AMERICAN NIGHTMARE

UNDERSTANDING THE MORTGAGE CRISIS

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On July 23, 2008, Carlene Balderrama, a 52-year-old woman from Taunton, Massachusetts, started her day like any other. She watched her husband and her 24-year-old son leave the house, ran her errands and cleaned the house. But then she went to the kitchen table and wrote out two notes, she faxed the first one and left the second on the table. She then walked into the living room and put the barrel of her husband's high-powered rifle into her mouth and ended her life. The first letter was sent to her mortgage company, which had scheduled a foreclosure on her home at five o-clock that evening, 90 minutes after her suicide. Balderrama had failed to make her mortgage payments for 42 months. Her fax stated that she would be dead before they came to foreclose on her home.

Despite the family's significant financial problems Carlene's husband was completely in the dark. Carlene had been in charge of the family's bills and had shredded the letters from the mortgage company before her husband could find them. Her husband returned home to find his wife dead and her suicide note on the kitchen table, which told him to use her life insurance to pay off their debt. Deepening the already incomprehensible family suffering, Carlene's last selfless attempt to save her family from financial ruin was in vain as suicide is not covered under life insurance policies. Though Balderrama's story seems inconceivable, stories like hers are likely to become more prevalent as the pressures of the mortgage crisis weigh down on individuals facing foreclosure.

Understanding Mortgages

It is impossible to begin to discuss the mortgage crisis without first understanding mortgages and their importance. A mortgage is "a loan to finance the purchase of real estate,

usually with specified payment periods and interest rates."[1] A payment period is the amount of time the mortgagee has to repay the loan, typically either 15 or 30 years, though longer and shorter terms are possible. There are two main types of mortgages, fixed rate and adjustable rate. A fixed rate mortgage (FRM) has a set interest rate for the entire period of the loan, while an adjustable rate mortgage (ARM) has a rate that can change throughout the payment period. The most common ARM, accounting for two-thirds of all recent ARMs[2], is called a "2/28," where the interest rate is a set "teaser" rate for the first two years of the mortgage and then increases to a higher adjustable rate for the last 28 years[3]. Adjustable rate mortgages usually have an interest rate based on a base index (the adjustable rate), which is then added to a fixed number, known as the spread. The most common base index for ARMs is the London Interbank Offered Rate (LIBOR), which typically has a value of between five and seven percent.

Mortgages are typically used as a means to provide the necessary collateral to afford the purchase of a home. Homeownership is typically the largest investment of an individual's life. In a 2006 report by the Center for Responsible Lending, the authors wrote, "for most families, homeownership is the most accessible path to economic security and is associated with a host of non-economic benefits, including safer neighborhoods, better health and higher educational attainment."[4] Because the value of a home is expected to appreciate over an extended period of time, owning a home can be seen as a long-term investment. In addition, there is a sense of pride and accomplishment for individuals who achieve homeownership, often seen as a pillar of the "American Dream."

Subprime Loans

The subprime mortgage market, which is currently viewed as the major culprit in today's financial crisis, was originally meant to be a means of increasing access to mortgages for individuals who would not have been approved in the prime market. Mortgages in the prime market are provided to individuals with high credit scores who pose little risk of defaulting on their loans. The subprime market "is intended to provide home loans for people with impaired or limited credit histories."[5] The borrowers in the subprime market would not qualify for prime loans as a result of their high loan-to-value ratios, high debt-to-income ratios, low documentation and low credit scores[6]. The loan-to-value ratio is the ratio between the amount of the loan and the value of the property; the debt-to-income ratio is just that, the ratio between the amount of debt that the mortgage causes and the individual's income. Low documentation refers to little or no documentation of the individual's income, which is overlooked in the subprime market. All of these factors make it impossible for the individual to receive a mortgage from the prime market.

