# WASTED WEALTH


## Why Banks Should Fix Mortgages Instead of Foreclosing On Homes

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# Introduction/Summary of Findings

More than four years since the beginning of the mortgage meltdown that plunged the United States into the worst financial crisis since the Great Depression, **housing is still the biggest obstacle to economic recovery.**[1] Middle-class families lost 40 percent of their net worth in the recession, most of it due to the housing crash, and are no better off today than they were 20 years ago.[2] Nearly one in four Americans owes more on their mortgage than their home is worth.[3] The unemployment rate remains above 8 percent, with more than 12 million unemployed.[4] Banks' lending to small businesses that create jobs has fallen to a 12-year low.[5] Foreclosures are expected to rise significantly this year and drag housing prices down even further.[6]

Minnesota had more than 21,000 foreclosures in 2011, three times more than in 2005. 13,181 of them were in the Twin Cities metro area.[7] This report looks at a sample of recent foreclosures in Minneapolis and finds that **banks are not doing enough to end the foreclosure crisis and its associated economic destruction.**

- Lenders with a history of improper mortgage servicing and foreclosure practices account for *at least half* of the foreclosures in Minneapolis.

- On average, banks lose more than $93,400, or *half* of the principal they are owed, when they foreclose on a home in Minneapolis. Banks could forgive the principal instead, keep many more people in their homes, and still come out ahead.

- Underwater homeowners in Minneapolis would need an average principal reduction of 35 percent to get right side up, significantly less than the loss banks incur on foreclosures.

- If banks reset mortgages to current interest rates and market value, they could save underwater Minnesota homeowners an average of $365/month on their mortgage payment, pumping more than $402 million into the local economy every year, which would help create more than 5,941 new jobs annually.

Most experts agree the only real way to fix the housing market is for banks to write down principal on underwater mortgages.[8] Widespread principal reduction is not only key to get the economy moving again—it is the right thing to do.

# "Unsafe and Unsound"

Many foreclosures can and should be avoided, but as the foreclosure crisis has exploded, mortgage servicers' response has been painfully inadequate. A group of state attorneys general and bank regulators found that, three years into the foreclosure crisis, mortgage servicers were reaching less than half of delinquent borrowers with foreclosure prevention efforts: [9]

> **"[T]oo many homeowners experience foreclosure when finding an alternative solution would be in the interest of both the homeowner and the mortgage holder.** Preventing these unnecessary foreclosures would help not only the struggling homeowners and mortgage investors, but **also the neighborhoods and local governments that bear the indirect costs of foreclosures."[10]**

In a government survey of nonprofit housing counselors last year, 76 percent of the counselors reported that overall their clients had a "negative" or "very negative" experience with their mortgage servicers. The most commonly cited problems were of homeowners receiving inconsistent or confusing information, speaking to a different representative each time they called, servicers losing their paperwork, and the decision-making process taking too long.[11]

The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Office of Thrift Supervision announced April 13, 2011, enforcement actions April 13, 2011 against 12 large residential mortgage servicers and two third-party vendors for **unsafe and unsound practices related to residential mortgage servicing and foreclosure processing.[12]**

The servicers are: Aurora Bank, Bank of America, Citibank, Everbank, HSBC Bank, JPMorgan Chase Bank, MetLife Bank, OneWest Bank, PNC Bank, Sovereign Bank, U.S. Bank and Wells Fargo Bank. The vendors are Lender Processing Services and MERSCORP. The reviews found critical weaknesses in servicers' foreclosure governance processes, foreclosure document preparation processes, and oversight and monitoring of third-party vendors, including foreclosure attorneys.[13] Some of the practices they found became commonly known as "robo-signing."

**These banks and service providers with documented improper practices serviced the mortgages on 50percent of homes in foreclosure in Minneapolis.[14]**

## Race, Predatory Lending, and Lost Wealth

African Americans and Latinos have been hit especially hard by the housing crisis.

