

EMERGING TRENDS

STATE ACTIONS TO TACKLE THE FORECLOSURE CRISIS

FORECLOSURE

**MITIGATION.
STABILIZATION.
PREVENTION.**



NGA Center for
BEST PRACTICES

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EXECUTIVE SUMMARY

The foreclosure crisis that emerged in late 2006 has grown worse. The number of foreclosures started in 2008 alone is projected to be 2.2 million according to the Mortgage Bankers Association.¹ And Credit Suisse is predicting there could be more than 8 million foreclosures associated with the current crisis by 2012.²

In September 2007, the National Governors Association Center for Best Practices (NGA Center) released *State Strategies to Address Foreclosures*, which provided an overview of the actions states were taking to curb foreclosures, regulate the mortgage market, and prevent predatory lending. The Issue Brief showed that states were taking the lead in keeping homeowners in their homes and in regulating mortgage brokers and lenders.

Since that publication, states have created many new policies and programs to continue responding to the growing foreclosure crisis. This report explores these new programs and the factors that affect states' responses, including the weakening national economy, which has put pressure on state budgets, and new federal programs that direct funding to states or affect state efforts to help homeowners obtain loan modifications.

Current state actions to curb foreclosures fall into three categories:

- **Mitigation** – In an effort to slow the number of homes that fall into foreclosure, states have stepped up efforts to reach out to at-risk borrowers, connect borrowers with counseling and legal assistance, negotiate agreements with loan servicers to streamline modifications, and improve the foreclosure process.
- **Stabilization** – As the number of foreclosures rises, so does the number of vacant and abandoned homes, which can attract crime

“... states have created many new policies and programs to continue responding to the growing foreclosure crisis.”

and decrease property values. States are working to stabilize neighborhoods with multiple vacant and abandoned properties by streamlining property acquisition, ensuring properties are located quickly and maintained properly, creating land banks, and designing programs to market foreclosed property to new, responsible homeowners.

- **Prevention** – Economists predict that the housing market will hit bottom in mid- to late-2009. As the market begins to grow again, it is important to protect borrowers from future housing crises. To prepare for better times, states are enacting laws to regulate mortgage brokers, increase transparency and disclosure during the loan origination process, prevent predatory practices, and improve financial education among consumers.

Governors see first-hand the impact foreclosures can have on their citizens and communities. This frontline perspective, coupled with states' nimbleness and flexibility in implementing policy and legislative solutions, means states have a vital role to play in addressing foreclosures and preventing more families from losing their homes.

INTRODUCTION

CHAPTER ONE



“Governors have led the nation in creating policies and programs to address foreclosures.”

In 2008, the nation’s foreclosure crisis worsened in many ways. The number of foreclosures and delinquencies grew, not only among subprime mortgages but also among prime mortgages. New residential construction dwindled, home sales dropped, and housing prices declined. The number of bank-owned properties ballooned.

The mortgage crisis spread to Wall Street, crippling banks and leading to the collapse or government takeover of former lending giants. The economy has stagnated and begun to shrink, which has added new financial burdens to American families. Unemployment reached 7.2 percent by the end of 2008—a 16-year high—and could peak around 9 percent by 2010.^{3,4} According to Moody’s Economy.com, some states could see unemployment reach double digits.

These indicators demonstrate the widespread implications of the foreclosure crisis and the importance of developing quick and effective policy responses to stem the rise of foreclosures. Governors have led the nation in creating policies and programs to address foreclosures. In September 2007, shortly after the collapse of mortgage giant Bear Stearns, the National Governors Association Center for Best Practices (NGA Center), released an Issue Brief titled *State Strategies to Address Foreclosures*, which reported policies and programs from 30 states designed to curb foreclosures, prevent predatory lending, and regulate mortgage loan originators.

Since September of last year, even more states have taken action to address the growing foreclosure crisis.ⁱ According to the National Conference of State Legislatures, 40 states introduced or enacted foreclosure legislation in 2008.⁵ State actions respond to the different phases of the foreclosure crisis: the boom, the bust, and the aftermath.ⁱⁱ

THE MORTGAGE LENDING BOOM

The years 2002 through 2005 saw an unprecedented rise in the number of mortgage loans originated in the United States. The ease of obtaining credit grew while interest rates plunged and innovative, nontraditional mortgage products proliferated in the market. Coupled with lax regulatory and industry oversight and new securitization tools that relieved lenders of the risk associated with new loans, the subprime loan market—comprised of high-cost loans originated to borrowers with credit deficiencies—flourished. The market share of subprime loans nearly tripled between 2001 and 2005, to 21 percent.⁶ A housing bubble grew and grew, inflated by buyers', lenders', and investors' confidence that housing prices would rise indefinitely.

During this period, the incidence of predatory lending rose alongside the growth in the subprime mortgage market share. Predatory lending practices, which gained attention when **North Carolina** enacted the nation's first state anti-predatory lending law in 1999, became more prevalent during the housing boom, prompting numerous states to enact similar protections for homeowners (in all, more than 30 states now have some form of anti-predatory lending law).

Today, governors are looking ahead to ensure that questionable lending practices do not reemerge when markets recover. A trend is emerging among states to develop new policies to safeguard against future housing crises and protect consumers when the housing market rebounds.

THE BUST

In 2006, housing prices began to stagnate in certain markets throughout the country, surprising homeowners and speculators who were counting on continually rising prices to appreciate the value of their properties until they could sell for a profit or refinance to a safer loan. Overheated markets, warmed by teaser rates, lax regulation, and low long-term interest rates, fed consumer appetite for new homes and put upward pressure on prices. Eventually, inflated home prices deterred new consumers from entering the market, leading demand and prices to stagnate. At first, homeowners held on—enduring interest rate shocks as their adjustable rate mortgages (ARMs) adjusted upward—in hopes that prices would rise again. Instead, prices fell steadily, bursting the housing bubble.

Many economists argue that booms and busts are part of the natural cycle of a market. Indeed, with home prices rapidly outpacing growth of income and wages throughout the 1990s and early to mid-2000s and the median home price increasing to more than four times the median family income,⁷ it is clear that the housing market is now undergoing a much needed correction.

Initially, it seemed as though the rise in foreclosures—which came as continually deflating housing prices lowered appraised values below the amount borrowers owed on their loans and made it difficult to refinance from nontraditional mortgage products to more secure, fixed-rate products—would be contained within the subprime loan market. Federal Reserve Chairman Ben Bernanke stated on several occasions in 2007 that the economic damage from foreclosures would be mostly contained in the subprime market. Instead, subprime foreclosures exposed highly rated mortgage-backed security bundles to losses, causing investors to balk. The mounting losses felled a series of Wall Street firms, which in turn led to extreme volatility in the stock

ⁱThis report examines the legislation, programs, and initiatives launched by states to address the rapidly evolving foreclosure crisis. As this situation is changing rapidly and involves a massive response on the state level, this report, while comprehensive, may not include every action taken by every state. Appendix C provides a chart of state actions covered in this report. The NGA Center's new State Foreclosure Response Web site details these actions and more, and will be updated regularly to include new state efforts.

ⁱⁱA *Washington Post* investigative series, "**Anatomy of a Meltdown: The Credit Crisis**," by Alec Klein and Zachary A. Goldfarb first described the foreclosure crisis in these terms. The series was published June 15-17, 2008.



“ The housing bust has been met with action from governors’ offices. States have established new programs and passed new legislation designed to mitigate the number of homes going into foreclosure. ”

market, shrinking individuals’ retirement accounts and other investments while leaving major banks and lenders in precarious positions.

As the economy has declined, the economic impact on individuals has become acute. The unemployment rate rose to 7.2 percent at the end of 2008, while food and gas prices soared over the summer. The added pressure of rising mortgage payments on ARMs and the difficulty accessing credit has caused more individuals to default on their mortgage loan payments, while others are cutting back on unnecessary expenses, which is having a ripple effect on industries such as retail.

The numbers associated with the housing crisis are stark. According to Credit Suisse, 8.1 million residential borrowers are predicted to lose their homes to foreclosure by 2012, and this number extends far beyond the subprime market. Twenty percent of homeowners are now “underwater” on their mortgages—in other words, they owe more on their homes than the homes are worth. By the

time the market stabilizes, up to 40 percent of homeowners could find themselves underwater.⁸

The housing bust has been met with action from governors’ offices. States have established new programs and passed new legislation to mitigate the number of homes going into foreclosure. State responses include efforts to reach borrowers at-risk of defaulting on their mortgages or losing their homes to foreclosure. States have set up hotlines and Web sites targeted at these individuals, while supporting local counseling agencies, creating programs to bring homeowners together with counselors and servicers, and even providing direct financial assistance to certain borrowers. Other states have recently taken steps that are more drastic, such as overhauling the foreclosure process and halting foreclosures while servicers modify loans. States also have enacted new laws to protect troubled homeowners from predatory schemes and renters from sudden eviction when their landlord is in foreclosure.

THE AFTERMATH

While experts disagree on the causes of and solutions to the housing crisis, everyone agrees that many current homeowners will lose their homes before the crisis is over. Many homeowners never should have been given a loan or overextended themselves by taking on debt they could not afford. Whether these homeowners knowingly took on this risk or were victims of predatory lending, they will not be able to continue owning their homes.

As such, the number of vacant and foreclosed properties will continue to grow, which could have harmful impacts on neighborhoods and local economies. Currently, there is a record number of unsold homes. These homes tend to be clustered together, and neighborhoods with multiple foreclosures are feeling the effects, including depressed housing values, increased crime, and unkempt homes creating eyesore after eyesore on previously thriving streets.

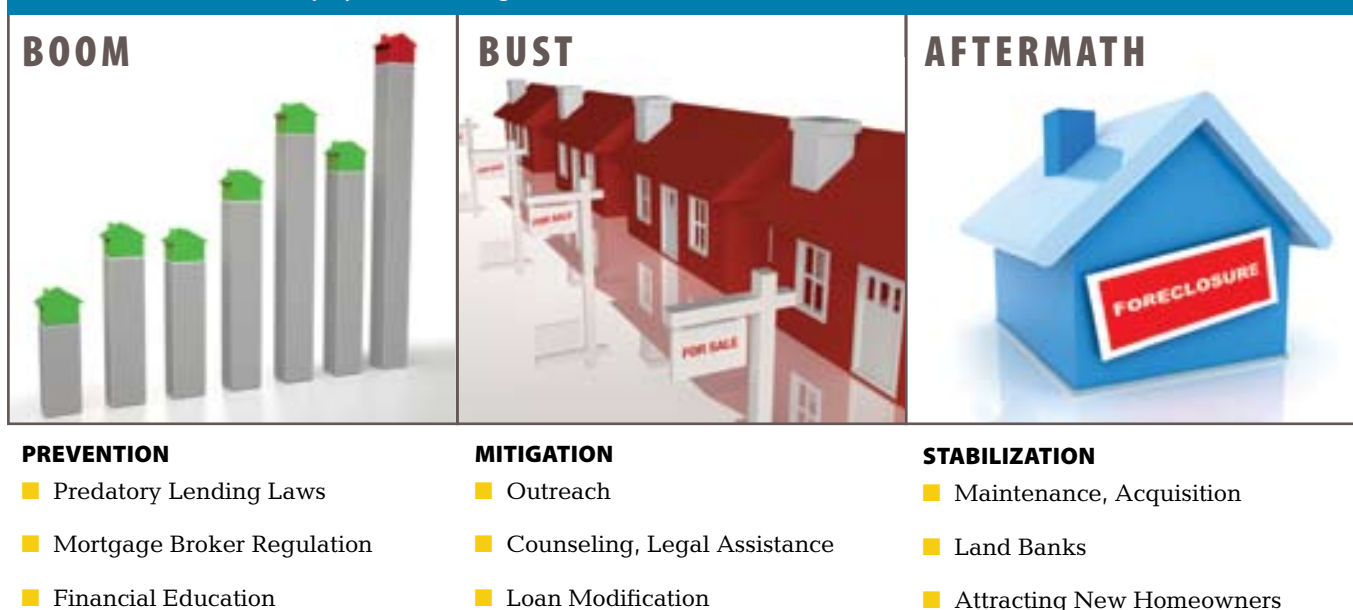
Thus, governors are working to ensure that neighborhoods with multiple foreclosures do not slip into decline. States with high foreclosure rates already have ramped up efforts to stabilize neighborhoods, from identifying and acquiring vacant property, to maintaining property or requiring lenders to perform the upkeep of their the real estate stock they now own (bank-owned/REO properties),

and rehabilitating and reselling foreclosed homes. Other efforts include providing technical assistance to former homeowners to help ease their transition and connect them with debt counselors, food stamps or other federal benefits, and safe and affordable rental opportunities.

Governors' efforts to stem the foreclosure crisis fit into one of three categories:

- **Mitigation**, including reaching out to at-risk borrowers, connecting borrowers with counseling and legal assistance, working with loan servicers to increase the number of modifications, improving the foreclosure process, providing transitional assistance to former homeowners, protecting borrowers from scams, and ensuring renters of foreclosed properties know their rights;
- **Stabilization**, including streamlining property acquisition, ensuring properties are located quickly and maintained properly, creating land banks, and designing programs to market foreclosed property to new, responsible homeowners; and
- **Prevention**, including enacting laws to regulate mortgage brokers, increasing transparency and disclosure during the loan origination process, preventing predatory practices, and improving financial education among consumers.

FIGURE 1. State Policies Employed in Each Stage of the Foreclosure Crisis



debt counselors, state and federal benefits, rental assistance, and, when unemployment is an issue, job training is one way states can help families regain their financial footing and become active participants in the economy again.

- Homeowners struggling to afford their mortgage payments have become targets of fraudulent schemes, like mortgage “rescue” operations and sham debt restructuring services. States have taken the lead in **stamping out predatory practices** that can exacerbate a homeowner’s already tenuous financial situation.
- Finally, many states are examining policies that dictate the fate of tenants of property that falls into foreclosure. Several states already have taken steps to **protect tenants**, including requiring notification and giving tenants additional time to vacate a property once it has fallen into foreclosure.

Two key trends have emerged among state efforts to mitigate foreclosures. First, in the area of outreach, foreclosure events or forums designed to connect struggling homeowners with debt consultants, legal aid, foreclosure counselors, and loan servicers have proved to be a successful and efficient means of moving homeowners into a loss mitigation strategy. Numerous states have adopted this strategy, which has been restructured and refined as states learn how best to serve their citizens.

Second, while several states have created agreements with loan servicers to modify delinquent loans or loans likely to become delinquent and a few states have revamped their foreclosure processes to give borrowers additional time to work with their loan servicers, **North Carolina** is the first state to bridge the gap between these two strategies. North Carolina’s effort to hold servicers responsible for developing loan modification options during the foreclosure process and requiring a 30-day delay of the foreclosure filing in cases that could benefit from a loan modification could ultimately become a model for other states seeking an aggressive strategy for curbing foreclosures.

RESOURCES AND ASSISTANCE FOR BORROWERS

States have several policy levers at their disposal for assisting homeowners who find themselves struggling to make their monthly mortgage payments. Many of these levers existed before the foreclosure crisis. Housing counseling agencies have long been a resource for homeowners who fall behind on their mortgages. Emergency payment assistance also has been an option for homeowners in some states for years. Since the advent of the foreclosure crisis, states have been working to maximize existing resources through coordination, expansion, and financial support. For example, **Pennsylvania** drew attention to its Homeowner’s Emergency Foreclosure Prevention program, first enacted in 1983, and its Refinance to an Affordable Loan program by holding a press conference in late 2007 to make the public aware of the programs and by launching a new refinance program supported by public and private funds. In **Illinois**, a coalition of 15 nonprofit housing groups came together in May 2007 to form the Illinois Statewide Foreclosure Prevention Network. The network was established to pool and coordinate the existing resources of key housing agencies in the state by providing additional resources for foreclosure counselors and increasing the capacities of participating organizations.¹⁰

The three main tools states are using to assist borrowers are:

- **Foreclosure Counseling Services** – States are working closely with area nonprofits to make foreclosure counseling services available and accessible to homeowners;
- **Legal Aid** – Some homeowners may require the help of a lawyer to address issues in their mortgage contracts, particularly those borrowers who are the victims of predatory lending, so states have begun working with their state bar associations to establish networks of volunteer lawyers who agree to provide their services pro bono; and
- **Financial Assistance** – A few states offer direct assistance to homeowners to help them make payments on their mortgage loans in the short term or refinance to a fixed-rate loan through the state housing finance agency.