The subprime market came about as a result of the Depository Institutions Deregulation and Monetary Control Act in 1980, which permitted interest rate caps, and the Mortgage Transaction Parity Act of 1982, which allowed variable interest rates and balloon payments[7]. These two acts essentially made subprime lending legal and allowed the lenders to place

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higher interest rates and fees on higher-risk borrowers. In addition to these laws, the increase in the subprime market was in large part a result of changes in the market interest rates. "In 1994, for example, interest rates increased and the volume of originations in the prime market dropped." As a result, the subprime market grew in size to balance the decline in the prime market. This market has quickly grown; in 1998 the share of mortgages originating in the subprime market was only ten percent, whereas in 2006 it was 23 percent[8]. However, it has been estimated that since 1998, "only nine percent of subprime loans have gone to first-time homebuyers."[9]

This means that the majority of subprime loans are refinances. Refinancing is a process by which an individual will pay off an existing mortgage by taking out a new mortgage. This new mortgage can be for a higher value, have a different payment period and/or have a different interest rate. The importance of refinancing will be discussed in further depth later, but it is important to realize that even with the higher percentage of subprime mortgages, the majority of them do not result in new homeownership. Because of the increased presence of subprime loans in the mortgage market, the impact of low performance in the subprime market has a large impact on the overall market.

The current mortgage crisis has revolved around the phrase "subprime mortgage" as a result of the high foreclosure rate among subprime mortgages. The statistics on the foreclosure rate in the subprime market in recent years can be defined at best as frightening. Those subprime mortgages that do result in home purchases are found to be six times more likely to end in foreclosure than purchase mortgages in the prime market[10]. This is a result of the riskier types of borrowers and the higher interest rates and fees that are associated with subprime loans. In addition, "as many as one in eight subprime loans originated between 1998 and 2004 ended in foreclosure within five years."[11] These numbers are staggering, and the sudden influx of foreclosures was not just a fluke in the system, but a confluence of a number of different problems.

: Why Now? Causes and Beneficiaries of the Current Crisis

Predators

One of the main explanations that can be seen in the media today is that predatory lending was taking place. A predatory mortgage loan is defined as "an unsuitable loan designed to exploit vulnerable and unsophisticated borrowers."[12] These loans tend to contain at least one of the following characteristics: higher interest rates and fees than necessary, "abusive terms and conditions that trap borrowers and lead to a spiral of increased indebtedness", and the targeting of women, the elderly and minorities (especially those who have equity in their homes)[13]. Subprime loans are already riskier because of the prevalence of adjustable interest rates, balloon payments (bulk payments made at the end of the payment period to pay off the remaining value of the loan), prepayment penalties (lenders charge fees to borrowers if they pay their mortgages off early), and little or no documentation used when writing the loan[14]. The risk caused

by subprime loans is increased dramatically when predatory lending takes place. The major culprit in predatory lending is the mortgage broker. According to the US Department of Housing and Urban Development, "mortgage brokers are involved in about 60 percent of all mortgage loan transactions."[15]

When an individual takes out a mortgage, he can either work directly with the mortgager or through a mortgage broker, who works as a link between the borrower and the lender. "Mortgage brokers, who originate the majority of subprime mortgages, have a strong incentive to close as many loans as possible, but very little reason to consider the loans' future performance."[16] Because mortgage brokers are writing the loans, but do not pay the costs of a default, they are less likely to concern themselves with borrowers' ability to repay the loan. Not only is the mortgage broker not held accountable for a default on the loan, but there are even incentives for mortgage brokers to create loans with higher interest rates and write a large number of loans, without consideration for the quality of the loan. An example of this is that some brokers "collect a 'yield-spread premium,' which is a cash bonus a broker receives for charging a higher interest rate on a loan than the lender required."[17] This leaves many wondering how it is possible that mortgage brokers could be writing loans that were impossible for the borrower to pay. The main explanation is that there is a lack of regulation and legal consequences for "making home loans that are predictably unsustainable."[18] With incentives to produce high interest loans and little or no care for the loan's performance, mortgage brokers were a major cause of the high rate of default on subprime mortgages.

