NCLR

# Rethinking TARP Implementation: Strategies to Reduce Latino Foreclosures

Presented at:

**Priorities for the Next Administration: Use of TARP Funds Under EESA**

Before:

**Committee on Financial Services**
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Good afternoon.  My name is Janet Murguía.  I am the President and CEO of the National Council of La Raza (NCLR)—the largest national Hispanic[1] civil rights and advocacy organization in the United States.  NCLR has been committed to improving opportunities for the nation's 44-plus million Latinos since 1968.  To this end, NCLR conducts research, policy analysis, and advocacy on a variety of financial services issues that impact the ability of Latinos to build and maintain assets and wealth.  I would like to thank Chairman Frank and Ranking Member Bachus for inviting me to share our concerns regarding the implementation of the Troubled Assets Relief Program (TARP).  More than a year into this crisis, foreclosure rates continue to rise, and an entire generation of wealth in Latino communities continues to erode.  We are confident, however, that reasonable and effective solutions  to this problem exist, and we are pleased to work with you to remedy the economic fallout created by troubled assets.

For more than two decades, NCLR has actively engaged in relevant public policy issues such as preserving and strengthening the Community Reinvestment Act (CRA) and the Home Ownership and Equity Protection Act (HOEPA); supporting strong fair housing and fair lending laws; increasing access to financial services for low-income people; and promoting homeownership in the Latino community.  For the last ten years, NCLR has been helping Latino families become homeowners by supporting local housing counseling agencies.  The NCLR Homeownership Network (NHN), a network of nearly 50 community-based counseling providers, works with more than 37,000 families annually, and enabled more than 25,000 to become first-time homebuyers in its first decade.  More recently, our focus has shifted to helping families keep their homes.  NHN members have counseled more than 7,000 homeowners facing foreclosure.  Our subsidiary, the Raza Development Fund (RDF), is the nation's largest Hispanic Community Development Financial Institution (CDFI).  Since 1999, RDF has provided $400 million in financing to locally based development projects throughout the country.  These relationships have increased NCLR's institutional knowledge of how Latinos interact with the mortgage market, their credit and capital needs, and the impact of government regulation of financial services markets.

NCLR is concerned that the Department of the Treasury chose to allocate funds in a manner that did not help homeowners avoid foreclosure, but rather favored investors and ignored crucial goals of TARP.  While the overarching purpose of TARP was to stabilize the U.S. financial system, the legislation established two critical objectives of pivotal importance to Latino families:  mitigate rising foreclosure rates, and increase the flow of consumer credit.  We are gravely disappointed that no measurable progress toward these goals has yet been achieved.

We commend members of this committee for making this discussion a priority as we begin a new congressional session and Administration.  Absent significant intervention that directly improves the ability of struggling families to pay their mortgages, foreclosure rates will continue to rise and our economy will continue to falter.  In my testimony today, I will provide a brief overview of the need for an effective national mortgage loss mitigation strategy and discuss how the initial TARP allocations have fallen short of the goals of the legislation.  I will conclude with a set of recommendations to ensure that the second TARP installment more fully meets the needs of the homeowners and communities impacted by foreclosures.

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[1] The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to identify persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, and Spanish descent; they may be of any race.

## Background

Soaring foreclosure rates is one of the most pressing issues facing the nation. For decades, many of us have worked together to build wealth in Latino and other underserved communities. As it is for all Americans, homeownership has been the traditional vehicle for Hispanic families to build wealth for their long-term financial well-being. Unfortunately, for many years, and for a variety of reasons, the conventional mortgage market has not served the Latino community well. In part as a result, many Latino homeowners were steered into mortgages that were never a good fit for them. Reckless and discriminatory lending has now been shown to endanger the safety and soundness of the entire mortgage market. Forecasters predict that eight million foreclosures will occur in the next four years—a figure that could climb even higher with rising unemployment rates.[2] For the Hispanic community, we expect the height of the crisis will likely come in 2009 and 2010, when interest rates are scheduled to adjust on loans common among Hispanic borrowers.[3]

NCLR has made a concerted effort to better understand how to prevent foreclosures among Hispanic and immigrant households and develop appropriate public policy and programmatic responses. NCLR has been funding foreclosure prevention counseling since 2005 and recently launched a campaign with the National Urban League (NUL) and National Coalition for Asian Pacific American Community Development (CAPACD) to expand efforts to help community-based organizations address the mounting foreclosure rates; partnerships with mortgage servicers and other industry stakeholders complement these efforts. In 2008, NCLR hosted three major convenings during which community leaders expressed their acute concern that responses to the financial crisis lacked balance. In particular, participants expressed their frustration at the substantial assistance directed to the financial services industry, as their community-level efforts struggled to meet the ever-increasing demands of their constituents facing foreclosure.