Foreclosure Counseling Services

Foreclosure counselors are first responders in the mortgage crisis and a primary resource for borrowers who fall behind on their payments. Counselors determine the reason for a borrower's delinquency and may serve as a liaison between the borrower and the loan servicer.

Most states refer borrowers to U.S. Department of Housing and Urban Development (HUD) certified counseling agencies, which staff counselors trained in housing issues. The onset of the mortgage crisis has created a demand for counselors trained to sort through complicated mortgage paperwork and negotiate with loan servicers. Hence, states and the federal government have given financial support to counseling agencies to train their staff to better serve homeowners at risk of foreclosure. Nevertheless, counseling agencies still grapple with a shortage of counselors qualified to handle rising demand.

The HUD contracts state housing agencies and nonprofit organizations throughout the nation to provide counseling to homeowners to help them meet the responsibilities of homeownership. Nonprofit housing agencies that successfully apply and become HUD-certified by meeting industry benchmarks and federal guidelines may compete for federal funding. Additionally, counselors of HUD-certified agencies are eligible to apply for training scholarships offered by HUD or approved organizations, such as NeighborWorks America®.

On December 26, 2007, President George W. Bush signed legislation authorizing a \$180 million National Foreclosure Mitigation Counseling (NFMC) program. The legislation named **NeighborWorks America**, a national nonprofit organization Congress created in 1978 to provide financial support, technical assistance, and training for community-based revitalization efforts, as the administrator of the NFMC program, which would establish a nationwide network of housing counselors and

train those counselors to work specifically with homeowners at risk of foreclosure. The network, which is part of the **HOPE NOW Alliance**—a federally established alliance among the counseling network, servicers, investors, and other mortgage market participants that provides free foreclosure prevention assistance—includes state housing finance agencies, HUD-approved counseling agencies, and NeighborWorks organizations. Using the grant money, NeighborWorks has established several new training courses for housing counselors, including an online Foreclosure Basics e-learning course.



The Minnesota Homeownership Center offers foreclosure prevention resources to homeowners and counseling professionals.

On July 30, 2008, President George W. Bush authorized a second allocation of \$150 million to be administered by NeighborWorks to continue the NFMC program. This round of funding included a provision specifying that an additional \$30 million of the allocation be used to help housing counseling agencies hire legal assistance to aid homeowners with mortgage-related legal issues.

NeighborWorks selects the recipients of the federal funding, including state housing finance agencies that distribute the funding among local counseling agencies. Thirty-five states received grants ranging from \$52,000 to \$8.8 million during the most recent funding round. States have used this funding to help local counseling agencies expand their capacities to deal with the rise in demand for counseling services and access training to better serve homeowners. Thirty-one states received grants through their housing finance agencies in the first round.

Many state housing finance agencies have used grant dollars from the NFMC program to coordinate

counseling services statewide by establishing a statewide counseling “network.” For instance, **Colorado** used its NMFC grant to expand the capacity of its successful foreclosure hotline.¹¹ **Minnesota** leveraged its \$4.3 million federal grant to expand the state’s counseling network from 37 counselors to 76 counselors. The network, which Governor Tim Pawlenty started in 2007, is hosted through the **Minnesota Homeownership Center**. The center offers foreclosure prevention resources to homeowners, and it provides resources for professionals. The center hosts a free training workshop series for professionals who work with homeowners at risk of foreclosure as well as a listserv to connect counselors and community partners to information on foreclosure prevention resources, events, and tools for consumers. It also offers fact sheets and handouts that explain the Minnesota foreclosure process, foreclosure laws, and federal programs. The center also provides marketing materials for foreclosure services.

Arizona used its federal grant to launch a statewide foreclosure prevention hotline and expand training opportunities on loss mitigation for state housing counselors.¹² Most recently, the Arizona Foreclosure Prevention Task Force partnered with the Federal Reserve Bank of San Francisco and Wells Fargo Bank to provide loss mitigation training for faith-based organizations.¹³

States’ work to improve and expand foreclosure counseling services go beyond the NMFC program. In June 2008, **New York** Governor David Paterson announced that \$20 million of the \$25 million added to the state’s Housing Trust Fund Corporation by the 2008-2009 budget would go to the **Subprime Mortgage Foreclosure Prevention Services Program**. The program awards grants to local nonprofits on an ongoing basis to expand their capacities to provide foreclosure counseling services to New Yorkers. The remaining \$5 million was set aside for training individual counselors in foreclosure prevention and loss mitigation strategies.¹⁴

In April 2008, **Massachusetts** issued \$2 million in Foreclosure Prevention Grants to local nonprofit agencies and municipalities for foreclosure counseling, first-time homebuyer counseling, and pre-purchase counseling for subprime borrowers.

The grants helped establish 11 foreclosure education centers throughout the commonwealth.¹⁵

States also are using technology to make it easier for borrowers to access information on HUD-approved foreclosure counselors. **Michigan**’s statewide foreclosure counseling network is searchable through an **online tool** hosted by the Michigan State Housing Authority’s *Save the Dream* Web site. **California** makes it easy for borrowers to locate an approved housing counselor through an **interactive map** and a county-by-county directory that lists contact information for counseling agencies and the languages spoken at each agency.

Minnesota hosts **telephone counseling “seminars”** for its homeowners. At a scheduled time, borrowers struggling with their mortgages can dial into a free, confidential telephone seminar, during which experts take questions in a radio-format style and provide information on modification options, success stories from other borrowers, and other details on ways borrowers can avoid foreclosure.

Colorado utilizes technology both to help borrowers access counselors—through an online, confidential e-mail communications—and to help counselors access training. The Colorado Foreclosure Taskforce has posted a training video for housing counselors on YouTube. The training, which focuses on loss mitigation and foreclosure prevention, was hosted by the Colorado Division of Housing in 2007. The training is still timely and useful for housing counselors, so the state has made it available free of charge through the popular video Web site. The training, available at www.youtube.com/user/ColoFCTaskforce, is two hours total and is divided into 18 six-minute parts online.

Other states, like **Delaware**, have made an effort to target training toward specific groups. In December 2008, Delaware hosted a “Relief Pitchers” seminar designed to educate community leaders about foreclosure and the issues facing homeowners struggling to pay their mortgages. The idea behind the seminar was to engage community leaders and encourage them to use their networks to reach out to struggling borrowers and encourage them to seek help.

New Jersey's Department of Banking and Insurance has compiled a "**Mayors Combat Kit**," which is an online compendium of materials on the state's foreclosure process, options for avoiding foreclosure, information on federal programs, legal and counseling services available in the state, foreclosure scams, and other information. **Utah** has developed a Foreclosure FAQ document for non-counselors, such as religious and other community leaders, to help people in congregations and communities who are facing foreclosure.

Legal Aid

For some homeowners, the services of a foreclosure counselor alone may not be sufficient to untangle the issues related to the homeowner's mortgage or financial situation. For homeowners who are the victims of predatory lending, mortgage fraud, or mortgage "rescue" scams, or who have other legal issues, legal assistance may be necessary. Thus, states have begun partnering with attorneys' associations to recruit lawyers to work on homeowners' foreclosure cases pro bono.

In early 2008, **Ohio** announced a **multiagency initiative** to connect homeowners with legal aid and pro bono lawyers to prevent foreclosures. Ohio, a judicial foreclosure state, which means that most foreclosures must go through the state's court system, has had more than 1,300 lawyers volunteer to provide their legal advice and assistance to help homeowners keep their homes.¹⁶ Borrowers can call the state's foreclosure hotline to determine whether they qualify for assistance from a pro bono or legal aid attorney. To be eligible, a homeowner's household income must be within 250 percent of the federal poverty guidelines. Lawyers volunteer for the program through the **Ohio State Bar Association**, which hosts foreclosure trainings. In the two months following the program's launch, there were 366 referrals, with 279 cases open and 66 cases settled or mediated.¹⁷ In 2008, the Columbus Bar Foundation and the Columbus Bar Association honored the program with the 2008 Outstanding Pro Bono Project of the Year.

In **Arizona**, the **Lawyers Helping Homeowners** program, coordinated by the State Bar of Arizona,

the Arizona Foundation for Legal Services & Education, and the Arizona Supreme Court, assigns pro bono attorneys to eligible homeowners facing foreclosure. Three legal aid organizations operating in 15 Arizona counties are participating in the program, and individual lawyers can sign up to volunteer through the program's Web site. In addition, the State Bar of Arizona along with Phoenix's Channel 12 KPNX TV hosted a special edition of its monthly Lawyers on Call program—which gives people the opportunity to have their legal questions answered by volunteer lawyers—focused on foreclosures and evictions.

Distressed homeowners can access pro bono legal advice in **Florida** through **Florida Attorneys Saving Homes**, a collaborative effort of The Florida Bar, The Florida Bar Foundation, Florida Legal Services, and the Real Property Probate and Trust Law Section of the Florida Bar. The initiative has its own toll-free hotline as well as an online form for Floridians seeking assistance. Since the program's launch in June 2008, it has received more than 10,000 calls and 5,000 intake forms.

In **Maryland**, the Foreclosure Prevention Pro Bono Project (FPPBP) already has trained more than 700 volunteer attorneys to assist distressed homeowners. Through FPPBP, lawyers receive training to provide advice and counsel to homeowners at public foreclosure events, offer direct representation to a homeowner as a pro bono client, or work with nonprofit counseling agencies by answering questions from agency counselors. FPPBP was launched in July of 2008 by Governor Martin O'Malley; the Maryland Judiciary; the Attorney General's Office; the Maryland State Bar Association; the Maryland Department of Labor, Licensing, and Regulation; and Civil Justice Inc., along with several other legal services groups. Since July, FPPBP and Civil Justice Inc., have hosted 14 public foreclosure events, bringing together 265 attorneys and 375 homeowners.¹⁸

New York, which offers training opportunities for foreclosure counselors, also has sponsored live webinars for New York attorneys on how to set up a pro bono foreclosure prevention panel. The

online training, which fulfills two continuing legal education credits, covers topics focused on how pro bono coordinators and managers can create an effective foreclosure prevention project working with volunteer attorneys from the community.

Financial Assistance

In 2007 and 2008, nine states (**Connecticut, Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, and Pennsylvania**) announced mortgage refinance programs offered through state housing finance agencies.ⁱⁱⁱ The goal of the refinance programs is to help homeowners struggling to pay their subprime and adjustable rate mortgages by allowing them to refinance to a 30-year, fixed-interest rate loan. Most states work with select lenders to finance the loans, although some states, like **Massachusetts**, finance and service loans directly.

However, after the launch of similar programs in several states, it became clear that most borrowers facing imminent foreclosure had so badly damaged their credit by missing payments that they could not qualify to refinance through states' housing finance agency loan standards. Other homeowners were ineligible for the programs because the size of their loan was too large or their income was too high.

As a result, **Connecticut** has revamped its program to reach more borrowers. The Connecticut Fair Alternative Mortgage Lending Initiative and Education Services (CT FAMILIES) program, announced in November 2007, gave first-time homeowners with subprime loans the opportunity to refinance to 30-year, fixed-rate amortizing loans through the Connecticut Housing Finance Authority (CHFA) at .25 percent above CHFA's regular rate of 6 percent. In February 2008, Governor M. Jodi Rell announced the program had been revamped to give more families access to it. Changes to the program included eliminating the first-time homeowner requirement, expanding eligibility to include homeowners who purchased their homes with a subprime ARM and later refinanced to another adjustable rate product, and offering the CHFA interest rate to borrowers. An additional change has been proposed and is awaiting approval that

would eliminate minimum credit score requirements for borrowers, allowing their eligibility for the program to be determined on a case-by-case basis.¹⁹ The program also includes \$4 million for the CT FAMILIES Second Mortgage Assistance Loan program for up to \$10,000 to cover closing costs; arrearages/late fees; water, sewer, or real estate tax liens; or for an appraisal gap. In June, the Connecticut Foreclosure Task Force released a progress report, which found that 66 CT FAMILIES home loans had been originated, totaling \$14.1 million.

Other states, including Connecticut, have introduced or expanded emergency mortgage loan payment assistance programs. **Connecticut** has directed \$64 million in new funding to its Emergency Mortgage Assistance Program, while **Delaware** has invested \$700,000 in additional funding to its \$650,000 Delaware Emergency Mortgage Assistance Program (DEMAP). The DEMAP program gives homeowners the opportunity to obtain a loan on a delinquent mortgage balance when the delinquency is the result of a hardship beyond the homeowner's control, such as illness or job loss. The DEMAP program offers continuing loans for paying delinquent balances and contributing to ongoing mortgage payments as well as non-continuing loans to pay a delinquent balance. DEMAP loans have a 3 percent interest rate and may not exceed \$15,000.

In **Michigan**, struggling homeowners may qualify for a HELP loan if a nonrecurring crisis temporarily prevents them from making payments on a Michigan State Housing Development Authority Loan. The \$3,000 maximum loan is interest-free and may be applied to the mortgage delinquency or toward the cost of the crisis that caused the delinquency.²⁰

A new program in **New Jersey** couples loan modifications and financial assistance. The Mortgage Stabilization Program offers to match lender contributions toward reducing borrowers' monthly payments to an affordable level and bringing the loan value below the appraised value so that borrowers may regain some lost equity.²¹ Lenders who choose to participate in the program agree to reduce eligible borrowers' payments to 33 percent of

ⁱⁱⁱFor more information, see **State Mortgage Assistance and Refinance Programs**, by Stephanie Casey Pierce, available on the NGA Center Web site.



“ Making homeowners aware of options and assistance for avoiding foreclosure...has been a critical first-step in states’ foreclosure mitigation efforts. ”

their monthly gross income and to an amount below the current appraised value. The state’s Housing and Mortgage Finance Agency (HMFA) matches lender’s contribution to lowering the loan value up to \$25,000, but no more than half of the difference between the loan amount and the appraised value. The contributions from the lender and HMFA become non-amortizing (no monthly payments) second loans that the borrower must repay when he or she sells the home. The loans carry the same interest rate as the first loan, and may be prepaid without penalty at any time. For example, if a homeowner holds a first lien on their primary residence for \$200,000, but the residence is now worth only \$150,000, they may receive a \$25,000 loan from HMFA and a \$25,000 loan from their lender. To be eligible for the program, borrowers must have a household income no higher than 120 percent area median income and must agree to participate in a financial counseling program.

OUTREACH TO AT-RISK HOMEOWNERS

In the absence of a state, federal, or private streamlined loan modification program (discussed beginning on page 17), the first and most important action a state can take to mitigate foreclosures is conducting outreach to homeowners at risk of losing their homes to make them aware of resources available to them and encouraging them to call their loan servicer or a foreclosure counselor for help. Statistics from foreclosure hotlines, such as the nationwide 888-995-HOPE, operated by the Homeownership Preservation Foundation and used in conjunction with the federal HOPE NOW Alliance, suggest that most homeowners wait until they have missed several mortgage payments before calling for assistance.^{iv} The more payments a homeowner misses, the more difficult it becomes for that homeowner to qualify for payment assistance, refinancing, or a viable loan modification.

^{iv}A **press release** from the Homeownership Preservation Foundation states that in the second quarter of 2007, only 21 percent of homeowners who called the 995-HOPE hotline were less than one month behind on their mortgage payments.

Thus, making homeowners aware of options and assistance for avoiding foreclosure and encouraging them to ask for help early has been a critical first-step in states' foreclosure mitigation efforts.

