Coping with Maryland's Foreclosure Crisis

If you own a house in Maryland, the odds are better than even that your home will lose an average $10,000 in value, as a result of the tidal wave of foreclosures washing over the state and nation.

Home foreclosures used to be something that happened to other people. Today, those other people may well be your neighbors. One in every 26 Maryland homeowners is expected to face foreclosure in the next two years. The sheer scale of the problem is causing ripple effects — from home values to tax base — that impact everyone.

St. Ambrose Housing Aid Center in Baltimore is fighting on many fronts to ease the crisis for individual homeowners and to preserve communities.

Who's Being Hurt?

Mrs. Charles (not her real name) contacted St. Ambrose to help her understand why her mortgage loan was about to be foreclosed. A mortgage broker had convinced her late husband to take out the loan a few months before he died, at age 84, and now the monthly loan payment exceeded Mrs. Charles' entire monthly income by $40.

The St. Ambrose staff discovered signs of fraud. Mr. Charles, who had been diagnosed with dementia prior to signing the loan, was not legally capable of entering the contract. The loan application listed Mr. Charles' monthly income as $2,900; in fact, his income was $807. Finally, the loan, which Mr. and Mrs. Charles thought was a fixed-rate refinance, was an adjustable-rate mortgage with negative amortization — so that even as they made their payments, the loan principle continued to increase.

After St. Ambrose brought this information to light, the mortgage loan servicer agreed to convert the loan to a fixed-rate mortgage and to reduce the principal balance to wipe out the effects of negative amortization.

There are tens of thousands more foreclosure stories in Baltimore alone. All of the stories do not involve fraud, but most of them do involve subprime mortgage loans – loans offered to consumers who do not qualify to borrow at more favorable prime rates. All of the stories do not have happy endings for the homeowners. There will be more bad news before the crisis ebbs.

Nationally, nearly 92,000 families lost their homes in July, a 14 percent increase from the month before, according to the Hope Now Alliance, an alliance of mortgage servicers, counselors and investors working to combat foreclosures.

"The problem is much worse than people generally recognize," says Anne Balcer Norton, Director of the Foreclosure Prevention Division at St. Ambrose. "It was already bad, but the other problems in the economy have made it worse. When people are stretched so tight, the increase in the price of gas or groceries can be enough to push them over the edge.

"Low-income homeowners are hurt first and worst," she adds, "but it's not just a problem for low-income residents. Between adjustable rates and the weak economy, it's now a middle class issue." Among the signs: more than 4 percent of Maryland homeowners with *prime* mortgages are behind on their payments — double the rate at the beginning of 2007.

"A year ago, the majority of the clients we saw were single African-American females with below-median income. But we're seeing more homeowners from the counties with exceedingly high property values and larger loans. A weak economy is making an already dire scenario much worse."

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What Caused It?

Until recent decades, a mortgage was a simple transaction between a homeowner and a lender, usually a bank or a savings and loan association. But innovative thinkers in the nation's financial markets (i.e., "Wall Street") created a new product in the 1990s called the mortgage-backed security. Now instead of the mortgage loan staying in the hands of the local lender, lenders bundle loans and sell them to investors.

