

Repairing the Housing Crisis

The Problem

The great American housing bubble has burst. Problems in the subprime mortgage market triggered a credit crisis that has frozen credit markets. Defaults on mortgages are spreading to credit cards, and to auto and student loans. Major banks have already written off \$100 billion in losses and are selling themselves to foreign investors on the cheap. The economy is headed into a recession, with the Federal Reserve lowering interest rates at a record rate, and Congress agreeing to a \$170 billion stimulus package in a desperate effort to limit the damage.

2.2 million homes went into foreclosure in 2007. In December, a new foreclosure was filed every five minutes, with more than a million more foreclosures projected for 2008. In Cleveland, HUD is selling foreclosed homes for less than the cost of a cup of coffee. Entire communities are affected. Foreclosed homes are targets for vandals and crime. Cities and states face declining revenues, and cuts in schools, police, sewers and roads have already begun. With housing prices in continued decline, homeowners are estimated to lose up to 4 trillion in the value of their homes. Experts now suggest that most homes purchased since 2004 have lost value; half of the homes bought in 2006 are worth less than the mortgage owed on them.

Tragically, it is working families – disproportionately in minority communities – who suffer the greatest losses. For most Americans, their home is their greatest asset, their largest savings. In recent years, Americans have re-mortgaged or taken out home equity loans, taking money out of their homes to pay off debts, meet rising costs, or take on new purchases. That option is now closed.

The Reason

The housing bubble – the staggering increase in housing prices that led to a classic speculative mania – had two roots. First, the Federal Reserve, seeking to lift the economy out of the last speculative mess – the dot.com collapse and the 9/11 shocks – lowered short-term interest rates to 1% and kept them there. With money cheap, deregulated banks and mortgage brokers went on a spree. They invented new ways to package risky loans into "asset-backed" securities, have them rated as safe investments and then peddle them across the world. Brokers could offload the mortgages they made overnight. They no longer cared if the borrowers could in fact afford the mortgages.

The result was a corporate wilding. Mortgage brokers were rewarded for persuading unqualified borrowers to buy into financial time bombs. Banks then sold those loans to financial engineers, who scrambled and re-sold them as if they were asset-backed securities. Private regulation – the rating agencies like Moody's – failed miserably. Public regulation was gutted. Federal Reserve Chair Alan Greenspan turned cheerleader, encouraging Americans to enter into mortgages with variable interest rates.

As long as housing prices went up, everyone prospered. But this was a classic Ponzi scheme. As soon as interest rates started to go up, and housing prices finally soared beyond reach of Americans – even with exotic "no doc" loans with teaser rates – the house of cards collapsed. With construction and housing driving the economic recovery, the entire economy hit the wall.

The Solution

Bailing out banks for irresponsible loans only encourages irresponsibility. Bailing out speculators who bought more home than they could afford is unfair. But this housing crisis now is driving down prices across the country, damaging the responsible as well as the irresponsible. The recession likely to result will be felt across the country. We need a solution that stops the hemorrhaging but doesn't bail out the irresponsible.

First, Congress must declare an effective moratorium on home foreclosures and Congress must work with banks to find affordable ways to renegotiate mortgages. This can't be done retail. A general moratorium on foreclosures – a freeze of interest rates for six months, while mortgages are renegotiated – is a vital first step. Every homeowner has a stake in stemming the tide of foreclosures.

A mechanism like the Federal Home Loan Mortgage Corporation should be created, in essence to act as the neighborhood banker. It would buy back mortgages at a deep price reduction from investors and banks (forcing them to take their losses). It could then renegotiate with homeowners – not speculators – to remortgage the home on affordable basis. This would stem the tide of foreclosures and limit drops in neighboring home prices.

At the same time, Congress must ensure that bottom-feeding mortgage brokers and banks are held accountable. Investigations of systematic fraudulent loan practices should result in indictments.