Creating Awareness

To build public awareness of available federal, state, local and nonprofit resources available to help homeowners avoid foreclosure, several states have launched outreach campaigns. Most of these campaigns use interactive webpages that allow homeowners to access information on avoiding foreclosure, recognizing foreclosure scams, and reaching HUD-approved counselors in their state. Several campaigns advertise hotlines, Web sites, foreclosure prevention events, and other resources that homeowners can use free of charge.



California has aggressively marketed the HOPE hotline to make borrowers aware of resources to avoid foreclosure.

California, for example, launched an aggressive advertising campaign in February 2008 to direct struggling homeowners to the national HOPE hotline and to the state's Web site, which includes contact numbers for loan servicers, a listing of housing counselors by county, resources for homeowners who have lost or will lose their homes, and links to qualified credit counseling agencies, among other information. The Web site, launched in November 2007, is available in both English (www.YourHome.ca.gov) and Spanish (www.SuCasa).

[ca.gov](http://www.ca.gov)). California's *90 Days of Hope* ongoing public education campaign makes use of billboards, sides of buses, and public service announcements to raise awareness of the options homeowners have to possibly avoid foreclosure.²¹ The print advertisements prominently display the national HOPE hotline number alongside links to the state's Web sites with the message, "There may be more hope than you think." The public service announcement series features the story of a formerly struggling California family that was able to find help and avoid foreclosure. According to the California State Consumer Services Agency, the national HOPE hotline reported a 300 percent increase in the number of calls it received from California families following the launch of the 90 Days of Hope campaign.²²

Similarly, **Maryland** and **Indiana** have used bus and billboard advertisements, postcard mailings, radio and print advertisements, and targeted outreach through community-based organizations to enhance their outreach campaigns. Through the **Indiana Foreclosure Prevention Network**, the Hoosier State has engaged local community groups to help distressed homeowners. For example, the state's Office of Faith Based and Community Initiatives contacted 10,000 clergy members to circulate foreclosure prevention resources. Indiana also has worked with AARP, county clerks, and trade associations such as Indiana Realtors and Indiana Land and Title to publicize its foreclosure prevention efforts. In total, the grassroots effort has been able to distribute 325,000 brochures around the state. This effort is targeted primarily in Indiana's cities because the state's foreclosures have so far been concentrated in its urban areas.²³

Several states have engaged the private sector in efforts to assist homeowners through outreach campaigns. **Indiana's** Indiana Foreclosure Prevention Network is a collaborative effort between the public and private sectors. Similarly, **Ohio's** *Save the Dream* campaign includes several private partners. Thanks to the private sector's involvement, Ohio's outreach campaign offers resources like legal assistance and participation by housing and mortgage experts from the private sector. Another

²¹The State of California's Consumer Home Mortgage Web site provides both state and federal resources for homeowners.

America. The Lieutenant Governor's Office routinely sends letters to at-risk Floridians inviting them to these events.^{vi}

To advertise their events, states, including **Indiana** and **New Jersey**, advertise housing fairs and other educational events on their foreclosure prevention Web sites. According to **Indiana's** foreclosure Web site, its events have successfully helped 700 homeowners stay in their homes thus far.²⁸ In **Connecticut**, which hosts housing fairs to educate homeowners on state and federal financial assistance programs and give homeowners the opportunity to meet with housing counselors, the Connecticut Housing Finance Authority (CHFA) works in conjunction with the governor's office to produce PSAs on local radio stations where housing fairs are held. CHFA also has advertised the program through flyers sent to homeowners who dialed into the call center and through local newspapers as well as by working with mayors' offices to distribute flyers to school children, local businesses, and community organizations. Servicers like Citi and Option One have sent flyers to their customers in Connecticut letting them know about the housing fairs.²⁹

Some states have specifically focused events. **Nevada** has held two workshops targeting the psychological impact of foreclosure on families. Other states' events are general in scope so that homeowners can find answers to a variety of questions, from refinancing to legal aid. Most of these state-sponsored events are held in neutral, public settings like libraries, community centers, and public school campuses (for example, see State Spotlight, right).

In preparation for the events, states, like **Mississippi**, encourage participants to bring copies of all prior correspondence with their lender. The Indiana Foreclosure Network's Web site includes a detailed list of recommended materials for homeowners interested in coming to events. Many of these materials require advanced preparation. For example, it is recommended that participants list household expenses, write down a description of their unique circumstances, and gather recent income documentation. While some states' events

State Spotlight: Delaware Outreach Efforts

In October 2008, **Delaware** had its largest month of foreclosure filings, with 500 home foreclosures filed total and 300 filings occurring in Newcastle County alone. Although it has experienced fewer foreclosures than surrounding states, the First State remains vulnerable to the problems associated with the country's housing crisis. Delaware's State Bank Commissioner's Office has been actively targeting at-risk homeowners to prevent foreclosure filings and avoid a housing crisis of its own. For example, after four missed payments, the Bank Commissioner's Office mails postcards directly to the delinquent homeowners. It also works with banks to identify homeowners who have missed some payments, but fewer than four, to help those borrowers avoid future problems. An estimated 7 in 10 delinquent homeowners in Delaware have had no contact with their loan servicer, according to a statement by the lieutenant governor.

To supplement such outreach efforts, the Bank Commissioner's Office sponsors foreclosure prevention events. Strategically held in areas that are easy to find, easily accessible, and familiar—such as well-known restaurants and community buildings—these events enable homeowners to interact with representatives from banks and loan service companies. Wells Fargo, Chase, SunTrust Mortgage, and Countrywide have attended Delaware's events in the past. Participants also are able to meet with housing counselors at these events. State officials attend the events to brief participants on available state and federal programs. The events draw between 50 and 150 attendees each.

require pre-registration, other states structure the events more loosely; for example, **Minnesota** does not require the participants to register, and participants can come and go as they please due to the "open house style" of the events. **Pennsylvania** holds webinars, sponsored by its Housing Finance Agency, so participants can access training and information sessions from their own homes.³⁰

^{vi}See Example: http://www.flgov.com/pdfs/20080814_hope_now.pdf

This suggests the importance of states working with loan servicers to help reach the best outcome for struggling homeowners. However, a **joint report** from the Office of Thrift Supervision (OTS) and the Office of the Comptroller of the Currency (OCC) reveals that nearly 60 percent of borrowers who received mortgage loan modifications during the first quarter of 2008 have re-defaulted. This finding raises questions about the efficacy of loan modifications. However, subsequent research suggests a reason for this high re-default rate may be the *quality* of the modifications.

The OCC/OTS report shows that of borrowers who received loans modifications in the first quarter of this year, 36 percent had re-defaulted (defined as being 30 days or more past due) after 3 months; 53 percent had re-defaulted after 6 months; and 58 percent had re-defaulted after 8 months. A similar trend is emerging among the cohort of borrowers who received loan modifications during the second quarter of 2008: After 6 months, 51 percent had re-defaulted.

There are several important caveats to consider. First, not all loan defaults lead to foreclosure. Second, the quality of the loan modifications is not known, and may be low, according to FDIC Chair Sheila Bair. A recent study supports this claim. According to the study, on average, modifications made on subprime and Alt-A loans in 2008 increased rather than reduced principal debt.³⁶ Sixty-eight percent of loan modifications involved capitalizing unpaid interest and fees and reamortizing the loan, whereas only 8 percent included a write-off of unpaid interest. Only 35 percent of modifications made in November 2008 reduced borrowers' monthly payments, while 45 percent actually increased the

What's in Your Mortgage? Types and Terms

Adjustable Rate Mortgage (ARM) – A mortgage with an interest rate that adjusts periodically according to a specified index such as the U.S. Treasury Department's published interest rates or LIBOR

Alt-A – Alt-A loans were originally designed for borrowers who would otherwise be "prime" but cannot qualify for the prime rate because of inconsistent income or a desire to provide less documentation than normally required; during the boom, Alt-A loans were originated to less creditworthy borrowers than previously

Balloon – A loan with small initial payments followed by one big payment that pays off the loan's balance

Interest-Only Mortgage – A loan with an initial payment that covers a loan's interest but not principal

Jumbo – A loan larger than the federal conforming loan limit, which is \$625K in high-cost areas and \$417K in other areas for 2009

Negative Amortization – A loan that grows in size over time rather than shrinks because payments do not equal the full amount of interest due and the unpaid interest is added to the principal balance of the loan

Payment Option – A loan that allows the borrower to choose how much to pay for a set period of time, usually resulting in negative amortization

Piggyback – A small loan made to finance the down payment needed to purchase a home and avoid PMI; homeowners with piggyback loans start out with very little to no equity in their homes

Prime – Loans for creditworthy borrowers that come with the lowest interest rates; most borrowers receive prime loans

PMI – Private mortgage insurance (PMI) is required for borrowers who put less than 20 percent down on their homes; it is an additional payment made to protect the lender from borrower default, which is more likely when the borrower has little home equity

Subprime – A loan type for borrowers with weak credit that typically comes with higher interest rates to offset the risk of lending to borrowers who are more likely to default

Teaser – A low payment amount for a temporary period of time at the beginning of a loan's life

2/28, 3/27 Hybrid ARM – These loans include both fixed- and adjustable-interest rate components with low, fixed teaser rates for the first two to three years, followed by a rate that adjusts annually or semi-annually for the life of the loan

monthly payment amount. Further, there are wide disparities among mortgage services with regard to the quality of the loan modification. For homeowners who are underwater on their loans and struggling to make payments, writing down loan principal to or close to the current home value has the potential to prevent many foreclosures. According to a **report** from the Mortgage Bankers Association, some estimates put the cost of foreclosure to the lender at as high as \$50,000³⁷ per home or 30 to 60 percent of the outstanding loan balance.³⁸ In some cases, the cost of a principal write-down may be less than the cost of the foreclosure.

The OCC/OTS findings mean that state and federal programs seeking to increase the number of loan modifications should carefully evaluate program requirements.

To ensure that borrowers and servicers are working together toward viable solutions for avoiding foreclosure, states have taken actions such as creating agreements with lenders and loan servicers, promoting or requiring mediation, and improving the foreclosure process.

Agreements with Loan Servicers

Beginning in 2007, governors began working directly with loan servicers and lenders to create plans for lowering the number of foreclosures. Through compacts and agreements, a number of loan servicing and lending companies have agreed to take steps to reduce the number of foreclosures by proactively contacting borrowers at risk of foreclosure and by streamlining certain loan modifications such as interest rate freezes on adjustable rate loans.

California Governor Arnold Schwarzenegger was the first governor to unveil an agreement with loan servicers. On November 20, 2007, Governor Schwarzenegger announced an agreement with 10 lending companies to streamline the loan modification process for subprime borrowers with

ARMs. The lenders—Carrington Mortgage Services, Countrywide Home Loans, HSBC Mortgage Services, GMAC Mortgage, Home Loan Services, Home Servicing, Litton Loan Servicing, OCWEN Loan Servicing, Option One Mortgage, and Wilshire Credit—agreed to reach out to borrowers before their loans reset, streamline the process for determining whether a borrower can afford the reset payment, and freeze interest rates for loans on owner-occupied homes for borrowers who are currently making timely payments.³⁹

On December 6, 2007, two weeks after Governor Schwarzenegger's announcement, U.S. Treasury Secretary Henry Paulson unveiled a similar proposal. Under the proposal, members of the HOPE NOW Alliance—which includes the nations' largest lenders and loan servicers—agreed to freeze interest rates for up to five years for certain borrowers holding subprime ARM loans. Alliance members had previously agreed to proactively contact at-risk borrowers to explore options for avoiding foreclosure. To qualify, borrowers must meet the following standards:

- Hold a subprime loan with an adjustable interest rate scheduled to reset between January 2008 and January 2010;
- Live in their home;
- Be current on their mortgage payments and have been no more than 60 days past due during the previous 12 months; and
- Be unable to afford monthly mortgage payments at the adjustable rate.⁴⁰

Since the launch of the "fast-track" loan modification program, HOPE NOW has announced 908,000 loan modifications, which include "fast-track" modifications.^{vii} However, shortly after lending companies began installing fast-track programs, London Interbank Offered Rate (LIBOR)—the most widely used reference rate for short-term interest rates worldwide,⁴¹ based on the

^{vii}Based on HOPE NOW Mortgage Loss Statistics Industry Extrapolations (see p.9 of **HOPE NOW November 2008 Loss Mitigation National Data**). The estimated 908,000 loan modifications since the launch of the fast-track program is the sum of total modifications completed between December 2007 and November 2008. HOPE NOW extrapolates its monthly loss mitigation data to an industry estimated aggregate. There is no data available on how many loan modifications were made through the fast-track program.

rate of interest that banks in Europe are willing to lend funds in U.S. dollars⁴²—dropped, which made post-reset payments significantly more affordable and reduced payment shock, thus disqualifying a number of ARM-holders from the fast-track program. According to HOPE NOW, the average ARM reset interest rate is 5.76 percent plus the 6-month LIBOR rate, which declined from 5 percent to 3 percent in the beginning of 2008, reducing the average post-reset interest rate from 11.25 percent to 8.25 percent.⁴³ As of December 23, 2008, the 6-month LIBOR was down to 1.85 percent (see Figure 2), which should help many borrowers avoid payment shock but also likely disqualifies numerous borrowers for interest rate freezes.

On January 11, 2008, **Michigan** Governor Jennifer Granholm announced an agreement with four of the state's major mortgage servicers, Flagstar, Countrywide, GMAC, and Option One. The servicers agreed to reach out to at-risk borrowers, develop a streamlined loan modification program to identify at-risk borrowers and offer certain borrowers a five-year interest rate freeze, work with HOPE NOW and the state to implement home preservation programs, and work to identify and address vacant properties while ensuring that those vacant properties owned by participating lenders are properly maintained. Moreover, the servicers agreed to make regular reports to the Michigan Office of Financial Insurance services on their outreach and modification efforts.⁴⁴

FIGURE 2. Since December 2007, the 6-month LIBOR rate has declined approximately 3 percentage points.



- Establish or continue internal policies that offer staff incentives for loan modifications.

HSBC, Ocwen, GMAC ResCap, Litton Loan Servicing, AmeriNational Community Services, and Citi are participating, allowing the state's network of HOPE (Homeowners Preserving Equity) counselors to work more closely with lenders to prevent foreclosure. Together, these companies service 23 percent of home loans in Maryland.

A new agreement between Bank of America and 11 states could prove to be a model for other loan servicers seeking to improve and expedite their loss mitigation efforts. On October 6, 2008, Countrywide Financial Corporation, which is now owned by Bank of America, halted foreclosures on the loans it services until new modification standards took effect on December 1, 2008. Under the new modification standards, borrowers with subprime loans or option ARM loans may receive a loan modification to bring their average payment down to 34 percent of their monthly income. To reach 34 percent, Bank of America will consider principal write-downs, which makes this agreement unique. According to press releases from participating states' attorneys general, the Bank of America agreement could prevent as many as 400,000 foreclosures.

