State Policy Responses to Foreclosure: 2008

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for the Pew Center on the States

Executive Summary

State governments are playing an increasingly critical role in creating solutions to the rising levels of foreclosures occurring in many communities. State and local leaders understand firsthand the direct and indirect harm that foreclosures can impose on neighborhoods and families. The majority of states have passed legislation that regulates lending for high-cost loans, and more than a dozen have set up programs designed to help distressed borrowers before and during the foreclosure process.

This report is based on a review of state laws and regulations, interviews with key informants, case studies of selected state programs and existing reports on foreclosure prevention strategies. It provides a snapshot of the current policy environment as of late 2007, amidst growing media attention regarding the problems within financial markets that are stemming in part from the subprime mortgage market. The emphasis of this report is on foreclosure prevention strategies that support homeowners and neighborhoods, rather than issues related to investment and financial markets or lending policies among banking institutions. State policies are playing a key role in attempting to address and mitigate the effects of mortgage foreclosures.

This report summarizes current efforts across the 50 states and District of Columbia, and highlights a wide range of approaches. These approaches vary based on the needs of the community; some areas are struggling with job losses and weakened economies, while others have housing markets that have progressed rapidly through a boom and bust cycle.

Reducing the Number of High-Foreclosure Loans Being Made

- ✓ Regulations on loan products
- ✓ Recommendations for consumer education and counseling
- ✓ Requirements for consumer counseling
- ✓ Licensing for mortgage providers (lenders and/or brokers)

Improving the Odds that Consumers can Manage a Mortgage Default

- ✓ Increased public awareness so borrowers know to seek help when facing default
- ✓ Consumer counseling hotlines and funding for counseling capacity
- ✓ Mandates for early borrower notification of available assistance
- ✓ Encouragement for lenders to modify defaulted loans to increase homeownership sustainability

Reducing the Harm of Foreclosure

- ✓ Regulations that prevent foreclosure rescue scams
- ✓ Publicly-supported short-term loans for borrowers facing income reductions
- ✓ Publicly-supported mortgage refinance funds for borrowers in default
- ✓ Programs designed to mitigate the harm of vacant foreclosed homes

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Strategies can be grouped into three categories. First are those designed to reduce the number of loans that put families at risk of foreclosure include policies to restrict overly capricious loans, education that helps consumers make more informed choices when applying for and closing on a mortgage, and policies that are designed to regulate the behavior of loan providers. Another set of policies aims to help borrowers who have fallen behind on their payments. These policies include connecting borrowers with counseling services, facilitating loan workouts where lenders restructure the loan and offer lower payments to the borrower, and special loan or grant programs that help borrowers bring their loan current. The final set of policies is aimed at helping those who are not able to become current on their mortgage. Some states are looking into programs that address the high number of vacant buildings that are left after homeowners enter into foreclosure, while others are considering loan funds to help borrowers regain their financial footing. In addition, many states have seen a dramatic increase in the number of so-called "foreclosure consultants" and are working to limit these unscrupulous consultants by restricting their activities.

The costs related to foreclosure can be high for both families and communities. Missed payments are generally reflected in credit reports, which can impair a borrower's ability to use short-term loans. Borrowers who loose their homes to foreclosure or seek bankruptcy may have severely damaged credit records, which will restrict their access to loans for several years. In addition, these borrowers suffer financial losses on the home. Foreclosure can also have negative social and emotional impacts on families as they lose their home and are forced to move. The impacts related to foreclosure also spill over into neighboring areas. It is common for homes to fall into disrepair during the default and foreclosure process. In addition, foreclosed-upon homes often sell at lower amounts than nearby homes, depressing neighborhood values. As the number of homes facing foreclosure in a particular area increases, the overall value of the neighborhood decreases. To the extent that homes remain vacant during the foreclosure process, properties may become a magnet for criminal activity, adding further blight to the neighborhood. These external costs can be significant for local communities.

States with greater potential for foreclosure problems can be identified based on an analysis of subprime home mortgage lending activity in 2005 and foreclosure incidence in 2007. Still, all states have some exposure to loans with high probabilities of foreclosure. Moreover, it is becoming clear that foreclosures are not limited to the subprime portion of the market; loans with adjustable rate features – even among borrowers with good credit by traditional standards – are experiencing rising levels of default as well. This makes it more difficult to ignore foreclosure as an issue impacting a more than just a subset of the population. Most existing state foreclosure programs are modest in scale, although some could expand given the availability of resources. While many of the state foreclosure intervention policies and programs reviewed could be replicated in other states, not all strategies are appropriate for all areas. Strategies that educate consumers or prevent problem loans from being made, however, have broader applicability.

As of late 2007, efforts at the national level are promising, but do not obviate the need for continuing efforts at state and local levels. States are likely to continue to be at the vanguard of addressing issues of high risk lending and foreclosure.

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1.0 Introduction

For nearly a decade, consumer and housing advocates have been issuing reports suggesting that too many American families have become embroiled in risky mortgage loans. In 2007, the debates over predatory lending practices, mortgage fraud, aggressive loan marketing and high-cost subprime loans came into the mainstream media, as financial markets began to reassess the scale and risks associated with mortgage lending. Much of the media attention has been on the solvency of lending institutions as well as the pervasive nature of modern credit markets (where the performance of home loans in Arizona impacts investors in Europe and Asia). Meanwhile, the focus of state and local policies has remained on homeowners in foreclosure as well as on the neighborhoods in which foreclosed-upon properties are located. Although state and local governments have been crafting policies to address high-risk lending and foreclosures since the late 1990s, the current environment – with rapidly rising foreclosures and intense media attention – has increased the pressure on states to adopt effective strategies to reduce the incidence of high-risk loans, provide support services to borrowers and mitigate the harm associated with this issue.

States are employing a range of strategies that prevent mortgage loans at high risk of foreclosure from being made, help consumers make informed choices in the mortgage marketplace, screen out malicious sellers of mortgage products and help borrowers who have begun the foreclosure process. None of these approaches equates to a silver bullet or inoculates a community from foreclosures. However, in combination, when they are tailored to the unique needs of a state's housing and mortgage market, state policies can address foreclosure as a social and economic issue especially within minority communities where high-risk lending tends to be concentrated.

1.1 The Foreclosure Crisis

The media has dubbed the current situation a "subprime mortgage crisis." Stories of fraudulent loan brokers, as well as greedy or inept borrowers frequently are used as prototypes of the typical foreclosure situation. While these cases do exist, the current and upcoming foreclosure trends will be much more complex.

The mortgage market has undergone a rapid transition in the last 20 years. Mortgage lending has shifted from a business conducted by over 10,000 lending institutions to a business where just a few dozen lenders dominate. The source of capital for loans has moved from deposits made by consumers and business, to bonds issued in financial markets. Loans today are more frequently made by independent brokers who are working on behalf of multiple lenders and are compensated based on the size and terms of the loan rather than how the loan performs. The advent of extensive data systems and credit scoring has allowed mortgage loans to be priced along a continuum of risk levels and terms, as opposed to a handful of rigid qualifications as they were in the past. This has created an opportunity for millions of borrowers to repeatedly access credit who previously would have been denied. It has also created a more challenging market for consumers to navigate plus increased opportunities for malfeasance.

Add to this mix a historically strong housing market from 2002 to 2006, where prices in many areas exceeded sustainable levels. Record volumes of loans were pushed through the mortgage lending system, with real estate markets promoting homes as an investment with rapid double-digit returns. Subprime loans combined with adjustable rate mortgages, loans with 'teaser' rates or even no negative repayment of principal, loan applications with no documentation of ability to repay and overly aggressive real estate appraisers and loan brokers exacerbated this toxic mix.

Borrowers were routinely told that if all else failed they could simply refinance their loan. But when home prices stopped ascending at record rates, the game of musical chairs suddenly stopped. Borrowers found they owed more than their home was worth. Investors providing mortgage capital no longer had assurance that loans were valuable assets. Lenders began to increase their standards for making loans, which eliminated borrowers who wanted to refinance loans from the market. It is important to note that although media attention has focused on borrowers with adjustable rate loans that will reset to higher rates after an introductory period (creating so-called 'payment shocks' and likely more foreclosures), the bulk of these resets are predicted to occur in 2008 and 2009. The problems of the mortgage market are just beginning. It could take up to five years for the process to unwind and recover. Analysts suggest the current wave of foreclosures is due primarily to loans with low 'teaser' rates. In 2008 a large wave of subprime adjustable rate loans will begin resetting to higher rates, continuing until late 2011. One estimate suggests over 8 million loans will reset, and nearly 1.9 million will foreclose assuming house prices continue recent patterns (Cagan 2007).

1.2 Taking Action

While examining today's foreclosure situation, it's clear there are multiple problems and issues that could be addressed. The longitudinal nature of mortgage lending is such that even if no additional high-risk loans were made tomorrow, it would take several years for loans from the past to mature beyond the time period when foreclosure is most likely. Traditionally, loans would go into default between two and five years after origination, since that is when the borrower owes the largest balance. Recent trends suggest a much shorter time frame of one to three years. Therefore, policymakers may need to simultaneously craft strategies to improve the quality of loans being made in the future, while addressing the effects of foreclosures on loans made in the past.

Given this context, prudent policymakers at the state level must continue examining options for reducing the harm from home foreclosures. This report will provide an overview of the current policy environment from the perspective of state leaders. It begins with a brief background on the foreclosure process, followed by a summary of data on foreclosure and lending trends. Next the report suggests a rationale for why state policy leadership on foreclosure issues is imperative under the current conditions. The report then summarizes a review of policies and programs across states (included as an appendix) into three categories: (1) preventing problem loans from being made, (2) helping borrowers in default avoid foreclosure and (3) creating alternatives to foreclosure. The report concludes with observations and recommendations for state policymakers considering new approaches to home mortgage foreclosures.

2.0 Understanding the Foreclosure Process

There are many reasons that may cause borrowers to become delinquent on their mortgage loan. For some, managing a budget is a challenge and certain bills are a priority in any given month. Most households pay their mortgage first, but some cannot make a payment by the due date. Borrowers who make mortgage payments after the due date will usually be forced to pay late fees, especially after the first occurrence. The longer a payment goes unpaid, the harder it becomes for a borrower to catch up. Knowing this, one method used by better mortgage loan servicers is to attempt to contact the borrower as soon as a payment is past due. The best servicing operations actually track payment envelopes in the postal system to verify if the check is in the mail. Lenders typically begin with phone calls to a borrower, using call-center based systems designed to find a borrower at home, then send letters, certified mail and even DVDs or representatives to the borrower's door. After two payments go unpaid, the borrower's situation becomes more challenging and the lender will increase efforts to make contact.

Missing two or more payments might be due to financial management issues within a household, but typically it is related to other problems. Traditionally, foreclosures were seen as a result of temporary disruptions in income such as job loss or other decrease in income. Other traditional causes of mortgage delinquencies included a health crisis, disability or divorce. Delinquencies in the current context follow this pattern to some extent, especially in markets with weak job markets or economies shedding higher-paying manufacturing jobs. But more and more reports show that borrowers are missing payments due to other factors, including simply not being able to afford the loan they were initially given. These loans might go into delinquency within a few months after being made.

Other borrowers maintain their employment and can afford their payments, but have adjustable rate loans which are resetting to higher interest rates and creating payments that are 30% to 50% higher than they were originally. In the most extreme cases borrowers have been provided loans with no minimum payments or payments based on extremely low interest rates. As the short-term 'teaser' period concludes, these borrowers realize they cannot afford the new larger payment. In the worst cases borrowers have been fraudulently led to sign onto loans with grossly inflated home valuations and payments that far exceed available income.

