



# TOO BIG TO FAIL

*How broad-based loan modification can save millions of families from foreclosure and put a floor on falling property values*

October 2008

---

Developed by CCISCO: Contra Costa Interfaith Supporting Community Organization and the PICO National Network.

Additional contributions from Center for Responsible Lending and the California Reinvestment Coalition.





## TABLE OF CONTENTS

Opening & Key Findings.....	3
Problem Statement.....	5
• Impact on Families	
• Second Wave of Foreclosures on the Horizon	
• Impact on Communities	
• Case-by-Case Loan Modification is Not Meeting the Need	
Successful Strategies.....	15
• National Level	
• Local and Regional Level	
- Diversion Programs	
- Federal Neighborhood Stabilization Funds	
- Maintenance of Vacant Properties	
Summary of Recommendations.....	21

## OPENING & KEY FINDINGS

Every ten seconds, another family in America loses their home. So far this year, lenders have foreclosed on an average of 250,000 families each month<sup>1</sup>. Estimates show that over 1.2 million homes have already been lost through subprime foreclosure, and another 2.2 million families with subprime loans are in serious danger of losing their homes over the next year.<sup>2</sup> As many as 12 million homeowners have zero or negative equity in their homes.<sup>3</sup>

The effect of the housing crisis on families and communities is staggering. Families with no place to go when they are forced out of their homes; the social fabric of neighborhoods torn apart; vacant houses posing crime and blight problems for cities and towns; housing and property values plummeting in areas around where foreclosures occur. All these only serve to further undermine an already weakened economy.



The current crisis in America's financial system started with a wave of irresponsible subprime lending that began more than a decade ago and reached widespread public attention last year with the dramatic increase in the foreclosure rate. Despite the enormity of the problem, the Department of the Treasury and the Federal Reserve have failed to muster an adequate response that tackles the root cause of the crisis – falling home values and the rising tide of foreclosures, what R. Glenn Hubbard, the former chairman of the Council of Economic Advisors under President Bush, is now calling “the elephant in the room.”<sup>4</sup>

One surefire method to “stop the bleeding” is to turn non-performing mortgages into performing mortgages, and to do this on a scale that will make a difference. Sheila Bair, chairwoman of the FDIC, has said that doing so could save the financial system 55 cents on the dollar, as well as the heartache and turmoil for so many families.<sup>5</sup> Attorney Generals from 11 states have asked major lenders and the federal government to do the same.

<sup>1</sup> “Fight for the Family Home,” Eric Nguyen, The New York Times, October 10, 2008

<sup>2</sup> Updated Projections of Subprime Foreclosures in the United States and Their Impact on Home Values and Communities, Center for Responsible Lending, September 23, 2008

<sup>3</sup> “Building a Better Bailout,” The New York Times, October 9, 2008

<sup>4</sup> “First, Let’s Stabilize Housing Prices,” R. Glenn Hubbard, The Wall Street Journal, October 2, 2008

<sup>5</sup> Remarks from FDIC chairwoman Sheila Bair, August 20, 2008



Unfortunately for families and our economy, the current system for turning non-performing mortgages into performing mortgages – modifying loans on a case-by-case, individual basis – is not working. It is like throwing a bucket of water on a raging fire. The federal government learned the hard way that bailing out failing banks on a case-by-case basis did not work. When will they recognize that the same principle applies for dealing with a still expanding foreclosure crisis that continues to sink housing values across the country? Families, and the American economy, need a new strategy.

This report looks at the extent of the foreclosure problem in America; the impact it is having on families and local communities; the current case-by-case strategy of dealing with loan modifications and the degree to which this strategy is failing; and the success of broad-based, systematic approach to modifying loans that can keep families in their homes and stabilize the housing market. The report uses Contra Costa County, California as a case study and includes specific recommendation for local communities, national lenders and federal regulators.

## PROBLEM STATEMENT

### Impact on Families

Rafael Martinez of Pittsburg, California is a construction worker who has owned his home for more than five years and had never missed a payment. After the monthly payments on his adjustable rate mortgage ballooned in the winter of 2007, he tried for more than six months to talk with his lender – IndyMac Bankcorp – about modifying his loan with no success. The day before he was going to lose his home, he received a letter from the FDIC – who took over IndyMac Bank in July – offering him the opportunity to modify his loan. He is now expected to keep his home.

On the other side of the country, in Framingham, Massachusetts, Romilda Silva is working 80 hours a week cleaning the homes of wealthy Boston suburbanites in order to try to save her home. An immigrant from Brazil who has been in the U.S. for over 20 years, in 2007 Romilda saw the monthly payments on her adjustable rate mortgage increase by over \$1,000. Officials at her bank – Washington Mutual – say that federal regulations restrict them from helping her modify her loan. She is now counting down the days until she may have to leave her home.

How will Romilda’s story end? Will it end like Rafael’s, with the opportunity to save her home after working tirelessly to do so? Or will it end like the stories of millions of others across the country who so far have lost their home, the single largest asset they will own in their lifetimes?

This is the true story of the financial crisis – what happens when millions of families are forced to deal with the biggest financial failure of their lifetimes. And what happens when this is repeated millions and millions of times across the country. We are only beginning to see the effects.

According to the Center for Responsible Lending, over 1.2 million subprime homes have been lost to foreclosure, and approximately 2.2 million subprime foreclosures are expected to occur in late 2008 and 2009, double their original estimate of 1.1 million made in 2006. More than one out of five homeowners with a subprime mortgage is currently in default.

The impact of these foreclosures extends beyond families and banks. Studies show that over 40 million homes in neighborhoods surrounding foreclosures will suffer price declines averaging over \$8,667 per home and resulting in a \$352 billion total decline in property

values. These projections do not take into account other price drops associated with the slowdown in local housing markets.<sup>6</sup> Underlying the tremendous uncertainty about the future of the American economy is the reality that housing values are in free fall in communities across the country.

