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Californians steel for collateral damage from subprime mortgage implosion

Civil rights violations are seen as foreclosures continue to worsen in 2008

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As California continues to reel from the subprime mortgage implosion, the ripple effects are adding to the pain. The extent of the damage is so pervasive that it promises to touch the lives of all Californians.

California is one of the nation's hardest-hit states. Nearly half of all subprime lenders are headquartered here. The high cost of real estate in California meant predatory lenders could reap higher profits here than in states with moderately priced housing. And California's white-hot housing market meant lenders could find countless home buyers desperate for a way to buy their first home, or to use their equity to meet the state's high cost of living.

"Housing affordability is a problem here," said Kevin Stein, Associate Director of the California Reinvestment Coalition in San Francisco. "Borrowers are more desperate, so lenders can make a lot more profit here than they can in other states. And regulatory oversight was lax in California, so consumers were not protected."

With the rate of foreclosures expected to worsen in 2008 as a record number of predatory loans reset at dramatically higher interest rates, the glut of unsold homes will continue to ravage property values throughout the state, especially in the Central Valley where the rate of foreclosure is highest. Consumer spending will drop as worries about the economy grow.

A record budget shortfall

With California facing a record budget shortfall, the timing couldn't be worse. Consumer advocates are bracing for cuts in social services and infrastructure as money for schools, police and other basic government services evaporates.

A report released by the House and Senate Joint Economic Committee reveals more than one million subprime loans in California. The report estimates a direct loss in property value of more than $18 billion in California alone, with an additional impact on neighborhood property values of nearly $5.5 billion.

Nationwide, the study estimates a $71 billion loss in housing wealth due to foreclosure, with an additional $32 billion reduction in the value of neighboring properties. The report can be found at http://jec.senate.gov/Documents/Reports/10.25.07OctoberSubprimeReport.pdf.

Californians are already feeling the impact of declining property values on their quality of life, as abandoned homes are taken over by drug dealers and crime moves into new neighborhoods. Because predatory lenders often target people of color, immigrants with limited English proficiency, and seniors for high-cost loans, vulnerable communities are feeling the brunt of the devastation. Ironically, only foreclosure guarantees a way out of affected neighborhoods, as falling property values make it impossible for others to sell and leave.

The impact of foreclosures

Foreclosures are also having an impact on the 25 percent of Californians who live in common interest developments. Distressed homeowners scrambling to save their homes often scrimp on homeowner association dues, creating shortfalls that must be made up by their neighbors.

The focus on homeowners has obscured the impact foreclosures have had on tenants. Often, they are the last to know that the bank is about to foreclose on their home. They face eviction and often find it impossible to recover their security deposits from their dispossessed landlords.

As lenders find it increasingly difficult to sell foreclosed properties, some are beginning to weather the storm by renting their properties to produce income. As a result, subsidized housing tenants with Section 8 vouchers are moving into new neighborhoods, where they sometimes encounter resentment.

Tensions rising

After multiple complaints of police harassment and racial tensions in Antioch, legal aid attorneys teamed up with Public Advocates to investigate. They recently released the results of their five-month investigation.

"The data shows that African-American families in Antioch are four times more likely than white families to be investigated by the Antioch Police Department's Community Action Team," said Public Advocates staff attorney Elisabeth Voigt. "We found disturbing evidence of racial profiling, as well as attempts to terminate the housing rights of law abiding African-American Section 8 families."

The Antioch police department has denied allegations of racism, insisting that police officers are simply responding to citizen complaints. The controversy remains unresolved and is not confined to Antioch. In northern Los Angeles County, similar tensions in Antelope Valley have arisen between predominantly white residents and new arrivals with Section 8 vouchers, who are disproportionately African-American. The story is bound to repeat itself in communities across the state and the nation as Section 8 holders start to rent homes in predominantly white enclaves.

Solutions exist

Despite this dire picture, clear solutions exist if only the political will can be mustered to implement them. To be effective, solutions will have to address both the current needs of subprime borrowers, as well as reforms to prevent the same fiasco from recurring in the next housing market upturn.