When consumers take out a mortgage, they enter into a contract to make payments under specific terms. If a borrower fails to make a payment, the contract is violated and the loan is in default. The borrower remains in default until the loan is brought current or an arrangement is made with the lender regarding payment and terms. Depending on the state and the borrower's circumstances, lenders may then initiate the foreclosure process with the goal of using the home's value to pay off the remaining mortgage amount. The foreclosure process varies by state, but borrowers generally have at least 60 days from their first missed payment to take action and avoid the start of foreclosure proceedings. The foreclosure process concludes when the borrower pays off the loan or signs the home over to the lender or when the lender takes possession of the home and attempts to sell it at a foreclosure auction. Generally speaking, lenders do not want to take possession of a foreclosed-upon home or sell it at auction. Homes in foreclosure usually sell far below market value, and properties can be expensive to maintain as time passes. As a result, lenders typically offer several options to borrowers prior to initiating the foreclosure process, including:

- Forbearance - a period of suspended or reduced payments;
- Repayment Plan – adding past due amounts to future monthly payments;
- Loan Modification - adding the past due amounts to the principal balance, extending the term of the loan; or reducing the interest rate;
- Sales Assistance – referrals to real estate agents and help putting the home on the market with the understanding that the borrower will pay off the mortgage when the home sells;
- Deed-in-Lieu of Foreclosure- the property is returned to the investor and the borrower walks away without a foreclosure mark on their credit history; and
- Pre-foreclosure sale (or 'short' sale) – the sale of the property for less than is owed on the mortgage.

2.1 Finding Help

Industry estimates suggest that of all the homes that have entered the foreclosure process, at least half of the borrowers avoided foreclosure because they were able to catch up on their loan or take advantage of a "workout" like those described above (Apgar and Duda, 2004). Such workouts are generally provided on a case by case basis. Lenders call or write borrowers and encourage them to speak with their loan servicer to explore various options. Still, even with foreclosure alternatives and the lender's incentives to avoid foreclosure, many borrowers fail to take advantage of options presented by their lender. Many borrowers, even those experiencing job loss or problems at home, do not make use of counseling or other services that might help their situation. One reason for this lack of take-up of services is that the vast majority of borrowers do not know about the various workout options that exist (Collins, 2007).

Recent media reports and public awareness campaigns may help change borrower perceptions somewhat, but many borrowers still do not know where to find help. Another problem is that borrowers in trouble often face a multitude of financial problems. Job loss and illness obviously create stress and anxiety, and feeling like financial issues are out of control can take a toll on families. Under these conditions borrowers may find it hard to search for and evaluate information and may become too paralyzed to take action. Focus groups and surveys indicate that stress and anxiety have a significant impact on borrowers, hindering their ability to be proactive and find remedies to their situation (Collins, 2007).

2.2 Targeting Homeowners

Foreclosure prevention policies are typically focused on owner-occupants rather than investors, speculators or landlords. In some markets a large share of real estate sales during the mid-2000s was driven by speculative investors seeking to buy homes, rent them and later sell them at a profit. Although these investors' properties may have a negative impact on neighborhoods and housing markets, owner-occupants are typically viewed as more deserving of support than investors. In theory, speculators understood the risks involved in buying the property and do not warrant specific interventions. In some cases, especially in older housing markets and larger cities, owner-occupants may also own apartments in the building.

Generally, foreclosures on properties with one to four rental units are considered the same as single-unit, owner-occupied dwellings.

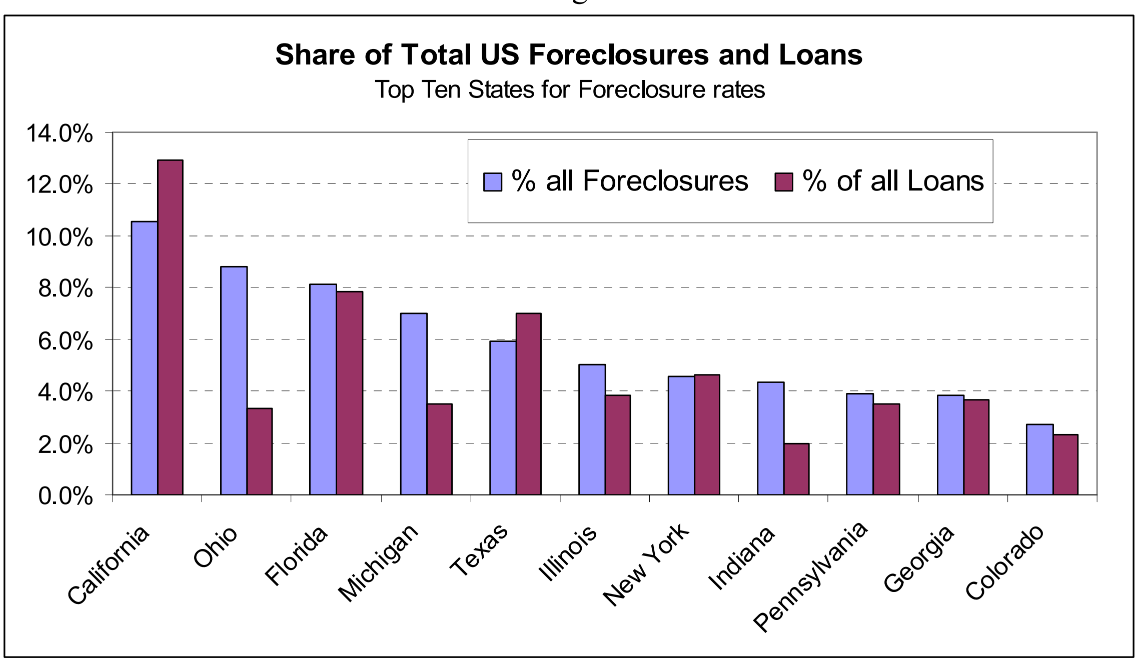
3.0 The Current Foreclosure Environment

According to the National Delinquency Study released by The Mortgage Bankers Association in September 2007, of over 44 million mortgage loans surveyed 2.2 million loans had payments past due, representing about 1 in 20 loans (5%). Of these, about 600,000 were in some stage of the foreclosure process. Among subprime loans, nearly 15% are past due and 5% are in foreclosure. This represents more than 340,000 loans and more than half of all the loans in foreclosure, even though subprime loans account for just 14% of all mortgage loans being serviced in the survey. Subprime loans with adjustable interest rates are among the most foreclosure prone, with rates of loans in foreclosure exceeding 8% for these types of mortgages. By comparison, only 400,000 loans total were estimated to be in foreclosure in March of 2006. In just 18 months, foreclosures increased nationally by 50%.

While these numbers are striking, they do not tell the whole story. First, foreclosures tend to be concentrated. More than half of all the foreclosures in the U.S. are in seven states. Figure 1 displays the share of all foreclosures and mortgage loans in the U.S. for the ten states with the highest rates of foreclosure. While California has the largest share of all foreclosures in the U.S., it also has the largest number of loans. Ohio, Michigan, Illinois and Indiana, on the other hand, have a much larger share of all foreclosures than they do mortgage loans.

Second, within each state foreclosures tend to be concentrated in neighborhoods that have disproportionately high shares of subprime lending. These areas are typically made up of families with modest incomes from non-white racial backgrounds. This concentration results in foreclosure becoming spatially focused on already weakened housing markets, further reducing the value of properties owned by lower-income homeowners.

Figure 1



3.1 State Patterns in Foreclosure and Subprime Lending

Table 1 provides more detail on lending and mortgage delinquency trends. Based on historic patterns of default, states with higher numbers of subprime loan originations in 2005 would be the most likely to have higher default (past due) and foreclosure rates in 2007. This pattern generally holds true with a few exceptions. First, states like Ohio, Michigan and Indiana – where foreclosures are rooted in weakened job markets – have higher default rates than the proportion of subprime loans in the market suggests when compared to other states. Second, some states with high rates of subprime lending have lower default rates than might be expected relative to other states, such as in California. Perhaps strong housing market values have resulted in high levels of subprime loans in these markets. It remains to be seen if foreclosures will markedly increase as these housing markets weaken and prices continue to decline. It is possible that these markets may experience even more foreclosures in the near future. It is also worth noting from Table 1 that the delinquency rates for subprime loans are multiple times larger than prime loans and subprime adjustable rate loans (ARMs) have even higher rates of delinquency.

The last two columns of Table 1 indicate if states have program or laws designed to regulate high-cost lending and if the state has launched a formal foreclosure prevention initiative. A total of 30 states have a law targeting the regulation of high-cost lending. High cost loans are a small very high cost subset of subprime lending; most state laws are not triggered until interest rates exceed 12% in the current market and fees total 5% at last of the loan amount. An estimated 20 states have launched formal foreclosure intervention or prevention initiatives in the last several years, and 15 have both high-cost lending and foreclosure intervention laws. Not surprising is the fact that states with higher shares of subprime loans are among those with high-cost loan regulations. Likewise, states with more foreclosures and higher shares of mortgages in delinquency are the ones most likely to have foreclosure intervention programs.

It is important to note that these data on loan delinquency are primarily drawn from one survey conducted by the Mortgage Banker's Association. While these data have been collected and released publicly for many years, they are based on survey sampling techniques. Other sources of foreclosure data may show slightly different estimates, although the relative order of magnitude should be consistent.

3.2 Foreclosure Data

Foreclosure filings are a public record, typically maintained by county government. Access to these data can be difficult, however, unless the filings are recorded in an electronic format and released for analysis. In many communities, vendors have developed databases filled with foreclosure filings with the intent to sell the information to real estate speculators interested in purchasing discounted property. These data vendors frequently receive media attention, but the quality of their data can be questionable. State policymakers should certainly use these and other data sources to monitor foreclosure trends in key markets, but should also validate the data carefully before using it to make critical decisions.

Table 1: Subprime and Foreclosure Frequency by State

	% of Loans Made That Are Subprime 2005 HMDA	% of Subprime Loans Past Due	% of Subprime ARM Loans Past Due	% Prime Loans Past Due 2006	Total estimated number of foreclosures	State with High Cost Lending Law	State with Foreclosure Intervention
Alabama	14.2	3.8	6.0	0.5	6,340		
Alaska	12.6	1.9	4.8	0.2	489		
Arizona	15.1	3.0	3.9	0.2	9,264		YES
Arkansas	9.0	3.3	5.4	0.4	2,794	YES	
California	19.6	5.1	7.4	0.1	62,459	YES	YES
Colorado	14.7	6.3	8.3	0.3	15,904	YES	YES
Connecticut	18.5	5.6	8.6	0.3	5,743	YES	YES
Delaware	14.8	4.5	6.8	0.6	2,153		YES
District of Columbia	11.9	3.3	4.5	0.1	541	YES	
Florida	19.9	5.3	7.6	0.4	48,224	YES	
Georgia	15.4	5.2	7.5	0.5	22,789	YES	
Hawaii	18.8	3.1	5.4	0.3	1,368		
Idaho	10.3	3.0	4.2	0.2	1,463		
Illinois	20.2	7.4	10.0	0.5	29,852	YES	YES
Indiana	14.5	9.4	14.1	1.2	25,625	YES	YES
Iowa	10.6	8.6	13.7	0.7	5,852		
Kansas	10.4	5.1	8.6	0.6	4,255	YES	
Kentucky	12.0	7.4	11.5	0.8	8,142	YES	
Louisiana	14.6	5.3	7.4	0.7	7,639		
Maine	18.3	8.0	13.2	0.5	2,459	YES	YES
Maryland	18.9	2.7	3.7	0.2	6,928	YES	YES
Massachusetts	17.5	7.1	10.7	0.3	10,009	YES	YES
Michigan	15.5	10.1	13.6	0.9	41,525	YES	YES
Minnesota	13.2	8.6	11.8	0.5	14,263	YES	YES
Mississippi	14.0	5.2	8.0	0.7	4,259		
Missouri	13.4	4.6	7.4	0.4	9,764		
Montana	8.4	3.6	5.4	0.2	861		
Nebraska	11.5	5.1	8.9	0.4	2,488		
Nevada	18.0	5.3	6.6	0.3	8,619	YES	YES
New Hampshire	16.3	4.5	7.5	0.4	1,994		
New Jersey	14.4	5.6	8.7	0.3	15,268	YES	
New Mexico	10.7	3.6	4.9	0.3	2,051	YES	YES
New York	18.2	5.6	10.4	0.4	27,041	YES	YES
North Carolina	11.5	3.8	5.6	0.4	13,833	YES	YES
North Dakota	5.8	4.3	5.5	0.2	426		
Ohio	14.4	11.9	17.2	1.4	52,169	YES	YES
Oklahoma	13.2	5.9	10.6	0.7	7,336	YES	
Oregon	11.7	2.3	3.1	0.1	2,950		
Pennsylvania	11.0	5.4	8.2	0.6	23,225	YES	YES
Rhode Island	24.4	7.3	11.0	0.3	2,090	YES	
South Carolina	12.9	6.0	8.5	0.6	9,510	YES	
South Dakota	7.5	5.7	9.9	0.5	833		
Tennessee	16.5	3.6	5.7	0.4	9,815	YES	
Texas	18.0	4.1	6.7	0.4	35,205	YES	
Utah	14.1	2.1	2.5	0.2	2,368	YES	
Vermont	13.9	6.5	9.7	0.2	558		
Virginia	12.3	2.8	4.3	0.1	7,048		YES
Washington	13.1	2.5	3.3	0.1	5,739		
West Virginia	6.6	3.4	5.5	0.5	1,367		
Wisconsin	11.1	7.9	11.6	0.5	9,546	YES	YES
Wyoming	11.0	2.5	4.0	0.1	304		

Sources: 2005 Home Mortgage Disclosure Act; September 2007 Mortgage Bankers Association National Delinquency Survey; author's tabulations from summary of state lending legislation and programs

4.0 Foreclosure and Public Policy

Some observers might be surprised that states have taken an active role in trying to prevent foreclosures. Some say that borrowers and lenders enter into private contracts, each having a responsibility to understand the risks involved. They also believe, to the extent that these risks are transferred to investors on Wall Street and beyond, that private parties should each be accountable for any losses without government involvement. This logic, however, is faulty for several reasons.