AUGUST 2008 – Center for Responsible Lending

Subprime foreclosures expected to occur (primarily in late 2008 through end of 2009)	2,164,000 homes lost
Surrounding homes suffering price declines caused by nearby subprime foreclosures	40.6 million homes
Decrease in home values	\$352 billion
Average decrease in home value per unit affected	\$8,667

### Second Wave of Foreclosures on the Horizon

While the subprime mortgage crisis has already brought our financial system to the brink of failure, some experts estimate that this is only the first wave of bad mortgages, and the next wave is going to have an even graver effect on the American economy.

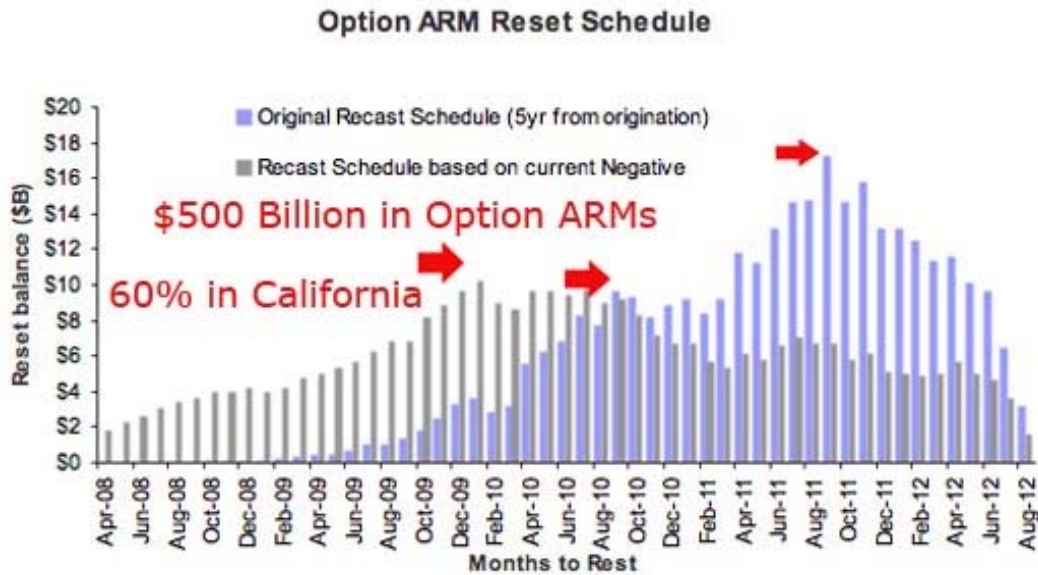
In September, the Mortgage Bankers Association announced that 4 million American homeowners – 9 percent of all mortgages in the U.S. – were either behind on their payments or in foreclosure at the end of June 2008. Signaling the degree to which the crisis is spreading beyond the subprime market, the study estimated that more than one of out every ten borrowers with a prime ARM is now delinquent or in foreclosure.<sup>7</sup>

The most frightening aspect of this statistic is how many of these homeowners have “Pay Option ARMs”, a mortgage product that offers borrowers deceptively low payments for the beginning of the loan – the lowest of which does not even cover the interest on the principal – which then reset when borrowers reach maximum debt limits. According to Fitch Ratings, these resets can increase a borrower’s monthly payments by more than \$1,000 per month *on average*. Fitch estimates that up to 80 percent of all Pay Option ARM borrowers started with

<sup>6</sup> Updated Projections of Subprime Foreclosures in the United States and Their Impact on Home Values and Communities, Center for Responsible Lending, September 23, 2008

<sup>7</sup> “Delinquencies and Foreclosures Increase in Latest MBA National Delinquency Survey,” Mortgage Bankers Association, September 5, 2008

the minimum payment per month, meaning they will see the highest resets in the coming years.<sup>8</sup> And over half of the \$500 billion in Pay Option ARMs are expected to reset by the end of 2010, with 60 percent of these in California.<sup>9</sup>



\*Chart from Credit Suisse Report

According to projections of the financial firm Credit Suisse, a total of 6.5 million families could lose their homes to foreclosure in the next five years.<sup>10</sup>

### Impact on Local Communities

Cities, towns and states are feeling the strain of this crisis. According to June 2008 census data, the U.S. is experiencing one its highest vacant housing rates in 50 years, with 2.8 percent of homes previously occupied by an owner now sitting vacant, and nearly one out of every ten rental units without a tenant.<sup>11</sup> City and state officials are worried that such a dramatic increase in the number of vacant properties will lead to blighted neighborhoods and an increase in crime.

<sup>8</sup> "Option ARMs: It's Later than It Seems," Fitch Ratings, September 2, 2008

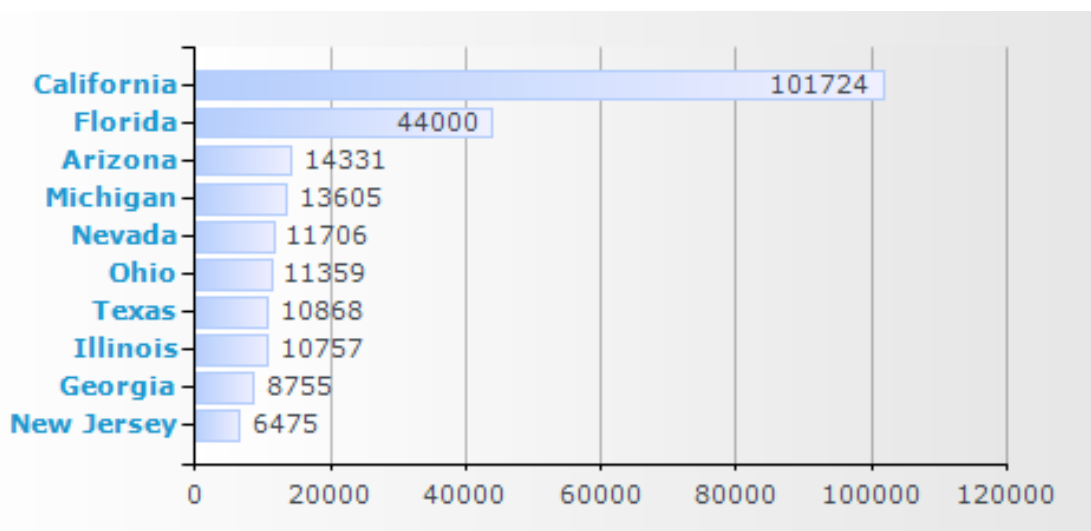
<sup>9</sup> "Bankers: Record Number of Mortgages Endangered," Associated Press, September 5, 2008