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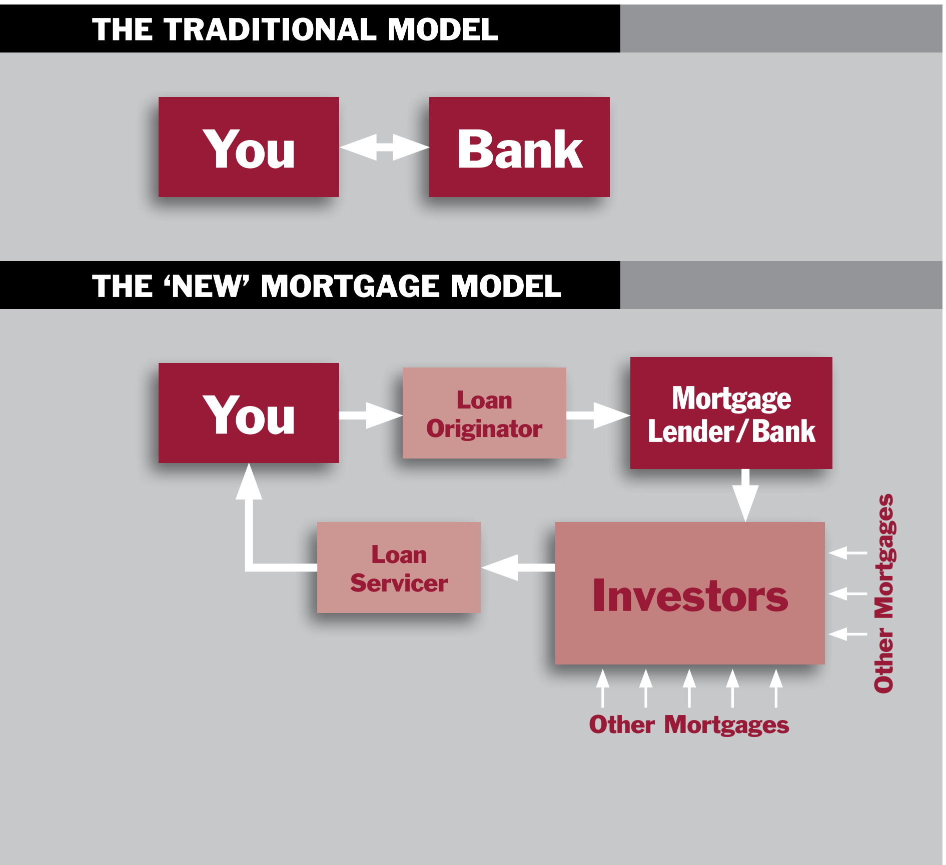
Instead of a direct relationship between homeowner and lender, two new "third parties" enter the picture: the mortgage broker, or loan originator, whose sole interest is in closing the loan, and the mortgage loan servicer, usually a large out-of-state third party, whose sole interest is in collecting the payments. The originator has no incentive to care whether the customer can keep up the payments in the future. The loan servicer's only responsibility is to the investors for whom he collects payments.

The concept of mortgage-backed securities had several "unintended consequences." The foreclosure crisis is the result of several factors that combined to create "a perfect storm" in the housing market.



- **Risky Loans** — Brokers expanded the mortgage market by selling aggressively to individuals in the subprime category — people who, because of their credit history, employment history or income, do not qualify for traditional mortgages at favorable prime rates. (Brokers also sold subprime products to buyers who could have qualified for prime loans on more favorable terms.)

  Subprime lending serves an important and legitimate function. However, many popular subprime mortgage loan types have features that increase foreclosure risk– such as adjustable interest-rates (ARMs), balloon payments, and prepayment penalties. The most popular loan type — known in the industry as an "exploding ARM" — offers a low introductory interest rate for the first two years, followed by semi-annual rate adjustments thereafter.

- **Lax Underwriting** — Mortgage originators added more risk to high-risk loans by failing to consider the borrower's ability to pay – particularly after rates adjust – or to require escrow for property taxes and insurance. In some cases, unscrupulous originators wrote "liar loans," on which no one required proof of the homeowner's income.

- **Lack of Accountability** — With third-party loan originators and third-party mortgage servicers replacing the traditional lender, no entity took responsibility for determining that homeowners were able to pay off their loans.

- **The Bubble Burst** — Though loan defaults and foreclosures were occurring for years, continued real estate appreciation hid these facts from the investors in mortgage-backed securities. Homeowners, too, used their equity to postpone a financial reckoning. When houses stopped appreciating, both investors and homeowners were stung.

St. Ambrose Housing Aid Center

St. Ambrose Fights Back Against Foreclosure

John and Linda (not their real names) were doing well financially until Linda was diagnosed with breast cancer and laid off from her job. After several surgeries, she found a new job, and the couple was once again able to afford their mortgage payments. In the interim, however, they had fallen many months behind. Despite repeated calls from St. Ambrose on the couple's behalf, the mortgage servicer scheduled a foreclosure sale unless the couple could make a $7,000 lump sum payment. St. Ambrose attorneys escalated the case, reminding the servicer that investors need not incur losses from a foreclosure sale when financially capable homeowners were eager to keep the home. The sale was cancelled, and John and Linda got a modified, fixed-rate loan, with the arrears added to the loan balance.

At St. Ambrose, the flood of calls started in the third quarter of 2007 and has continued. Calls from homeowners facing foreclosure have more than tripled in a year.