4.1 Sustaining Homeownership is Important

First, financial and credit markets have a strong level of regulation. In order for markets to operate efficiently, information needs to be transparent and accessible. Fraud and deception distort market outcomes and justify a role for the public sector for regulating a marketplace. Providers of almost all financial products, from stocks to life insurance, are required to meet certain thresholds of behavior and provide accurate information about risks and costs. Thus, regulation has a long-standing role in these markets. Regulation in mortgage markets is further supported due to the special role that housing and homeownership play in society. Owning a home—frequently dubbed as the "American Dream"—is the primary way that families accumulate and build wealth over time. Owning a home represents a major stake in society and is a significant asset. Proponents of homeownership have long advocated for public policies that encourage homeownership. But policymakers must keep in mind that society benefits from home ownership, not just home buying. After encouraging buyers to make the initial investment, policies are needed that support homeownership and help owners stay in their homes.

4.2 The Costs of Foreclosure are Spreading

The second reason that foreclosure intervention is needed is that the costs of foreclosure are not limited to the borrower and lender. Foreclosures do carry a cost for lenders and investors who fund the lender's pool of loans: Losses range from 20 cents to 60 cents on the dollar, with one estimate of a typical lender's foreclosure cost averaging $58,800 in the early 2000s. For borrowers, the loss of a home can be devastating. In addition to emotional distress and financial loss, a foreclosure tarnishes the borrower's credit record for many years.

But beyond homeowners and lenders, foreclosures can create tremendous economic and social burdens for communities. Foreclosures may trigger a domino effect of increased crime, abandoned houses, plummeting property values, disinvestment, lower municipal tax receipts, and costlier city services. When neighbors see nearby homes going through foreclosure, it undermines their confidence in the area. Homes in the foreclosure process may become vacant, providing a place for crime or other problems in the neighborhood. In addition, local governments often end up footing the bill. One study estimates that the financial burden of an abandoned, foreclosed property can be over $30,000 in police, fire and code enforcement costs, and on average these properties have a municipal cost of approximately $7,000 per foreclosure (Apgar, Duda and & Nawrocki Gorey 2005) Another estimate regarding neighborhood property values suggests each foreclosure is associated with a 0.9% decrease in property values within 1/8th of a mile, or an estimated $139,000 per foreclosure in a typical single family neighborhood.

One study suggests foreclosures will reduce U.S. economic activity by $166 billion in 2008 due to declines in the real estate and construction industries, as well as consumer spending. Property values are projected to decline by $519 billion due to the number of homes in foreclosure which depress resale values, over and above the decline expected from cyclical decreases in home values. To the extent that state and local governments rely on property taxes, real estate fees and sales taxes as revenue sources, there will be a negative impact on government resources. An analysis of 10 states estimates an aggregate loss in tax revenue of $6.6 billion (Global Insight, 2007).

4.3 The Key Role of State Policies and Programs

Clearly, states have reasons to be concerned about foreclosures; particularly those states where foreclosures are rising rapidly and threatening the health and vitality of its neighborhoods. States have a regulatory role to play. Much of the subprime lending activity in the last decade has taken place through lenders and brokers that are not regulated by the major federal bank regulatory agencies. Loans made by brokers, correspondent lenders and mortgage bankers often fall under the purview of the Federal Reserve, U.S. Department of Housing and Urban Development and state regulatory agencies. The state regulatory apparatus may be used to oversee the quality of loan origination professionals in these sectors, although state approaches vary significantly. An additional reason why states are well positioned to address foreclosure issues is because almost all states also have housing finance agencies, which are active players in the mortgage market and have access to capital through the issuance of bonds. Also, because governors have the "bully pulpit" of the media and power of persuasion, state governors can help get the attention of borrowers, promote consumer education and encourage consumers to seek help. In addition, state attorney generals can use the threat of prosecution to convene industry leaders and craft wide-ranging solutions to default and foreclosure. States have been the source of innovation and experimentation in the area of regulating high-cost loans. While the impact of state regulations is far from uniform, these approaches represent pilots of potential strategies which may be worth replication in other areas.

Federal Financial Institution Oversight

Board of Governors of the Federal Reserve System - oversees state-chartered banks and trust companies that belong to the Federal Reserve System

Federal Deposit Insurance Corporation (FDIC) - regulates state-chartered banks that do not belong to the Federal Reserve System

Office of the Comptroller of the Currency (OCC) - regulates banks that have the word "National" in or the letters "N.A." after their names

National Credit Union Administration - regulates federally charted credit unions

Office of Thrift Supervision (OTS) - oversees federal savings and loans and federal savings banks

Department of Housing and Urban Development – regulates independent mortgage companies that are non-depository institutions

4.4 What about the role of the Federal Government?

The Federal government is highly involved in the regulation of the mortgage market. There are six major financial regulatory agencies regulating some 7,000 lending institutions in the U.S. These agencies have had numerous discussions about regulating high cost lending and other foreclosure interventions. In the past year, the Treasury Department has also entered into these discussions. There has been little consensus so far; only general support for promoting education and counseling. The Federal Reserve Board has the broadest-ranging powers over the origination of mortgage loans, and has at least persuasive power over lender management of loans in foreclosure. The federal Home Ownership Equity Protection Act of 1994, or HOEPA, is a federal high-cost lending law requiring disclosures and limiting the terms of high cost loans. In practice, very few HOEPA loans are actually made, however, because the rate and fee triggers are high. Approximately 30 states have enacted laws with lower thresholds or added regulations to extend HOEPA's provisions to reach a marginally-larger number of loans. Changes to HOEPA have been proposed, but are unlikely to be implemented in the near future.

One of the more important issues in bank regulation relates to the treatment of institutions with a national charter, such as those regulated by the OCC and OTS. A 2006 Supreme Court case (*Watters v. Wachovia NA*) established the long-standing role of federal preemption over state regulations. While debated among constitutional experts as a signal of the role of federal versus state government, advocates for state laws have been frustrated because state regulations may not be enforced on federally-chartered banks or their non-bank subsidiaries. In practice, many nationally chartered banks do monitor state legislation, and some even limit their lending activities within the scope of the law. One general counsel for a large lender suggested in an interview that staying within the state laws has public relations value. In addition, the costs of remaining within the state laws are low enough that even slight chances of being open to legal liability keep risk adverse counsel from engaging in practices outside state laws.

5.0 Current State Strategies to Address Foreclosure

State laws and regulations regarding high-cost mortgages, mortgage brokers, foreclosure interventions and borrower education/counseling can be difficult to define. State policies are frequently revised. Legislation requiring appropriations or administrative enforcement may not be fully supported. Some policies are implemented by executive orders or agency rulings rather than legislation. In some cases policies may even be over-turned by the courts. For this report, information was collected from a variety of sources on state strategies regarding the following issues:

- High Cost Loan Law/Regulations – beyond Federal HOEPA laws
- Other Mortgage Origination Law/Regulations – especially licensing and certification
- Foreclosure Intervention Law/Regulations – banning rescue fraud; offering refinance
- Consumer Education Campaigns– homebuyer education and/or default counseling
- Statewide Foreclosure Task Forces – public or public-private efforts to study foreclosure issues and make recommendations for action

Appendix table 1 summarizes the policies and programs across states based on existing reports, internet searches, a review of available legislation and interviews with key informants. This is not a comprehensive list; laws and provisions were included based on a preliminary review of their intent and some important state initiatives may have been un-intently omitted. The purpose of this exercise is not to provide a report card or evaluation of each state's attempt to address issues of foreclosure. Rather, it is meant to show the magnitude of effort among states, and highlights the wide range of activities that states have employed to attempt to regulate the mortgage market and/or protect consumers.

Overall, an estimated 30 states have high-cost loan laws designed to extend the provisions of HOEPA. Most of these laws were passed between 2002 and 2004, although a few laws had their genesis in the 1990s and several others were passed in the past year as attention focused in on mortgage lending practices. In addition, approximately 36 states have laws designed to regulate mortgage brokers or originators. While most states require mortgage brokers to file paperwork and charge a nominal fee to be able to take loan applications, many states have also established licensing requirements as well as minimum competency levels based on education, experience or certification.

About 20 states have laws or programs specifically designed to address the issues that borrowers in foreclosure face. Of these states, eight have established loan funds that can be used to refinance borrowers who have loans they cannot afford, or can provide short-term loans to help borrowers overcome financial difficulties. To protect borrowers in foreclosure from unscrupulous real estate investors or "foreclosure consultants," nine states have created laws regulating firms that claim to "rescue" borrowers from default. At least 15 states have established statewide consumer education efforts, many of which are using foreclosure counseling hotlines. Finally, at least 14 states have setup statewide foreclosure task forces in order to develop responses to foreclosure. Nearly all of these state foreclosure intervention actions have begun in the last two years.

The following sections provide more detail on various models used by states to address problems in mortgage lending and foreclosure. Policy strategies are grouped into three general categories: (1) reducing the number of problem loans being made, (2) improving the odds that borrowers in default can manage the default, and (3) reducing the harm of or creating alternatives to foreclosure

6.0 Reducing the Number of High-Foreclosure Loans Being Made

Foreclosures will always be part of the mortgage market. A market without foreclosures would suggest that loans were being made so conservatively that few borrowers would qualify. Plus, even among low-risk borrowers, unexpected life events can occur that result in default. But as riskier borrowers enter the market, more precaution is warranted. Just as the notion of no foreclosures suggests an inefficient market, an environment where the majority of loans are going into foreclosure presents the opposite extreme.

Typically, public policies respond to the market as a continuum. Low-risk loans with low interest rates and fees receive the least scrutiny. As the cost of the loan increases, measured as interest rates and/or fees, more disclosures must be presented to ensure the borrower fully understands the contract. Likewise, counseling, especially when provided by a trusted third-party, can help consumers better understand the terms of their loan if it's provided in a timely manner. In some cases loan terms may be deemed so onerous, in isolation or in combination with other terms, that they are simply banned from the marketplace. Increased precautions or product banning become more relevant when the consumer lacks information or capacity to adequately search for a loan product. This approach is consistent with the policy and regulation models used in a number of other consumer markets, including pharmaceuticals, food products and industrial processes. The application of this model to the financial and mortgage markets is a natural extension of these approaches.

6.1 Regulations on loan products

The provisions of the Home Ownership and Equity Protection Act of 1994 (HOEPA) cover loans with high rates and fees, requiring added disclosures and banning certain product features. HOEPA is focused on home equity loans (also called "Section 32" loans). First lien mortgages with an annual percentage rate (APR) higher than 8 percentage points than the rate on Treasury securities of comparable maturity (usually a 30 year T bond) and second mortgages with an APR more than 10 percentage points greater are covered under the act. The other triggers under HOEPA are total fees and points larger than 8% of the total loan amount (or more than $547 in 2007 if the loan is under $6,800). Only refinance and home equity loans are covered.