Other lending institutions have taken steps in recent months to increase and improve loan modifications. For example, J.P. Morgan Chase announced it is developing a streamlined loan modification protocol to help 400,000 borrowers with \$70 billion in mortgages over the next two years. The FDIC, which now controls IndyMac, announced a plan to modify mortgages to 31 to 38 percent of a qualifying borrower's monthly income. The FDIC aims to modify up to 2.2 million at-risk loans through 2009. Troubled loans owned by Fannie Mae and Freddie Mac are also up for loan modifications. Under the new **Streamlined**

Judicial and Non-Judicial Foreclosures

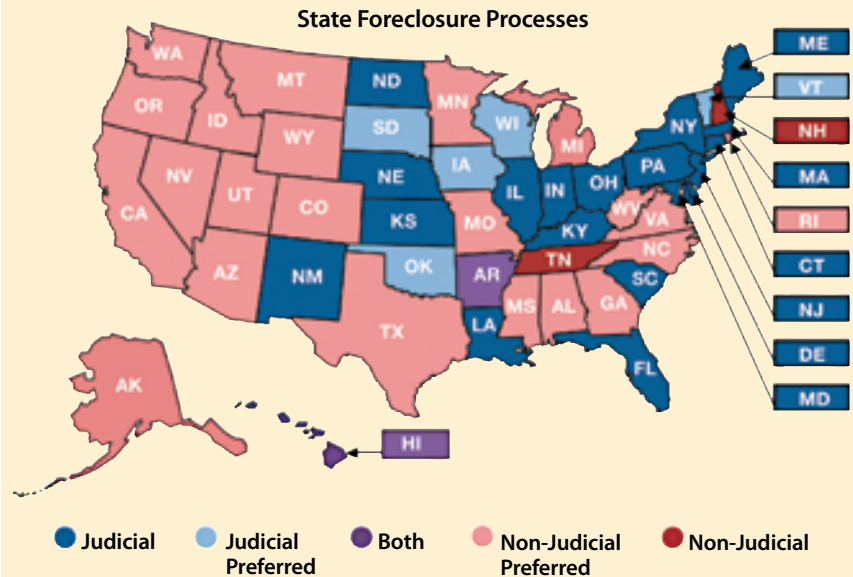
The foreclosure crisis has made terms like "judicial" and "non-judicial" foreclosure commonplace, but the difference between a judicial foreclosure state and a non-judicial foreclosure state is not always clear.

Judicial and non-judicial (also called "statutory") are terms that refer to the process by which a foreclosure is executed.

In a **judicial** foreclosure, the foreclosure proceeding is handled by the state's court system. The lender files a "lis penden" with the courts, and the homeowner has the right to a hearing. If the court finds in favor of the lender, a foreclosure sale is scheduled. In some states, the homeowner may also owe the lender court costs, also called deficiency judgments.

In a **non-judicial**, or **statutory**, foreclosure, the foreclosure process is defined by a state's statutes. In general, a lender initiates the process by sending a notice of default or notice of intent to foreclose to the homeowner. After a defined period, the lender or trustee schedules a foreclosure sale.

In many states, both judicial and statutory foreclosure processes exist, but one process is used more than the other. The map below shows which states primarily employ judicial versus non-judicial foreclosures.



Source: RealtyTrac.com, "Foreclosure Laws and Procedures by State," accessed February 2, 2009. Also see: Amy Crews Cutts and William A. Merrill, *Interventions in Mortgage Default: Policies and Practices to Prevent Home Loss and Lower Costs*, (McLean, VA: Freddie Mac, 2008).

Modification Program, loans belonging to borrowers who have missed three or more payments are eligible for modification. These government controlled programs include the option for principal write-down.

Through the HUD-FHA Hope for Homeowners (H4H) program, eligible borrowers can refinance to a secure, FHA-backed loan guaranteed at 96.5 percent loan-to-value for loans originated that are between 31 percent and 43 percent of the borrower's monthly income. To participate, lenders must waive prepayment penalties and late fees. Importantly, H4H offers junior lien holders an immediate payment in consideration for releasing their liens to execute a new mortgage. This provision aims to tackle the problem of second liens on numerous loans that make it difficult for borrowers to obtain a modification or refinance.

Improve the Foreclosure Process

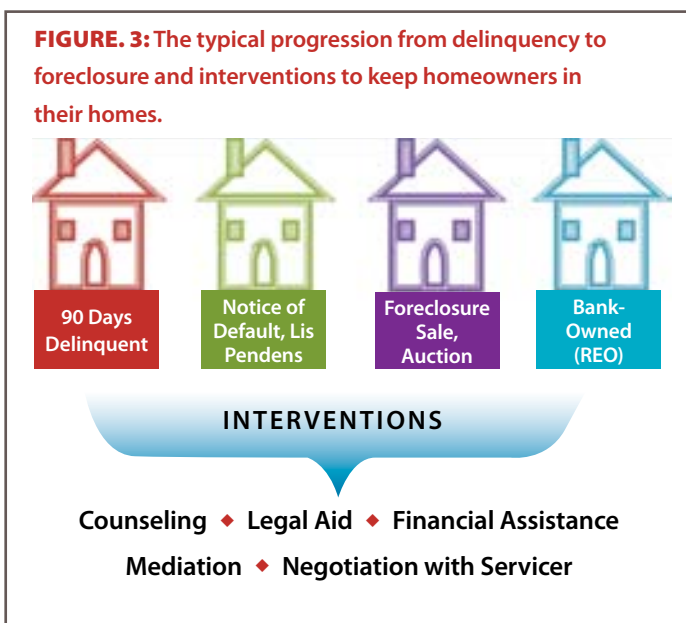
In response to the mortgage crisis, states have begun examining their foreclosure processes to ensure borrowers have adequate time to work with their loan servicer to avoid losing their homes, to make the foreclosure process more transparent, and to expedite foreclosure in cases where the home is abandoned. First and foremost, states have taken steps to ensure that homeowners receive adequate notice of foreclosure or impending foreclosure, and that the notice includes information on what

homeowners can do to avoid losing their homes. For example, **Arizona, California, Colorado, Connecticut, Georgia, Hawaii, Illinois, Kentucky, Maryland, Massachusetts, New Jersey, New York, North Carolina**, and **Virginia** passed legislation in 2008 requiring lenders to notify borrowers before initiating a foreclosure proceeding.⁴⁷ Several states require that the notice of default or notice of foreclosure includes information on state resources, the phone number of the loan servicers, and details on counseling and other resources the borrower can turn to for assistance avoiding foreclosure.

For example, **California S.B. 1137** provides that for loans originated between January 1, 2003 and December 31, 2007, lenders must contact a borrower 30 days before filing a notice of default. Borrowers may request a meeting within 14 days to work with the lender to restructure the loan. **Colorado H.B. 1402** requires lenders to notify delinquent borrowers at least 30 days before filing a notice of election and demand and at least 30 days after default, which means the notice of election and demand may not take place until the borrower is at least 60 days delinquent. **Virginia S.B. 797** requires lenders that make more than four loans in a 12-month period to notify borrowers in writing of their intent to send a notice to accelerate the loan balance at least 10 days before actually sending the notice. Borrowers may then request an additional 30 days to work with the lender to restructure the loan. On May 13, 2008, **Georgia** Governor Sonny Perdue signed into law **S.B. 531** to lengthen the notice period from 15 days to at least 30 days before the scheduled foreclosure sale. SB 531 also requires that the certified letter giving the homeowner notice of the foreclosure sale include the name, address, and telephone number of the "individual or entity who shall have full authority to negotiate, amend, and modify all terms of the mortgage with the debtor."

Some states also have revamped their foreclosure processes to provide borrowers additional time to work with their servicers to avoid foreclosure. While no state has declared a blanket moratorium on foreclosures, changes in some states' processes have temporarily halted new foreclosures.

In April 2008, **Massachusetts** established a **new foreclosure system** requiring lenders to send a





“ ... states have taken steps to ensure that homeowners receive adequate notice of foreclosure or impending foreclosure, and that the notice includes information on what the homeowner can do to avoid losing the home. ”

delinquency notice to borrowers 90 days before enacting a foreclosure proceeding. The notification also must be filed with the Massachusetts Division of Banks. The 90 days, deemed a “right-to-cure” period, prevented any new foreclosure actions for 90 days, beginning May 1, 2008. Governor Deval Patrick and Attorney General Martha Coakely strongly encouraged lenders to use this period to restructure as many delinquent loans as possible for borrowers who would be able to make their monthly payments with reasonable adjustments to their loan terms.

Also in April, **Maryland** enacted a **new law** that requires lenders to notify borrowers of intent to foreclose at least 45 days before filing a foreclosure action in court. The law also stipulates that the foreclosure action may not be filed unless the borrower is at least 90 days delinquent on his or her mortgage payment. Additionally, when the action is filed, the lender must personally serve the borrower with court papers, and the lender may not sell the property in question until 45 days after the papers have been served. Borrowers may cure their

delinquency up to one day before the foreclosure sale. In all, the new process guaranteed an initial 90-day period (45 days notice plus 45 days to cure) during which no new foreclosure sales could take place in the state after the law took effect.

On November 1, 2008, **North Carolina's State Home Foreclosure Prevention Project** took effect.⁴⁸ The law requires lenders to notify both borrowers and the North Carolina Office of the Commissioner of Banks of intent to foreclose at least 45 days before initiating a foreclosure proceeding. The Office of the Commissioner of Banks has committed to review every loan with a notice to foreclose during within the 45-day period, and if the office determines the homeowner could stay in the home with a reasonable loan modification, it reserves the right to extend the allowable foreclosure filing date an additional 30 days. The law means that North Carolina had an initial 45-day period during which no new foreclosure proceedings took place in the state. Some foreclosures were delayed as long as 75 days. The state negotiated with loan servicers to modify as many loans as possible during this period.

California recently proposed a streamlined loan modification program. In November 2008, Governor Arnold Schwarzenegger **announced a plan** to revamp California's foreclosure process, develop a model for streamlining loan modifications, and promote responsible lending. The proposal includes:

- A 90-day stay of the foreclosure processes—to give lenders and homeowners time to negotiate a loan modification—for homeowners in default who are not already in an aggressive loss mitigation program with their servicers;
- A Loan Modification Model, which would serve as a guide for servicers in their loss mitigation efforts;
- Authority to enforce federal laws and regulations to curb predatory lending and fraud and to discipline violators;
- Expanded fiduciary duties for mortgage brokers to ensure originated loans are in the best interest of the borrower;
- Standardized licensing requirements for mortgage loan originators and participation in the Conference of State Bank Supervisors (CSBS)/American Association of Residential Mortgage Regulators (AARMR) national licensing database; and
- A new requirement that all borrowers entering into nontraditional loans first participate in pre-counseling interviews to ensure they understand the terms of their loan.

A new proposal in **Colorado** would give qualified homeowners an additional 90 days to negotiate with their loan servicers to avoid foreclosure. The proposed legislation, which was developed with input from lenders, servicers, and homeowners' advocates, would ask HUD-approved housing counselors to consider a homeowner's financial situation and the potential costs and benefits to the lender from making a loan modification that the homeowner would be able to sustain. If the counselor determines that the homeowner is a good prospect for a workout, the counselor may invoke a 90-day timeout during the foreclosure process. During that period, the counselor would work with the servicer and the borrower to negotiate a solution. The homeowner must continue making payments of at least two-thirds of the principal and interest due

each month, plus 100 percent of taxes and insurance. According to the bill's sponsors, the bill would help focus the state's resources on those homeowners most likely to succeed with a modification while taking advantage of the state's network of housing counselors. To participate, homeowners would be required to contact a counselor within 20 days of receiving a notice of default; the default notice would inform homeowners of this opportunity and provide appropriate contact information.⁴⁹

For states with a judicial foreclosure process, mediation has become a tool to bring lenders and homeowners to the same table to negotiate options that would help the homeowner remain in his or her home. **Connecticut**, for instance, established in June 2008 a **Foreclosure Mediation Program** in which a neutral mediator—a judicial branch employee—works with the homeowner and lender to reach a "fair, voluntary, negotiated agreement."⁵⁰ The program is voluntary for the homeowner, confidential, and free of charge. Connecticut law requires that lenders inform borrowers of the program by attaching a notice and a Foreclosure Mediation Request form to the front of the foreclosure complaint. If the homeowner chooses to participate, the homeowner and the lender have 60 to 90 days to negotiate. The program is supported by a \$2.5 million state appropriation.

New Jersey Governor Jon Corzine signed A3459/S8 on December 1, 2008, to allocate \$12.5 million in state funds to prevent foreclosures.⁵¹ The funds will help support and expand counseling and mediation services to help borrowers avoid foreclosure. Earlier, on October 16, 2008, the New Jersey Judiciary announced a **statewide foreclosure mediation program**. The program is mandatory for all cases in which homeowners contest owner-occupied foreclosure actions. In uncontested actions, the courts notify homeowners and encourage them to participate in the mediation program. If the homeowner does not respond and the courts enter a default judgment, mediation is still an option for that homeowner until the home goes to a sheriff's sale.

Other states have instituted foreclosure processes that provide for mediation. Examples include:

- **Iowa** – Through the Iowa Attorney General's Office and the Iowa Mediation Service, Iowa

launched a Mortgage Mediation Program on September 11, 2007. Borrowers can sign up online for this voluntary program.

- **Ohio** – The Ohio Foreclosure Prevention Task Force recommended that Ohio's judicial system examine foreclosure mediation as an option to help more borrowers obtain loan modifications. The Ohio Supreme Court recommended this action as well, so counties throughout Ohio have begun installing mediation programs. In Stark County, the mediation program was successful in helping 50 percent of the homeowners who participated, according to a September 2008 article in the Canton Repository.

TRANSITIONAL ASSISTANCE

Despite optimistic estimates that assume efforts to prevent foreclosures will be successful, it is clear that a large number of people will still lose their homes to foreclosure. **North Carolina**, for example, believes its new loss mitigation program, if fully implemented with the participation of all major servicers in the state, will prevent 50 percent of homeowners in distress from losing their homes. The flipside, of course, is that 50 percent *will* lose their homes.

Who are the individuals that will lose a home during this crisis? Some are speculators, who purchased property as investments hoping to earn fast cash from rapidly appreciating housing values. These individuals may have become stuck with these homes when prices began to stagnate and fall, and they are more likely to walk away when their loan turns upside-down. On the other end of the spectrum, some individuals who will lose their homes are the victims of predatory lenders. These individuals may have purchased or refinanced their home with a high-cost, nontraditional loan filled with excessive fees and penalties they cannot reasonably afford. For some, it may not be possible to save their home from foreclosure.

Many homeowners who will face foreclosure are families who simply bought more home than they could afford, hoping prices would continue to rise giving them the opportunity to refinance into an affordable loan. Or, they are families who have

fallen on hard times as a result of economic or other circumstances. If reasonable modifications, even write-downs, cannot make their home loans affordable for those who bought more home than they could afford, then most of these families will be forced to find new housing. For people experiencing major hardships, such as a death in the family, unemployment, disability, or divorce, those who cannot recover quickly may also find themselves unable to remain in their homes.

Foreclosure has a number of negative impacts on individuals and families that reach beyond the loss of their home. Foreclosure can ruin an individual's credit, which makes it difficult to secure loans in the future; but more urgently, this can make it difficult to locate safe and affordable rental housing, as many landlords require credit checks for new tenants. Foreclosure, which uproots families, can have an especially negative impact on children.

As the foreclosure crisis continues, states may begin to shift resources toward helping those families who have lost or will lose their homes transition from homeownership. States may want to consider ways to help families find decent rental housing; repair their credit; work with the school system to provide support for children; and connect with state and federal benefits such as health care, food stamps, and utility assistance. Moreover, people who lose their homes because of a job loss may benefit from job training to help them find new employment.

Connect Families and Individuals to Benefits

An important but inexpensive way states can help families who have lost their homes is to connect them with federal benefits that can help them put food on the table or access health care while they regain their financial footing. States may already have the means to identify those families who are facing foreclosure and may be eligible for additional assistance. States may want to consider using the information to reach out to these families and make them aware of benefits for which they might be eligible, such as Supplemental Nutrition Assistance, Medicaid, and Temporary Assistance for Needy Families (TANF). In recent years, cities and states have begun to take advantage of new

technologies in an effort to improve access to public benefits for low- and moderate-income individuals. Innovations include electronic benefit screening tools that screen or prescreen individuals for benefits through a simple electronic questionnaire^{viii} and streamlined multibenefit applications that allow individuals to fill out just one application, which can be accepted by multiple programs for determination of benefit eligibility.

Help Families Find Safe and Affordable Rental Housing

Those who have lost their primary residence to foreclosure often move to rental housing. However, the slumping housing market has increased demand in the rental market. Finding safe and affordable rental housing may be even more challenging for those whose credit has been damaged because of foreclosure. States have begun examining ways to help connect former homeowners with decent rental housing.