Then, we need a watchdog, not a lapdog, to regulate the banking sector. Deregulation has given bankers multimillion dollar personal incentives to produce more and more exotic instruments that even they don't understand. After the crash, the Federal Reserve issued rules requiring mortgage lenders to assess whether the borrower actually has the income needed to repay the loan. But Banking 101 is only a first step. We must restore rules for debt/asset ratios so banks and other investment houses essentially acting like banks can't lend more money than they can safely afford. We need a comprehensive look at how to re-create sensible rules that can provide speed bumps to curb speculative manias. The next time America embarks on a national commitment to increase home ownership, we'll do it through win-win policies in which government and private markets cooperate – not policies that deregulate and leave the field open to swindlers.

Telling the Story

◆ **Stories to Look for**

- ◆ Families pushed out of their homes because their adjustable rate mortgages ballooned above their monthly incomes. Or families stuck with "upside down" mortgages—in which the debtor owes more than the house is worth.
- ◆ Families who trusted their broker and were misled.
- ◆ Homeowners on blocks blighted with abandoned houses, who find their homes plummeting in value through no fault of their own. Municipalities forced to dip into precious resources to cut lawns, scatter squatters, and board up windows to fight neighborhood blight.
- ◆ Loss in property tax revenue to local government with an impact on school funding.

Spotlight Story

- The city of Shaker Heights, Ohio, is spending millions of dollars to maintain vacant houses in an effort to contain blight and real-estate panic. The city is installing alarms, fixing broken windows and mowing lawns at the vacant houses in hopes of preventing a snowball effect, in which surrounding property values suffer and worried neighbors move away.¹ In Slavic Village, Ohio, 1,500 homes have been abandoned, and neighbors live beside empty houses that attract scrap-metal thieves and drug dealers.²
- Mark and Kerrie Russo, a Jackson, New Jersey couple raising two young daughters, bought a home in 2005 with a 30-year fixed-rate loan, based on their solid credit history. Then, a local mortgage broker began sending them letters offering to refinance their loan. A new product, the sales pitch said, allowed home owners flexibility to choose from a menu of different payments from one month to the next. What the broker didn't explain was that it was a "negative amortization" loan – an expanding debt that buried the couple deeper in hock even as they thought they were paying down their mortgage balance.³
- In Cleveland, HUD is offering homes to the city for a dollar each. HUD foreclosed on the houses because they had federally insured mortgages, and can't find other buyers.⁴

Hot Facts

◆ **Mortgage brokers wrote loans they knew could not be paid back.**

- ◆ High risk sub prime loans went from 2.6% of U.S mortgages in 2000 to 13.6% in 2006.⁵
- ◆ A new home foreclosure was filed every five minutes in December 2007. There were 2.2 million foreclosure filings in 2007, up 75% from 2006.⁶
- ◆ More than half (55%) of people who got sub prime loans had credit scores high enough to qualify them for better loans at better rates.⁷
- ◆ 50% of home loans given to African-Americans and nearly 42% of loans given to Hispanics last year were high-cost loans compared with 18% for whites and more than 24% for the overall population.⁸
- ◆ Shareholders in the securities industry lost \$74 billion in equity in 2007. But firms still paid their staff a record \$38 billion in bonuses.⁹

◆ **Homes have lost value, and communities have lost funding.**

- ◆ U.S. home values have dropped between \$2 and \$4 trillion.¹⁰
- ◆ One out of every ten homes in America is worth less than the mortgage owed;¹¹ and fully half of the homes bought in 2006 are now worth less than the mortgage owed.¹²
- ◆ Roughly 40% of funding for K-12 education comes from local property taxes, which are dropping with home values.¹³

◆ **The mortgage crisis has forced a financial contagion across the entire economy.**

- ◆ Auto loan defaults are up 16% since last year and credit card failures are up 25%.¹⁴
- ◆ With college costs on the rise and household income on the decline, families have borrowed against their homes for college. But that source is drying up.¹⁵

Public Pulse

People generally blame borrowers for getting into trouble, but they also see bank responsibility. They see a role for banks to renegotiate failing deals, though they hesitate to invite government intervention. There is a clear partisan split in attitudes. A December 2007 Rasmussen poll of adults found more blame for “individuals who borrowed more than they could afford” than “Wall Street investors” (54% v. 25%). The division was even more clear along party lines: Republicans blame individuals over Wall Street, 69% to 12%; Democrats blamed Wall Street over individuals, 37% to 42%.