<sup>10</sup> Fixed Income Research, Credit Suisse, April 22, 2008

<sup>11</sup> "Home Prices Seem Far from Bottom," Vikas Bajaj, The New York Times, October 16, 2008

Reports estimate that an increase in the foreclosure rate to about 2.8 foreclosures for every 100 owner-occupied properties corresponds to an increase in neighborhood violent crime of approximately 6.7 percent.<sup>12</sup> Research by PICO’s Philadelphia affiliate, the Eastern Pennsylvania Organizing Project found that the presence of one abandoned house on a block reduced the value of all other homes by an average of \$7,000.<sup>13</sup>

**New Foreclosures, August 2008** \*RealtyTrac



California has been particularly hard hit by the mortgage crisis. In the first eight months of 2008, nearly 28 percent of all foreclosures occurred in California. In August 2008, this figured hit one-third.<sup>14</sup> One of every thirty households in the City of Stockton received foreclosure notices this year, and that follows a year when Stockton had the highest number of foreclosures proportionally of any city in the country. The County of Los Angeles has had 24,691 homes become vacant, bank-owned properties this year.

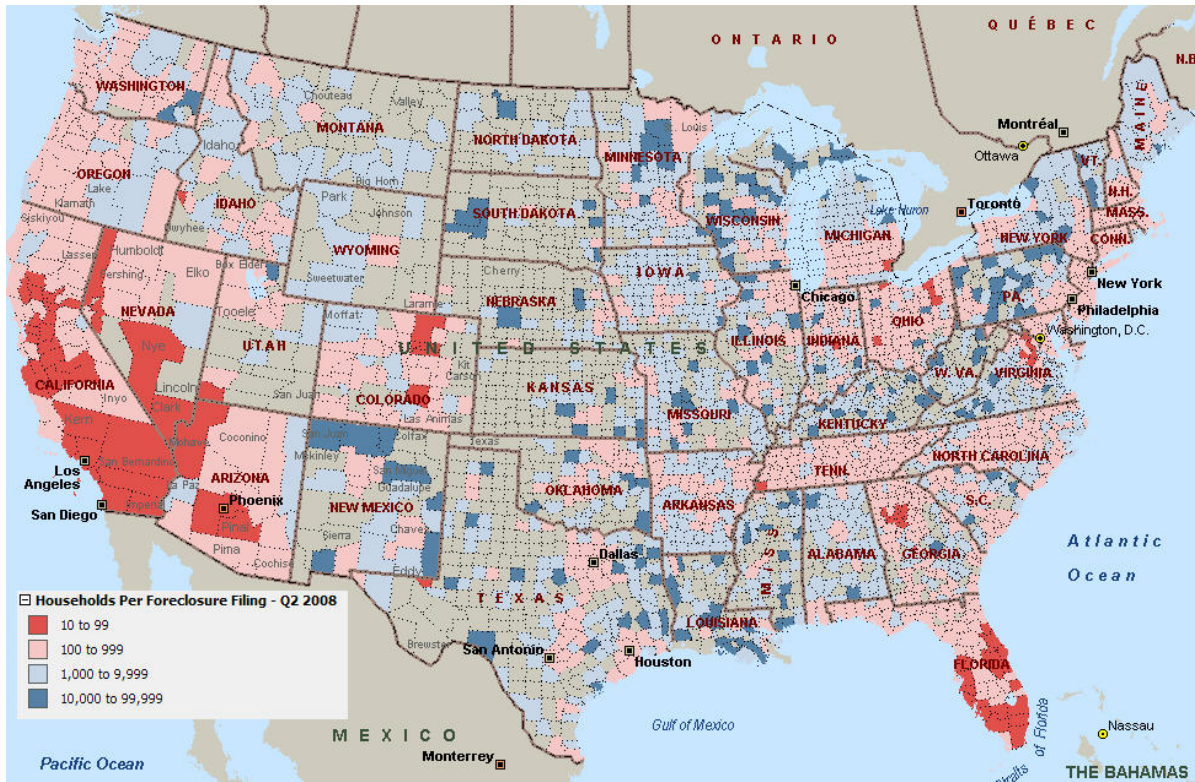
One example of the many cities across the nation that have been devastated by the foreclosure crisis, but have also responded at the community level, is Richmond, California. In

<sup>12</sup> “There Goes the Neighborhood: The Effect of Single-Family Mortgage Foreclosures on Property Values,” Dan Immergluck & Geoff Smith, June 2005

<sup>13</sup> Blight Free Philadelphia: A Public-Private Strategy to Create and Enhance Neighborhood Value, Research for Democracy, Temple University, 2001.

<sup>14</sup> RealtyTrac

Richmond, nearly 35 percent of all single family homes in the “Iron Triangle” neighborhood are already foreclosed and abandoned.<sup>15</sup> In Contra Costa County, where Richmond is located, there has been a 139 percent increase in foreclosures over the past year.<sup>16</sup> In some neighborhoods in Antioch and Richmond, one out of every three houses is in some stage of the foreclosure process. The city of Antioch in particular has been the epicenter of the foreclosure crisis in the Bay Area. In eastern Antioch, 4.1 percent of all homes went through foreclosure in 2007, according to DataQuick Information Systems.<sup>17</sup> This rate is equal to the hardest-hit neighborhood of Stockton, which is considered the foreclosure capital of California and even the nation.