Montana Governor Brian Schweitzer announced the launch of www.MTHousingSearch.com, a new housing locator service designed to help connect Montanans with rental housing, in July 2008. The Web site, sponsored by the Montana Board of Housing, provides free, detailed information on available rental properties throughout the Montana. Property owners and managers may post available properties on the Web site free of charge. The Web site employs a mapping tool and offers online tools and information to renters such as an affordability calculator, a rental checklist, and information on renter rights. The Web site also contains resources on rental assistance, utility assistance, domestic violence shelters, and homelessness.

On its MD HOPE Web site, **Maryland** directs homeowners for whom foreclosure is unavoidable to its Department of Housing & Community Development housing locator service. The housing locator service, available at www.mdhousingsearch.org, is a free, searchable database of properties in Maryland. Users may search by county and specify their rent range and whether they have a Section 8 voucher. The Web site includes a calculator to help users determine what they can afford to rent.

Tax Relief

In 2007, Congress passed the Mortgage Debt Relief Act to allow taxpayers to exclude income from the cancellation of debt on their principal residence. According to the IRS, debt reduced through mortgage restructuring, as well as mortgage debt forgiven in connection with a foreclosure, qualifies for the relief. In the past, any debt forgiven on a mortgage loan, which occurs if a bank agrees to allow a homeowner to sell his or her home through a short sale for less than the value of the loan, would be considered income, which could greatly increase one's tax liability. For low- and moderate-income families, a significant increase in tax liability compounded with an already perilous financial situation could cause greater financial distress. Under the new law, from 2007 to 2012 a homeowner may qualify for up to \$2 million in forgiven debt. Since the passage of this law, states like **Arizona**, **California**, and **Oregon** have passed legislation to align state tax laws with the federal law.

Employment

In December 2008, the unemployment rate in the United States increased to 7.2 percent—a 16-year high. Sudden job loss is an event that commonly leads to foreclosure. For workers who have lost jobs as a result of the economic downturn, states can help by connecting them with information on job training. **Arizona's Feeling the Economic Crunch** Web site, for instance, has links to resources for individuals who have lost their jobs or may lose their jobs, including a job search, job training, and unemployment insurance.

Connecticut Governor M. Jodi Rell launched a job training program for delinquent borrowers in June 2008. The **Mortgage Crisis Job Training Program** (MCJTP)—which is funded by the state and administered by Workplace, Inc., Southwestern Connecticut's Regional Workforce Development Board, in conjunction with other regional workforce development boards—assigns job training teams throughout the state to work with regional workforce development boards to provide job training and placement assistance to delinquent borrowers who are unemployed,

^{viii}For an overview of benefit screening tools utilized on the local level, see the report from the National League of Cities' Institute for Youth, Education, and Families: *Screening Tools to Help Families Access Public Benefits*.

underemployed, or need to increase their income through a second job. Financial education and credit counseling is available for participants. As of the end of December, more than 1,300 people have been referred to the program and more than 300 individuals have met with and been assessed by a MCJTP specialist.

Usually, unemployment leads to foreclosure, not the other way around. However, for workers employed by the housing industry—realtors, construction workers, mortgage bankers, builders—the rise in foreclosure is leading to unemployment. In states like

California where a significant sector of the population is employed by the housing industry, the mortgage crisis has simultaneously contributed to foreclosures and job loss. To combat this problem, Governor Arnold Schwarzenegger announced in March 2008 funding to train workers adversely affected by the housing slump.⁵² The \$10.5 million **program** targets carpenters, steel workers, and cement workers who have been hit particularly hard by a downturn in the housing market that has slowed construction. The training programs aim to give these workers new skills that are applicable to public and commercial construction projects. In 2007, California passed \$42 billion in infrastructure bonds, boosting construction jobs for projects such as schools, levees, and transportation. Following retraining, workers are re-employed through a public-private partnership among the state's Labor and Workforce Development Agency, the California Workforce Investment Board, local workforce investment boards, and employers in affected industries.

In September 2008, governors David Paterson of **New York** and Jon Corzine of **New Jersey** announced new actions to assist displaced financial industry workers. The states organized "rapid response" sessions for displaced workers to provide them with basic information on how to file an unemployment claim, possible training opportunities, labor market information, and workshops covering everything from resume writing to interviewing skills.⁵³ Along with

Connecticut, the states are seeking funding to support job retraining for the estimated 82,000 displaced financial service workers expected to lose their jobs by the end of 2009.⁵⁴



Since the start of the foreclosure crisis, foreclosure "rescue" scams have been on the rise.

PROTECT HOMEOWNERS FROM SCAMS

Since the housing market bust, there has been a rise in foreclosure "rescue" scams. Con artists purporting to help troubled homeowners trick them into relinquishing their titles or selling at a

price lower than they would receive on the market. Victims of foreclosure rescue scams—often the same people susceptible to predatory lenders—lose even more than they would under normal foreclosure circumstances. State laws to protect homeowners from such fraudulent activity can help to prevent scammers from exacerbating the already difficult and costly process of foreclosure.

At least 23 states have laws prohibiting foreclosure "rescue" scams. Many of the laws enacted recently (within the past five years) have similar provisions such as:

- Defining "foreclosure consultant" as a person who contacts a homeowner with an offer to help the homeowner avoid foreclosure;
- Requiring a "foreclosure consulting contract" to be prepared by the foreclosure consultant and signed by the homeowner and consultant;
- Including specifications for the format of the contract and language to be included in the contract;
- Giving the homeowner the right to cancel the contract; and
- Prohibiting payment to the foreclosure consultant unless all services, as dictated in the contract, have been preformed.

In 2008 alone, 14 states enacted new laws to prohibit rescue scams. Among these laws, **California** and **Maryland** have imposed some of the tightest restrictions on foreclosure consultants (denoted below as “FC”). California and Maryland each prohibit foreclosure consultants receiving compensation for “rescue” services. Below is a side-by-side comparison of the key components of each bill:

TABLE 1. Restrictions on Foreclosure Consultants: California and Maryland

California	Maryland
Prohibits FCs from acquiring interest in a residence in foreclosure.	Prohibits FCs from acquiring interest, directly or indirectly, in the residence.
Prohibits FCs from taking power of attorney from an owner.	Prohibits FCs from taking power of attorney from an owner.
Requires a contract notifying the owner of his/her right to cancel.	Requires contract in owner’s language to disclose right to cancel within 5 days.
Allows the owner to cancel the contract up to 5 days after the transaction.	Requires full disclosure of services and information on value of residence.
Requires contract to be in the same language used to speak with the owner.	Requires FCs who provide real estate brokerage services to be licensed.
Requires an FC to register and to obtain and maintain a surety bond of \$100,000.	Prohibits some property conveyances and requires full disclosure of conveyances.
Makes it a crime to violate these requirements.	Makes it a misdemeanor crime to violate this law.

In addition, Governor M. Jodi Rell has proposed legislation that would seek to protect consumers from predatory debt relief practices in **Connecticut**. The legislation would target individuals that aim to make money for debt negotiation, including foreclosure prevention services such as foreclosure “rescue” scams. According to Governor Rell, “‘debt negotiators’ are in the business of charging high fees for services that may be performed for a nominal fee or even free of charge... [T]his so-called help is nothing more than an attempt to charge unnecessary fees for services that these consumers could have received for free or for a nominal fee with a reputable company.” If enacted, the legislation would:

- Amend existing law to pertain to persons who offer debt negotiation services;
- Require debt negotiators to obtain a license as a nonprofit organization and to maintain the required bond to ensure the consumer’s money is safe;
- Provide the state banking commissioner with stronger enforcement tools to prevent the fraudulent use of licenses; and
- Authorize the commissioner to issue an order imposing a civil penalty against any person that violates the outlined provisions.

Table 2 denotes which states have enacted foreclosure rescue legislation and includes links to the related bills or statutes.

TABLE 2. Summary of State Foreclosure Rescue Legislation

State	Law	Link	Date
California	An act relating to mortgages	A.B. 180 (S. 2007-2008)	September 25, 2008
Colorado	Colorado Foreclosure Protection Act	S.B. 06-071	May 30, 2006
Delaware	Mortgage Rescue Fraud Protection Act	S.B. 252 (GA 144)	August 21, 2008
Florida	Foreclosure fraud	C.S./H.B. 643	May 28, 2008
Georgia	Ga. Code Ann. § 10-1-393(b)(20)(A)	Ga. Code – Go to: Title 10, Ch 1, Art. 15, Part 2.	Before 1990
Hawaii	Mortgage Rescue Fraud Prevention Act	H.B. 2326 (24th Leg., 2008)	June 4, 2008
Idaho	Consumer Foreclosure Protection Act	S.B. 1431 (2nd Reg. S., 2008)	March 18, 2008
Illinois	Mortgage Rescue Fraud Act	S.B. 2349 (94th G.A.)	June 1, 2008
Indiana	Mortgage rescue protection fraud	S.B. 0390 (S. 2007)	April 10, 2007
Iowa	An act related to foreclosure consultants and foreclosure reconveyances	H.F. 2653 (S. 2008)	April 25, 2008
Kentucky	An act relating to mortgages and declaring an emergency	H.B. 552 (08RS)	April 24, 2008
Maine	An act to protect homeowners from equity stripping during foreclosure	L.D. 2189/ H.P. 1559 (2007-2008, 123rd Leg)	April 11, 2008
Maryland	Protection for Homeowners in Foreclosure Act	H.B. 361 (S. 2008, emergency bill)	April 3, 2008
Massachusetts	Ban against foreclosure rescue transactions	Press Release	August 30, 2008
Minnesota	Statute 325N. Mortgage Foreclosures	Statute 325N	2004
Missouri	Mo. Ann. Stat. §§ 407.935 - .943	Chapter 407	1991
Nebraska	Nebraska Foreclosure Protection Act	LB 123 (S. 2008)	March 10, 2008
Nevada	Mortgage lending and related professions	Chapter 645F, Nevada Revised Statutes	2007
New Hampshire	A bill regulating the practice of foreclosure consultants	H.B. 365 (S. 2007)	July 16, 2007
New York	An act to amend the real property law, in relation to distressed property consulting contracts	S.B. 8143 (2008)	August 5, 2008
Oregon	An act relating to regulation of loan originators	S.B. 1064 (2008 Special Session)	March 11, 2008
Virginia	Consumer Protection Act	H.B. 408 (S. 2008)	March 14, 2008
Washington	Concerning distressed property conveyances	H.B. 2791 (2007-2008)	March 31, 2008

Many of the laws above were modeled on **Minnesota** Statute 325N, which was enacted in 2004. However, states such as **California, Georgia,** and **Missouri** have laws created much earlier; California's original foreclosure rescue law was passed in 1979. The legislatures in each of these states have passed or proposed legislation to update these laws.

ENSURE RENTERS KNOW THEIR RIGHTS

Several states are examining their foreclosure laws to determine whether the tenants of foreclosed property are adequately protected under existing laws. Anecdotal reports have suggested that some tenants have been evicted without notice after paying rent on a property in foreclosure. Most new legislation in this area seeks to improve notification of foreclosure to tenants and give tenants sufficient time to move after receiving the notice.

For example, in **S.B. 1137, California** gives tenants or subtenants in possession of a rental housing unit at the time the property is sold in foreclosure 60 days to vacate the property, as specified.

Illinois has recently enacted two laws to ensure tenants of foreclosed properties do not get evicted without ample notification. **S.B. 258**, signed in August 2007, provides that a tenant who is current on his or her rent must be allowed to remain in their unit for at least 120 days following notice of the foreclosure or through the duration of their lease, whichever is shorter, so long as the tenant continues to pay his or her rent in full. **S.B. 2721**, signed in August 2008, amends S.B. 258 to apply to tenants who are current on their rent as well as those who have made a good faith effort to be current on their rent and those who may not be current but who did not receive notification that the property was in foreclosure. The amended law allows tenants to continue to make a good faith effort to pay their rent during the 120 days and prevents the new owner of the foreclosed property from evicting tenants unless the tenants receive an eviction notice. The tenants must then vacate the property within 90 days.

Massachusetts Chapter 206 of the Acts of 2007 provides that upon a foreclosure of residential property, a tenant under an unexpired term for years or a lease for a definite term in effect at the time of the foreclosure by sale is deemed a tenant at will. The foreclosure does not affect the tenancy agreement of a tenant whose rental payment is subsidized under state or federal law. To ensure tenants in Massachusetts understand the commonwealth's laws and their rights, the Office of Consumer Affairs and Business Regulation (OCABR) has created a **Tenant's Rights Brochure**. The brochure, which is available in English, Spanish, Portuguese, Haitian Creole, and Chinese, explains tenants' rights under Massachusetts law with regard to property maintenance, rent payments, and eviction. The brochure and the OCABR **tenant information Web site** include contact information for nonprofits and legal service agencies that can help tenants who find themselves in foreclosed building or home. Additionally, Massachusetts recently hosted a seminar for housing counselors and attorneys to help them learn to better assist tenants of foreclosed properties.⁵⁵

Minnesota Governor Tim Pawlenty has signed two pieces of legislation to improve tenant protections. **H.F. 3476/ S.F.1918** states that once a landlord has received notice of a mortgage foreclosure sale, he or she may only enter into a lease agreement longer than two months or the lesser of the time remaining in the contract cancellation period or the mortgagor's redemption period. In addition, the landlord must notify the tenant of the foreclosure sale before entering into any agreement with the tenant. Within one month after the expiration of the foreclosure redemption period, the landlord must provide the tenant a two-month notice to vacate.

In April 2008, Governor Pawlenty signed **S.F. 2910**, which requires courts to order the expungement of eviction cases in which the tenant occupying a property was there because the property was in foreclosure and the tenant did not receive the required notice to vacate.

North Carolina, through **H.B. 947**, signed in November 2007, gives tenants of property to be sold via a foreclosure sale the right to be notified. The law also allows tenants who receive the notice to cancel their rental agreement with their landlord.

A resource that may be useful for comparing and contrasting state laws related to tenancy and eviction is available from the National Low Income Housing Coalition. The resource is a **matrix of foreclosure and eviction practices by state** and is updated through July of 2008. The coalition also has a **webpage** dedicated to the impact of foreclosure on renters. The page includes links to research and publications on renters and foreclosures from inside and outside the organization.

OTHER INNOVATIONS

States are constantly developing and testing new programs that could help curb economic and other consequences of foreclosures. Equity sharing arrangements and lease-purchase programs are two ideas state and local governments are exploring.

In one example of a shared-equity arrangement, the lender would agree to reduce the amount the borrower owes on a home if the value of the home has fallen below the mortgage amount. The lender would reduce the mortgage to the current appraised value, and in return, the homeowners would share any future appreciation on the home with the lender. When the homeowner sells the home or refinances the loan, the lender recoups a percentage of any profit made on the home.^{ix}

The **Southeastern Economic Development Corporation** in San Diego, **California**, offers a current and perhaps generous example of a shared-equity model. Through the First-Time Homebuyer Shared-Equity Program in southeastern San Diego, new homebuyers may apply for a shared-equity loan. Eligible applicants earn less than 120 percent of the area median income and agree to purchase

property in the corporation's area of interest. Loans up to \$40,000 are available interest-free. As long as the homebuyer resides in the home, that person does not need to make a monthly payment. The loan is forgiven if the buyer resides in the home for 25 years. A homeowner who sells or transfers the property before the loan is forgiven must pay back the loan principal at the time of the sale/transfer, and a portion of the home's equity realized upon the sale must be returned to the program.

In **Texas**, the city of Austin uses a shared-equity model through the **Austin Housing Finance Corporation** (AHFC). Under this model, or the "Affordability Protection Policy," income-eligible buyers and current homeowners may obtain assistance with their mortgage or with reconstruction services.⁵⁶ In return, the AHFC retains "first right of refusal" to buy the house from the homeowner to resell at the appraised value when the homeowner is ready to transfer the property. If the homeowner sells the home on the market, he or she must share appreciation realized at the sale with the AHFC. Equity gained by AHFC goes toward providing assistance for other new homeowners.