St. Ambrose has responded to the crisis on multiple fronts.

Representing and Counseling Homeowners

St. Ambrose has expanded its Foreclosure Prevention Division in response to a surge of calls from homeowners seeking help. In one year, the program staff has nearly tripled, with three attorneys and four housing counselors.

"We cannot save everyone's home," Norton says. "Our mantra is 'sustainable homeownership.' If it's reasonable to have the loan terms modified, and that will keep you in your home, we'll ask for it. If someone is unemployed or completely under water, we'll work to explore the alternatives. The alternatives may not necessarily mean staying in the home. We do what's in the homeowner's best interests over the long term."

For a homeowner facing foreclosure, the broad options are:

- **A Loan Work Out** — A deal with the lender. The lender may choose to offer to modify the mortgage, arrange a payment plan for past due amounts, or accept a lump sum to bring payments current. He may also allow the homeowner time to sell the house.
- **Giving up the House** — a fair market sale might allow homeowners to recover some of their equity. A short sale applies when the homeowner owes more than the value of the house. Another option is "deed in lieu of foreclosure" — homeowner turns over the house to the mortgage holder, in return for canceling the mortgage debt.
- **Filing for Bankruptcy** — a last resort. Homeowners could lose the house as well as other valuable property. On the positive side, it wipes out most debts and offers a fresh start.

St. Ambrose has achieved impressive results for homeowners. In the first six months of this year, housing counselors closed more than 1,200 cases. In more than one-fourth of the cases, counselors and loan servicers worked out a fair deal that allowed the homeowners to continue or modify their loan and keep their home. Another 27 percent were referred to another agency or to the St. Ambrose legal staff for further assistance.

Only 13 percent resulted in foreclosure, another 2 percent resulted in a property sale outside of foreclosure, and 6 percent ended with the homeowners filing for bankruptcy protection.

"We have terrific staff," says Norton. It's also a uniquely qualified staff. Every member of the Foreclosure Prevention Division has a background in the mortgage or real estate industry. "We can talk to lenders in their language," Norton says. "Instead of approaching the lender with a sad story, we're going in with a proposal. We say, for example, that based on our assessment, this loan is sustainable if you do this – lower the interest rate 2 percent, or extend the term, or what have you."

"What tremendous advocacy you can do for your clients when you can share their stories with people who can make a difference for them!"

Having lawyers on staff has also made a big difference in getting results. When negotiations stall at the lower- or middle-management levels, St. Ambrose attorneys can quickly escalate to upper management, often with a good outcome for the homeowner.

Finally, St. Ambrose is no newcomer to foreclosure prevention services. "We've provided those services for 31 years," says Norton, "and we've had attorneys on staff for 20 years."

St. Ambrose Housing Aid Center

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The Foreclosure Crisis Affects You!

Public Policy Advocacy

In addition to putting out the fires, St. Ambrose is trying to minimize future risks to homeowners through public policy advocacy.

St. Ambrose participated actively on the governor's task force on the mortgage crisis. "It was a thoughtful process," Norton recalls. "You had consumer groups sitting at the table with industry, and we managed to get many problems hashed out." Many of the task force recommendations became law in 2008. One major victory for borrowers is a new requirement that brokers must consider the homeowners ability to repay the loan.

St. Ambrose has also worked closely with the Maryland Department of Labor, Licensing and Regulation, which regulates mortgage lenders and mortgage brokers.

"It's an exciting time," says Norton. "We are seeing changes. We feel we are having an impact." She has met U.S. Secretary of the Treasury Henry Paulson and "talked frankly about the problems low-income borrowers are facing." St. Ambrose also has actively participated in discussions with Governor Martin O'Malley and his Administration.

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This newsletter was underwritten by NeighborWorks® America

Anne Balcer Norton, Director of the Foreclosure Prevention Division at St. Ambrose Housing Aid Center, speaks at the governor's February press conference on addressing loan service abuse. She is flanked by Maryland Governor Martin O'Malley (left) and Lt.Governor Anthony Brown (right).

St. Ambrose Housing Aid Center

has been working to prevent foreclosures for 30 years. St. Ambrose provides free counseling to homeowners, and its attorneys and default mortgage counselors represent homeowners in talking to lenders and finding a solution.

To learn more, call 410.366.8550 or visit our website at www.stambrosehousing.org.