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Federal Policy Recommendations to Help New York Homeowners

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I. Introduction

Subprime mortgage lending triggered the foreclosure crisis. Subsequent declines in the economy and in home values are increasing the risk of mortgage default and foreclosure. Following is a summary of the present outlook and most current proposed solutions taken from industry analysts, regulators, scholars and the media.

II. Grave National Predictions

Credit Suisse, the international financial services conglomerate, issued a report in April 2008 on foreclosure trends in the United States, projecting approximately 6.5 million foreclosures by the end of 2012.¹ An updated report in December 2008 increased that number to 10 million, factoring in a rising unemployment rate of 9 percent and continuing declining home values. In September of 2008, almost half of subprime borrowers were “underwater” - in mortgages with higher outstanding principal balances than the value of the property.² By 2011, Credit Suisse expects this number to rise to 72 percent. Homeowners who owe more than their house is worth may be compelled to default and walk away from their home.³ If drastic measures are not taken immediately to stem the rise, Credit Suisse predicts that by 2012, one out of every six households with mortgage debt will be in foreclosure.⁴

¹ Rod Dubitsky, Larry Yang, Wen Zhang, and Thomas Suehr, *Foreclosure Trends—A Sobering Reality*, Market TABS Fixed Income Research, April 22, 2008, at 6. Available at <http://portfoliomx.com/pdf/Credit%20Suisse%20Fixed%20Income%20Forecast%2022Apr2008.pdf>.

² Rod Dubitsky, Larry Yang, Stevan Stevanovic, and Thomas Suehr, *Foreclosure Update: Over 8 Million foreclosures expected*, Fixed Income Research, December 4, 2008, at 1. Available at <http://www.nhc.org/Credit%20Suisse%20Update%2004%20Dec%2008.doc>. Estimates vary, for example Zillow estimates that one in six (17.6 percent) of all homeowners had negative equity; a number up from 14.3 percent at the end of Q3 2008. Jackson, Paul, “One in Six Borrowers Underwater on Mortgage, Zillow Says” (February 3, 2009) available at <http://www.housingwire.com/2009/02/03/one-in-six-borrowers-underwater-on-mortgage-zillow-says/>.

³ See, *Id.* at 3.

⁴ *Id.*

III. New York's Delinquency and Foreclosure Rates

Though overall, New York seems to be faring better than many states, ranking 39th in the country in terms of foreclosure numbers, the data predictions are still not good for our state. The most current report is that produced by HALT, the Governor's Interagency Task Force *To Halt Abusive Lending Transactions* as of December 31, 2008. According to that report, as of the 3rd quarter of 2008, almost **45,000** New York homes were in some stage of the foreclosure process (a 43 percent rise from 2007).⁵ **One-third** of all subprime loans were 90 days or more past due, with the number continuing to rise.⁶

As of the 3rd quarter of 2008, New York fell below the national average in all categories of loans being 90 or more days past due *except* for subprime adjustable rate mortgages ("ARMs"):

Table 1: Mortgage loans 90 days or more past due: NY/US comparison

	<u>New York</u>	<u>US</u>
All loans	1.61%	2.20%
All prime	.80%	1.29%
All subprime	5.65%	7.01%
Prime ARMs	5.46%	8.09%
Subprime ARMs	32.18%	28.84%

Halt Report. Source: MBA National Delinquency Survey

We have also seen a dramatic increase in foreclosures in New York, as charted in the following table showing the increase of loans in foreclosure by various loan categories. *Nearly 25 percent of NY subprime ARMs are in foreclosure, exceeding a national rate of about 21 percent:*

Table 2: NY mortgage loan foreclosure rates: 2006/2008 comparison

	<u>Q1 2006</u>	<u>3Q 2008</u>
Prime fixed	0.34%	0.71%
Prime ARMs	0.6%	3.57%
Subprime fixed	2.47%	5.49%
Subprime ARMs	4.72%	24.51%

Halt Report. Source: MBA National Delinquency Survey

⁵ HALT: The Governor's Interagency Task Force *To Halt Abusive Lending Transactions* Report as of December 31, 2008, submitted by Richard H. Neiman (NY Superintendent of Banks) and Deborah VanAmerongen (Commissioner, Division of Housing & Community Renewal), at 3.

⁶ *Id.*

In addition to the increased default and foreclosure rates in New York, the HALT report highlights another significant problem – by the end of 2008, **79 percent** of the foreclosures in New York were concentrated in the top ten counties of the State; with Queens and Brooklyn accounting for 25 percent of all filings and Long Island comprising 20 percent.