New Jersey Governor Jon Corzine announced a new program on January 9, 2009, that aims to help foreclosed families by working with local nonprofit agencies to execute lease-purchase agreements.⁵⁷ The Housing Assistance and Recovery Program (HARP), established by **S-1599**, gives foreclosed homeowners the opportunity stay in their homes while paying affordable rent until they can buy back the property. HMFA will provide financial support through the Housing Assistance and Recovery Program Support Fund to select nonprofit and public entities to execute lease-purchase agreements with existing homeowners who meet program requirements. The \$15 million program is funded from the Long Term Obligation and Capital Expenditure Fund.

^{ix}For more information on shared equity homeownership models, see Chapter IV, "Policy: The Role of State and Local Government in Supporting or Impeding the Expansion of Shared Equity Homeownership" in: John Emmeus Davis, *Shared Equity Homeownership: The Changing Landscape of Resale-Restricted, Owner-Occupied Housing*, (Montclair, NJ: National Housing Institute, 2006). Also see Andrew Caplin, Noel B. Cunningham, Mitchell L. Engler, and Frederick Pollack, *Facilitating Shared Appreciation Mortgages to Prevent Housing Crashes and Affordability Crises*, (Washington, DC: The Brookings Institution, 2008).

Noting the link between foreclosure and homelessness, some states are linking their homelessness prevention programs to foreclosure prevention work. According to the National Association for the Education of Homeless Children and Youth, some school systems have reported an increase in the number of homeless children served in 2008.⁵⁸ In an effort to prevent families from moving from homeownership to homelessness, **Arizona** and **Massachusetts** have taken steps to direct assistance toward homelessness prevention. In Arizona, the state housing agency is investing in new affordable permanent housing and support services.⁵⁹ In Massachusetts, a proposal by Governor Deval Patrick announced January 6, 2009, would reorganize state agencies that provide services for the homeless in order to combine emergency shelter programs with the state's housing resources. The proposed legislation would focus on rapid re-housing and housing stabilization and pilot new programs based on tested homelessness prevention models such as Housing First and flexible rent supports.

Other states have begun promoting their homelessness prevention or emergency assistance funds as options for homeowners who face losing their homes but do not have the funds to move to new housing. For instance, the New Hampshire Department of Health and Human Services provides **Emergency Assistance to New Hampshire** families experiencing a housing or utility crisis by providing eligible families payments for rent or utility security deposits, household fuel deliveries, or outstanding rent, mortgage and utility debts. The aim of the program is to help families avoid homelessness or avoid having a utility terminated that would result in the lack of heat, hot water, or cooking fuel. Emergency assistance payments cannot exceed \$450 for heat, hot water, and cooking fuel; the amount charged by a utility for utility deposits; \$650 for rental housing and security deposits; or more than two months' outstanding mortgage, rent, or utility debt.

STABILIZATION

CHAPTER THREE



“ A first step in creating a neighborhood stabilization program is identifying where foreclosed properties are in a community. ”

The current foreclosure crisis has drastically increased the inventory of unoccupied housing. There is a 10.4 month supply of unsold homes, up from the 8.9 month supply a year ago and the 6.5 month supply two years ago.⁶⁰ In June 2008, 17 percent of this unsold inventory—or 750,000 of 4,495,000 homes—was bank-owned properties.⁶¹ For states and cities focused on the welfare of individual families and neighborhoods, the growing inventory of unsold homes, particularly bank-owned properties (REOs) presents an immediate and pressing challenge. A single home foreclosure has been shown to lower the value of surrounding homes and empty houses invite crime and decay. In fact, it is estimated that each of the closest fifty homes around a foreclosed property will depreciate by an average of \$3,000.⁶² To prevent neighborhoods that have experienced multiple foreclosures from declining, states and communities are working to develop neighborhood stabilization strategies that seek to:

- Identify, register, and map vacant properties;
- Manage the inventory of vacant and abandoned homes;
- Acquire foreclosed and other vacant properties;
- Repair or rehabilitate homes;
- Resell vacant properties to responsible homebuyers; and
- Repurpose or recycle property into space that adds value to a community.

IDENTIFY, REGISTER, AND MAP VACANT PROPERTIES

A first step in creating a neighborhood stabilization program is identifying where foreclosed properties are in a community. Keeping track of the locations of foreclosed homes and other vacant residences can help a community pinpoint areas of need.

There are at least two ways for states to locate vacant properties. First, states and localities can work with the local post offices to identify residences that are no longer receiving mail. The post office is sometimes the first entity to know that a resident has vacated their home.

Second, states are working with banks and lenders to obtain information about homes going into foreclosure. **Massachusetts**, for example, requires copies of all foreclosure notices to be filed with the Division of Banks. The aim of this law, which took effect May 1, 2008, is to improve transparency and help track foreclosures and the brokers and lenders whose loans lead to foreclosure. The Division of Banks also is using this information to compile a list of contacts responsible for maintaining vacant foreclosed properties, and there are proprietary databases that provide this information.⁶³

Several local governments have enacted vacant property registration ordinances. These ordinances have a two-fold purpose. First, by requiring lenders to register vacant properties with the local government, localities can keep track of where the vacant properties are located. Second, local governments can use the vacant property information as a tool to ensure that the companies responsible for securing and maintaining vacant properties are fulfilling their duties. The Chula Vista **Abandoned Residential Property Registration Program** in **California** is often cited as a model for vacant property registration ordinances. The city's ordinance requires lenders to act on the "Abandonment and Waste" clause in their mortgage contract, which gives lenders the authority to enter, secure, and maintain property they own that has become vacant.⁶⁴ The city's ordinance requires lenders to visit homes with delinquent mortgage loans to determine whether they are vacant. If the property is vacant, lenders must register the property with the city and hire a property management company to maintain it. They must inspect the property once a week and post 24-hour contact information on the property. Five hundred properties were in the Chula Vista registry as of June 2008.

Mapping is a tool that many local governments are using to help keep track of the location and condition of vacant properties. In **Massachusetts**, the city of Boston photographs each vacant property and keeps a **database** of the properties to match the information with assessment, permit, and title data to help develop strategies for returning the properties to use. Additionally, the city generates a **map of vacant properties**, which helps identify areas of need and alerts developers to potential rehabilitation opportunities.^x

The federal Neighborhood Stabilization Program (NSP) provides funding for planning and technical assistance in connection with NSP-eligible activities. These costs, together with administrative costs, are subject to a cap of 10 percent of the total amount of the NSP grant plus 10 percent of program income.

MANAGE THE INVENTORY OF VACANT AND ABANDONED HOMES

As the number of foreclosed homes rises, it is imperative that states and cities ensure vacant properties are properly managed and maintained. Vacant homes must be physically maintained, which involves tasks such as cleaning out gutters, trimming the grass, and checking pipes for leaks. Vacant homes, which are magnets for crime such as vandalism; squatting; and theft of appliances, copper wiring, and other commodities, must be also be kept secure.

NSP funds may be used to acquire, repair, redevelop, sell, or rent foreclosed and abandoned properties—thus giving states and local jurisdictions the important tools to assure that a portion of the vacant housing inventory is recycled back into the market. NSP grantees can thereby acquire and rehabilitate the proverbial worst houses on the block—the houses that would otherwise stand in the way of rehabilitating or redeveloping other homes in a neighborhood or community—or to demolish them if they are blighted. If used in connection with NSP-qualified land banks, funds may be used to maintain, market, and facilitate redevelopment of foreclosed and abandoned properties.

^xFor more information, visit the city of Boston's **Abandoned Buildings Survey Web site**.

A Key Resource: The Neighborhood Stabilization Program

NSP allocations were made for each state and certain metropolitan areas based on the number and percentage of foreclosed homes, subprime loans, and defaulted loans.

Funds must be obligated within 18 months of receipt of the grant, and grantees must expend at least the amount of the initial allocation of NSP funds within four years of receipt of those funds or HUD will recapture and reallocate the amount of funds not expended. (Expenditures greater than the allocation can result from program income.) Funds may be used to acquire, rehabilitate, demolish, or redevelop and then to sell, rent, or land bank foreclosed and abandoned properties—including multifamily housing. Homebuyer counseling is an eligible expense if provided in connection with the resale of properties. Funds can be used for property maintenance and holding costs under certain circumstances, such as during the acquisition, rehabilitation, redevelopment, and land-banking processes. NSP funds cannot be used to fund foreclosure prevention.

While NSP was approved by Congress in the form of Community Development Block Grants (CDBG), the program has a number of alternative requirements, including some that provide more flexibility to states in terms of program operations and payment for administrative costs. In addition, as with CDBG, “program delivery” costs can be funded in addition to administrative costs—meaning that costs of personnel or contracted services can be funded as part of the cost to carry out eligible activities. In addition, developer fees are allowable expenses if related to NSP-assisted rehabilitation or construction activities.

Unlike the regular CDBG program, states may operate NSP funds directly and/or award funds to local jurisdictions, including local jurisdictions with their own allocations and Indian tribes. Any entitlement community may opt to allow its state government to manage its grant.

Another tool cities and states have to keep properties in good shape is code enforcement. Typically applied on the local level, code enforcement helps ensure that property owners are complying with land use laws, housing codes, building regulations, and permits. To encourage compliance, local governments assess fines or penalties, some of which may grow steeper with the length of time it takes for the owner to address violations.⁶⁵

Other maintenance tools for local governments include:^{xi}

- Establishing an entity or hiring a property coordinator to track and manage the enforcement of state and local property laws;
- Adopting property maintenance codes that establish minimum guidelines for the management of occupied residential and commercial buildings;
- Using nuisance abatement authority, which enables municipalities to step in to fix property problems that pose a threat to the community; and
- Filing for receivership, which gives municipalities the authority to file civil court action to take control over a property that has fallen into poor condition while charging the property owner for the cost of all repairs.

Most of the tools discussed above are best applied on the local level. Thus, the state role in managing vacant properties owned by nongovernment entities may be to support local government efforts. As the number of foreclosures grows and the national economy weakens, both state and local governments are seeing their revenues decline. In cases where shrinking revenues hinder municipal efforts to ensure vacant homes are being properly secured and maintained, states can provide financial support and technical assistance to local governments. For example, with the launch of its new \$13.6 million *Housing Arizona* initiative, **Arizona** set aside \$500,000 in the State Housing Trust Fund to help

^{xi}This list is taken from the National Vacant Properties Campaign’s “Strategies and Technical Tools” Web site, which includes model practices from local governments on each tool.

local communities plan and apply for NSP funds and to receive technical assistance for operations and financial management. States also can help broker partnerships among municipalities, nonprofits, community development corporations, and lenders to improve efficiency for and expand capacity to maintain vacant homes. Finally, states can assist local governments by expanding local government nuisance abatement powers.

ACQUIRE FORECLOSED AND OTHER VACANT PROPERTIES

When a foreclosed property sits vacant for several months or even years, when the owner abdicates responsibility for upkeep of an empty home, or when it is unclear who bears responsibility for a home's maintenance, state and local governments may choose to acquire the property and assume responsibility for rehabilitation and disposition. Acquisition may be carried out in several ways:

- **Tax foreclosure** – When a property owner fails to pay property taxes, the local government may foreclose after a period of delinquency determined by state law;
- **Condemnation** – When an unoccupied property is considered blighted under state law, authorities may condemn the property and seize control; and
- **Purchase Bank-Foreclosed Property** – State and local government entities may negotiate for the purchase of bank-foreclosed property or other residential property. It is important for governments considering this option to keep in mind that any property purchased with NSP dollars must be purchased for at least 5 percent below the current-market appraised value, and the average purchase price of the entire portfolio of properties must be at least 15 percent below market value.^{xii}

When **Maryland** Governor Martin O'Malley was mayor of Baltimore, he launched **Project 5000**, which was an effort to acquire, rehabilitate, and

return 5,000 vacant and abandoned properties to the housing market. To acquire the properties, the city used a combination of tax foreclosures, condemnations, and property transfers. Then, Baltimore negotiated discounted services from realtors, law firms, title companies, and other businesses to turn the properties around in an expedient manner. Three years later, Baltimore reached its acquisition goal of 5,000 properties and has now exceeded 6,000 property acquisitions. Approximately one-third of the properties have been conveyed, sold, or scheduled for redevelopment.⁶⁶

States, cities, and counties have limited resources with which to acquire vacant properties. In areas where available funds will not cover the cost of acquiring all properties in need of rehabilitation, governments may consider using their inventory and mapping information to classify neighborhoods by need and potential impact. This can help guide private development and government intervention. For example, in 2001, The Reinvestment Fund, working with the city of Philadelphia in **Pennsylvania**, created six typologies to describe the city on the census tract level: regional choice, high-value/appreciating, steady, transitional, distressed, and reclamation. The city's Neighborhood Transformation Initiative took a citywide approach, as opposed to targeting only declining neighborhoods, but the classification system helped shape the activity and development aimed at each neighborhood.^{xiii}

ESTABLISH A LAND BANK

When a state or city has a vast number of vacant properties, one option to consider is creating a land bank. A land bank, for the purpose of the NSP program, is a governmental or nongovernmental nonprofit established—at least in part—to assemble, temporarily manage, and dispose of properties and vacant land. Land banks are often owned and operated on the local level; however, states may have to enact legislation that enables local

^{xii}See "Q. Purchase Discount," on p. 58,342 of the *Federal Register Notice*. Note that in cases where the state or local government entity chooses to use the specified HUD methodology that accounts for discount equivalent to the total carrying costs that would be incurred by the seller if the property were not purchased, the average portfolio discount must be at least 10 percent.

^{xiii}For an in depth discussion of the city of Philadelphia's challenges and successes with implementing the Neighborhood Transformation Initiative, see: Stephen J. McGovern, "**Philadelphia's Neighborhood Transformation Initiative: A Case Study of Mayoral Leadership, Bold Planning, and Conflict**," *Housing Policy Debate* vol. 17, no. 3 (2006): 529-70.

government entities to establish land banks. The **Genesee County Land Bank** in **Michigan** is often cited as a model for land banks. The land bank was made possible by a 2004 state law that enabled local governments to establish land banks, and provides that they may:

- Recapture 50 percent of property tax revenues for the first five years after the transfer of a land bank property to a private owner;
- Borrow money;
- Issue tax-exempt financing; and
- Select properties from tax-delinquency roles.⁶⁷

Of key importance to the Michigan land bank model is the state's 1999 tax foreclosure law (PA 123) that reduced the amount of time a property is vacant and allowed bulk acquisitions of tax foreclosed properties. According to its **brochure**, the Genesee County Land Bank renovates and sells or rents 25 to 50 homes per year and demolishes 100 to 200 blighted properties.

The Genesee County Land Bank maintains its vacant properties using one of three strategies. Through its Clean and Green program, neighborhood associations agree to take responsibility for the maintenance and cleaning of properties in their area. Under the Adopt-a-Lot program, individuals, groups, or organizations may agree to beautify nearby vacant lots. For all other properties, the land bank requests bids from local maintenance companies for contracted upkeep.

Public agencies have used land banks in several states, including **Georgia**, **Kentucky**, **Michigan**, **Missouri**, and **Ohio**. In **California**, the San Diego City-County Reinvestment Task Force has considered creating a land bank targeting bank-owned properties worth up to \$400,000.⁶⁸

SmartGrowth America's **state toolkit** on land bank legislation contains sample legislative language, considerations, communications strategies, and political strategies for states looking to establish a land bank. NSP is a new and potentially very significant public resource for land banking of

foreclosed and abandoned properties. Grantees have up to 10 years to redevelop properties acquired with NSP funds, and therefore, NSP offers "patient capital" for acquisitions, demolition of blighted properties, and program delivery costs during the acquisition stage. NSP-funded land banks must operate in a defined geographic area, as proposed and justified in the grantee's application and then approved by HUD.

As already noted, NSP funds may be used to facilitate redevelopment, marketing, and disposal of qualified properties, as well as "temporarily managing" and maintaining them. If the land bank is a governmental entity, it may use NSP funds to pay for costs of maintenance of abandoned or foreclosed properties that it does not own, provided that it charges the owner for the full cost of the services or places a lien on the property.