Borrowers with loans subject to HOEPA have a three day right of rescission to decide whether or not to sign the loan after receiving a special disclosure form detailing the terms, conditions and a warning that they could lose their home if they fail to pay. HOEPA loans may not contain balloon payments for less than five years or negative amortization, where monthly payments are too small to pay off the loan and cause an increase in the amount owed. Among other provisions, HOEPA loans cannot contain prepayment penalties lasting more than five years. By law, lenders are required to underwrite loans based on the borrower's ability to repay the loan and may not 'flip' or refinance a HOEPA loan into another HOEPA loan within the first 12 months, unless the new loan is in the borrower's best interest.

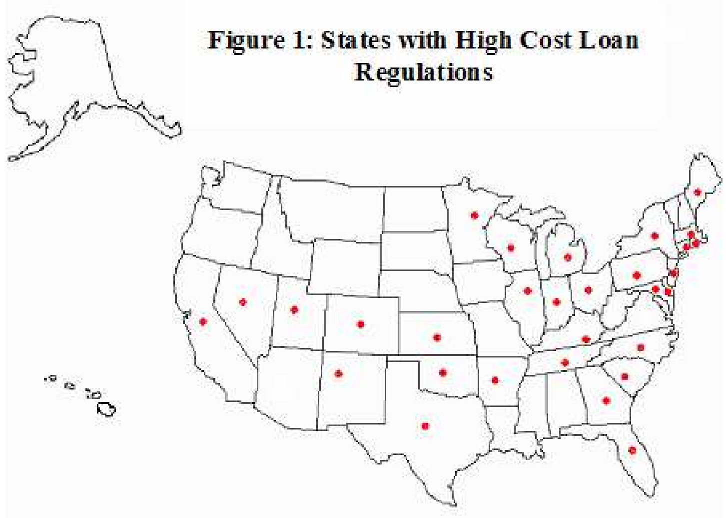


Figure 1: States with High Cost Loan Regulations

At least 30 states have passed laws to augment HOEPA. Some apply the law to purchase loans as well as refinance and home equity loans. Others add restrictions or require additional disclosures, including specific 'plain language' cautions to the borrower. About 21 states mention counseling for borrowers: eight require it and 13 recommend it (all but two counseling provisions are related to counseling after a loan is approved but before it is originated—only Michigan and

Maryland recommending counseling as part of the application forms). Few HOEPA loans are made in most states because lenders tend to make their high-cost loans below the HOEPA thresholds in order to avoid these provisions. As a result, state laws related to high cost lending have lower triggers for fees (most often) and interest rates (less often). This results in more loans being covered by the law, but still only those loans that are in the highest cost portion of the market.

North Carolina's law is often cited as being a model for state (and federal) legislation of high-cost loans. The state uses the same APR triggers as HOEPA but has a lower fee trigger, requires counseling and bans prepayment penalties for loans under $150,000. North Carolina's law also extends to mortgages of all types, including purchase loans. It only excludes reverse mortgages and high-cost loans more than $300,000.

6.2 Recommending or Requiring Consumer Education and Counseling

Homeowner counseling programs can help prevent foreclosures by making consumers aware of the intricacies of their mortgage decisions often signaling caution to both the homeowner and the lender. Counseling can also make homeowners aware of the pitfalls that accompany taking out a mortgage that they cannot afford or agreeing to a refinance that is not in their best interest. Many states have passed legislation promoting pre-purchase counseling or homebuyer education for low-income, minority or first-time homebuyers. Other states have included counseling provisions in high cost loans laws. Counseling may be required or recommended. States where counseling is required may include a waiver process for borrowers to sign if they decline counseling. States recommending counseling often refer consumers to state agency websites or a list of HUD approved counseling agencies.

The timing of counseling is important to consider. Counseling ten days before a loan closes will provide more time for a borrower to explore alternatives than counseling provided three days before the closing. Counseling or education provided when an initial application is completed may be even more valuable.

While counseling is a worthwhile process for many homeowners, requiring counseling for a particular set or class of homeowners should be done thoughtfully and carefully. Successful counseling requirements have been narrow in focus and have targeted a specific set of loans (Collins, 2007b). Without careful consideration of who ought to benefit from counseling requirements, issues of volume and capacity of counseling organizations can hinder good intentions. Counseling agencies tend to be nonprofits with few opportunities to earn revenue from their services. The system of delivering counseling generally has a small capacity in most areas relative to the number of mortgage applicants in any year—there are not enough counselors available to serve most loan applicants. Telephone based counseling is one alternative to provide counseling at a larger scale. Regardless of the delivery mode, the length of the counseling session must be sufficient and the quality of the session must be high (Collins, 2007b).

Passed in July 2005, the Illinois Predatory Lending Database Law went into effect in January 2006 but was suspended less than ten months later under immense scrutiny from consumer advocates and lenders. Also called HB 4050, this law mandated counseling for loan applicants under a four-year pilot program isolated to just ten zip codes within Cook County. Counseling by HUD-certified counseling agencies prior to the completion of a mortgage transaction was required for any mortgage applicant with:

- a FICO score below 620 (one cutoff for subprime borrowers), or
- a FICO score between 621-650 and if any one of following were also involved:
    - second refinance within the last 12 months, or
    - an interest only loan, or
    - an ARM with an initial fixed period of three years or less, or
    - the mortgage application does not require the verification of income.
- a mortgage with a prepayment penalty
- a mortgage with negative amortization, such as a "option ARM" where payments are optional for some period, or
- points and fees exceeding 5% of the loan amount.

This law is a good example of the hazard of mandating counseling for a large number of borrowers. At least one analysis suggested housing sales declined in the effected zip codes compared to nearby areas, in part due to lenders being unwilling to make loans for homebuyers subject to regulations. A new version of HB 4050, known as SB 1167, was signed into law on November 2, 2007 and will go into effect in July 2008. This version expands the program to all of Cook County and re-focuses counseling requirements by the type of loan rather than the credit history of the borrower. All first-time homebuyers or any borrower seeking a refinance loan in Cook County will be referred for counseling if the loan has one or more of the following traits:

- Interest only
- Negative amortization
- Points and fees that total more than 5% of the loan
- Pre-payment penalties
- ARM loan of 3 years or less

Community advocates are concerned the capacity of HUD-certified counseling agencies will not be able to deliver to all of Cook County (200 zip codes). This could impact the quality of counseling as well as processing times required to close loans. Advocates argue mandatory counseling requirements ought to be made in conjunction with increased funding for counseling services. Staff from one of the largest and most qualified counseling agencies in Chicago reported that their agency's counselors will not be able to keep up with demand. Current counselor caseloads are between 80 and 90 clients (30-40 cases is more appropriate) and waiting time to see a counselor has reached two weeks even without SB 1167 having gone into effect.

6.4 Licensing for Mortgage Providers

All fifty states have established a process for documenting mortgage brokers, who are independent agents selling mortgages on commission on behalf of a number of lenders. Brokers are distinguished from loan providers who represent a single lending institution or a firm that has a direct supply of mortgage capital. Typically, brokers never own the loan and are at little risk if the loan does not perform (in theory lenders might not do business with a broker who facilitates a high share of loans that are in foreclosure, but many lenders lack information on the original broker by the time the foreclosures occur). Brokers are also compensated based on completing a loan closing, through fees paid by the borrower, the lender making the actual loan, and/or through a yield spread premium where the broker receives revenue based on a premium charged on the mortgage's interest rate. Brokers thus have a strong incentive to encourage their customers to refinance often and take out larger and larger loans. Borrowers may even mistakenly consider the broker to be a trusted agent that represents them, as opposed to a sales representative who is promoting loan products. Mortgage brokers comprise a large share of mortgage lending in some markets, especially among minority and low-income borrowers. This situation is ripe for dishonest brokers to take advantage of borrowers. As a result, at least 36 states have established minimum standards for mortgage brokers beyond registration fees and documents. These include provisions such as posting of bonds, having a minimum amount of financial assets, passing exams and completing educational courses. The intent of these laws is to reduce the incidence of 'fly-by-night' broker operations and upgrade the level of professionalism in the field.

7.0 Improving the Odds of Managing a Mortgage Default

While the previous set of strategies is designed to prevent problem loans from being made, another set of state initiatives is designed to help borrowers who realize they can no longer afford their mortgage payments. These borrowers may not yet be in foreclosure, but are in default and as time passes are at risk for having foreclosure proceedings initiated.

7.1 Public awareness to seek help when facing mortgage default

In general, borrowers do not know where to turn when they face a financial problem that is preventing them from making a mortgage payment. Most borrowers do not know that they should call their lender and most lack information on the alternatives that lenders can offer. Although borrowers in default might benefit from a range of social and financial services depending on their situation, few seek help. In some cases a short session with a financial counselor can help uncover assets that can be sold, such as a car or boat, or can help borrowers rearrange their budget so they reduce expenses and free up dollars to cover their mortgage payments. But most borrowers do not know such services exist and therefore do not take actions which might improve their ability to become current on their mortgage.

Indiana, Maryland, Massachusetts and Ohio have used their state leaders to garner media attention around the idea that borrowers at risk of default should seek help. Activities include statements issued by the governor, plus press releases, Web site links and informational brochures providing referrals to appropriate services. Private lenders have been very supportive of these approaches and are generally willing to provide financial and in-kind support.

7.2 Promoting default counseling

Getting homeowners to make contact with their lender or servicer when they are having trouble making their mortgage payment has been a challenge. Research shows as many as half of the borrowers in foreclosure have not been in touch with their servicer (Apgar and Duda, 2004). Yet, independent, third-party counseling agencies have been successful in helping homeowners contact their servicer, especially through hotlines. Outreach promoting hotlines has stressed the importance of early contact with servicers.

Several states have developed or participated in efforts to connect homeowners with counseling and other foreclosure prevention resources through hotlines. Approximately 20 states to date have partnered with the Homeownership Preservation Foundation (HPF), which provides hotline services 24 hours a day, seven days a week through the "Homeowner's HOPE Hotline." Currently, HPF coordinates six, HUD-certified housing counseling agencies to provide the phone counseling and has developed relationships with key servicing institutions to connect borrowers directly with their servicer if appropriate. This program has plans to expand capacity throughout 2008.

Through a partnership with NeighborWorks® America, some borrowers may be referred by HPF to face-to-face counseling provided by a local, nonprofit organization. The national Ad Council has launched a public service campaign promoting the availability of HPF and NeighborWorks® America counseling services. The campaign began in June 2007 and HPF reports that the campaign has increased the number of borrowers calling for help. This advertising has also prompted homeowners to call *before* they were one full payment behind (Homeownership Preservation Foundation, 2007).

States often use the HPF hotline in tandem with local services. Local nonprofit agencies may not be able to handle the increasing demand for foreclosure prevention services due to capacity and funding constraints. A service like the HPF HOPE Hotline can provide homeowners with counseling services immediately instead of requiring them to wait for local services to become available. Staff at local agencies report that tapping into the robust counseling structure at HPF frees up more time for them to provide face-to-face counseling for difficult cases. HPF figures show that over 191,000 calls this year have been fielded by the Hotline as of December 9, 2007 with nearly 73,000 homeowners receiving telephone counseling assistance. In the third quarter of 2007, 15% of callers were referred to local NeighborWorks® America affiliates for face-to-face counseling.

The availability of face-to-face counseling services is key to any foreclosure prevention program. Some providers have chosen to create state or local hotlines that direct borrowers to counseling agencies that offer face-to-face counseling services. Centralizing intake functions can smooth efficiency and bring limited scale to state-wide efforts. Colorado provides an example of a state-led initiative to provide residents access to counseling services through a state-wide hotline. The Colorado Foreclosure Prevention Hotline provides a toll-free number for Colorado residents to call for counseling services. Callers are then routed to a local service provider where they can receive face-face-counseling. Some callers opt for only telephone counseling although the Hotline reports that just 15% of callers have preferred telephone counseling over appointments with locally based counseling agencies.