The mortgage brokers put the borrower in contact with the lender, typically a bank. Within the subprime mortgage crisis there have been a number of banks that have been major players. The top ten subprime lenders in Massachusetts between 1993 and 2007 (according to research conducted by Christopher Foote using the Warren Group dataset and the list of subprime lenders provided by the Department of Housing and Urban Development) included Option One Mortgage Corporation, Fremont Investment & Loan, Long Beach Mortgage Company and First Franklin Financial[19]. The top ten lenders accounted for 41,114 subprime loans that were issued in this 14-year period, 68.1 percent of which were subprime purchase mortgages[20]. The top subprime lender in Massachusetts during this period was Option One Mortgage Corporation, which issued 11,243 subprime loans[21]. All ten of these lenders have since been shutdown[22].

So how did these banks and mortgage brokers get away with their predatory lending practices? The fault lies in the lack of regulation of the mortgage sector, an issue that is not easily fixed. Because high interest rates and additional fees are common in high-risk loans, it is difficult to distinguish predatory loans from loans that were highly risky and therefore required a higher expense on the part of the borrower. In some cases, these high interest loans are necessary for the borrower to be able to receive a loan at all, due to the risk to the lender. According to a 2001 publication by Fannie Mae, additional complications arise in regulating subprime loans because "there is little, if any, publicly available data regarding loan terms, such as interest rates, origination points, processing or closing fees, and special provisions such as balloon payments, credit life insurance, and prepayment restrictions."[23] This makes it difficult to investigate the origination of the loan and its costs to the borrower in order to categorize it as a subprime or predatory loan. The article continues by explaining that even with "a clear technical distinction between legitimate subprime lending and predatory lending, there exists a huge gray area between the two,"[24] making it difficult to place firm regulations on high risk lending that would protect borrowers from predatory lenders. Regulating high risk lending could potentially eliminate subprime lending entirely, putting the government in a difficult situation.

Why Foreclosures Are Increasing

There are additional trends that have been present with subprime borrowers that have increased the rate of foreclosure. One of these trends has been a decline in the amount of money put into the home, the down payment. In the prime market, if the borrower is not able to put down at least 20 percent of the value of the home, he is required to pay for private mortgage insurance (PMI), which will cover the lender's losses if the loan cannot be repaid or the value of the mortgage is not recovered in foreclosure and subsequent sale.

Many subprime purchases are made with little to no equity in the homes, meaning that the homeowner has a low level of investment in their home. Typically the buyer takes out more than one purchase mortgage and the cumulative value of the mortgages is the purchase price of the home. "In 2007, 40 percent of Massachusetts residents who lost their homes to foreclosure had put no money down when they bought their homes"[25] and "52.4 percent [of these Massachusetts residents] put down less than five percent."[26]

In addition to a lack of equity in their homes, there has been a high level of refinancing of mortgages. As already noted, refinancing takes place to change the payment period, interest rate, value and terms of a loan. Refinancing has been used in recent years as a method to remove equity from the home by taking out higher valued mortgages. "American households have used refinances...to pull money out of their homes at an unprecedented rate: over two trillion dollars in the past five years alone."[27] The declining equity in the homes has the same affect as not having a down payment, there is a smaller investment being made by the homeowner. An increase in the number of refinances has a direct impact on the likelihood of foreclosure. "Homes that were purchased in 1999 and foreclosed upon in 2007 had an average of 1.6 subprime mortgages during their ownership experiences. The comparable number for homes purchased in 1999 that have not yet been foreclosed upon or sold is only 0.2."[28] Furthermore, the risk of losing one's home increases by 36 percent for borrowers that refinance more than once[29]. One of the main reasons for the increase in refinancing and loss of equity in the homes is the downward turn in the economy.