The following summary stems from a Rasmussen December 10, 2007 poll of adults,¹⁶ a CNN December 10, 2007 poll of adults,¹⁷ and a December 10, 2007 on line poll by *The Wall Street Journal Online* and Harris Interactive:¹⁸

◆ **Who is at fault?**

- ◆ Borrowers:
 - Rasmussen: 54% blame "individuals who borrowed more than they could afford."
 - CNN: 51% say "borrowers willingly entered into those agreements and have no one to blame but themselves."
 - Harris: 16% "Home buyers [are] primarily responsible for the trouble in the housing market and mortgage business."
- ◆ Banks and business:
 - CNN: 46% say "borrowers are the victims of bad lending policies by the banks who provided mortgages to them."
 - Rasmussen: 25% blame "Wall Street investors" for the sub prime and foreclosure crisis.
 - Harris: 52% "Mortgage lenders and brokers [are] primarily responsible for the trouble in the housing market and mortgage business."
- ◆ Government:
 - Harris: 21% "Government regulators [are] primarily responsible for the trouble in the housing market and mortgage business."

◆ **What should be done?**

- ◆ Rasmussen: 26% say the federal government should “aid Americans who took out sub prime loans on homes and now face foreclosure”; 39% oppose federal aid; and 35% are not sure.
- ◆ Harris: 48% say “direct lenders are most responsible for making sure that borrowers are able to pay their mortgages and should be required to modify loan terms on mortgages given to owners who couldn't afford them.”

Message Box

Us on Us	Them on Us
<p>We need to hold irresponsible banks and brokers accountable, and help hard-working families who got swindled.</p> <p>We shouldn't bail out irresponsible lenders or borrowers, but we must act to keep the housing crisis from undermining the economy, and devastating home values.</p> <p>We need a government watchdog, not a lapdog, over the financial community, to limit financial speculation and predatory lending practices.</p>	<p>If you took out a confusing loan, it's your fault. Don't ask people who acted responsibly to bail you out.</p> <p>Regulation will simply shut down credit to borrowers. What we need is personal responsibility not more government red tape.</p>
Us on Them	Them on Them
<p>They deregulated bankers, brokers and hedge fund operators, who savaged working families reaching for the American Dream, and devastated the entire economy.</p> <p>Now they want to protect the bad actors, instead of holding them accountable.</p> <p>Few families have received help while foreclosures skyrocket, property values sink, credit dries up and local budgets get squeezed.</p> <p>They've taken only minor steps – hoping to “sandbag,” according to one lobbyist, the major reform families in crisis need.</p>	<p>“Innovative mortgage products have helped millions of Americans afford their own homes ... Unfortunately, some of these products were used irresponsibly.” (Bush, Dec. '07)</p> <p>We've worked with the mortgage industry to freeze rates and help people refinance.</p>

Additional Resources

The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got Here.

<http://jec.senate.gov/Documents/Reports/10.25.07OctoberSubprimeReport.pdf>

Subprime Mortgage Crisis Causing African Americans to Experience Greatest Loss of Wealth in Modern U.S. History.

http://www.democracynow.org/2008/1/17/report_subprime_mortgage_crisis_causing_african

Women are Prime Targets for Subprime Lending: Women are Disproportionately Represented in High-Cost Mortgage Market.

<http://www.consumerfed.org/pdfs/WomenPrimeTargetsStudy120606.pdf>

Losing Ground: Foreclosures in the Subprime Market and their Cost to Homeowners:

<http://www.responsiblelending.org/pdfs/foreclosure-paper-report-2-17.pdf>

Subprime Spillover: Foreclosures Cost Neighbors \$202 Billion; 40.6 Million Homes Lose \$5,000 on Average.