\*Chart from Realty Trac

<sup>15</sup> *ibid*

<sup>16</sup> “Foreclosures Quadruple in State, Bay Area,” James Temple, San Francisco Chronicle, April 23, 2008

<sup>17</sup> “In Contra Costa, Evictions Becoming Common,” San Francisco Chronicle, March 9, 2008

## Local Foreclosure Rankings and Rates, in cities with PICO affiliates

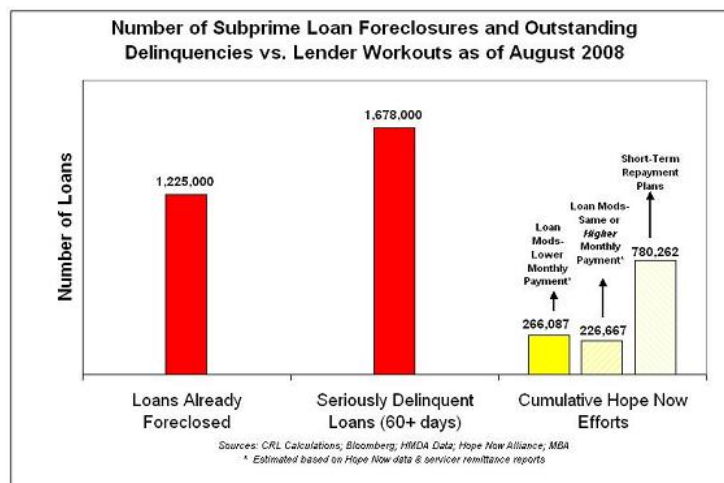
\*U.S. Department of Housing and Urban Development, September 2008

State	Community	Foreclosure Rank	Local Foreclosure Rate	Local Abandonment Risk
MI	FLINT	4	12.8%	High
CA	STOCKTON	11	12.3%	High
CA	SAN BERNARDINO	16	11.8%	High
CA	MODESTO	33	10.8%	High
FL	PALM BAY	44	10.30%	Medium
CA	KERN COUNTY	59	9.7%	High
CA	SAN BERNARDINO COUNTY	62	9.6%	High
CA	FRESNO	70	9.4%	High
CA	RIVERSIDE	77	9.2%	Medium
CA	RICHMOND	79	9.1%	High
MA	BROCKTON	80	9.00%	High
CA	RIVERSIDE COUNTY	81	8.9%	High
CA	SACRAMENTO	82	8.9%	Medium
CA	SANTA ANA	85	8.8%	High
CA	BAKERSFIELD	95	8.4%	High
CA	OAKLAND	103	8.1%	High
CA	ANTIOCH	115	7.7%	High
MI	GENESEE COUNTY	116	7.6%	Medium
PA	ALLENTOWN	118	7.50%	High
FL	BREVARD COUNTY	136	7.00%	Low
CA	LOS ANGELES	140	6.8%	Medium
CA	LONG BEACH	143	6.8%	Medium
CA	ANAHEIM	144	6.7%	Low
AL	BIRMINGHAM	153	6.50%	High
CA	CHULA VISTA	162	6.2%	Low
PA	PHILADELPHIA	176	5.70%	High
CO	DENVER	184	5.50%	High
MO	KANSAS CITY	188	5.40%	High
CA	SAN DIEGO COUNTY	191	5.2%	Low
CA	SAN DIEGO	196	5.0%	Low
CA	ALAMEDA COUNTY	199	5.0%	Low
CA	CONTRA COSTA COUNTY	201	4.8%	Medium
LA	NEW ORLEANS	211	4.40%	High
CA	ORANGE COUNTY	221	4.0%	Low
CA	SAN JOSE	224	4.0%	Low
LA	BATON ROUGE	227	3.90%	Medium

## Case-by-Case Loan Modification Is Not Meeting the Need

Since the subprime mortgage foreclosure crisis erupted last year, the federal government has launched multiple efforts to help homeowners rework delinquent mortgages. These programs, which have relied primarily on urging mortgage companies to voluntarily modify the terms of existing mortgages, have done little to reverse the trend of rising foreclosures. In 80 percent of cases, voluntary loan modification does not reduce monthly payments; and in many cases, voluntary loan modification actually *increases* a borrower’s principal debt.<sup>18</sup>

A September report from Hope Now – an alliance of home counselors, investors, and other mortgage market participants aimed at helping struggling homeowners – shows that voluntary attempts to renegotiate delinquent mortgages is not keeping pace with the number of foreclosures. While a total of 1.7 million loans were reported as seriously delinquent in August 2008, only 266,087 (15 percent) received loan modifications that resulted in lower monthly payments, while 226,667 received loan modifications that actually resulted in higher monthly payments, and 780,262 negotiated “repayment plans,” which involves deferring or rescheduling payments, but not altering the original terms of the loan. As the chart below shows, the number of homes that have been foreclosed on or at-risk of foreclosure literally dwarfs the number of families who have been able to lower their monthly payments.<sup>19</sup>



Even in the cases where borrowers were able to modify their loans, unless the interest rate – and when needed, the principal debt – is reduced to a level that borrowers can afford, many will end up back in delinquent status. The State Foreclosure Prevention Working Group

<sup>18</sup> “Rewriting Contracts, Wholesale: Data on Voluntary Mortgage Modifications from 2007 and 2008 Remittance Reports,” Alan M. White, August 2008

<sup>19</sup> Hope Now Loss Mitigation National Data July 2007 to July 2008

estimates that up to 20 percent of loan modifications made over the past year are currently delinquent.<sup>20</sup>

The latest report of the State Foreclosure Prevention Working Group, for the period January through May, 2008 found that nearly 8 out of 10 seriously delinquent homeowners are not on track for any modification. Even more stunning is the 28 percent decline of homeowners working toward a loan modification, which means 40,000 fewer loans were in loss mitigation in May than in January.<sup>21</sup> According to the report:

*"Servicers appear to have reached the 'low hanging fruit' of subprime loans facing interest rate resets, while not developing effective approaches to address the bulk of subprime loans which are in default before interest rate resets... The mortgage industry's failure to develop systematic approaches to prevent foreclosures has only spurred declines in property values and further increased expected losses on mortgage loan portfolios ... We fear continued reactive approaches will lead to another wave of ... preventable foreclosures."*

Massachusetts Attorney General Martha Coakley – a member of the Working Group – wrote that between July and September, “lenders issued 4,721 new foreclosure notices in Massachusetts. During that same period, only 144 loan modifications were filed in the Registry of Deeds. We have reviewed those 144 modified mortgages and found that virtually none reduced the monthly payment owed by the homeowner.”<sup>22</sup>

In California, 71,930 properties were foreclosed in May 2008 while only 9,225 received some form of loan modification during that same month. According to the California Department of Corporations, only 278 of the 121,094 loan workouts between January and June 2008 resulted in reductions of principal balance – 0.2 percent of the total workouts.<sup>23</sup>

In late 2007, the ratings agency Moody’s released the results of a survey it conducted of the modification practices of subprime mortgage servicers regarding borrowers that have or will experience an interest rate reset on their loans in either 2007 or 2008. Sixteen servicers with a total servicing volume of approximately \$950 billion, or roughly 80% of the market, provided data.

*Moody’s Investor Services attracted national attention in 2007 when it surveyed loan servicers and found that only 1% of loans scheduled for an interest rate reset were*

---

<sup>20</sup> State Foreclosure Prevention Working Group Data Report 3, September 2008

<sup>21</sup> State Foreclosure Prevention Working Group Data Report 3, September 2008

<sup>22</sup> “Modifying Some of Those Loans,” The Boston Globe, October 2, 2008

<sup>23</sup> California Department of Corporations Mortgage Servicers Survey, August 2008

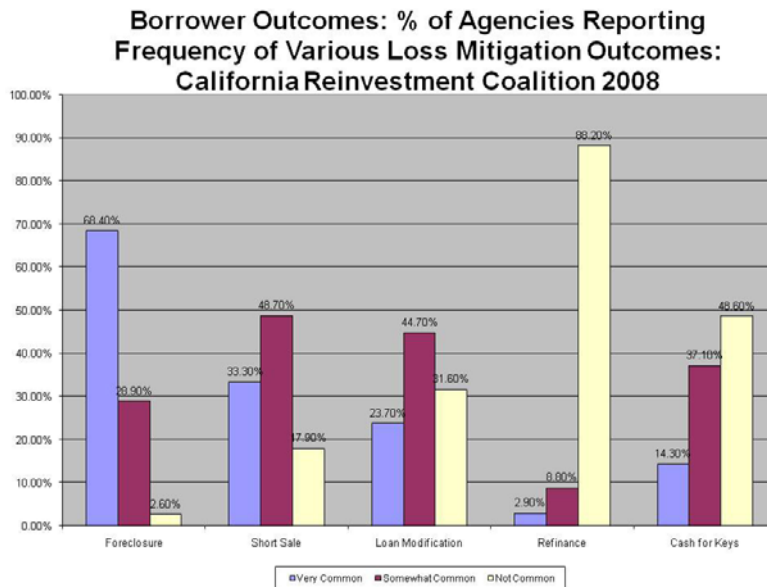
modified. Moody's updated the survey and found that loan modifications had improved, but only to a still unacceptably low 3.5%.<sup>24</sup>

The California Reinvestment Coalition, in their third report surveying the loan modification practices of major lenders in California, reported that,

*Loan modifications and refinances are not happening. Only 9 agencies – less than one quarter of those responding – said that loan modifications were a “very common” outcome for borrowers, which is 3 more than the 6 groups with this outcome in the last survey. Meanwhile, only 1 group, or 2.9% of respondents, reported that refinancing were a “very common” outcome for borrowers. Conversely, 12 groups, or 31.6% of those reporting, said that loan modifications were “not common,” and a significantly large number of respondents, 30 groups, or 88.2% of those reporting, said that refinancings were “not common.”<sup>25</sup>*

On principal write downs, the report finds virtually no lender employing this strategy.

*Write downs [were] virtually nonexistent. No group reported that principal write downs were a very common occurrence, while only 2 groups reported it as a somewhat common occurrence. A whopping 34 groups report that principal write downs are not common.*



<sup>24</sup> “Subprime Loan ‘Mods’ Still Fall Short – Moody’s,” Al Yoon, Reuters, December 18, 2007

<sup>25</sup> “The Continuing Chasm between Words and Deeds,” California Reinvestment Coalition, April 2008

All of these findings point to the fact that a relatively small percentage of people in danger of losing their home have been able to sit down with their lenders to explore real options to avoid foreclosure. This confirms the experience of many CCISCO members in Antioch, who had been trying for months to set up face-to-face meetings with their lenders to talk about their loans.

The \$700 billion bailout plan passed by Congress in September gives the U.S. Treasury new responsibilities and new powers to facilitate loan modifications to prevent avoidable foreclosures. Treasury is obliged to implement a plan to maximize assistance for homeowners, including encouraging servicers to modify loans, using loan guarantees and credit enhancements to facilitate loan modifications and identifying opportunities to acquire troubled assets in ways that facilitate loan modification. However, these provisions in the bailout legislation will only benefit families facing foreclosure if the Treasury takes immediate and serious action to support mass loan modification, which it has not done to-date, despite urging by the FDIC and other policy-makers. The US Treasury holds the key to unlocking the foreclosure crisis; now the question is whether they will use that key to stem the tide of foreclosures and thereby put a floor under falling property values.

# SUCCESSFUL STRATEGIES

## National Level

As we have just seen, the current system by which borrowers can modify the terms of their loans – the case-by-case, voluntary system that the government has been urging mortgage companies to implement – is too weak and small-scale to truly have an impact on the current foreclosure problem. And given the second wave of pay-option ARM foreclosures on the horizon, it is important to act now to develop a more effective strategy for dealing with the problem.