Table 3: NY Counties with highest foreclosure rates

Top 10 counties account for 79% of filings:			
1. Queens	7,743	6. Westchester	2,429
2. Suffolk	5,621	7. Richmond	2,223
3. Kings	5,391	8. Erie	2,184
4. Nassau	3,722	9. Orange	1,301
5. Monroe	2,625	10. Bronx	1,990

HALT Report at 15. Source: RealtyTrac®

IV. Home Price Declines in New York

New loan originations have dropped in New York by **22 percent**.⁷ However, New York has fared better than other states when it comes to home price declines, declining by **7 percent** overall in NY compared to a 21 percent national decline.⁸ Yet, as with foreclosures and delinquencies, this price decline still poses a significant problem for our state. Looser underwriting standards of lenders in the last several years allowed homeowners to finance 90 to 100 percent or more of the value of their home. Declining housing values inevitably mean that more homeowners are paying on mortgages that are more than the value of their homes. For some, it may necessarily mean that walking away from their home makes more economic sense for them than continuing to make payments on a depreciating home.

⁷ *Id.* at 3.

⁸ *Id.* at 8.

Table 4: NY home price index

OFHEO Home Price Index by Select NYS MSAs

(base quarter/year is 1Q 1995)

	Home Price Index			% Change HPI		
	3Q2006	3Q2007	3Q2008	3Q2006-3Q2007	3Q2007-3Q2008	3Q2006-3Q2008
US	379.4	387.3	369.4	2.10%	-4.60%	-2.64%
Northeast	615.2	611.5	585.2	-0.60%	-4.30%	-4.88%
NY	650.1	661.3	636.1	1.70%	-3.80%	-2.15%
Albany-Schenectady-Troy	191.9	201.1	200.91	4.80%	-0.10%	4.70%
Binghamton	166.3	176.7	189.25	6.20%	7.10%	13.80%
Buffalo-Niagara Falls	141.1	146.1	149.95	3.60%	2.61%	6.27%
Elmira	147.1	152.5	150.27	3.70%	-1.48%	2.15%
Glens Falls	203.3	216.7	221.4	6.60%	2.15%	8.90%
Ithaca	194	193.8	202.03	-0.10%	4.25%	4.14%
Kingston	273.8	276.6	262.5	1.00%	-5.10%	-4.13%
Poughkeepsie-Newburgh	297.7	297	238.08	-0.20%	-19.85%	-20.03%
Rochester	136.9	139.6	139.41	2.00%	-0.14%	1.83%
Syracuse	157.3	162	166.24	3.00%	2.60%	5.68%
Utica-Rome	155.2	167.4	170.35	7.80%	1.75%	9.76%
Nassau-Suffolk	297.5	295.7	277.76	-0.60%	-6.07%	-6.64%
New York-White Plains-Wayne	271.9	276.1	263.07	1.60%	-4.72%	-3.25%

Definition: The Home Price Index is a weighted, repeat-sales index, meaning that it measures average price changes in repeat sales or refinancings on the same properties (as found at: <http://www.ofheo.gov/hpi.aspx?Nav=269>.) The base quarter/year for these indices is 1Q 1995.

Original Source: HALT, The Governor's Interagency Task Force to Halt Abusive Lending Transactions. Report as of December 31, 2008. Submitted by Richard H. Neiman, New York Superintendent of Banks, which obtained the data from the Office of Federal Housing Enterprise Oversight (OFHEO).

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V. Recommendations for Federal Proposals

Many proposals are being discussed with the end goals being to stabilize the housing market and to stimulate the economy. Unfortunately there is no “one size fits all” solution, particularly now as the increase in foreclosures is due to a falling economy as much as it is a consequence of the subprime lending boom. All solutions must be aimed at: (1) stopping the growing surge of foreclosures and keeping people in their homes, and (2) getting more money into the hands of consumers to spend in our economy.

a. Stopping foreclosures

Loan modifications that make monthly payments affordable must be achieved and must be done on a mass scale. Despite rhetoric by the industry that they are trying to work with homeowners and that it is better for them to keep people in their homes, even the best attempts are not working.⁹

Homeowners need affordable loans. ***Incentives must be instilled in all future distributions under TARP to mandate that those receiving TARP funds modify loans in volume and do the modifications using an affordability standard.*** Proposals as set forth originally by the FDIC that aim at reducing the monthly payment to a 31 percent to 38 percent debt to income ratio offer a start. We are at a point where it is accepted by both regulators and the industry that interest rates need to be lowered, though unfortunately, this is still being achieved only on a case-by-case basis. Investors need to start bulk interest rate reductions.

b. Principal Balance Reductions

Less widely accepted than interest rate reductions is the need for principal balance reductions. There are two pieces to this problem. First, many homeowners, particularly subprime borrowers, were sold loans based on inflated appraisals. This seems to vary based on geographic region in New York but we know that large pockets of communities are “underwater” in their homes, owing more than what the home was actually worth at the time the loan was made. At its very core, it is a matter of fundamental fairness that these inflated appraisal loans be cured.