<http://www.responsiblelending.org/pdfs/subprime-spillover.pdf>

Endnotes

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 - ² Thomas Ott and Michael O'Malley, "The Foreclosure Crisis: What it means for Northeast Ohio," *The Plain Dealer* 24 January 2008. http://blog.cleveland.com/metro/2008/01/the_foreclosure_crisis_what_it.html
 - ³ John W. Schoen, "Fraud, Abusive Lending Crushes Dreams for Millions of Home Owners" MSNBC, 10 April 2007. <http://www.msnbc.com/id/17929461/>
 - ⁴ Thomas Ott and Michael O'Malley, "The Foreclosure Crisis: What it means for Northeast Ohio." See note 2.
 - ⁵ Ellen Florian Kratz, "The Risk in Subprime," *Fortune Magazine*, 1 March 2007. <http://money.cnn.com/2007/02/28/magazines/fortune/subprime.fortune/index.htm>
 - ⁶ RealtyTrac Staff, "U.S. Foreclosure Activity Increases 75 Percent in 2007," RealtyTrac 29 January 2008. <http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=3988&acct=64847>
 - ⁷ Rick Brooks and Ruth Simon, "Subprime Debacle Traps even Credi-Worthy," *Wall Street Journal* 4 December 2007. <http://www.azcentral.com/business/articles/1204biz-subprimetrap1204-ON.html>.
 - ⁸ "Study: Minorities Issues More Subprime Loans," *Daily Real Estate News*, 5 October 2007. <http://www.realtor.org/rmodaily.nsf/0/597b416e3fe879b28625736b004fe383?OpenDocument>
 - ⁹ Christine Harper, "Wall Street Plans \$38 Billion of Bonuses as Shareholders Lose," *Bloomberg.com* 19 November 2007. <http://www.bloomberg.com/apps/news?pid=20601103&sid=ahE8xVisWsbE&refer=us>
 - ¹⁰ Vikas Bajaj and Edmund Andrews, "Reports Suggest Broader Losses From Mortgages," *New York Times* 25 October 2007. <http://www.nytimes.com/2007/10/25/business/25mortgage.html?pagewanted=print>
 - ¹¹ Reuters, "One in 10 home loans is under water: Economy.com," 22 February 2008. <http://www.reuters.com/article/bondsNews/idUSN2259847620080222>
 - ¹² "Quarterly Home Values Reports: First Quarter January-March 2008." <http://www.zillow.com/quarterlies/QuarterlyReports.htm>

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- ¹³ *Graph 13: Percentage Distribution of Total Revenue for Public Elementary and Secondary Education in the United States, by Region and Revenue Source: Fiscal Years 1990 to 2005*, Graphs in Education Finance, National Center for Education Statistics.
http://nces.ed.gov/edfin/graph_topic.asp?INDEX=13
- ¹⁴ Vikas Bajaj and Louise Story, "Mortgage Crisis Spreads Past Subprime Loans," *New York Times* 12 February 2008. <http://www.nytimes.com/2008/02/12/business/12credit.html?pagewanted=print>
- ¹⁵ Carmen DeNavas-Walt, Bernadette D. Proctor, and Jessica Smith, *Income, Poverty, and Health Insurance Coverage in the United States: 2006*. United States Census Bureau. August 2007. <http://www.census.gov/prod/2007pubs/p60-233.pdf>. (Adjusted for 2006 dollars); See also: United States Department of Education, National Center for Education Statistics, *Digest of Education Statistics, 2007*. http://nces.ed.gov/programs/digest/d07/tables/dt07_320.asp. (Adjusted for inflation)
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http://www.rasmussenreports.com/public_content/business/general_business/54_say_individual_borrowers_to_blame_for_mortgage_crisis_25_fault_wall_street_investors; See also: "Toplines – Subprime Mortgages – December 7-8, 2007," *Rasmussen Reports* 7-8 December 2007.
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http://money.cnn.com/2007/12/11/news/economy/cnn_mortgage_poll/index.htm
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