The Financial Crisis

Increasing food costs and high unemployment rates are just a few of the signs of our declining economy, which has had an important effect on increasing foreclosures. "Over the past two decades, after-tax income for the bottom 60 percent of families climbed only five to 15 percent, while costs for such basics as housing, child care, and health care rose 53 to 75 percent."[30] An increasing cost of living has resulted in an inability for many borrowers to keep up with their mortgage payments. In addition to the higher costs, there is more uncertainty of one's income: "a 2004 study reported that the average annual variation in income for middle-income households... has doubled since the 1970s,"[31] making large mortgage payments harder to payoff. Overall, these factors combine to create an atmosphere where individuals have less flexibility in terms of their income. A major addition to this problem is that in recent years there has been a significant decline in the savings rate of individuals. The personal savings rate has declined over the past two decades and has actually been negative since midway through the year 2005[32]. This is not unique to the US. In fact, there has been a decline in the savings rate across the majority of the 30 Organization for Economic Co-Operation and Development countries since the beginning of the 1990s[33]. Specifically, the savings rate in the United States declined by 3.0 percent between 1995 and 2000[34]. During this same period, the savings rate in Italy declined by 7.3, the savings rate in Canada declined by 3.9 percent, and the savings rate in the United Kingdom declined by 4.4 percent[35].

A lack of savings means that borrowers are unable to deal with shocks to their income or large increases in their mortgage payments. We have already discussed the prevalence of ARMs in the subprime market. Because the rates are constantly changing, these mortgages provide more uncertainty to the borrower. The increase in interest rates over recent years has resulted in unexpected additions to the monthly payments on ARM mortgages. A low savings rate means that many borrowers were unable to afford the change and were forced into foreclosure. In addition to the increase in interest rates over recent years, the down turning economy has also brought higher unemployment rates; job loss for individuals with little to no savings makes it impossible to keep up with mortgage payments. Because these individuals have little or no money to draw from when they lose their jobs or face unexpected costs, they are "likely to attach a steep discount to future payoffs" on their home from the appreciation rate; they are in need of cash and so are willing to forego future benefits from homeownership in return for money now[36]. These people are likely to go into foreclosure or try to sell their homes as a means of increasing their current wellbeing, but they lose the possibility of wealth accumulation that comes from homeownership[37].

A complicating factor is declining house prices. This decline has had an important impact on the number of foreclosures in recent years. A decline in house prices means that typical methods for borrowers to get out of mortgage trouble, such as refinancing their mortgages, taking out home loans, or selling are now out of the picture[38]. Once prices decline, many homeowners can no longer sell their homes for a price that is high enough to pay off their mortgages because mortgages are taken out based on the original purchase price. Declining housing prices cause a situation of negative equity in the home, where the value of the loans taken out on the home is actually greater than the house's worth. The decline in house prices has a direct effect on the foreclosure rate. "A borrower who has seen his property's value fall by more than 20 percent since the initial purchase is 15 times more likely to lose the home to foreclosure relative to someone who has seen his property appreciate by 20 percent"[39]. It is important to note that although foreclosure rates are higher during periods of low or no housing appreciation, this does not mean that there are not failed loans during times of high appreciation[40]. The difference is that during times of high appreciation, it is possible for homeowners to avoid foreclosure through refinancing their loans or selling their property, whereas with low or declining appreciation rates, this is not an option. Because borrowers in the subprime market are constantly on the edge of defaulting, they are incredibly sensitive to changes in the appreciation rate of their homes[41].

The Bundlers

There were foreclosure filings for one in every 534 American homes in January of 2008, yet there is still no solution[42]. One of the most significant complications in the current mortgage market is the secondary market. In order to decrease the risk of loss due to loan default, lenders sell their loans to investors; this creates a "secondary market" for mortgage loans[43]. The origination of this process was in the 1970s when the first mortgage-backed securities were sold to investors. These initial loans were sold to investors as individual loans[44]. This process has changed through the years, and now the mortgages are bundled together by investors to be resold as securities; these securities include both high and low risk mortgages. The first of these collateralized debt obligations (CDOs) was created by Michael Milken in 1987[45], and this unregulated market of reselling mortgages has grown in size since its start. It is attractive to both investors and lenders because "investors now [have] a liquid instrument and lenders [have] the option to move any interest rate risk associated with mortgages off of their balance sheet.[46]" According to Cameron L. Cowan, speaking on behalf of the American Securitization Forum, the benefits of securitization are numerous. He explains that "chief among these [benefits] is the contribution of securitization to lower borrowing costs both for individuals and corporations."[47] He continues by noting the increased flexibility provided to the loan originators and the additional opportunities for investment.[48]