The Colorado Foreclosure Prevention Hotline was launched in February 2006 after the Colorado Foreclosure Prevention Task Force realized that the state already had a large number of counseling agencies with the experience and capacity needed to deliver foreclosure prevention counseling. The Task Force preferred sourcing their hotline locally rather than nationally and receives funding from the state's Division of Housing as well as lenders to support this effort. Marketing activities and a strong leadership role by the Governor has successfully raised awareness of the Hotline. It is hoped that future funding for the Hotline will increase through a line-item in the state's budget. Hotline organizers report that the average monthly volume for the hotline is 1,769 calls, and year to date figures as of November 2007 show that over 18,000 calls have been placed to the hotline (Brothers Redevelopment, 2007). A recent survey of hotline callers suggest that this approach is working. For callers that entered into a relationship with a counselor, four out of five avoided foreclosure in some way.

Having trouble paying your mortgage?

Your home is your biggest investment. If you can't make your next mortgage payment, or if you are already behind, don't wait another minute to find help.

Financial difficulties can make you feel hopeless, but there are ways to find help. The Homeownership Preservation Foundation has joined forces with mortgage lenders, nonprofit organizations and city government agencies to provide homeowners with assistance and resources to help you get back on track.

Call the homeownership hotline at **1-888-995-HOPE** for immediate assistance:

- Receive FREE advice and support from **nonprofit**, **HUD-certified organizations** – 24 hours a day, 7 days a week
- Develop a realistic household budget to help ensure long-term homeownership
- Learn how to work with your lender to bring your mortgage up to date

Call 1-888-995-HOPE

Operated by the Michigan State Housing Development Authority (MSHDA), Michigan's Save the Dream hotline was started in 2007 to direct homeowners to a housing counselor in their county. The hotline was launched as part of the announcement of two new loan refinance initiatives launched to help borrowers facing default.

Helping homeowners to take action, seek counseling and make contact with their lenders are vital to any foreclosure prevention effort. Utilizing a hotline approach has shown to be a successful strategy. Whether a state chooses to tap into a pre-existing national approach or develop its own state-wide hotline, links to well-staffed and skilled counselors is necessary. Hotlines must also be promoted by recurring marketing and outreach strategies and are particularly successful if elected officials take part in the promotion.

7.3 Mandates for early borrower notification of available help

The mortgage servicing industry has a long history of collecting payments from delinquent borrowers. Servicers today operate large call centers and payment management systems to track payments, handle borrower questions and to send borrowers information on the status of their accounts. Servicing prime loans, especially fixed rate loans, is a simple process. Low delinquency rates mean that servicers traditionally do not contact prime borrowers even several weeks after a payment was missed because prime borrowers typically catch up the following month.

Subprime servicing, however, is a very different proposition. Subprime borrowers may not be able to catch up even one week after missing a payment without some sort of corrective action. Moreover, loans with terms that involve increasing payment amounts may require special notice to borrowers. Typically, subprime servicers do not want borrowers to refinance their loan and most have used rules that restrict communication about payment changes to a few months prior to the rate change.

The structure of the servicing industry also can slow borrower communication. During the first 30 to 90 days of delinquency, a borrower will directed to the servicer's collections department. Collections staff are trained in how to encourage borrowers to send in payments but few other issues. After some period of delinquency, borrowers are transferred to loss mitigation departments. Loss mitigation personnel tend to be better trained and are authorized to discuss loan workout options. Other than FHA loans, borrowers in delinquency are not required to hear about housing or default counseling from their lender.

California, Minnesota and Indiana are among the states working to have borrowers receive information about their options earlier in the foreclosure process. California regulators have sought voluntary agreements with servicers to reach out to borrowers with high-risk adjustable rate loans so they can prepare for upcoming payment changes. Minnesota has required lenders to notify borrowers about state foreclosure counseling and assistance services as well as the availability of a referral service that provides access to HUD-approved housing counseling. Indiana requires that information about state-provided resources be included in foreclosure notices. These simple approaches might help borrowers take more proactive actions to cure their default before the foreclosure progresses to a more severe stage.

7.4 Encouragement for lenders to modify loans in default to be more affordable

Loan servicers administer loans made through a variety of channels with a range of terms. A servicing portfolio might include tens of thousands of loans, from which interest and principal has been bundled into hundreds of different mortgage backed securities. The investors in these securities stipulate a particular protocol for collecting payment from loans. All securities have a provision for handling defaults and determining which investors are paid (and which are not) if cash flows are less than predicted. Some loan workouts, such as forbearance plans, do not represent a significant reduction in cash flows to the security. These repayment plans simply push current payments back by 6 to 12 months, but all payments are intended to be repaid. Loan modifications, however, represent a reduction in interest rates or alternation in loan terms. These imply a reduction in cash flow to investors. Investor pooling and servicing agreements (PSAs) usually limit the number of loans in any given bundle that can be modified in order to control potential losses. Servicers generally may not offer modifications until later stages of delinquency, usually after foreclosure has started or is imminent. The problem with this approach is that by the time modification options are offered, borrowers may be too far behind to work out a solution. Increasingly, industry observers suggest that the only chance for many borrowers, especially those with adjustable rate loans facing significant payment increases, is for loans to be modified into fixed-rate loans at more affordable interest rates.

Most lenders and servicers argue they can modify loans on a case-by-case basis. But state leaders, from governors to bank supervisory agency directors, have begun to push for a more wholesale approach of modifying all adjustable rate loans to meet certain criteria. Governors in California, Massachusetts, and Ohio have most prominently suggested that lenders modify loan terms on a larger scale. Meanwhile, the Conference of State Banking Supervisors and a select group of attorneys general have been exploring regulatory, statutory and legal actions to facilitate more loan modifications for mortgages with significant payment shocks in the short term.

8. Reducing the Harm of Foreclosure

Even after foreclosure proceedings have begun, borrowers have options to avoid foreclosure. In fact, historically, as many as half of all delinquent borrowers can avoid foreclosure by curing their delinquency, obtaining a loan workout or selling the home (Cutts and Green 2005). It is unclear if this pattern will be maintained in the current environment, but clearly the start of foreclosure proceedings does not mean that families are destined to lose their homes.

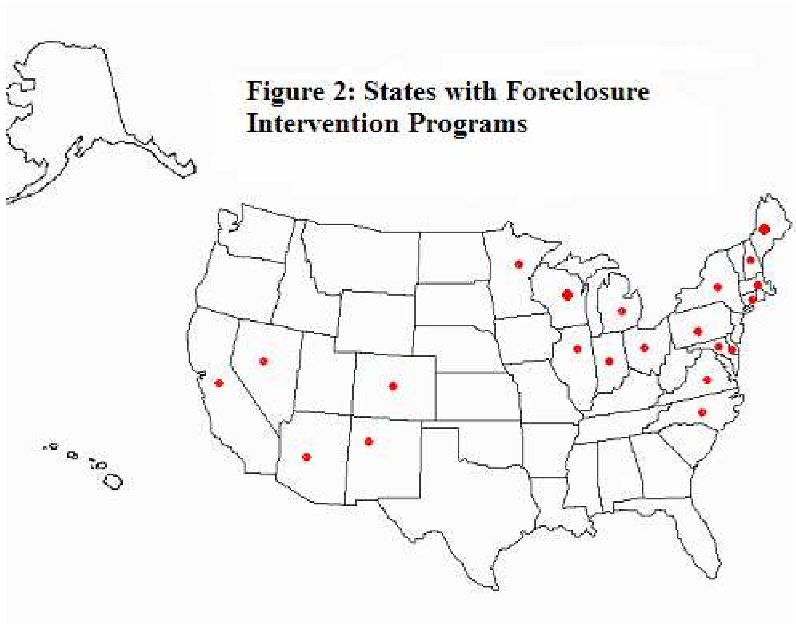


Figure 2: States with Foreclosure Intervention Programs

At least 20 states have launched formal foreclosure intervention programs, in addition to the states promoting or funding housing counseling for borrowers in distress.

8.1 Regulations against foreclosure intervention businesses defrauding borrowers ("Rescue Fraud")

At least nine states have enacted legislation aimed at preventing foreclosure rescue scams. These scams typically involve "foreclosure consultants" who charge clients a fee to help them avoid foreclosure. These "consultants" promise to work with the homeowner's lender or servicer, but often do nothing more than what the borrower could do on his or her own. "Equity property purchasers" also promise to help homeowners stay in their homes. They encourage homeowners to sign the deed of their home over to them and then rent or lease the property back to the homeowner, often with higher payments than the original mortgage amount. In many cases, the homeowner does not realize that they have given up ownership of the property.

Laws aimed at protecting homeowners from foreclosure rescue schemes have generally included the following provisions:

- Notice and cancellation rights of contracts with foreclosure consultants
- Disclosures of terms and conditions, as well as right of rescission
- Capping or prohibiting compensation that the foreclosure consultant can charge and prohibiting payment until all services are performed;
- Rescind or prevent the transfer of property to a foreclosure consultant
- Establishing criminal and civil penalties

While most laws are less than a year old and effects are yet to be seen, many consumer advocates feel that the new laws have created an environment in which it is more difficult for foreclosure consultants to operate. Maryland was one of the first states to pass emergency legislation to address foreclosure rescue scams. Passed in May 2005, the Maryland Protection of Homeowners in Foreclosure Act sought to protect homeowners from unscrupulous organizations that were portraying themselves as rescue outfits. The Act criminalizes the activities and permits damages to be paid to the victim if the consultant knowingly violates the Act. Minnesota (2004), Colorado (2006), Illinois (2006), Indiana (2006), Massachusetts (2007), New Hampshire (2006) and New York (2006) have all enacted similar legislation. Massachusetts regulations only allow distressed property transfers to occur between family members or those that have been organized by nonprofit organizations.

Colorado's Foreclosure Protection Act prohibits foreclosure consultants from charging up-front fees, which eliminates many firms from the market. In addition, the law requires that all agreements made with a foreclosure consultant be in writing, in English and translated into the borrower's native language. Under this law, homeowners have a three-day right of rescission for any agreement signed with a foreclosure consultant. Illinois' Mortgage Fraud Rescue Act of 2007 also requires that any person who seeks to help a homeowner at risk of foreclosure fully discloses, in writing, the terms of the services, all associated costs and a right of rescission. Any sale must be close to the home's appraised value and violators are subject to criminal liability.

8.2 Publicly-supported short-term loans for borrowers facing income reductions

In aggregate, at least $500 million of loan funds have been made available by states as a means of helping borrowers avoid foreclosures through short-term or emergency loans. These loan funds are typically funded by public and private sources, including proceeds from taxable bond issues. In other situations, pools are guaranteed or insured by state agencies to encourage private lenders to participate.

While homeowners seeking help today are less likely to be experiencing situations that result in temporary interruptions in income such as job loss, divorce or medical expenses that may have caused them to fall behind, loan funds that are targeted towards such situations where opportunities for recovery of income exist are an important tool. Many have used such loan funds to become current on their mortgage or to help them maintain their mortgage during a temporary setback such as unemployment

Chicago's HOPI Model

Beginning in 2002 the City of Chicago and NHS Chicago, a leading nonprofit community development agency, began an initiative to address a near doubling of foreclosures in the city, most of which concentrated in low-income neighborhoods. Increasing numbers of vacant buildings began appearing on once stable blocks. Working with the Federal Reserve Bank of Chicago, NHS convened the Home Ownership Preservation Initiative (HOPI) with key lending, investment, and servicing institutions, Seeking to preserve sustainable home ownership and to reclaim foreclosed homes as neighborhood assets HOPI has met at least twice annually releasing research on foreclosure and developing innovative new strategies, many of which have been replicated nationally.

The Homeowners Emergency Assistance Program (HEMAP) in Pennsylvania was one of the first state led foreclosure assistance funds. Designed in the 1980s as the state struggled with a massive transition away from manufacturing employment and record unemployment, the program provides a limited number of short-term (up to two years) loans to help borrowers bridge a period of unemployment. Loans are restricted to borrowers who are in default through no fault of their own and all borrowers must work with local nonprofit housing counselors. The program will make mortgage payments on behalf of the borrowers during the emergency assistance period. HEMAP provides funds to nonprofit agencies to counsel delinquent homeowners and assist them with their application for aid. Mortgage payments are made by HEMAP directly to the lender on the homeowner's behalf, with HEMAP making up the difference between the applicant's monthly contribution and the lender's required payment. The state requires that all lenders must send a notice of the HEMAP to homeowners who are at least 60 days delinquent. In 2004, there were nearly 2,500 approvals for the program. In the last decade, over $160 million in loans were made, most of which were eventually repaid. Delaware, Michigan and Massachusetts have recently created similar funds to provide small emergency assistance loans.