First, as several presidential candidates have proposed, a moratorium on foreclosures is urgently needed to stem the hemorrhaging while solutions are put in place. Thus far, only Massachusetts has seen fit to protect its residents with a foreclosure moratorium. Given the enormous amounts of money lenders contribute to California elected officials, we're unlikely to see a moratorium imposed in our state.

With nearly 500,000 California subprime loans scheduled to reset at dramatically higher interest rates in 2008, the sheer number of distressed homeowners who are or will soon face foreclosure demands a systemic, broad-based approach to transform predatory mortgages into sustainable loans. Thus far, the shortage of housing counselors has meant that many homeowners have had to approach mortgage servicers on their own.

The results have been dismal. A survey conducted last year by Moody's Investor Service found that most mortgage servicers had only modified approximately one percent of their loans that reset in the months of January, April and July 2007.

Restructuring loans

Federal Deposit Insurance Corporation Chair Sheila C. Bair has advocated that all subprime mortgages services simply restructure all subprime adjustable interest rate loans to borrowers who are current in their payments but won't be able to afford the higher amounts due when their interest rates go up. Bair wants mortgage servicers to convert all such loans to fixed rate ones at interest rates that will allow a reasonable profit and still be affordable to the borrower.

"This would be no bailout," Bair wrote in a New York Times op-ed published on October 17, 2007. "These borrowers would still be required to make their monthly payments – at rates higher than what prime is today. Billions in savings would be generated by avoiding the administrative, legal, marketing and other costs of foreclosure, which can run to half or more of the loan amount. And avoiding foreclosure would protect neighboring properties and hasten the recovery of markets burdened by an excess supply of houses."

The full text of Bair's op-ed appears at http://www.nytimes.com/2007/10/19/opinion/19bair.html?ex=1350446400&en=c1fcc3bfe785528e&ei=5124?ner=permalink&exprod=permalink.

Hope Now Alliance Plan

Bair's common-sense approach was never adopted. Instead, the Bush Administration, after months of inaction, finally unveiled its Hope Now Alliance Plan.

Unfortunately, the Bush plan does more to benefit lenders than borrowers. First, it's completely voluntary – lenders can ignore it.

Second, borrowers must owe at least 97 percent of their home's value to participate in the plan. Due to the deadly combination of inflated appraisals at closings and falling home prices since, many eligible homeowners owe more than their home is currently worth. If those families don't plan to stay in their homes long enough for home prices to rise again, many would be better off simply walking away from their loans.

Third, the Bush plan bars participation by borrowers with strong credit scores. It shuts out the 40-50 percent of subprime borrowers who qualified for prime loans but were steered to high-cost mortgages by predatory brokers who sought the higher fees available from subprime loans. Ironically, these borrowers might feel tempted to miss a few payments to join the ranks of borrowers whose weak credit scores make them eligible for relief.

In contrast, a bill that would help borrowers and hold predatory lenders accountable for their greed faces tough

opposition from the Bush administration. Current bankruptcy law allows judges to modify the terms of mortgages for vacation homes to enable owners to keep their homes. But judges are barred from making any changes in mortgages for primary homes.

The result is that owners sufficiently wealthy to afford two homes are eligible for relief that single-home owners are barred from enjoying. The bill in question would amend federal law to empower bankruptcy judges to order the same loan modifications for primary homes as they do for vacation homes.

Absent a change in bankruptcy law or the willingness of lenders to voluntarily modify predatory loans, homeowners who want to avoid foreclosure must scramble to refinance their home. The federal government could help by offering a reasonably priced refi product, and a bailout fund to help borrowers make their current payments until they refinance. But the Bush administration remains hostile to both ideas.

That means distressed homeowners must find their own solutions. To do so, they need to become sophisticated consumers by learning about how mortgages work, and the specific loan modifications they'll need from lenders to be able to afford their monthly payments. And they'll need to acquire this expertise from people they trust, a difficult task given the exploding number of foreclosure rescue scams that prey on the unwary.