REPAIR OR REHABILITATE HOMES

Once a local government entity has acquired a foreclosed property, it must begin working to put the property back into use. In areas where demand for housing exists and foreclosed properties are habitable, states can focus on repairing homes to be transferred to new homeowners. A growing body of anecdotal evidence suggests that many of today's bank-foreclosed properties are badly damaged by former homeowners or by vandals and thieves that target the property after it becomes vacant. These homes, or older homes that have deteriorated over time, may require more robust rehabilitation. At least two states have recently launched projects to repair and rehabilitate homes to resell to new homeowners.

Massachusetts launched a \$20 million pilot project to help nonprofit and for-profit developers purchase and rehabilitate foreclosed property.⁶⁹ The program targets areas throughout the commonwealth that are most affected by the foreclosure crisis. The program creates a state-sponsored, low-interest loan fund using \$17 million from private lenders and \$3 million from private, nonprofit foundations. The goal of the program is to quickly acquire abandoned and at-risk

properties and turn them over to new homeowners or renters.

New York Governor David A. Paterson announced a program in May 2008 that provides \$25.5 million in grants and financing to create and renovate affordable housing in New York City and Western New York.⁷⁰ The program includes \$2 million to buy and renovate foreclosed homes in New York City to put them back on the market quickly. This \$2 million was awarded to the Housing Partnership Development Corporation for its **Neighborhood Stabilization Initiative**. The goal of the initiative is to purchase and rehabilitate 50 foreclosed homes in neighborhoods at risk of decline as a result of multiple foreclosures.

NSP funds may be used to directly acquire, rehabilitate, and resell properties to income-eligible buyers. Homes have to be sold at or below cost, which may include developer fees. In addition to, or instead of, engaging directly in the development process, a grantee may fund a sub-recipient or provide financing directly to homeowners or developers.

Twenty-five percent of the NSP funds made available to a grantee must be used to provide housing for households whose income does not exceed 50 percent of area median income. In addition, all beneficiaries of housing must have incomes at or below 120 percent of area median income, and state and local NSP programs must include long-term affordability provisions that are approved by HUD. To simplify compliance in that respect, HUD allows grantees to incorporate the exact requirements of the HOME program.

NSP provides great flexibility in devising various forms of subsidies—including soft second mortgages, grants, low interest rates, and written-down home prices—that make it possible for very low-income families to buy homes.

RESELL VACANT PROPERTIES TO RESPONSIBLE HOMEBUYERS

Getting new, responsible homebuyers to purchase homes is key to helping jumpstart the housing market in states where inflated values priced potential homebuyers out the market or where lack of consumer confidence has dampened sales. States can breathe life into weak markets and fill vacant homes by marketing bank-owned and government-owned homes to new buyers, bridging the affordability gap to help responsible borrowers take the step into homeownership and improving the likelihood that new borrowers will succeed as homeowners.

Eligible uses of NSP funds for acquisition, rehabilitation, and resale of homes are described in the section on Repairing and Rehabilitating Homes.

Market Vacant Homes to New Buyers

Some localities are working to entice new homeowners to purchase foreclosed property to ensure that recently foreclosed homes or newly rehabilitated homes do not sit empty for extended periods of time. In **Massachusetts**, the Boston Home Center, a division of Boston's Department of Neighborhood Development, has sponsored trolley tours of the city's foreclosed properties.⁷¹ Those who participate in the tour have the opportunity to take a city-sponsored home buying course. Additionally, the city offers an ongoing series of workshops related to home buying, and in particular, purchasing foreclosed property and buying homes that need work.^{xiv}

Bridge the Affordability Gap

To reduce the number of vacant, foreclosed properties, **California** launched a \$200 million **Community Stabilization Home Loan Program** to help first-time homebuyers purchase foreclosed properties in neighborhoods hit hard by the foreclosure crisis.⁷² The program gives first-time homebuyers the opportunity to purchase homes with below-market interest rate loans in select zip codes throughout California. Under the program, several lenders have agreed to sell their foreclosed properties at least 12 percent below estimated value. The program, administered by the California

^{xiv}Information on Boston Home Center events is available on the **Boston Home Center Web site**.

Housing Finance Agency (CalFHA), requires homes to fall under CalFHA sales price limits and families to meet income requirements.

Fairfax County, **Virginia**, has launched an effort to spend \$10 million in tax revenue for the purchase of 200 foreclosed homes, 10 of which will be purchased outright, while the rest will be purchased by eligible buyers with government-back loans. The low-interest loans and other homeownership assistance are targeted toward first-time homebuyers who earn up to 80 percent of the area median income.

The *Housing Arizona* initiative, recently launched in **Arizona**, includes \$2 million for first-time homebuyers' down payment assistance to help families take advantage of the affordable housing stock that exists throughout the state.⁷³

In **Massachusetts**, the Department of Housing and Community Development has provided support to the Citizens' Housing and Planning Association (CHAPA) to establish a **Massachusetts Foreclosed Properties Clearinghouse** to facilitate the disposition of bank-owned properties to nonprofit organizations, local housing agencies, municipalities, private owners, owner occupants, and other purchasers. The program is expected to launch late-February 2009. Seven major lenders have entered into an agreement to provide information on 1-4 unit properties throughout the state and to give the nonprofits a seven-day window to make an offer.⁷⁴ The goals of the program are to help lenders, servicers, and trustees of REO properties sell their properties more efficiently and responsibly; provide affordable housing opportunities to low- and moderate-income residents; stabilize neighborhoods; prevent responsible tenants of foreclosed properties from being evicted; and ensure that bank-owned properties are sold to responsible owner who will not perpetuate the cycle of foreclosure and property decline.

In 1996, **Maryland** enacted the Neighborhood Stabilization and Preservation Act to provide a **tax credit** on property taxes for owner-occupied homes purchased in designated neighborhoods in Baltimore. Throughout the 1970s and into the 1990s, the city of Baltimore experienced a rapid

decline in population. The tax credit was designed to encourage families to purchase homes in affected neighborhoods to reduce the number of vacant and abandoned properties. The Neighborhood Stabilization and Preservation Act gave homeowners up to an 80 percent credit on their property taxes for the first five years of ownership. The credit was then reduced by 10 percent each year until the 11th year of homeownership, after which it expired. The tax credit, which eventually applied to homes purchased through 2002 in the city and 2005 in the county, was paid for by the state of Maryland, the city of Baltimore, and Baltimore County. An evaluation of the impact of the tax credit on individual neighborhoods indicated that the tax credit was most effective when combined with other incentives, such as low-cost loans.

Through lease-purchase programs, families who may have spotty credit histories or little savings but who have steady work histories and sufficient income to afford rent, may temporarily lease a property until they are ready to become homeowners. A program underway in **North Carolina**, run by the Self-Help CDC, puts a portion of the tenant's rent into a savings account for down payment and closing costs. After about five years of credit repair and savings, the tenant will ideally be ready to purchase their home from Self-Help.⁷⁵

REPURPOSE PROPERTY INTO SPACE THAT ADDS VALUE TO A COMMUNITY

States and cities dealing with a depressed demand for housing or overall depopulation may choose to repurpose foreclosed property to make sure it best serves community need. Rehabilitating property for purchase by new homeowners could be an ineffective strategy in areas where there are few interested buyers. Even states with comparatively robust housing markets may want to consider whether it could benefit the community to repurpose some properties. For example, a single family home could be transformed to multifamily housing and sold to an investor to be used as rental housing. As it becomes more difficult for individuals to obtain mortgage loans, the demand for quality rental

housing will increase. States and cities may want to examine ways to convert condominiums, single family homes, and other residential properties to rental housing.

As noted, NSP will fund the acquisition and, in certain circumstances, the demolition of foreclosed and abandoned properties. NSP may be used to redevelop properties for residential and non-residential uses, including public parks, commercial uses, or mixed residential-commercial uses.

Additionally, states and cities may want to consider demolishing severely blighted properties and converting the land to public space, such as a city park or community center, or to commercial space for business development. In Wayne County, **Michigan**, a local nonprofit has acquired 20 blighted properties and is working to convert those properties into community gardens. The nonprofit recruits volunteers to care for the land, which is used to grow fruits and vegetables for local residents. Anyone can go to the garden to pick their produce for free, and the leftover food is donated to local food banks.⁷⁶

CONSIDERATIONS FOR STATES

As states craft their neighborhood stabilization strategies, it will be important to consider how their short-term action plans to stabilize neighborhoods through HUD NSP funding link to long-term housing policy goals. Because states must obligate their grant dollars within 18 months, all actions taken using NSP funding will by definition be near-term actions. States may want to consider how neighborhood stabilization strategies established within the 18

months, beginning January 15, 2009, could impact the state's long-term housing policy. For instance, states and cities that start new land banks will want to develop a plan for operating those land banks after NSP funds are expended.

States also may want to consider strategies to expand their capacity for implementing neighborhood stabilization efforts. Partnerships or coalitions will be important, particularly for local governments, for expanding capacity and improving efficiency in implementing new programs. Community development corporations, private industry (e.g., banks and lenders, title insurance companies, and appraisers), developers, and nonprofits are all potential partners for state and local governments to consider.

Finally, states must carefully examine HUD NSP guidelines to determine which actions may be funded through NSP and which may not, which actions will have the most positive impact in what geographies, and which activities are simply not possible because the delivery capacity cannot be identified or created within a few short months. For instance, foreclosure prevention, an important component of neighborhood stabilization, is not an eligible use for NSP funds. Moreover, targeting requirements means that states and local governments must choose carefully among potential projects to ensure they are meeting program guidelines. In some cases, states may want to augment NSP funds with state dollars to expand the reach of their neighborhood stabilization plans.

PREVENTION

CHAPTER FOUR



“ As the dust settles from the foreclosure crisis, governors will focus on ways to prevent problems in the mortgage market. ”

As the dust settles from the foreclosure crisis, governors will focus on ways to prevent problems in the mortgage market. A number of states have anti-predatory lending laws, but many states found that during the housing boom, predatory lenders found ways to sidestep existing laws with new mortgage instruments. Hence, several states already have amended existing lending laws or enacted new statutes that address directly problems that contributed to the housing bust.

Additionally, states are working to improve and expand oversight of the mortgage loan industry, particularly over mortgage brokerages and individual mortgage loan originators. States have worked to establish a national registry of mortgage loan originators and a new regulatory framework to improve oversight and transparency that most already have adopted. Along with this focus on regulation comes attention to making the mortgage loan process more transparent and consumer friendly to help ensure that borrowers are fully aware of how their loans are structured.

Finally, it has become evident that consumers' struggles now and over the next few years will not be limited to making mortgage payments on time. Americans have taken on an unprecedented amount of debt that likely will become more difficult to manage as the economy slows. Thus, governors are renewing their attention to policies and programs that promote financial education. Financial education includes everything from pre-purchase counseling for potential homeowners, to mandatory financial education curricula in schools, to financial education workshops and courses for adults.

The key to states' prevention work is to ensure that when the housing market rebounds, appropriate laws and regulations will be in place to keep credit available and accessible to consumers, protect consumers from predatory practices, and prevent mortgage fraud.

LAWS TO PREVENT PREDATORY LENDING

In 1999, **North Carolina** enacted the first “anti-predatory lending law,” which took aim at abusive mortgage practices designed to charge borrowers unnecessary or exorbitant fees or direct borrowers into high cost loans. The law responded to a rise in unscrupulous lending practices that corresponded with the loosening and availability of credit. North Carolina’s anti-predatory law was directed toward mortgage lenders that fell just below the standards set by the 1994 Federal Home Ownership Equity Protection Act (HOEPA). North Carolina’s law and other similar state laws are also sometimes referred to as “Mini-HOEPA” laws. HOEPA defined a “high-cost” loan (a loan with a high interest rate that triggers a number of protections for the borrower) as a loan 8 percentage points higher than the Treasury securities rate or with points or fees exceeding 8 percent of the loan amount or \$400, whichever was greater.

Following the enactment of North Carolina’s law, a number of states adopted similar legislation, either to increase the level of protection for consumers or to reinforce the Federal HOEPA law. To date, at least 35 states have some sort of predatory lending law, with the strongest laws in **Arkansas, California, Georgia, Illinois, Massachusetts, New Jersey, New Mexico, New York, North Carolina, South Carolina, and West Virginia.**⁷⁷ State anti-predatory lending laws include provisions such as restricting the amount of points and fees that may be applied to a loan, restricting prepayment penalties on subprime loans, and banning excessive loan flipping. The number of provisions and their level of restrictiveness varies by state.

The current wave of foreclosures has prompted some states to update their predatory lending laws so they apply to practices and policies that evolved during the mortgage lending boom, such as giving risky, nontraditional mortgage products to subprime borrowers without consideration of their ability to repay the loan. Balloon loans, option-ARMs, and jumbo loans requiring little or no documentation are a few examples of nontraditional mortgage products that flourished from 2003 to 2006, often originated to subprime borrowers who qualified for lower cost loans or who should not have qualified for such products at all, given their income and credit

histories. Hence, governors have taken steps to curb lenders who intentionally push or deceive borrowers into signing up for risky mortgage loans, or fail to consider whether the loan is in the best interest of the borrower.

For example, **Kentucky** Governor Steve Beshear signed H.B. 552 in April 2008. The bill establishes a number of new laws aimed at encouraging lenders and servicers to reach out to homeowners who may be in danger of foreclosure, protecting homeowners from mortgage “rescue” scams, and making the foreclosure process clearer. Additionally, the bill establishes new protections for consumers against predatory mortgage lending practices, including:

- Banning actions to improperly influence a real estate appraisal;
- Prohibiting prepayment penalties on loans lasting longer than three years or 60 days before the first interest rate reset, whichever is less;
- Limiting prepayment penalties to no more than 3 percent of the outstanding balance the first year, 2 percent the second year, and 1 percent the third year;
- Banning prepayment penalties on high-cost loan the borrower agrees to accept the loan with the prepayment penalty and rejects a loan without a prepayment penalty;
- Restricting the threshold of points and fees allowed on a mortgage loans to 4 percent of the total loan amount or \$2,000, whichever is greater;
- Prohibiting a lender from allowing a borrower to make payments that are applied only to interest and not to the principal;
- Establishing criteria to evaluate and require lenders to verify a borrower’s ability to repay the loan; and
- Requiring mortgage loan brokers to act in good faith toward the borrower.

In June 2008, **Connecticut** Governor M. Jodi Rell signed H.B. 5577, which established a fiduciary duty—i.e., an obligation to act in the best interest of another party—from all lenders and mortgage brokers to borrowers. The bill also restricts the financing of insurance and refinancing that does not benefit the borrower. It prohibits the influencing

of real estate appraisers, requires disclosures of yield spread premiums, and for “nonprime” loans, restricts prepayment penalties and bans interest rate increases associated with default.

Maine Governor John Baldacci signed into law **L.D. 2125** in January 2008 to strengthen truth in lending laws to protect homeowners from predatory lenders. The law broadens existing definitions of “nontraditional” and “residential mortgage loan;” specifies ways in which a creditor may verify a borrower’s income and requires documentation of the verification; and prohibits a creditor from disregarding statements submitted by the borrower regarding the borrower’s income.

A new law in **Maryland**, signed by Governor Martin O’Malley in April 2008, restricts prepayment penalties on certain subprime loans and requires lenders to consider a borrower’s ability to repay.

Minnesota S.F. 2881, signed by Governor Tim Pawlenty in May 2008, also requires verification of a borrower’s ability to repay and imposes penalties on mortgage brokers who fail to comply with this requirement. A law enacted in **Washington** by Governor Chris Gregoire in March 2008 prohibits prepayment penalties later than 60 days before a loan’s first interest rate reset and negative amortization.