The Minnesota Housing Finance Agency and 18 nonprofit counseling agencies provide counseling and loan funds to prevent mortgage foreclosure as part of the Foreclosure Prevention Assistance Program (FPAP). Delinquent mortgage borrowers receive financial and debt-management counseling as well as help negotiating with lenders and access to emergency loans up to $5,500. For FY'07 (October 1, 2006-September 30, 2007), 94 loans were made totaling $426, 479. Like Pennsylvania, lenders are required to notify delinquent borrowers about the availability of the FPAP program. However, the program is rather limited in scope.

NHS of Chicago also has operated a foreclosure intervention loan program since the 1990s. However, the number of loans made under this program has dramatically decreased over the last couple of years because of the changing nature of the delinquencies. NHS states that those seeking foreclosure intervention require more than a short-term approach to their delinquency.

Short-term, emergency foreclosure prevention loans work well for situations that are temporary in nature and where homeowners are able to demonstrate that they will be able to resume payments. Often, these sort of intervention loans make the most sense in markets where homeowners face foreclosure due to job layoffs. The current mortgage market, with a large number of fully-employed borrowers unable to afford their adjustable rate loans, is not appropriate for this approach. In practice, these loan pools tend to be small relative to the scale of borrowers in need.

Tax Treatment of Forgiven Mortgage Debt

When borrowers are successful in negotiating with lenders to write off a portion of their loan balance, through a short sale, short refinance or other mechanism, the amount of the debt 'forgiven' may be treated by the IRS as income. Lenders may report that income to the IRS on 1099 forms, thus making the borrower responsible for taxes owed, including penalties for non-withholding.

There have been discussions at the national level to change the treatment of mortgage debt released as part of a workout. Several states have explored tax treatment in foreclosure, recommending IRS action as well as changes to state tax codes.

Pennsylvania's program has routinely run out of resources before the end of the fiscal year. Even if small in scale, however, these programs can play a powerful role in gaining public and media attention regarding the foreclosure issue, and can increase the potential for help. If borrowers think they can obtain a grant or loan funds they may be more willing to search for assistance or obtain financial counseling.

8.3 Publicly-supported mortgage refinance funds for borrowers in default

Another strategy at least a half dozen states are offering to homeowners is a refinance option to pay off troubled loans. These refinance programs ensure homeowners can sustain a new mortgage with reasonable loan terms.

For example, Ohio launched the "Opportunity Loan Refinance Program" in April 2007 to help borrowers refinance high-cost loans. The loan program allows lenders to originate fixed-rate loans for eligible borrowers which are then purchased by the Ohio Housing Finance Agency (OHFA) using taxable bonds (at no cost to Ohio taxpayers). To fund the program, $100 million in taxable bonds have been allocated. However, the Ohio Foreclosure Prevention Task Force has asked that OHFA expand its underwriting criteria so that more homeowners can qualify for the program, expanding its size.

In July 2007, New York's "Keep the Dream Alive" program was launched. With $100 million available to help between 500-700 families refinance out of high-risk loans, New York's Housing Finance Agency hopes to help families transition into an affordable, low-interest loan that will increase the likelihood of avoiding foreclosure. Those with interest only, adjustable rate or other unconventional loan terms are being targeted for the program. Borrowers must receive homeownership counseling from approved housing counseling agencies prior to loan approval. Critics say the program is unable to assist New York City homeowners due to loan limits but efforts are underway to expand this.

Massachusetts, Delaware, Pennsylvania, Michigan, and Montana have also announced refinance programs. However, many homeowners are unable to access refinance programs due to severe credit issues, declining property values, and tightening underwriting standards among lenders. Consumer advocates and housing counselors worry that refinance funds are too limited to help homeowners affected by the current subprime crisis. It is important for states to accurately assess the amount of flexibility that is required to meet homeowner's refinance needs and to structure programs appropriately.

Proposals in Congress in late 2007 to increase the amount states can raise by issuing mortgage revenue bonds (MRB) appear promising. Many housing advocates have long argued the state MRB maximum issuances—also called the "MRB cap"—are set at too low a rate. At least one proposal would raise the per capita amount each state can raise by issuing tax-advantaged mortgage revenue bonds when the proceeds are used for refinancing troubled subprime loans.

Table 3: Summary of Loan Funds

State	Fund	Use	Amount
Delaware	Emergency Mortgage Assistance Program	Up to $15,000 emergency loan for borrowers in foreclosure to pay past due balance and/or up to 12 future mortgage payments	$2 million
Maryland	Lifeline Refinance Mortgage Program	Borrowers with ARM or interest only loan with upcoming reset can receive 40 year fixed rate loan – within income limits	$100 million, including $10 million loan loss reserve and $25 million in housing agency bonds
Massachusetts	Home Saver Foreclosure Prevention Program	Borrowers up to 60 days behind victim of predatory lending	$250 million, including $60 in taxable bonds as guarantee
Michigan	Adjustable Rate Mortgage Refinance	Refinance ARMs into below-market rate fixed rate loans before delinquent	Funded by taxable bonds
Michigan	Rescue Refinance Program	Refinance ARMs into below-market rate fixed rate loans after delinquent at risk of losing their home	Funded by taxable bonds
New Jersey	Homeownership Preservation Refinance Program (HPRP)	Refinance for borrowers who cannot rate reset or other loan terms or have been denied a loan modification.30 and 40 year fixed rate loans available. Must meet income and maximum mortgage limits.	$30 million
New York	Keep the Dream Mortgage Refinance Program	Borrowers with ARM or interest only loan with upcoming reset can receive 40 year fixed rate loan – within income limits	$100 million
Ohio	Opportunity Loan Refinance Program	Refinance ARMs into fixed rate loans before delinquent – within income limits	$100-500 million in taxable bond proceeds
Pennsylvania	Refinance to an Affordable Loan (REAL)	PHFA buys current loan for borrowers unable to afford their current loan or who owe more than the home is worth	$25 million bond issue
Pennsylvania	Homeowner Equity Recovery Opportunity (HERO)	Refinance ARMs into below-market rate fixed rate loans for borrowers less than 60 days delinquent	$25 million bond issue
Pennsylvania	Emergency Mortgage Assistance Program (HEMAP)	Short term loan to bring back payments up to date; Also ongoing assistance with up to 24 payments.	Approx. $20 million annually from loan repayments and annual appropriation

8.4 Addressing Foreclosure, Vacancies, Turnover and Blight

Foreclosures have always been a cause for alarm for neighborhood groups due to the potential for these properties to become neglected and vacant. While many localities have programs in place to deal with troubled properties, these efforts were designed to deal with existing vacant properties, not a rising tide of vacant homes in a short time period in otherwise stable neighborhoods. The scale and cost of addressing the rehabilitation needs of older vacant properties can be daunting under any environment. With a large volume of properties entering foreclosure, efforts to deal with vacant, foreclosed properties will become more challenging and more important for neighborhood preservation and revitalization.

Both Massachusetts and Minnesota have recently announced programs to address the increase in vacancies left in the wake of the current foreclosure crisis. In addition, the Ohio Foreclosure Prevention Task Force has recommended strategies to deal with the aftermath of foreclosures. These states, and efforts emerging in other states, generally include the following strategies:

- Expedite property transfers once a foreclosure judgment is completed, getting the property into the hands of the new owner occupant as quickly as possible.
  - Ohio is using a system whereby specially-appointed master commissioners administer the post-judgment process from entry of judgment to transfer of title.
  - Ohio is considering a two-track system that would quickly move investor properties through foreclosure as opposed to owner-occupied properties.
- Grants for property rehabilitation. The costs of deferred maintenance and major repairs for homes in foreclosure can be significant. In many cases, rehab costs are greater than market rates necessitating subsidy to cover appraisal gaps. In some cases homes simply need to be demolished.
  - Illinois and Minnesota have developed small programs to recover properties from lender REO (Real Estate Owned—that is homes lenders have taken possession of and need to sell off) and then turn them over to local community development organizations to renovate for first-time homebuyers. While the number of properties remains small, homes located in targeted areas can have a significant impact.
- Funding and recognition for municipal code enforcement, land banking and neighborhood planning and redevelopment.
  - Ohio has explored using tax foreclosures to secure properties or propel rehabilitation.
  - State housing finance agencies can also prioritize use of Low Income Housing Tax Credits to help redevelop vacant properties

Because REO properties are a depreciating asset, lenders are increasingly willing to sell properties in bulk at a significant discount or even donate some properties to a public entity or nonprofit development agency. This can require significant capital resources, extensive negotiation and carefully managed housing construction activities. Combined with the scattered site nature of single family homes in foreclosure and the poor quality and location of the most depreciated REOs, taking on a portfolio of properties should be approached with great caution. The experiences of the City of Chicago and Chicago NHS as part of the HOPI initiative suggest the costs of such a program can actually exceed the costs of building new homes.

A related issue for homes in foreclosure which contain one or more rental units is what happens to existing tenants. Have paying renters provides at least some cash flow for maintenance, taxes and other expenses. But when marketing a home in foreclosure, potential new owners generally prefer an empty property which they can invest in and then sign leases with new tenants. There are few protections for renters in a property in foreclosure and many may find they are evicted on short notice. Massachusetts, Illinois and Minnesota have explored additional protections to provide some extended availability of housing for renters in these situations.

8.5 State Foreclosure Task Forces

Task forces centered around foreclosure intervention strategies have helped many states to marshal resources and their efforts have greatly increased their ability to implement those strategies. Task forces have generally included members from the financial industry as well as representatives from nonprofit agencies, state and local government. These bodies set priorities and help keep the issue of foreclosure in the public spotlight.

Convened by the Governor in March 2007 and chaired by the Director of the Ohio Department of Commerce, the Ohio Foreclosure Prevention Task Force was made up of 25 members from government, industry, and the nonprofit sector. The task force approved 27 recommendations under seven themes. Recommendations included the following:

- the development of public awareness campaigns,
- funding goals for counseling including at least $2 million in new state funds,
- more flexibility within Pooling and Servicing Agreements (PSAs),
- improvements to Ohio's foreclosure processes,
- stronger protections for homeowners, and
- strategies for dealing with the aftermath of increased numbers of foreclosed homes.

Ohio's task force included the involvement of high-ranking government officials as well as the experienced nonprofit practitioners and staff of financial institutions. Workgroups developed that included the knowledge and expertise needed to formulate appropriate recommendations, including support for specific state legislative initiatives. In the final report, a group from the lending community included a dissenting "minority report" expressing alternative perspectives on a number of points, most prominently the task force's emphasis on loan modifications for borrowers in default.

Goals and Outcomes of the New York Halt Abusive Lending Transactions, the HALT Interagency Task Force:

Analyze foreclosure data
  - report issued
- Develop refinance programs to help homeowners
  - completed
- Create statewide outreach and educational campaigns targeting vulnerable borrowers
  - program begun
- Expand consumer protections
  - recommendations presented
- Pursue enforcement actions against those engaging in wrongful conduct
  - legal actions being investigated

Another state task force that continues to implement strategies is Massachusetts's Mortgage Summit Working Groups. Convened by the Massachusetts Division of Banks, the Summit was held in November 2006 and produced two working groups which focused their work on Rules and Enforcement and Consumer Education and Foreclosure Assistance. The group issued a report in April 2007 entitled, "Report of the Mortgage Summit Working Groups-Recommended Solutions to Prevent Foreclosures and Ensure Massachusetts Consumers Maintain the Dream of Homeownership." Figure 3 illustrates this group's primary findings.

While not convened by the state, advocates in Colorado successfully pulled together a varied group to form the Colorado Foreclosure Prevention Task Force. This group's main achievement to date has been the Colorado Foreclosure Hotline which fields calls from state residents who are having trouble making their mortgage payment. This task force provided a fast and efficient process for the development and implementation of the hotline and provides the space necessary to raise funds for the service.