The California Reinvestment Coalition has asked California lawmakers to provide a $10 million fund to increase the number of HUD-certified housing counselors, who offer free advice to troubled homeowners with unaffordable mortgages. To be effective, the legislature should pass authorizing legislation that provides such a fund as an urgency measure, which requires a two-thirds vote in the Senate and in the Assembly. Otherwise, the funds won't be available before 2009, because all California bills that are not urgent become effective the January after enactment. By that time, foreclosures will have peaked, tens of thousands of families will have lost their homes, and worst-hit communities will be marked by abandoned properties and soaring crime rates.

Help available

Not content to wait and see if legislators agree to pay for more housing counselors, the California Reinvestment Coalition persuaded lenders to donate $4.6 million. The funds will start covering the salaries of new California housing counselors as early as February.

The legislature's inability to enact meaningful solutions in 2007 has motivated some California cities to develop their own remedies. OneCalifornia Foundation recently announced a new initiative to help Oakland homeowners avoid foreclosure. The Foundation's Community Homeownership Fund will offer Oakland residents a flexible line of credit via deferred-interest loans that need not be repaid for ten years, unless the homeowner sells or refinances the home.

To be eligible, a family must live in the home, be current on their payments, and demonstrate that they won't be able to cover their loan when it resets to a higher interest rate. The family must also undergo financial counseling. More information about the Fund is available by visiting http://www.onecalif.com/onecalfoundation.aspx and clicking on "news articles about OneCal's CHF."

Cities may also want to protect their residents from foreclosure by borrowing a page from San Francisco's Project Connect. Started by Mayor Gavin Newsom, Project Connect periodically brings volunteer attorneys, social workers and others together to provide a one-stop service center for homeless people.

The same convenient help can be provided to desperate homeowners by bringing together volunteer consumer attorneys who can screen loan documents for Truth in Lending Act violations. Such mortgages can be rescinded, and statutory attorneys' fees and costs are available to cover legal fees. Volunteer fair housing attorneys can similarly screen clients for Fair Employment and Housing Act violations, which also offer remedies that include attorneys fees. Housing counselors can provide information about mortgages, and suggest options available to homeowners whose loans are legal but unaffordable. And lenders with affordable rescue products can educate homeowners about how they might qualify to refinance their loans.

State and local governments can also offer help to tenants who face eviction when their landlords can't afford their mortgage payments. New laws are needed that guarantee tenants at least four to six months' notice that they will have to move, require the return of security deposits before the lender reclaims a foreclosed property, and provide tenants with funds they may need to locate, lease and move into new housing. Given the scarce amount of accessible housing, tenants with disabilities should be given additional time to find new homes.

A one-stop service center can also help state and local governments enforce fair housing laws by identifying lenders and brokers who discriminate by targeting subprime loans to people of color, immigrants with limited English proficiency and other people protected from predatory lending under California's Fair Employment and Housing Act. The Department of Corporations and the Department of Real Estate, which receive complaints from consumers, can also identify predatory lenders and brokers whose names surface again and again.

The names should be given to the Department of Fair Employment and Housing, which receives federal funds to prosecute fair housing and fair lending cases. DFEH should alter its website to let visitors know that it will prosecute fair lending violations, and should add information about predatory lending to the publications available on its site.

California is facing an unprecedented financial disaster that will ruin the lives of affected homeowners and

ravage entire communities. Much more needs to be done, and done quickly.

For more information about how plaintiff attorneys can help, please see the September 2007 edition of *Public Interest Forum*. For information about what other states have done to protect residents from the subprime mortgage meltdown, please see the October 2007 edition of this column. Governor Arnold Schwarzenegger's $1.2 million public awareness campaign, and what Assembly Democrats plan to introduce in the 2008 legislative session, are both covered in last month's *Public Interest Forum*.

Resources for homeowners:

• HOPE Hotline: 1.888.995.HOPE (www.995hope.org) provides free mortgage counseling and operates 24 hours a day, seven days a week.

• www.yourhome.ca.gov

• www.sucasa.ca.gov (en Español)

• http://adc.asm.ca.gov/issues/MortgageCrisis

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