REGULATIONS ON MORTGAGE BROKERS AND LOAN ORIGINATORS

Along with new state laws to prevent predatory lending practices or enhance existing protections for consumers against predatory lenders, states have taken steps to ensure that mortgage brokers and loan originators, which are regulated by states, are adequately regulated and monitored. According to the Office of Thrift Supervision, until recently, mortgage brokers originated an estimated 70 to 80 percent of subprime loans in the United States.⁷⁸ With about 20 percent of subprime loans now in default, states have been working to improve oversight of mortgage brokers and loan originators, license individual mortgage loan originators and improve licensing requirements, and enact regulations to improve the mortgage origination process to make it

more transparent and easier for borrowers to understand.

To improve accountability of the mortgage industry, state mortgage regulators, working with the Conference of State Bank Supervisors, have created the **Nationwide Mortgage Licensing System (NMLS)**.⁷⁹ NMLS, which a taskforce of regulators began developing in 2003, is a database of information on individuals and companies that originate mortgage loans. NMLS assigns a unique identifier to each company and individual loan originator to track information on mortgage loan performance. The system also aims to streamline the state licensing process for lenders and brokers. **Twenty-three states participate in NMLS**, which was launched in January 2008. Thus far, the NMLS database contains information on more than 11,300 mortgage companies; 10,200 mortgage company branch locations; and 50,800 loan officers.

On July 30, 2008, the Housing and Economic Recovery Act of 2008 became law. Title V of this act builds on states’ efforts by requiring all mortgage loan originators to be either state-licensed or federally registered. All mortgage loan originators must be licensed or registered through NMLS.

Additionally, 45 states have adopted regulatory **guidance on nontraditional mortgage products**, and 40 states have adopted **guidance on subprime mortgage products and lending practices**. The guidance mirrors 2006 and 2007 guidance issued by federal financial regulatory agencies and applies to state-licensed mortgage entities not subject to federal interagency guidelines.

Finally, several states have recently passed laws establishing a clear fiduciary responsibility of mortgage brokers and loan originators to borrowers, requiring originators to act in borrowers’ best interest. These states include **Colorado, Connecticut, Kentucky, Maine, Minnesota, North Carolina, Ohio**, and **Rhode Island**. Provisions in legislation enacted by these states includes language that either requires mortgage loan originators to act in “good faith” toward the borrower, consider the borrower’s ability to repay the loan, or originate loans that are in the “best interest” of the borrower.

These provisions seek to ensure that lenders are not originating loans without considering whether a borrower can reasonably repay their loan assuming, for instance, an adjustable rate reaches its highest possible amount and the borrower's income stays the same. Additionally, these laws are designed to prevent loan officers from flipping loans, steering a borrower into a high-cost loan, or failing to disclose to the borrower important information about loan terms.

States also have increased the penalties associated with violating statutes designed to protect consumers from predatory and fraudulent activity. **Arizona** Janet Napolitano signed H.B. 2040 in June 2007, making mortgage fraud a class four felony and a pattern of mortgage fraud a class two felony.⁸⁰ **Kentucky** passed H.B. 552 in April 2008 creating the Mortgage Fraud Act. The act defines mortgage fraud, makes it easier to prosecute perpetrators of mortgage fraud, and sets up a Mortgage Fraud Fund to aid prosecutors. **Minnesota** Governor Tim Pawlenty signed **S.F. 2881** in May 2008 to extend penalties for predatory lending and mortgage fraud. In **Washington**, H.B. 2770, signed in March 2008, establishes criminal penalties for mortgage fraud, making it a Class B Felony.⁸¹

States also have sought to make loan terms more transparent to the consumer. One reason that borrowers can be deceived into signing up for mortgage loans with terms they are unaware of is the sheer quantity of mortgage papers they receive at closing and the technical, legal language used in mortgage documents, which may be confusing for those without law degrees. These documents give predatory lenders who wish to hide predatory terms or excessive fees an advantage, as they may be buried in the stack of paperwork. Predatory lenders have been known to rush the closing process, warning homeowners that they will lose their opportunity to purchase if they take the time to consult a lawyer or counselor before signing.

To make the mortgage process more transparent, CSBS and AARMR worked with federal regulatory agencies to develop a two-page mortgage loan disclosure document. The document clearly states the borrower's monthly payments, including principal, interest, and taxes. Mortgage loan originators would be required to disclose the highest

possible payment under an ARM loan as well as any yield spread premiums, points and fees, and ballooning payments. The document includes warnings about certain terms such as yield spread premiums and urges borrowers to discuss these terms with the broker before signing.

HELP NEW HOMEOWNERS SUCCEED THROUGH EDUCATION

Improving regulatory oversight and restricting predatory lending practices can help improve transparency in the mortgage lending process and promote responsibility by financial institutions. However, this only addresses a piece of the problem. Lack of due diligence on the part of borrowers and homeowners or a lack of financial understanding landed numerous borrowers in hot water. Had more homeowners made responsible decisions, the impact of the housing slump likely would have been less devastating.

States can help empower consumers to make responsible financial choices by promoting financial education. While mortgage disclosure documents may make fees, interest-rate spreads, and other mortgage terms more clear, borrowers must understand how their choice to take on a mortgage loan will affect their budget and as well as the other personal and financial responsibilities that go along with owning a home.

There are two ways to promote responsible financial choices by homeowners. First pre- and post-purchase homeownership counseling can help borrowers avoid signing up for loans that may not serve their best interest, make borrowers aware of the many responsibilities that go along with homeownership, and support new homeowners as they tackle these new responsibilities. Second, financial education courses that focus beyond homeownership can help individuals improve their financial acuity in many areas, from budgeting and saving to paying down debt and investing.

Homeownership Counseling

Rebooting the nation's housing market will depend on attracting new, responsible buyers to reduce the supply of empty homes and provide business for banks, realtors, construction workers, and other housing-related professions. However, to be



“ Numerous states offer free homeownership counseling to residents thinking of purchasing a home. ”

successful, new policies and programs must consider the likelihood these new buyers will succeed as homeowners. Pre- and post-purchase counseling can help improve the chance that new buyers will thrive financially in their new homes.

Numerous states offer free homeownership counseling to residents thinking of purchasing a home. Some states offer counseling to residents, some to first time homebuyers, and others require it for those purchasing a home through the state housing finance agency. **Illinois** requires homeownership counseling for all potential first-time homeowners seeking to purchase a property in Cook County (which includes Chicago) with a nontraditional mortgage loan.⁸² **California** requires all participants in the state's Community Stabilization Home Loan Program (discussed previously) to receive homebuyer education from approved homeownership counselors. Loan refinance programs offered in **Illinois, Maryland, Massachusetts, New York,** and **Ohio** require

participants to undergo homeownership counseling as part of their refinance agreement. Post-purchase counseling, which may either be foreclosure intervention counseling or homeowner sustainability counseling for those who are having trouble keeping up with the responsibilities of homeownership, is now widely available via state and national hotlines. On its foreclosure prevention Web site, **Washington** provides a list of post-purchase housing counselors who are providing free services to homeowners.

Financial Education

Homeownership counseling is one piece of a financial education, which seeks to help individuals understand the basics of personal finance. Through financial education programs, individuals can learn about saving, budgeting, credit, and homeownership. In 2007 and 2008, at least 16 states enacted legislation to improve and expand financial education.

Teaching skills such as budgeting, saving, and accounting to children and youth can empower them to make responsible financial decisions as adults. In recent years, there has been a movement toward making financial education part of school curricula. According to the Jump\$tart Coalition for Personal Financial Literacy, at least 17 states require financial education to be incorporated into public school curricula. Three states, **Missouri**, **Tennessee**, and **Utah** require a separate course committed to personal finance.⁸³

Some recent efforts to promote financial education specifically address problems that contributed to the current housing and economic slump. **Illinois S.B. 2387**, signed in August 2008, adds homeownership to the financial literacy component of the consumer education instruction required for public high school students. Homeownership education includes the basic process of obtaining a mortgage and covers the concepts of fixed and adjustable interest rates, subprime versus prime loans, and predatory lending. **Iowa** Governor Chet Culver signed **H.F. 2555** in April 2008 to inform the public about investing in securities and spotting securities fraud. In May 2008, **Kansas** Governor Kathleen Sebelius signed **H.B. 2746** to increase penalties on mortgage brokers that engage in fraudulent activities, stabilize the real estate recovery fund, and

authorize monies in the fund to go toward grants to high schools and universities for teaching courses on money management and homeownership.

Washington Governor Chris Gregoire signed **S.B. 6272** in February 2008 to provide information to Washingtonians about laws regulating financial institutions and to help members of the public obtain information about financial products. The law further authorizes the director of financial institutions to establish, administer, and implement financial literacy and education programs. Moreover, the legislation appropriates funds for homeownership pre-purchase outreach and education and post-purchase counseling and support.

Other states added financial education to their school curricula in 2008. **Colorado** plans to add a core curriculum that includes financial literacy, defined as financial responsibility and planning skills, money management skills, and decisionmaking skills. The core curriculum must be adopted by school districts and accredited nonpublic schools for grades 9 through 12 by 2010-2011 and for grades kindergarten through 8 by 2014-2015.⁸⁴ **Utah** has established a financial and economic literacy “**passport**” to track student learning of financial concepts such as income, saving and investing, money management, consumer protection, spending and credit, and risk management.

CONCLUSION

CHAPTER FIVE

States have launched a massive response to the foreclosure crisis. In 2008 alone, governors in 33 states signed 70 pieces of legislation to combat the rise in foreclosures. Nearly all states have adopted new regulations to improve oversight of the mortgage lending industry. At the same time, the federal government has created several programs and enacted new laws to reduce the number of foreclosures, and many of these laws put responsibility in the hands of state policymakers for finding and implementing solutions to help mitigate foreclosures and defaults, stabilize neighborhoods, and prevent future foreclosures.

In 2008, attention shifted to more aggressive programs and solutions to tackle foreclosures. Governors have moved beyond voluntary agreements with loan servicers to revamped foreclosure processes that require servicers, borrowers, and mortgage counselors to work together to help families stay in their homes, either through mediation or through loan notifications that require certification of loss mitigation activity. As recently as 2007, an overrun of vacant property was an issue in only a handful of states. Now, armed with new grants from HUD, all 50 states and 5 territories have formulated specific plans for locating, securing, acquiring, and disposing of vacant properties. Moreover, states have taken major steps toward improving regulation of mortgage lenders and loan originators. Before 2006, a majority of states had anti-predatory laws, and most states required mortgage brokerages to be licensed. However, not all state anti-predatory lending laws enacted measures exceeding the standards of the federal HOEPA law, and some states lacked education requirements and mandatory criminal background checks for mortgage brokers. Now, many states have adopted or expanded anti-predatory lending laws

“ The work of the nation’s governors is laying the groundwork for a healthy housing market when the current crisis has passed and the economy rebounds. ”

to improve consumer protection and respond to new lending issues that arose during the housing boom.

States have also recognized the potential impact on both families and communities of the many families who have already lost their homes or will lose their homes despite all efforts. In 2009, states may need to expand efforts to address the needs of former homeowners, from working with school administrators and counselors to help children displaced because of foreclosure and helping families find safe and affordable rental housing and avoid homelessness, to helping former homeowners repair their credit and regain their financial footing and connecting families to important benefits like food stamps, Medicaid, WIC, TANF, or the EITC.

The work of the nation’s governors is laying the groundwork for a healthy housing market when the current crisis has passed and the economy rebounds. These state policies—which aim to promote personal and corporate responsibility, provide for critical regulatory oversight while ensuring access to credit, and expand viable affordable housing options for low- and moderate-income families—are important steps to rebuilding the nation’s crippled housing market.

APPENDIX A:

DIRECTORY OF STATE FORECLOSURE ASSISTANCE WEB SITES

Alabama

Foreclosure Assistance
Alabama 2-1-1

Arizona

Arizona Foreclosure Prevention
Task Force
Arizona Foreclosure Help-Line:
877-448-1211

California

Consumer Home Mortgage
Information
www.yourhome.ca.gov, www.sucasa.ca.gov

Colorado

Colorado Division of
Housing Homepage
Colorado Foreclosure Hotline
Web Site
877-601-HOPE

Connecticut

CT FAMILIES
Avoiding Foreclosure
Connecticut Law About Foreclosure
The Connecticut Mortgage
Foreclosure Assistance Hotline: 877-
472-8313

Delaware

Delaware Foreclosure Information

Florida

Foreclosure Prevention Links
and Resources
Florida Housing Help
Florida H.O.P.E. Task Force

Georgia

Georgia Foreclosure Resources

Idaho

Foreclosure Prevention Resources

Illinois

Foreclosure Assistance
Mortgage Fraud Hotline: 800-532-8785

Indiana

The Indiana Foreclosure Prevention
Network
877-GET-HOPE

Iowa

IowaMortgageHelp.com
Iowa Mortgage Help Hotline:
1-877-622-4866

Kentucky

Protect My Kentucky Home
866-830-7868

Maryland

Maryland HOPE
877-462-7555

Massachusetts

OCBAR Foreclosure Resources
MassHousing Foreclosure
Prevention Resources
Pro Bono Foreclosure Assistance
Hotline: 800-342-5297
Division of Banks Hotline 800-495-
BANK

Michigan

Save the Dream
866-946-7432

Minnesota

Minnesota Home Ownership Center
Foreclosure Prevention
Hotline: 866-462-6466

Missouri

Avoid Foreclosure
888-246-7225

Montana

Foreclosure Prevention

Nevada

Nevada Foreclosure Help
Nevada 2-1-1

New Jersey

New Jersey Homeownership
Preservation Effort (NJ HOPE)

New York

Subprime Foreclosure Prevention
Services Program

North Carolina

NC Foreclosure Help
Foreclosure Scam Hotline:
877-5-NO-SCAM

Ohio

Save the Dream
Foreclosure Prevention Hotline:
888-404-4674

Oregon

Foreclosures in Oregon

Pennsylvania

Alternatives to Avoid Foreclosure
Foreclosure Prevention Program
Foreclosure Mitigation
Counseling Initiative

Texas

Texas Foreclosure Help
Foreclosure Prevention

Utah

Utah Foreclosure Help
Foreclosure, Mortgage Fraud &
Predatory Lending

Vermont

Mortgage Assistance Program
888-568-4547

Washington

Protecting Washington Homeowners
& Buyers
877-894-HOME

Wisconsin

Wisconsin Foreclosure Resource

APPENDIX B:

STATE FORECLOSURE TASK FORCES

State(s)	Name of Task Force
Arizona, California, Colorado, Illinois, Iowa, Massachusetts, Michigan, New York, North Carolina, Ohio, and Texas	State Foreclosure Prevention Working Group
Arizona	Arizona Mortgage Fraud Task Force Arizona Foreclosure Prevention Task Force
California	Interdepartmental Task Force on Non-Traditional Mortgages
Colorado	Colorado Foreclosure Prevention Task Force
Connecticut	Subprime Mortgage Task Force
Delaware	Lieutenant Governor's Foreclosure Task Force
Florida	Florida H.O.P.E. Task Force
Indiana	2007 Interim Study Committee on Mortgage Lending Practices and Home Loan Foreclosures Indiana Foreclosure Prevention Network
Illinois	Illinois Statewide Foreclosure Prevention Network
Hawaii	Mortgage Broker Task Force
Kansas	Attorney General's Task Force to Address Home Foreclosures
Maryland	Homeownership Preservation Task Force
Massachusetts	Mortgage Summit Working Groups
New Jersey	New Jersey Home Ownership Preservation Effort (NJ HOPE)
New Mexico	Governor's Task Force on Mortgage Lending
New York	Halt Abusive Lending Transactions (HALT)
Ohio	Foreclosure Prevention Task Force
Oregon	Mortgage Lending Work Group
Texas	Texas Foreclosure Prevention Task Force Texas Residential Mortgage Fraud Task Force
Utah	Utah Foreclosure Prevention Taskforce 2008
Virginia	Virginia Foreclosure Prevention Task Force
Washington	Governor's Task Force for Homeowner Security

ENDNOTES

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