PICO believes the best way to attack the increasing number of foreclosures – and by extension, falling housing values – is to implement a systematic, broad-based approach to working with homeowners to modify their mortgages. While any approach to modification will require a certain degree of case-by-case attention, there needs to be a large-scale, systematic response in order to stabilize the housing market and keep families in their homes.

Because you are a valued IndyMac Federal Bank, FSB<sup>®</sup> customer,  
**We want to help you stay in your home.**

September 12, 2008

Reduce your monthly payment of principal and interest to \$2,504.26 and bring your loan current!

**If you have questions, call toll-free: 1.866.293.3232**

0792504 20080902 10  


Sample A. Sample  
 1 Banting  
 Irvine, CA 92618-3601

Loan #: 89999992  
 Property Address: 1 Banting  
 Irvine, CA 92618

**Dear Sample A. Sample,**

IndyMac Federal Bank proposes to permanently modify your mortgage, bring past due amounts current, and provide you with an affordable monthly payment.<sup>26</sup>

What we offer:	What you do:
<ul style="list-style-type: none"> <li>Specifically, based on income information you have provided, we will cap your interest rate at the current prime rate of 6.500% set by Freddie Mac for your remaining loan term.</li> <li>In addition, to provide time for you to regain a more secure financial footing, we will reduce that rate to 3.000% for the first five years of your loan. This will result in a monthly principal and interest payment of \$2,504.26 for the first five years, a reduction of \$789.87. You will continue to be responsible for taxes and homeowners' insurance on your home. We will provide you with an estimate of your monthly expenses for taxes and insurance, by separate letter in the coming days. Please note that this payment for principal and interest on your modified mortgage does not include monthly amounts to cover your taxes and insurance. However, you should include taxes and insurance amounts in determining your monthly housing expenses.</li> <li>After five years, your loan will slowly readjust to 6.500% by no more than 1% each year. The enclosed Modification Agreement includes a chart showing your payments during the life of your modified loan.<sup>26</sup> There are no fees or other charges for this modification.</li> <li>In addition, to help make your mortgage more affordable, we have reduced your payments by extending the amortization on your mortgage by an additional ten years. However, the maturity date of your mortgage has not changed. This means that you will continue to make monthly payments until the original maturity of your mortgage, but since payments are now calculated over an extended term, a substantial balloon payment will be due then.</li> <li>Our offer to modify your mortgage to provide you with an affordable payment is based on currently available information from you about your income. However, to finalize this modification, we must verify your income to confirm that you qualify. To verify your income, please sign and return the enclosed Request for Transcript of Tax Return (4506). If you wish to provide alternative verification, please contact us at <b>1.866.293.3232</b>. To remain eligible for this modification, you also must continue to make timely modified mortgage payments.</li> </ul>	<p><b>All it takes for you to bring your mortgage current and confirm you qualify for this modified mortgage is to:</b></p> <ol style="list-style-type: none"> <li>Sign and return the enclosed Modification Agreement along with a check for \$2,504.26 to be credited for your monthly principal and interest payment and</li> <li>Provide verification of your income to confirm that you qualify for the proposed modification.<sup>26</sup></li> </ol> <p>If your verified income is different from our information, we will contact you to discuss a different modification to your mortgage that may help you keep your home.</p> <p>We want to help you stay in your home, so please return the signed Modification Agreement, your check, and verification of your income by 9/30/2008.</p>

**Other options:** Can't afford the reduced payments? If after reviewing this offer you decide you still cannot afford your home, please call us at **1.877.908.4387**. We may be able to help you. We look forward to hearing from you.

Sincerely,  
  
 Brandon Letman  
 First Vice President  
 IndyMac Federal Bank, FSB



The most successful example of a broad-based loan modification strategy has been the FDIC's fast track loan modification program as part of its takeover of IndyMac Bancorp. After taking over IndyMac in July 2008, the FDIC moved quickly to address the 60,000 delinquent mortgages in IndyMac's portfolio. In late August, IndyMac sent letters to 10,000 borrowers for whom the bank had recent income information.

In these amazingly simple and straightforward letters – that arrived via priority mail to make them stand out and ensure that delinquent borrowers would actually open them – IndyMac offered borrowers a new rate with significantly lower payments. All that the borrower had to do to accept the new offer was sign the letter and mail it back to the bank. So far, there has been a 75 percent response rate and approximately 50

percent (5,000) loans have been modified. The average reduction in a borrower's monthly payment: \$430.<sup>26</sup>

<sup>26</sup> "IndyMac's Fast Track Mortgage Modification Program," Christopher Palmieri, Business Week, October 8, 2008

IndyMac's goal was to reduce monthly payments to no more than 38 percent of gross monthly income. To get there, the bank has a number of tools at its disposal:

1. It can reduce interest rates either temporarily or permanently (IndyMac turns all adjustable-rate mortgages into fixed rate mortgages).
2. It can increase the term of loans to up to 40 years.
3. It can issue forbearance on some amount of the principal (i.e. a 0% interest rate on that amount).

In October, IndyMac sent another 20,000 letters to borrowers whom they believe qualify for modification but who need to contact IndyMac before the bank could make them an offer. The bank is currently gathering data on the success of this group.

While this sort of immediate assistance has been an answer to the prayers of many struggling homeowners, FDIC Chairwoman Sheila Bair is clear that modification is not a social program – that it makes good business sense as well.