The securities are rated to indicate how risky they are, although it is almost impossible to find out the exact contents and "CDO ratings may mislead investors because they can obscure the risk of default."[49] Although ratings are not necessarily accurate, the securities deemed as "riskier" are given lower preference in being paid off. This means that if a borrower defaults on a loan, the investors with the least risky loans receive payment first; they are followed by the next lowest risk investors, and those with the riskiest securities are paid off last, if at all. Because mortgages are packaged into securities and then sold off, it is nearly impossible to determine the 'true owner' of specific mortgages and the investors are "protected by a legal doctrine called 'holder in due course' which prevents borrowers from making claims against the purchaser of their loan, even if, for example, that loan contained abusive features."[50] This causes significant problems for borrowers who begin to face default on loans that they should not have been given in the first place. These borrowers have no way to combat the faulty loans they were given and are forced to either face foreclosure or find a way to keep up with unsustainable mortgage payments. "As of June 30, 2006, mortgage-backed securities were the largest segment of the United States bond market, accounting for 23 percent of all bond market debt outstanding."[51] The impact of increasing foreclosures has had a direct impact on investors who purchased the securities and is one of the many negative results of the mortgage crisis.

Are there victims?

Many subprime lenders lacked the financial saviness necessary to understand the role a mortgage is meant to play and the types of mortgages best suited for their needs. In focus groups conducted by Boston Community Capital in July 2008 with homeowners in Boston who were facing foreclosure, many explained that they were in this situation today as a result of being told that they could essentially use their homes as ATMs, removing equity when they needed money. There was no consideration for the fact that appreciation rates could fall and that this could result in the loss of their homes.

Because borrowers saw their homes as a source of income, not an investment for the future, they continuously removed equity from their homes, which resulted in higher mortgage payments. Many of the borrowers were "on the edge," meaning that they could pay their mortgage payments each month, but just barely. As a result, if there was any unexpected expense or decline in income, the individuals could no longer pay off their debt. Unfortunately, Merrill Lynch has predicated that housing prices are unlikely to increase in coming years. They have forecasted a decline in housing prices by 15 percent in 2008, ten percent in 2009 and five percent in 2010[52]. This means it is unlikely that the situation will improve in the next few years.

Within the focus groups conducted by Boston Community Capital, a number of the participants explained their troubles as a result of "bad luck". This included job loss, illness, divorce and death. As a result of these situations, the borrowers could no longer afford their payments and ended up in foreclosure. This is closely linked to the decline in the savings rate, which was discussed earlier. Without a financial cushion for times of trouble, any change in the borrower's income resulted in a default on their loans. The fault for this can be found in both the borrower and the lender. The borrowers lacked the necessary preparation for dealing with a fluctuation in their income, while the lenders were providing loans with monthly payments that the borrowers could just barely afford.

In order to gain a better understanding of the "normal" scenario, I will walk us through a common borrower's situation. Although there is truly no single case that could be used to represent the experiences of all borrowers, this scenario is based on my own research of the mortgage history of over 900 borrowers who went into foreclosure during the period between December 2007 and June 2008. Let's start with our borrower, Fred. Fred purchased his home in 2003 for $200,000. He received a first purchase mortgage for $150,000 and a second mortgage for $50,000, both from the same lender. The first purchase mortgage was a 30-year adjustable rate mortgage with an initial rate of six percent and an adjusted rate of LIBOR plus 5.75 percent. His second purchase mortgage was a 15-year, fixed rate mortgage with an interest rate of eight percent. You will notice that this means that Fred has now purchased a new home without paying a penny out of pocket. After two years, Fred decides to refinance both of his mortgages. The first purchase mortgage is refinanced as a 30-year adjustable rate mortgage, but this time the interest rates are slightly higher than his original interest rates, and the second purchase mortgage is refinanced and becomes a $75,000 mortgage with a similar fixed interest rate. In 2006, Fred begins to experience higher expenses, maybe his child gets sick or he loses his job, and he can no longer pay off his larger mortgage. The larger mortgage then goes into foreclosure and because Fred now has negative equity in the home and housing prices have declined since his original purchase, he cannot sell the home for enough money that he can pay off his debt. Sadly, Fred loses his home and must find a new place to buy or rent.