Task forces pull together stakeholders, help circulate foreclosure research, and tap into member's knowledge and expertise to generate solutions. While it is only one of many steps that states can take to address rising foreclosures, a task force can engage the necessary players and can also hold them accountable for progress.

Figure 3: Massachusetts Task Force Recommendations: 2007

1. Criminalize Mortgage Fraud

Goal: Mortgage fraud becomes a criminal offense with a penalty up to 10 years imprisonment and/or $50,000 fine. Multiple cases of fraud could receive up to 20 years imprisonment and fines up to $500,000.

Status: Requires legislation or emergency regulation by the Office of the Attorney General.

2. Increase Mortgage Licensing Requirements

Goal: Support National Mortgage Licensing System (NMLS) and expand licensing requirements to include all mortgage originators, increase capitalization and net worth requirements for brokers and lenders, require minimum licensing requirements of 5 years for lenders and 3 years for brokers.

Status: Division of Banks proposed regulations for minimum experience requirements for brokers and lenders as well as increased net worth requirements and a surety bond for lenders and brokers.

3. Increase Funding of the Division of Banks

Goal: Increase enforcement ability of Division of Banks by increasing mortgage lender and broker fees.

Status: Governor supported legislation to provide the Division of Banks funding for enforcement.

4. Adopt Federal guidance on non-traditional mortgages

Goal: Adopt parallel guidance that can be applied to lenders that are not federally regulated.

Status: Division of Banks adopted parallel guidance in January 2007 for non-traditional mortgages such as interest only and payment option ARMs.

5. Change Foreclosure Laws

Goal: Improve rights of consumers in the foreclosure process.

Status: Governor supported legislation to require pre-foreclosure notification to homeowners and the Division of Banks and post-foreclosure reporting of costs and proceeds of the home sale.

6. Create Foreclosure Database

Goal: Division of Banks to develop a database to track information on pre-foreclosure notification and foreclosure petitions.

Status: Legislation introduced to require that the name and license number of lender and broker be recorded on all mortgages when filed with the registry of deeds.

7. Prevent Foreclosure Rescue Scams

Goal: Require that transactions with foreclosure consultants be in writing and no payment until all services rendered. Provide a 5 day grace period to cancel the contract.

Status: Attorney General emergency regulations prohibiting unfair and deceptive foreclosure rescue scams were introduced preventing distressed property transfers only to non-profits, between family members or arranged by a non-profit community or housing organization.

8. Increase consumer awareness around foreclosures and increase resources

Goal: Support of statewide and grassroots awareness campaign in multiple languages; increase availability of homeownership counseling and borrower workshops by non-profit agencies.

Status: Developing partnership with The Homeownership Preservation Foundation

9. Create Foreclosure Intervention Products

Goal: Create a mortgage product to help refinance out of unsustainable loans and provide credit enhancements for high-risk mortgages. Seek participation of private lenders.

Status: MassHousing established $250 million Loan Refinance Program offering fixed-rate refinance loans.

9.0 The Role of National Initiatives

There are several national initiatives related to foreclosure intervention that states can use as complementary resources. These programs are all relatively new in their development, and additional efforts are underway which could be initiated in 2008. As of late 2007, however, the key efforts state policymakers should examine include FHASecure, the National Mortgage Licensing System (NMLS) and the HOPE NOW Alliance.

9.1 FHA as a Refinance Source

State housing finance agencies tend to be a major use of Federal Housing Administration (FHA)-insured mortgage products. Until the emergence of subprime loans, these loans were the high risk alternative available for borrowers with credit problems or who were unable to qualify for other loans. With the growth of the subprime market, the use of FHA loans has declined markedly. Recent efforts have aimed to revise FHA so it may engage in lending to a wider array of borrowers, and potentially complete with subprime loans. In August 2007, FHA launched FHASecure. This loan program has flexible underwriting criteria and can be used to refinance certain adjustable rate loans even for delinquent borrowers. Borrowers with interest-only and payment-option adjustable-rate mortgages can pay off their mortgage and take out an FHASecure program loan, assuming they can afford the payments and have positive equity in their home. Borrowers can also pay off delinquent loan payments with the new FHASecure loan.

These loans are available only through FHA approved lenders to owner-occupants (no investors) with an existing non-FHA insured ARM that has a reset provision between June 2005 and December 2009. Borrowers must have a history of on-time mortgage payments at least six-month before the loan reset. Loans may be for up to 97% of the home's value and borrowers may not be approved if the mortgage payment exceeds 31% of their income. Also borrowers may not have a ratio of total debt to income of more than 43% of total income.

Because most state housing finance agencies have an existing relationship with FHA-approved lenders and many housing agency mortgage products are FHA insured, the

FHASecure loan may prove to be a valuable tool. Of course there are restrictions on these loans, notably the loan to value ration and income to debt ratio. States may be able to offer second mortgages and grants to help more borrowers qualify for these loans, but for many borrowers in serious distress these loans will not be available.

9.2 Promoting Accountability of Mortgage Professionals—the NMLS

Many states have implemented licensing requirements and standards for individual loan originators that include education requirements, testing, and criminal background checks. Currently, approximately 36 states require licensing or registration of individual loan originators. The goal of creating accountability among state mortgage professionals to prevent mortgage fraud has led to the creation of the Nationwide Mortgage Licensing System (NMLS) by the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR). This web-based system will allow state-licensed mortgage lenders, mortgage brokers, and loan officers to apply for, amend, update or renew a license online for all participating state agencies using a single set of uniform applications.

The program is set to begin in early 2008 with seven states and will expand as more states are added to the system in 2009. Once underway, the registry will be operated by the State Regulatory Registry, LLC, a nonprofit organization. The system is voluntary but does rely on states using common forms and data fields. In some states this will require enabling legislation and/or redesigned licensing forms to comply. To date, 40 state agencies have signed a Statement of Intent to be part of the system. The NMLS will create a single record for each licensed company, branch and loan officer and each control person, regardless of the number of states in which they conduct licensed activities. The goal is to enhance transparency within the industry and to provide greater consumer protection.

The system does not cover federally chartered or state chartered banks, however. Critics point out that some of the largest and most recent fines and settlements for abusive lending practices went to banks that will not be included in the NMLS. They argue that not until all originators are subject to the same requirements, will true consumer protection be achieved. CSBC estimates that the database will cover approximately 70% of all loan originators.

9.3 The HOPE NOW Alliance

The U.S. Department of Treasury and the Department of Housing and Urban Development encouraged leaders within the financial, servicing, counseling, investment and other mortgage markets to gather together under the HOPE NOW Alliance (www.hopenow.com). The Alliance coordinates efforts to improve outreach efforts to assist homeowners who are behind on their mortgage. Begun in late 2007, the Alliance includes investors and mortgage securities dealers in an effort to seek larger scale methods of delivering loan workouts and counseling to borrowers at risk of default. The Alliance represents 11 lenders servicing more than four out of five subprime loans in the market.

HOPE NOW has established a national direct mail campaign to contact at-risk borrowers, encouraging them to call their lender or a housing counselor through The Homeownership Preservation Foundation's 888-995-HOPE hotline. It has also recommended a standard model of communication between loan servicers and third-party counselors, and is developing a shared platform for servicers and counselors to develop options for borrowers. The Alliance supports expanding telephone counseling including the reimbursement of counseling fees from securitization.

In November 2007 HOPE NOW sent 300,000 letters to homeowners at risk of foreclosure encouraging them to contact the HOPE Hotline. Development of a web-based servicing tool that will help loss mitigation specialists and counselors reach loan workout decisions using a common decision platform is also in process with a blend of public, charitable and private sector support.

In December 2007 the HOPE NOW Alliance released information regarding a plan to allow some borrowers with adjustable rate mortgages due to reset to freeze their interest rates at current levels. This is the first evidence that lenders and investors are willing to consider 'wholesale level' loan modifications for any borrower with loan meeting specific criteria, as opposed to a case-by-case review. Such modifications would be offered to borrowers for whom homeownership is still viable and not currently in foreclosure.

The rate freeze will be in effect for five years, after which time interest rates will reset or the borrower will need to refinance into another loan, if one is available. Only borrowers with a loan originated between before 2005 and July 2007 qualify, and only those borrowers with a credit score below 660. Although the federal officials suggest up to 1.2 million borrowers qualify for the five-year freeze on mortgage rate resets rates, other analysts have suggested as few as 150,000 to 350,000 actually qualify according the current HOPE NOW provisions. Additionally, only owner-occupants qualify—not investors.

While rate resets have grabbed media attention, and some families will face significant increases in their payments, the bigger risk for further foreclosures is the softening of the real estate market. A study by economists at the Federal Reserve of Boston examining 12 years of data on Massachusetts homebuyers finds 18 percent of homes initially financed with a subprime mortgage experienced at least the start of foreclosure proceedings at least once (Gerardi, Shapiro and Willen, 2007). The authors conclude the most significant factor in modeling foreclosure are home prices. Subprime borrowers are most sensitive to declining home values, especially if they have little remaining equity.

Critics are quick to point out the HOPE NOW effort will only help a portion of borrowers at risk of default. While it may achieve faster results than case-by-case loan reviews by loan servicers, for some borrowers this effort will only delay the inevitable foreclosure. If housing values continue to decline and borrowers have no refinance alternatives as the supply of subprime credit retreats, lower payments for even five years may not be sufficient to prevent defaults.

10.0 Measuring Outcomes

States obviously want to establish accountability measures to evaluate the effectiveness of ant-foreclosure efforts. However, it can be challenging to evaluate a foreclosure prevention system without complicated designs. Rather than conducting an evaluation to prove how the effort causes foreclosures not to happen, most states focus instead on tracking the activities of programs.

Existing studies of programs in Chicago and Minnesota suggest that counseling programs, when delivered at the appropriate time, can help borrower to avoid foreclosure. Data from counseling hotlines also has provided indications that services can present new options to borrowers searching for help. State initiatives should design systems to track data appropriate for the initiative involved. For example:

Hotlines & Counseling:
- How borrower heard about service
- Main reason for delinquency
- Loan amount
- Income
- Number of payments behind
- Type of loan (ARM, Interest Only)
- Lender / Servicer Name
- Date of foreclosure filing
- Cumulative length of counseling
- Property Address

Loan Programs:
- Number of loans
- Amount of loans
- Type of loans / type of previous loans refinanced
- Loan repayment rates

Prosecution of Fraud
- Type of fraud
- Dollar value lost / at-risk
- Referrals to other services

Vacant Property Reclamation:
- Number of properties
- Appraised values
- Repair / Rehabilitation investment
- Resale value
- Demographics of new occupants

These data will provide many insights into who is being served and provide information about the nature of foreclosures and the need for services. Regular, tangible data is very important to garner ongoing support for a foreclosure intervention project.

In addition to the data collection described above, a follow up survey can be conducted though the mail or telephone to a sample of clients. This can include questions about how well services were perceived and how helpful they were to the borrower's outcome. Another approach is to monitor public records to see how borrowers seeking help fare after receiving services. If few borrowers move into foreclosure then the program could be viewed as having a positive effect. Even better is to compare the performance of borrowers receiving services to those who do not, providing a stronger comparison group. In some cases, lenders may be willing to track the loan performance of a sample of borrowers receiving help compared to other borrowers. Often such data is difficult to track and share, but this data is very valuable for monitoring services.

11.0 Conclusions

Foreclosure are an increasing threat to families and neighborhoods. In addition to the financial and social losses borrowers suffer, foreclosures also spill over into neighboring areas as homes to fall into disrepair during the default and foreclosure process and depress neighborhood home values. These external costs can be significant for local communities. Recognizing these threats, and armed with legislative and regulatory approaches, states are making strides to reduce the number of high-risk loans being made and mitigate the harm of foreclosures for families and neighborhoods.

While media attention has focused on subprime loans, the weakness of home values and retreat of credit to conventional suggests rising levels of default should be expected for a wider set of the market. This makes it more difficult for state leaders to ignore foreclosure as a public policy issue.

While most existing state foreclosure programs are modest in scale, they offer hope for borrowers and make be able to expand given further resources. While many state foreclosure intervention policies and programs reviewed could be replicated in other states, not all strategies are appropriate for all areas. States with softer job markets may need more payment assistance programs, for example, while states with overheated home prices may need fixed rate refinance loan programs.