In announcing IndyMac's decision to implement a systematic approach to modifying loans, Ms. Bair stated that,

*Foreclosure is often a lengthy, costly and destructive process. Avoiding foreclosure not only strengthens local neighborhoods where foreclosures are already driving down property values, it makes good business sense....By turning troubled loans into performing loans, we enhance their overall value. Indeed, recent statistics reinforce this long standing conclusion. Over the past few years, FDIC sales of nonperforming loans have yielded about 32% of their book value, while sales of performing loans have produced returns of more than 87%.<sup>27</sup>*

In the FDIC press release that accompanied the announcement, it stated that, "IndyMac Federal will only make modification offers to borrowers where doing so will achieve an improved value for IndyMac Federal or for investors in securitized or whole loans."<sup>28</sup>

Michael Krimminger, special adviser for policy to Ms. Bair, went on to say, "This is not a social program. This is a situation where the value of keeping someone in their home by avoiding

---

<sup>27</sup> Remarks from FDIC chairwoman Sheila Bair, August 20, 2008

<sup>28</sup> "FDIC Implements Loan Modification Program for Distressed IndyMac Mortgage Loans," August 20, 2008

foreclosure makes business sense. That's not always the case, but in many cases, avoiding foreclosure will give us the best value on the loans."<sup>29</sup>

The assertion that foreclosure is an expensive endeavor, and is rarely in the financial interests of lenders, was affirmed by IndyMac Federal Bank communications director Evan Wagner. Mr. Wagner estimated that, due to the decline in housing values, lenders can lose 20-40 percent upfront when foreclosing. Add onto this the time it takes to process a foreclosure, legal fees, realtor fees, a slow housing market, maintenance on the property while it's in the banks possession, and another loss when it goes to foreclosure sale, and a bank might end up selling the asset for 40 cents on the dollar.<sup>30</sup>

The success, so far, of the FDIC's IndyMac model has resulted in Bank of America agreeing to adopt a similar program as part of a legal settlement with the State Foreclosure Prevention Working Group, which had sued Countrywide Financial (which Bank of America bought in July) for predatory lending practices. In early October, Bank of America agreed to help distressed borrowers who had gotten a subprime or pay-option ARM loan with Countrywide between 2004 and 2007, by cutting monthly housing payments to no more than 34 percent of gross income.

Joe Price, Bank of America Chief Financial Officer, stated that, "By taking projected foreclosure losses and instead directing those funds into these proactive foreclosure prevention efforts, we create a solution in the best interests of both our customers and the investors whose loans and securities we service."<sup>31</sup>

In response to Bank of America's decision, the Attorneys General from 11 states issued a letter on October 7, 2008 to 16 major lenders, asking them to follow Bank of America's lead and do the same.

*We believe that every major servicer of subprime loans should adopt these types of programs as soon as possible...We urge you in the strongest possible terms to adopt a comprehensive, streamlined and effective loan-modification program as soon as possible.*<sup>32</sup>

While it remains to be seen how Bank of America actually implements this program, the fact that they have agreed to this program is a step in the right direction.

---

<sup>29</sup> "Bailout's Dry Run for Troubled Borrowers," Carolyn Said, San Francisco Chronicle, September 25, 2008

<sup>30</sup> Conversation with Evan Wagner, October 17, 2008

<sup>31</sup> "Bank of America Announces Nationwide Homeownership Retention Program for Countrywide Customers," October 5, 2008

<sup>32</sup> State Foreclosure Prevention Working Group Letter, October 13, 2008

While some assert that loan modifications only offer temporary relief, and that many borrowers who modify end up falling behind again on their payments, IndyMac Federal Bank's Mr. Wagner noted a few key differences between IndyMac's program and other past loan modification strategies.

*In the past, when banks were doing loan modifications, they started from viewpoint of "What is affordable for the bank?" Our starting point is, "What is affordable for the customer?"*

Mr. Wagner continued to point out that many past loan modifications were not, in fact, modifications but loan "workouts." While loan modifications make changes to the loan for the future, loan workouts oftentimes simply put into place a repayment plan to make up for late payments, without fundamentally altering the loan. This is a key difference.<sup>33</sup>

While the FDIC IndyMac program is a good start, it is likely that lenders will have to go further in accepting principal reductions as part of many loan modifications. Many families will simply not be able to pay their monthly payments without principal reductions. And sharp declines in housing values have put many families underwater, where they owe more than their homes are worth. Lenders must face the reality that they will not recoup their loans in foreclosure. It will be better for communities, lenders and the economy if homeowners have the incentive and the ability to stay in their homes, and not walk away.

It is clear that many families facing foreclosure should not have taken out these loans in the first place, and many will not be able to save their homes. But of the 6.5 million families at-risk of losing their homes, there are millions who could get back on track on their payments and remain in their homes. Every homeowner in the nation has a stake in keeping as many homes out of foreclosure as possible. The best way to put a floor on falling property values is to stop the cycle of foreclosures. Just as the case-by-case approach to responding to failing financial institutions did not work, we need a more systematic approach to preventing foreclosures. The American housing market is simply too big to fail.

While the key to solving this problem rest in many cases in the hands of large financial institutions and federal regulators, it is important to underline the fact that local communities have shown that they can play a critical role in preventing unnecessary foreclosures and stabilizing neighborhoods. We will go on to look at some of these local responses in the next section.

---

<sup>33</sup> Conversation with Evan Wagner, October 17, 2008

## Local and Regional Level

While the national scope of the foreclosure issue creates the need for action at the federal level, cities, towns, counties and states can take important steps to help minimize the number of foreclosures that occur in their regions and help deal with the impact on their communities.

### 1. Diversion Programs

The most notable example of local action is occurring in Philadelphia, whose innovative Residential Mortgage Foreclosure Diversion Pilot Program has had great success in slowing the tide of foreclosures and keeping people in their homes. During the first three months of the program, the city has been able to avert the sale of nearly 80 percent of the properties that have come before it.<sup>34</sup>

The components of the program are quite simple. Before any property in the process of foreclosure can be scheduled for sale by the sheriff's office, it must first be referred to officials who will attempt to work with the borrowers, lenders, and courts to modify the loan and avoid foreclosure. Of the 552 properties that came up for review between April and July 2008, 230 were permanently removed from the sale list, and 200 had their planned sale date delayed.<sup>35</sup>

The city has put \$2 million towards legal counselors in order to assist residents, and Mayor Michael Nutter has already expressed continued support in 2009 to meet the expected increase in foreclosures, saying that it will help protect neighborhoods from falling property values that occur when there is an increase in the number of abandoned houses.

