclosed real estate reenters the market at lower prices.

Foreclosed real estate negatively impacts neighborhoods, including neighborhood schools. Foreclosed borrowers will have difficulty restoring their credit rating, potentially eliminating their ability to be a future homeowner. Borrowers are uninformed about their alternatives when they are unable to make their payments. Staffs who service loans are unprepared to manage borrower inquiries. Loan counseling agencies are understaffed and under funded. Some mortgage lenders have gone bankrupt and left properties unattended. Large volumes of foreclosures with a declining market and restriction of credit may lead to serious blight conditions in some communities.

All of these factors contribute to potential decline in the quality of life in low and moderate-income communities as they have received the highest levels of concentrated sub prime loans and consequent foreclosures. Absentee owned, foreclosed properties, vacant and not regularly managed represent a serious problem and could cause further decreases in property values and increases in crime. The need to monitor and respond to this situation on a local level is significant.

Possible Causes

- There is not one but rather a spectrum of causes ranging from the individual borrower speculation to federal monetary policy.
- Unregulated funds from new state licensed mortgage lenders, many of which are no longer in business, offered highly competitive sub-prime and predatory loan product.
- Home mortgage brokers being paid double and triple commissions for sub prime and predatory home loans targeted at low income and ethnic borrowers.
- Lack of state supervision or authority to regulate interest rates and loan terms coupled with a lack of intent to do so.
- Absence of supervision over Fannie Mae and Freddie Mac and their policies related to securities purchase of sub prime and predatory home loan products.
- Indications of intentional targeting of low income and ethnic communities by mortgage brokers for sub prime and predatory products resulting in concentrations of these loans and subsequent foreclosures.
- No national regulations related to securities and leveraged finance obligations for Wall Street investments

Current Conditions

- Ongoing increases in foreclosures of single-family homes with highest concentrations in low income and ethnic dominant census tracts and predominantly sub prime products. **(ATT 3)**
- Ongoing decrease in property values. **(ATT 3)**
- Decreased access to home mortgage credit. **(ATT 4)**

- An ongoing fluctuation in securities markets which alternately increase and decreases homebuyer credit access and destabilizes lending industry on Wall Street. (ATT 4)
- Continuing failure of state licensed mortgage lenders. (ATT 4)
- Disappearance of 42,000 mortgage brokers nationally with proportionate share in the SD region. (ATT 5)
- Slowly evolving federal legislation (ATT 6) with primary response coming from Federal Reserve Bank release of discount credit to member banks which is intended to infuse more capital into home mortgage lending thereby encouraging refinance and new mortgage borrowing.
- General lack of adequate funding for local non-profits to do early intervention home mortgage foreclosure counseling in spite of local efforts to coalesce these services and increase skills.

Recommended Actions

Local Actions

- The RTF should work with City and County housing agencies to examine the feasibility of creating a regional land bank to purchase foreclosed, bank owned properties on the market over nine months for the purpose of establishing first time affordable homebuyers initiative.
- Request that City and County CDBG Departments seek to increase grant making to non-profits involved in financial education and home loan foreclosure (HUD certified).
- The RTF should work in collaboration with United Way, San Diego Foundation and major lender foundations to increase funding and capacity of non-profits providing financial education to build skills in foreclosure prevention.
- The RTF should work in partnership with local non-profits and state coalitions to negotiate with major lenders for reasonable workout programs and loan products for customers experiencing foreclosure.
- Request that the city, county and state legal authorities develop an enforcement strategy for interdicting, reducing and removing predatory mortgage lending practices in the region including the review of potential securities violations.
- The RTF should request that the City and County establish an ordinance regarding inspection and monitoring of foreclosed properties for code violations and on going maintenance.

- The RTF should request that County Tax Assessor monitor and notice delinquencies in tax payments with bank owned/ foreclosed properties.

Legislative/Administrative

- Request that City and County lobbyists pursue federal and state legislation which;
 - provides increased funding of non-profits for foreclosure counseling
 - establishes rules and regulations for unregulated mortgage companies and brokers
 - applies the Community Reinvestment Act to credit unions, mortgage companies
 - expands lending capacity of VA and FHA for foreclosure alternatives
 - increases oversight of securities markets, mortgage brokers and state licensed mortgage lenders
- Lobby for State Department of Corporations and Banking to establish regulations for mortgage brokers and mortgage lenders that define standards for full disclosures, restrict steering and misrepresentation.
- The RTF should work with appropriate congressional offices to request that FNMA and Veterans Administration modify loan limits to adjust for cost of housing in the San Diego market.
- The RTF should work with appropriate congressional offices to encourage FNMA and Veterans Administration to develop foreclosure alternative loan products, to engage in aggressive marketing efforts and to include financial education assistance through local non-profits.
- Request that Federal Reserve Bank or appropriate legislation establish guidelines for hedge funds and securities that are related to sub prime single home mortgages.

- ATTACHMENT 1 - summary-RTF Report by Bouton and Associates
- ATTACHMENT 2 - diagram of sub prime capital sources
- ATTACHMENT 3 - charts illustrating foreclosures and property values
- ATTACHMENT 4 - article and charts from EIR regarding securities markets and FRB capital access
- ATTACHMENT 5 - quote from HUD official
- ATTACHMENT 6 - NCRC legislative chart