As of late 2007, efforts at the national level are promising, but do not obviate the need for continuing efforts at state and local levels. States are likely to continue to be at the vanguard of addressing issues of high risk lending and foreclosure.

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Web Sites for More Information

Center for Responsible Lending
The Center for Responsible Lending (CRL) is a unit of the Center for Community Self-Help (Self-Help), based in Durham, NC. Self-Help is one of the nation's leading community development lenders and has provided $3.5 billion in financing to help more than 40,000 under-served families own homes or small businesses. The CRL is partnering with other like-minded organizations to sustain the initial success of anti-predatory lending laws and continue reform efforts federally and in other states. The main components of its work are legislative and policy advocacy, coalition-building, litigation, and industry research. www.responsiblelending.org

Homeowners Emergency Mortgage Assistance Program (HEMAP)
One of the first of its kind, the HEMAP program provides eligible Pennsylvania residents who are facing foreclosure with assistance through its loan fund. www.phfa.org

Homeownership Preservation Foundation
The Homeownership Preservation Foundation creates partnerships with local governments, nonprofit organizations, borrowers and lenders to help families overcome obstacles that could result in the loss of their homes. HPF offers 1-888-895-HOPE, a national homeowner assistance line to help individuals and families who are struggling financially. www.hpf-online.org

National Consumer Law Center (NCLC)
The National Consumer Law Center is America's consumer law expert, helping consumers, their advocates, and public policy makers to use powerful consumer laws to build financial security and assure marketplace justice for vulnerable individuals and families. Provides training to attorneys interested in doing pro-bono work for non profit organizations. www.consumerlaw.org

NeighborWorks America
NeighborWorks America is a national nonprofit organization that works to revitalize communities through affordable housing opportunities, training, and technical assistance. The Center for Foreclosure Solutions was created by NWA to reduce the rate of foreclosures as well as the negative impact of foreclosures on borrowers and communities. The Center is convening and supporting a coordinated foreclosure prevention and intervention strategy in communities nationwide**.** www.nw.org

The Reinvestment Fund
TRF is a national leader in the financing of neighborhood revitalization. What began in 1985 as a small community development organization working in Greater Philadelphia, has evolved into a progressive, results-oriented, socially responsible community investment group that today works across the Mid-Atlantic region. Recent work includes studies on foreclosure filings in Delaware and Pennsylvania. www.trfund.org

Appendix Table 1: Summary of State Lending and Foreclosure Interventions

	High Cost Loan Law/Regulation	Other Mortgage Origination Law/Regulation	Foreclosure Intervention Law/Regulation	Statewide Consumer Education Campaign / Hotline	Statewide Foreclosure Task Force
Alabama		2001 SB 38 (broker licensing)			
Alaska		2007 HB 162 (broker/lender credentialing)		YES (2005)	
Arizona		2007 HB 2040 SB1221 (Residential Mortgage Fraud)		YES (2002) HOTLINE	YES (2007)
Arkansas	2002 Arkansas Home Loan Protection Act 1340 (high cost loan regulations)	2004 Fair Mortgage Lending Act (broker licensing credentialing) rev 2007			
California	2002 California Covered Loan Law 4970 (high cost loans; disclosure; counseling recommended; lower trigger than HOEPA, referral to counseling hotline)	1994 Finance Lenders Law (broker/lender licensing and credentialing)	2007 Department of Corporations Release No. 61-FS (Notice to loan servicers)		YES (2007)
Colorado	2002 Colorado Consumer Equity Protection Act (high cost loans; disclosure)	2007 SB 203 (Mortgage Broker Licensing)	2007 HB 1322 (Mortgage Fraud Prevention Act)	YES (2006)	YES (2006)
Connecticut	2001 HB 6131; 2002 HB 5073 Connecticut Abusive Home Loan Lending Practices Act (high cost loans)	1995 First Mortgage Broker License Act (broker licensing and credentialing)		YES (2005) HOTLINE	YES (2007)
Delaware			2006 Emergency Mortgage Assistance Program (DEMAP)	YES (2001) HOTLINE	
District of Columbia	2002 Home Loan Protection Act Title 26A Ch 20 (high cost loans; disclosures; counseling recommended)	1996 Mortgage Lender law (broker/lender licensing)			
Florida	2002 Florida Fair Lending Act SB 2262 (high cost loans; disclosure; counseling recommended)	2007 SB 1824 (Mortgage broker regulation)		YES (2007) HOTLINE	
Georgia	2002 Georgia Fair Lending Act HB 1361 (high cost loans; counseling required; lower trigger than HOEPA)	1994 Georgia Residential Mortgage Act (broker licensing and credentialing)			
Hawaii		2007 Mortgage Brokers And Solicitors Act (broker licensing and credentialing)	2007 HB 1306 HB 1336 (Mortgage fraud against seniors)		
Idaho		1996 Residential Mortgage Practices Act (broker licensing and credentialing)			

	High Cost Loan Law/Regulation	Other Mortgage Origination Law/Regulation	Foreclosure Intervention Law/Regulation	Statewide Consumer Education Campaign / Hotline	Statewide Foreclosure Task Force
Illinois	2003 815 ILCS 137 High Risk Home Loan Act (high cost loans; disclosure; counseling recommended; lower triggers than HOEPA)	1987 Residential Mortgage License Act (broker/lender licensing and credentialing)	2006 Mortgage Rescue Fraud Act	YES (2004) HOTLINE	YES (2006)
Indiana	2005 Home Loan Practices ("Article 9") (high cost loans; disclosure; counseling recommended)	2004 Indiana Loan Broker Act (broker licensing and credentialing)	2007 SB 0390 Mortgage Rescue Fraud Law 2007 HB 1753 (counseling)	YES (2006) HOTLINE	YES (2006)
Iowa				YES (2007) HOTLINE	
Kansas	2000 Regulation of Agreements and Practices (16a-3-207) (high LTV loans; mentions counseling is available)	2006 Mortgage Business Act (broker/lender licensing and credentialing)			
Kentucky	2003 High-Cost Home Loan Law (high cost loans; counseling recommended, disclosure) 2006 Predatory lending law	2004 Mortgage Broker License (286.08) (broker/lender licensing and credentialing)		YES (2005)	
Louisiana		1999 Louisiana Residential Mortgage Lending Act (broker/lender licensing and credentialing)			
Maine	2003 PL49 (high cost loans; disclosure) 2007 Predatory Lending Law (counseling required)	2007 Act To Protect Maine Homeowners from Predatory Lending (broker licensing)			
Maryland	2002 Maryland Covered Loan Law (high cost loans; disclosure; counseling recommended at application; lower triggers than HOEPA)	2005 Financial Regulation License HB 1040 (broker/lender licensing and credentialing)	2005 Foreclosure Counseling Services Law (mandates borrowers in foreclosure be referred to counseling); 2006 Lifeline Refinance Mortgage Program; 2007 Homeowners Preserving Equity (HOPE)	YES (2005) HOTLINE	YES (2007)
Massachusetts	2004 Predatory Home Loan Practices Act (high cost loans; counseling required; lower triggers than HOEPA)		2007 Home Saver Foreclosure Prevention Program (Foreclosure prevention loan fund)	YES (2005) HOTLINE	YES (2006)
Michigan	2002 Consumer Mortgage Protection Act (disclosure; counseling recommended at application, referred to counseling hotline)		2007 Adjustable Rate Mortgage Program and Rescue Refinance Program	YES (2006)	YES (2006)
Minnesota	2002 Residential Mortgage Originator and Servicer Licensing Act (disclosure) 2007 Predatory Mortgage Practices (high cost loan regulations)	2007 HF1004/SF 809 (broker regulation)	2007 Foreclosure prevention loan fund; Funding for expanding counseling	YES (2003) HOTLINE	YES (2007)
Mississippi		2000 SB 3100 Mortgage Licensing Law (broker regulation)		YES (2006)	
Missouri			2007 Foreclosure Rescue Ffraud		

	High Cost Loan Law/Regulation	Other Mortgage Origination Law/Regulation	Foreclosure Intervention Law/Regulation	Statewide Consumer Education Campaign / Hotline	Statewide Foreclosure Task Force
Montana		2003 Montana Mortgage Broker and Loan Originator Licensing Act (broker/lender licensing and credentialing)		YES (2007) HOTLINE	
Nebraska		2007 Mortgage Bankers Registration and Licensing Act			
Nevada	2007 Predatory lending law (high cost loan regulations)	2004 Mortgage Brokers and Mortgage Agents (broker/lender licensing and credentialing)- rev 2007	2007 Predatory lending law (Rescue fraud prevention)	HOTLINE PROPOSED 2007	
New Hampshire			2007 Foreclosure consultant practices act (rescue fraud prevention)		
New Jersey	2002 New Jersey Home Ownership Security Act (high cost loans; disclosure; counseling required)	1996 New Jersey Licensed Lenders Act (broker/lender licensing and credentialing)			
New Mexico	2003 Home Loan Protection Act (high cost loans; lower triggers than HOEPA; disclosure; counseling recommended)			YES (2004) HOTLINE	YES (2007)
New York	2000 High-Cost Home Loan Law (lower triggers than HOEPA; disclosure; counseling recommended) Rev 2007		2007 Home Equity Theft Prevention Act (rescue fraud); 2007 Keep the Dream refinance fund; 2007 HALT	YES (2007)	YES (2007)
North Carolina	1999 High-Cost Home Loan law (high cost loan regulations; counseling required)	2001 Mortgage Lending Act (broker licensing)	2007 HB 1374 Consumer protections in loan servicing	YES (2001)	
North Dakota					
Ohio	2002 HB 386 Sec. 1349.26 (high cost loan regulations; disclosure) 2006 Homebuyer Protection Act	2002 Mortgage Broker Act (broker registration)	2007 Opportunity Loan Refinance Program	YES (2005) HOTLINE	YES (2007)
Oklahoma	2003 Home Ownership and Equity Protection Act (high cost loan regulations, counseling recommended)	1997 Mortgage Broker Licensure Act (broker/lender licensing and credentialing)		YES (2006)	
Oregon		Mortgage Bankers and Brokers Law (broker/lender licensing and credentialing)			
Pennsylvania	2001 Consumer Equity Protection Act (high cost loans; counseling recommended, disclosures)	1989 Mortgage Bankers and Brokers and Consumer Equity Protection Act. (broker licensing and credentialing) rev 2001	2007 Refinance to an Affordable Loan (REAL); Homeowner Equity Recovery Opportunity (HERO)		
Rhode Island	2006 Home Loan Protection Act (high cost loan regulations; disclosure, counseling required; lower threshold than HOEPA)	Rhode Island Mortgage Broker License Law (broker licensing and credentialing)	2006 Madeline Walker Act (rescue fraud prevention)	YES (2002)	

	High Cost Loan Law/Regulation	Other Mortgage Origination Law/Regulation	Foreclosure Intervention Law/Regulation	Statewide Consumer Education Campaign	Statewide Foreclosure Task Force
South Carolina	2003 High-Cost and Consumer Home Loans Act (high cost loan regulations; counseling required)	2005 Registration of Mortgage Loan Brokers (Title 40) (broker/lender licensing and credentialing)		YES (2002)	
South Dakota					
Tennessee	2006 Home Loan Protection Act (high cost loan regulations; counseling recommended, disclosure)				
Texas	2002 High Cost Home Loan Law (high cost loan regulations; counseling recommended, referral to counseling hotline)	2000 Mortgage Broker License Act (broker licensing and credentialing)			
Utah	2004 High Cost Home Loan Act (high cost loan regulations; disclosure; counseling recommended)	2007 Utah Residential Mortgage Practices Act (broker/lender licensing and credentialing)			
Vermont					
Virginia		1987 Mortgage Lender and Broker Act (broker registration)			YES (2007)
Washington		1994 Mortgage Broker Practices Act (broker/lender licensing and credentialing)			
West Virginia		2000 Residential Mortgage Lender, Broker and Service Act (fee restrictions)			
Wisconsin	2004 Responsible High Cost Mortgage Lending law (high cost loan regulations, counseling recommended)			YES (2007)	
Wyoming					