Another noteworthy plan to keep an eye on is New Jersey, where the state legislature is debating establishing a \$30 million fund that would go towards paying for "emergency loans, counseling services and efforts by nonprofits to buy foreclosed properties and return them to productive uses." The state would raise this money by charging lenders a \$2,000 fee to initiate foreclosure proceedings. The legislation would also give New Jersey homeowners facing foreclosure up to six months to renegotiate their loans to be able to stay in their homes.<sup>36</sup>

---

<sup>34</sup> "Philadelphia Pilot is Model in U.S. Housing Crisis," John Hurdle, Reuters, September 25, 2008

<sup>35</sup> *ibid*

<sup>36</sup> "NJ Lawmakers trying to tackle housing crisis," Angela Delli Santi, Associated Press, October 20, 2008

## 2. Federal Neighborhood Stabilization Funds

In July 2008, Congress approved \$4 billion to go to cities, counties, and towns to help stabilize housing values. These “neighborhood stabilization funds” – and other federal housing money – can be used to support foreclosure diversion programs similar to the Philadelphia plan, or to acquire, rehabilitate and sell vacant foreclosed homes to families.

In order to receive the funding, cities and towns must present to the federal government their plan for using the money by December 1. As cities and states develop their plans, it will be essential that they solicit real community input and draw on successful strategies that have been used to slow foreclosures and shrink the supply of vacant and abandoned housing.

## 3. Maintenance of Vacant Properties

In some regions hard-hit by the foreclosure crisis, cities and towns have passed ordinances that require banks to maintain vacant foreclosed homes. With studies showing that crime rates increase – and property values decrease – when a neighborhood passes a threshold in the number of vacant properties, requiring banks to maintain properties on a regular basis can prevent some of the fallout that comes with foreclosure.

In California, Senate Bill 1137 allows local governments to impose a \$1,000-a-day fine on financial institutions that fail to maintain vacant properties if problems aren't fixed within 14 days. The new law allows cities "to go in, abate the problem and tack [the cost] on to the tax bill" without having to enact a local ordinance, said California state Sen. Don Perata, the bill's sponsor.<sup>37</sup> An October 13<sup>th</sup> report from ForeclosureRadar showed a 61.8 percent drop in foreclosures in California from August to September, suggesting the new law is working.<sup>38</sup>

In Massachusetts, the City of Lawrence passed a “Bank Responsibility Ordinance” that requires banks to register any property they foreclose on and then take responsibility for securing and maintaining the building until it is resold. The City charges banks to register the property and can fine them if they failure to adequately maintain vacant homes.

---

<sup>37</sup> "Vacant-Property Fees Add to Mortgage Firms' Woes," Ruth Simon, Wall Street Journal, July 29, 2008

<sup>38</sup> "State Foreclosures Fall Drastically," Michael Shaw, Los Angeles Business, October 14, 2008

## SUMMARY OF RECOMMENDATIONS

PICO National Network and Contra Costa Interfaith Supporting Community Organization propose the following steps to keep families in their homes and stabilize neighborhoods.

### To keep families in their homes

On the NATIONAL level:

1. The U.S. Department of Treasury should require that any bank it invests in adopt FDIC protocols. Treasury should also adopt these protocols for any loans that it purchases, and should press servicers to adopt these protocols when the federal government owns a partial stake in a mortgage.
2. Broad-based loan modification should apply to sub-prime, option ARM and other Alt-A mortgage loans and, like the Bank of America agreement, the goal should be to reduce mortgage payments to 34% of monthly income.
3. When interest rate reductions are not sufficient to reduce monthly payments to 34 percent of monthly income, loan modifications should include principal reductions.

On the LOCAL & REGIONAL level:

1. Cities and counties can create foreclosure diversion or moratorium programs that encourage lenders to modify loans (a model is the Philadelphia Foreclosure Diversion program which has reduced foreclosures by 80 percent).
2. Cities should use federal funds or their own local funds to provide more access to mortgage and credit counseling

### To stabilize neighborhoods

On the NATIONAL level:

1. Lenders and federal regulators should work to speed up disposition of vacant property to families and providing non-predatory loan products to families to buy homes. Lenders should shift their disposition of bank-owned properties to mitigate against speculation and encourage owner-occupancy. They should also partner with non-profit housing organizations to acquire the properties to ensure that they remain affordable.

On the LOCAL & REGIONAL level:

1. Cities and counties should make effective use of new Federal Neighborhood Stabilization funds and other federal housing money to acquire, rehabilitate and sell vacant foreclosed homes to families. They should also explore incorporating job training and employment opportunities for local residents to maintain and rehabilitate vacant properties
2. Local cities and counties should adopt ordinances that require banks to maintain vacant foreclosed homes.

## **PICO NATIONAL**

PICO helps engage ordinary people in public life, building a strong legacy of leadership in thousands of local communities across America.

Non-partisan and multi-cultural, PICO provides an opportunity for people and congregations to translate their faith into action. More than 50 different religious denominations and faith traditions are part of PICO.

With more than 1,000 member institutions representing one million families in 150 cities and 17 states, PICO is one of the largest community-based efforts in the United States. Together we are lifting up a new vision for America that unites people across region, race, class, and religion.

## **CCISCO**

Contra Costa Interfaith Supporting Community Organization is committed to building civic engagement and increasing public participation by those most affected by injustice and inequity in Contra Costa County. We are a multi-ethnic, multi-generational, interfaith federation of 25 congregations and youth organizations representing over 35,000 families across the county.

For more information on PICO National Network, visit [www.piconetwork.org](http://www.piconetwork.org).

For more information on Contra Costa Interfaith Supporting Community Organization, visit [www.ccisco.org](http://www.ccisco.org).