The racial disparities in subprime mortgage lending have been well-documented. Minority borrowers were much more likely than white borrowers to receive high-cost subprime loans.[20]

Wells Fargo, the top mortgage lender in Minnesota, was a major player in the subprime crisis that crashed the economy and has been the subject of fines, investigations, and lawsuits related to its lending and foreclosure practices.[21]

Wells Fargo's lending practices in Minneapolis from 2005–2009 show a pattern of subprime lending with disparate impacts on minority borrowers. In Minneapolis, **Wells Fargo was 4.8 times as likely to make subprime loans to African American borrowers** as white borrowers. **Latinos were 2.4 times as likely as whites to receive a subprime loan** from Wells Fargo.[22]

What's more, the bursting of the housing bubble and subsequent recession has fueled a record-high wealth gap between whites, African Americans and Latinos. Minority households experienced greater losses because home equity constituted a relatively large portion of their wealth compared to other types of assets. **Median wealth fell by 66 percent among Hispanic households, 53 percent among black households, and just 16 percent among white households.[23]**

**The median wealth of white households is now 20 times that of black households** and 18 times that of Hispanic households. These ratios are about *twice as high* as the ratios that existed before the onset of the housing crisis and recession.

# Unreasonable and Unnecessary

Too often, mortgage servicers have pursued foreclosure instead of working with distressed homeowners on a mortgage modification. Modifications that reduce the homeowner's monthly payment by reducing the interest rate and forgiving principal keep more people in their homes and avoid economic destruction to homeowners, neighborhoods and governments as well as investors.

The Center for Responsible Lending (CRL) noted that, three years after the start of the housing crisis, foreclosures outpaced loan modifications at a rate of 12 to one. Since mortgage servicers are supposed to maximize revenue to the mortgage investor, CRL tried to find out why servicers were modifying so few loans. They analyzed a wide range of scenarios and found that, in most cases, modification resulted in a better outcome for investors than nonmodification and concluded:

> **"… the low levels of modification are not the result of servicers acting in the financial interest of the investor but something else entirely.** Some other potential reasons for this failure could be the lack of capacity in mortgage servicing companies, misalignment of incentives due to the servicer compensation structure, lack of investor involvement, borrower confusion, and/or poorly designed program eligibility criteria … **it is clear that under the current system, a great deal of economic waste is taking place.** For that reason, **we recommend that all servicers be required to conduct a loss mitigation analysis prior to foreclosure sale and to share the results of that analysis with borrowers and investors.** Disclosure of all the inputs and calculations used in the determination will enable homeowners to verify the information used in making the determination and will give the investors a true picture of how much money they are losing from foreclosures."[15]

The costs investors incur as a result of foreclosure include legal and servicing fees, property maintenance, sales costs and the depressed prices that foreclosed properties bring on the market. The loss severity, or the percentage of principal lost when a loan is foreclosed, can be enormous.[16]

**An analysis of recent foreclosure sales in Minneapolis shows that** the average foreclosed borrower owed $188,000 of principal at the time of foreclosure, and the typical foreclosed home was subsequently sold for $94,600. **Investors lost an average of $93,400, or 50 percent of the balance owed on the loan.**[17]

This is a conservative estimate of the losses investors incurred when these servicers chose foreclosure over modification, since it does not include all of the fees, maintenance, and sales costs that go along with foreclosures. Since these costs are not included, the servicer could presumably have **written down the balances owed on these loans by 50percent, kept many more people in their homes, and the investors would still have come out ahead** compared to a foreclosure.

# Underwater

Compare this 50percent to the average underwater homeowner in Minneapolis, who owes 155 percent of the value of their home. Their principal would only need to be written down by 35 percent to get above water.[18]

Homeowners who are underwater are far more likely to default on their loans and fall into foreclosure than those who are not, while borrowers with fair market value mortgages are much more likely to continue to pay their mortgages and continue producing revenue for the investors.

## **Behind the Numbers:** Monique's Story

North Minneapolis resident Monique White's experience is a vivid example of banks' ongoing failure to fix what they broke.

After state budget cuts eliminated her full-time job as a youth counselor, White's paycheck from her part-time job was not enough to cover her mortgage payments. She said "it was just a crazy nightmare" trying to work with U.S. Bank on a loan modification, and she went into foreclosure. "A house across the street from mine just sold for $9,500, and the bank would rather kick me out and let the house sit empty than renegotiate my $130,000 mortgage. It makes absolutely no sense." White's neighborhood was particularly hard hit by the foreclosure crisis and her house was worth only $30,000. White found another second job and trained for a new career. She said, "I'm not asking for a handout. I'm just asking them to give me time, meet me halfway."