Shock Waves : Cyclical Consequences

The impact of a foreclosure spreads from the investor, who purchased a share of mortgage, to the city where the foreclosure takes place. Let's start by looking at the most obvious effect, that of the foreclosure on the individual. There are

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the obvious emotional impacts of foreclosure, the most extreme being the example of Carlene Balderrama. Foreclosure results in a decrease in an individual's credit score, which makes it more difficult for an individual to acquire loans in the future and, when one can receive a loan, the payment will be much higher[53]. Additionally, as already discussed, homeownership is an opportunity for wealth accumulation over the long term. The loss of one's home means the loss of opportunity for future capital gain. It has been estimated by the Center for Responsible Lending that "subprime loans made during 1998-2006 have led or will lead to a net loss of homeownership for almost one million families;"[54] that is one million families who have lost the chance to accumulate long-term wealth. They have estimated that almost 15.6 percent of the subprime loans that have been written since 1998 either have or will end in foreclosure [55]. Not only does the increase in foreclosure mean that the borrower loses the possible wealth accumulation from the current property, but "research indicates that homeowners who give up homeownership for any reason can take more than a decade to get back in"[56]. The loss of the "American Dream" and one of the greatest opportunities for wealth accumulation can be impossible to reclaim.

The increase in foreclosures has a significant impact on both the cities and neighborhoods being hit hardest. The cities lose the tax revenue that comes from occupied homes[57]; the Homeownership Preservation Fund has done a study on the impact of foreclosure on the cities and has estimated that the "typical cost incurred by the city for a vacant foreclosed property sold at auction [is] between $5,400 and $7,000."[58] When there are five or even ten foreclosure auctions on a single street, the costs to a city are anything but insignificant. Because there tends to be a high concentration of foreclosures in specific neighborhoods, the impact on communities is debilitating. The results of vacant, boarded-up and abandoned houses range from a further divestment in the community to lower levels of social capital. Abandoned buildings provide locations for the selling and use of drugs, foster increased criminal activity, and can become the home for neighborhood trash, squatters and stray animals [59]. In addition, abandoned buildings become a source of income for criminals who will raid the properties and remove copper wiring and other building components that can be resold for profit[60].

In looking at the effects of foreclosures on crime, Dan Immergluck, an Associate Professor in the City and Regional Program in the College of Architecture at Georgia Institute of Technology, and Geoff Smith, a Research Project Director at the Woodstock Institute, found a causal relationship. In their study, they discovered that "an increase of... about 2.8 foreclosures for every 100 owner-occupied properties in one year... corresponds to an increase in neighborhood violent crime of approximately 6.7 percent."[61] An increase in violence, drugs, and overall criminal activity has a direct impact on the desirability of the community.

Immergluck and Smith did another study on the impact of foreclosures on housing prices. They concluded that "each conventional foreclosure within an eighth of a mile of a single-family home results in a 0.9 percent decline in the value of that home"[62] and that "properties located within 150 feet of an abandoned unit sold for over $7,000 less than other properties."[63] As we have already discussed, the decline in housing prices has had a major impact on the increase in foreclosures. Because of the direct link between foreclosures in a neighborhood on the property values of surrounding homes, foreclosures tend to be highly concentrated in certain areas. This concentration tends to be in poorer, minority areas. This is a result of the fact that the lower-income homeowners are unable to acquire mortgages from the prime market and that over half of all loans to African American borrowers are subprime loans, while four-tenths of loans to Latinos are subprime loans[64].

There has also been a significant impact on the creditors. Listening to the news, it is impossible to avoid hearing about the number of lenders and investors who have gone bankrupt as a result of the mortgage crisis. On one website dedicated to keeping track of these "imploded lenders," there are 277 creditors listed as those that have "imploded" since late 2006 and 19 listed as "ailing" lenders[65]. Included under the list of "imploded lender" are the well-known cases of Bear Stearns and Wells Fargo and the less notorious names of National Wholesale Funding and KH Financial[66]. The impact of foreclosures is both significant and widespread, but what can be done to stop it?