Second, many homeowners now find themselves “underwater” because of the economic crisis and decreasing property values. As the Credit Suisse report, as well as scholars, points out, there is a growing economic disincentive for these homeowners to continue to pay on mortgages that far exceed the value of their homes.

This is why we support the bankruptcy reform proposals currently before Congress that would allow judges to “cram down” and modify the mortgage debt to the fair market value of the home. Even if this legislation passes, this tool alone will not solve the problem. Bankruptcy is a complicated process and, according to Credit Suisse, may only be a valuable cure for about 20 percent of

⁹ OTS and OCC data indicate that over 50% of the mortgage loans modified in the first quarter of 2008 were thirty or more days in default within six months. Office of the Comptroller of the Currency and Office of Thrift Supervision, United States Department of the Treasury, *OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, Third Quarter 2008*, at 5. Available at <http://www.occ.gov/ftp/release/2008-150a.pdf>. In a sample of 3.5 million loans, more than half the modifications did not result in lower payments for borrowers, and that principal debt actually increased for homeowners. Alan M. White, *Deleveraging the American Homeowner: The Failure of 2008 Voluntary Mortgage Contract Modifications* (January, 09 2009). Connecticut Law Review, Forthcoming, at 5. Available at SSRN: <http://ssrn.com/abstract=1325534>.

the problem loans. Again, investors holding these loans must be incentivized to lower principal balances, starting with attaching conditions to TARP and other federal intervention such as tax policy.

c. *Mortgage Servicers*

Mortgage servicers are the companies who interface with the homeowner collecting payments and proceeding with loss mitigation options and foreclosure when borrowers fall behind. They do not own the loans but rather are contracted to work on behalf of the investors. Their authority to work with homeowners and approve remedies such as loan modifications is limited by the agreements they have with the investor of the loan. In addition, the compensation structure for servicers, who profit from the fees and costs incurred when a loan defaults further deters servicers from working with homeowners to find solutions to keep them in their homes.

These fundamental ailments in the system must be fixed. Just as the industry relied on mortgage brokers to make their loans, with perverse financial incentives for brokers to make inflated and unaffordable loans, mortgage servicers with similarly counter-productive compensation structures are being relied on to orchestrate the remedies. Practical problems with servicers including run-around toll-free numbers, a serious lack of resources to service the growing number of homeowners in default and outdated loss mitigation options that were developed in an era of economic boom that don't meet the reality of homeowners today are additional obstacles.

These impediments are not insurmountable and can be righted by Congress through regulation, as well as through conditions tied to financial assistance through TARP to the financial services industry.

d. *Economic Stimulus Provisions*

The mortgage lending world cannot be viewed in a vacuum. Increasingly, Americans have been paying more of their disposable income to banks for the servicing of debt. Lower monthly mortgage payments and lower total mortgage debt obligations will immediately return assets to homeowners that they can rely on for wealth-building – one of the fundamental reasons for promoting homeownership in America.

More immediately important for the economy, lower payments and debt will ensure more disposable income for New Yorkers, income we believe that primarily will go back into our state and local economies. Though all economic classes have been affected by the crisis, reduced mortgage debt particularly will impact middle and lower-income New Yorkers who are in need of extra money to make it through this economic crisis.

It is critical also to recognize that the banks and investors holding mortgage debts are the same players who hold our credit card debt, car loans and

manage our bank deposits. We must begin to look to other areas in which disposable income has increasingly been weaned from consumers to go into the hands of financial institutions. TARP conditions could also be established and/or Congress could regulate the interest rates and fees that consumers are being charged in the broader realm of financial transactions. Again, it is a matter of fairness, as well as of keeping money in the hands of American spenders to put back into the broader economy.

VI. Conclusions

The first step to re-building our economy is stabilizing the housing crisis. Only then will foreclosures decrease, housing prices rise again, and families and communities be able to once again depend on their greatest wealth-building assets. Following is a summary of our five primary recommendations:

- Condition future TARP disbursements on participation by the industry in making long-term affordable loan modifications for homeowners on a large-scale basis.
- Require the US Treasury Department to develop meaningful mass loan modification programs.
- Support reform of the bankruptcy code to allow judges to reasonably modify primary residence mortgage debt to the value of the security interest (the home).
- Regulate mortgage lending to ensure fairness and prevent unfair and deceptive practices in the future.
- Regulate credit card practices, bank fees and other financial services to prevent an irrational drain of disposable income from consumers to the banks.