Only after waging a months-long public battle to stay in her home with the help of her community Occupy Homes Minnesota and Neighborhoods Organizing for Change (including a face-to-face conversation with U.S. Bank CEO Richard Davis at the bank's annual shareholders' meeting), White was finally offered a mortgage modification that will lower her monthly payment to an affordable level.[19]

# Conclusion

The Great Recession and anemic recovery have been characterized by a vicious economic cycle. As homeowners have been laid off or had their wages cut, a larger share of their shrinking income is going to mortgage payments on a home that has lost much of its value. They have little money left over for consumer spending that could go into the economy and spur job creation. Unemployment is now the primary cause of foreclosures, which further drags down the housing market. Underwater homeowners —who generally can't afford to sell their homes for less than the amount they owe—are also unable to refinance and take advantage of current low interest rates to reduce their mortgage payments.

**The only real way to break this vicious cycle and fix the housing crisis is for banks to write down the principal on underwater mortgages.**

If banks reduced the principals and interest rates on underwater mortgages to market value, it **would save underwater Minnesota homeowners an average of $365/month** on their mortgage payment, **pumping more than $402 million into the local economy** every year, **which would help create 5,941 new jobs** every year and help replenish the state and local tax base.[24]

Republican presidential candidate **Mitt Romney** agrees it makes sense to reset mortgages. He recently said, ***"My own view is you recognize the distress, you take the loss and let people reset. Let people start over again; let the banks start over again."***[25]

Big banks that caused the financial crisis got trillions in taxpayer bailouts and have not done nearly enough to get the economy moving again. It is long past time for Wall Street to hold up their end of the bargain and bail out Main Street by ending the foreclosure crisis once and for all.

## BY THE NUMBERS: Wasted Wealth in Minneapolis and Minnesota

- **50% -** Percent of Minneapolis foreclosures in which the lender has a documented history of "unsafe and unsound" foreclosure practices
- **50% -** Percentage of principal banks lose on Minneapolis foreclosures
- **35% -** Percentage of principal reduction that would turn an upside-down Minneapolis homeowner right side up
- **$93,000 –** Amount banks lose per foreclosure in Minneapolis
- **155% -** Percentage of home value owed by underwater homeowners in Minneapolis
- **$365/month –** Amount underwater Minnesota homeowners could save with principal reduction
- **$402 million –** Amount of annual economic stimulus created by principal reduction in Minnesota
- **5,941 – Number** of new Minnesota jobs created annually with principal reduction

# Recommendations

The economic and social disaster caused by the mortgage crisis is a national—even international—problem. Policymakers at all levels of government, industry leaders, homeowners and communities can all take important steps to mitigate the damage caused by unnecessary foreclosures and push for a permanent solution.

1) Banks should halt foreclosures until they have written down mortgages to current market value and reset interest rates for all underwater homeowners.

    - Most experts agree principal reduction is the only way to fix the housing market, which is the biggest drag on the economy.

2) President Obama should fire Edward DeMarco, acting director of the Federal Housing Finance Agency, for refusing to allow mortgage giants Fannie Mae and Freddie Mac to reduce principal on distressed mortgages.

    - As the overseer of Fannie Mae and Freddie Mac, which own more than half of the mortgages in the United States, DeMarco is the single biggest obstacle to widespread principal reduction.

3) Cities, counties and states should adopt foreclosure mediation programs that require banks to meet face-to-face with the borrower and a mediator to discuss alternatives prior to proceeding with foreclosure. As part of mediation, banks should be required to conduct and share the results of a loss mitigation analysis with the borrower to show why they decided to pursue a foreclosure rather than a mortgage modification.

    - There is growing recognition of the effectiveness of mediation in preventing unnecessary foreclosures. At least 24 states have implemented foreclosure mediation programs. More than 70 percent of mediations reach a settlement.[26]

4) Homeowners who believe their bank is proceeding with an unfair or unnecessary foreclosure should enlist the support of their family, friends, neighbors, and community and pledge to stay in their home until the bank negotiates with them.

    - Putting public pressure on the bank by occupying one's home can be an effective method to achieve an affordable mortgage modification.[27]

# ENDNOTES


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