Salvation?

Currently the United States Government has enacted a plan to provide nearly four billion dollars in funding to assist areas that were hit the hardest by the mortgage crisis. "Congress mandated that the money [provided] be allocated based on the number and percentage of foreclosures, homes financed with subprime loans, and homes in default or delinquency in the community. Once the formula is set, [the United States Department of Housing and Development] has 30 days to dole out the funds. Government officials then have 18 months to put the money to use in their neighborhoods."[67] The goal is to increase the availability of affordable housing while simultaneously decreasing the number of vacant properties. "Sean O'Toole, founder of foreclosureradar.com, a foreclosed properties website for real estate professionals... [declared that] '$4 billion is kind of a meaningless sum... It can't possibly make a difference. You've brought a pistol to a nuclear war.'"[68] Considering the extent of the problem and the cost to renovate many of these homes, this response is understandable.

Another attempt being made to seek retributions for the cost of the mortgage crisis is through the law. There have been 170 cases "filed in federal courts during the first three months of 2008"[69]. With these additional cases, it is highly probable that the "subprime mortgage and related filings – now totaling 448 cases over the 15 months ending March 31, 2008 – will soon surpass the 559 savings-and-loan cases of the early 1990s."[70] However, because the majority of these cases have not been closed, it is impossible to know the impact they will play in the current crisis and it is unlikely that they will provide the compensation needed by the extensive number of families who have lost their homes. Given that these current efforts are inadequate to meet the needs of the nation, it is necessary to look at what else can be done.

The major emphasis of efforts to deal with the current crisis should be on preventing future foreclosures. This begins with increasing regulation in the origination process of the mortgages and decreasing the incentives for mortgage brokers to create unsustainable loans. An important alteration to the process, which has been advocated by the Center for Responsible Lending, would be to create set pricing for subprime markets that is transparent and has "market-driven prices for mortgages representing similar risks"[71]. This change would decrease the opportunities for predatory lending and unfair pricing for less knowledgeable borrowers. Lenders should be required to create sustainable loans, which take into account the loan-to-value ratio, debt-to-income ratio and the borrower's unique situation. The borrower should be able to repay the loan even if housing prices decline or interest rates increase. There is currently no room for adjustment. "Almost half of Massachusetts forecloses had owned their homes for less than three years."[72] Because the foreclosure process itself takes approximately six months, this means that borrowers were facing default on their loans less than two and a half years after receiving their loans, an exceptionally short period of time. Lenders must not allow their borrowers to purchase their homes without equity, as this is a lower investment by the owner and is less likely to be successful.

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Additionally, Alan Mallach at the Metropolitan Policy Program at the Brookings Institution explains that one of the steps that state governments should take is to both ensure a fair foreclosure process (one that provides the owner with adequate time to attempt to sell his/her home, provides clear notices to the borrower of the impending foreclosure, etc.) and encourage lenders to pursue alternative options to foreclosure[73]. Lenders must be willing to be flexible and to adjust the rates and payment periods for loans that are currently in default. Readjusting the mortgage payments so that they are sustainable can salvage some of these mortgages. Banks face higher costs in foreclosure and holding the properties than they will from refinancing the loans.

Unfortunately, there is no easy solution to the mortgage crisis, and it does not appear to be ending in the near future. In fact, it has turned much worse. With the fall of Fannie Mae and Freddie Mac, the selling of Lehman Brothers, and the billions of dollars in government support being supplied to A.I.G., things are looking much worse for the financial world. The crisis has spread beyond the subprime market and, in many ways, beyond the mortgage market in general. As we have become more aware of the crisis through these public bank failures and the decline of the American market, it is important that we do not forget the individuals who are most directly affected, those who are facing eviction. Without certainty for the future and with the threat of losing their own "American Dream," many may find themselves taking drastic measures to keep their homes or protect their families. / END

Notes

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