Furthermore, our work with thousands of families facing foreclosure has shown that despite many high-profile efforts, voluntary loan modification programs are not working. Those who need assistance the most are still not able to access it. A survey of NHN counselors revealed that it takes an average of *three months* to receive a loan modification approval or denial from a loan servicer and that many of the loan modifications that are offered to borrowers are not affordable or sustainable. One-third of our grantees report having to turn away clients because their agencies are operating beyond capacity; many have turned down the opportunity to participate in Home Rescue Fairs because they cannot afford to take on additional cases.[4] As we brace ourselves for even greater demand in 2009, we anticipate that so-called "piggyback" Option Adjustable Rate Mortgages (ARM) and upside-down loans will continue to present the greatest challenge to securing loan modifications.[5]

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[2] Rod Dubitsky et al., *Foreclosure Update: Over Eight Million Foreclosures Expected* (New York, New York: Credit Suisse, December 4, 2008).

[3] Ibid.

[4] Home Rescue Fair is a one-day outreach event that offers individuals facing foreclosure the opportunity to receive free advice and resources from housing counselors, attorneys, and loan servicers.

[5] "Piggyback loan" refers to a second mortgage loan given at the time of a home purchase or refinance. The borrower will have two loans—a primary and secondary (piggyback), which may be held by a different lender. Option ARMs allow borrowers to choose between payments that amortize in 30 years, 15 years, an interest-only payment, and a minimum payment that is less than interest only. Industry experts estimate that 60%–80% of Option ARM borrowers are making minimum payments. See Nick Carey, "Option ARMs, Next Chapter in U.S. Housing

During the Emergency Economic Stabilization Act (EESA) debate, NCLR expressed concern that the act did not contain language emphatic enough to motivate the Secretary of Treasury to implement a systemic loan modification program.[6] Assurances were made by the Treasury and financial institutions that good faith efforts would be made to modify loans. However, the Treasury has made no such efforts, and the voluntary efforts of servicers have been inconsistent at best. Now, more than ever, firm legislative language is integral to accomplishing our shared goal of reducing foreclosures and providing aid to homeowners.

**Priorities for the Next Administration**

As dozens of economists have stated, our current economic woes largely stem from the trouble in the housing market. Yet, the Treasury has refused to apply any TARP funding—or funding from any other source—directly to mending the housing matter. In fact, Secretary Henry Paulson has rejected serious proposals to create a large-scale modification program and has not applied any meaningful conditions to TARP recipients in this regard.[7] At this point, $365 billion has been designated for financial institutions, and prospects for homeowners facing foreclosure have not improved.

In addition to the substantial evidence available in published studies and reports, the actual conditions faced by real people substantiate the need for immediate intervention. Melissa M. is one of the few first-time homebuyers in Phoenix, Arizona who is able to qualify for a conventional mortgage. She completed a homeownership counseling program and began working with a real estate agent to find the house that was right for her family. She ultimately chose a Real Estate Owned (REO) property. Despite the fact that she is qualified and ready to purchase the home, the servicer has blocked the process. Working with her agent and housing counselor, she has spent the last four months attempting to satisfy the servicer's requests. Each time they call, the servicer demands a different piece of information, or she is transferred to a different agent.

In Los Angeles, California, an NHN counselor has been unable to obtain a loan modification for her 76-year-old client because the servicer uses national averages to determine what is acceptable for a family budget. Because the servicer is unwilling to use a local index that reflects costs in Los Angeles for the family budget, the elderly couple is in danger of losing their home. In Stockton, California, a working couple with an Option ARM was denied a

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Crisis," *Reuters*, February 1, 2008, http://www.reuters.com/article/reutersEdge/idUSN2436651820080201 (accessed January 8, 2009). When borrowers make the minimum payment, the excess principal and interest is tacked on the balance of the loan (known as negative amortization), and the loan will reset when the amount owed is between 115% and 120% of the home value. Many Option ARM borrowers are "upside down," but so are many borrowers with standard mortgage products who are in areas where home values have dropped significantly.

[6] National Council of La Raza, "NCLR Urges Congress to Include Homeowners in Bailout Bill," news release, September 23, 2008; National Council of La Raza, "Civil Rights Groups Call on Congress to Assist Homeownership in its Economic Recovery Package," news release, September 30, 2008.

[7] See U.S. Department of the Treasury, "Remarks by Secretary Henry M. Paulson, Jr. on Financial Rescue Package and Economic Update," news release, November 18, 2008; House Committee on Financial services, *Testimony by Treasury Secretary Henry M. Paulson, Jr. before the House Committee on Financial Services,* 110th Cong., November 18, 2008; and Tami Luhby, *FDIC's Bair pushes aggressive mortgage plan*, CNNMoney.com, November 14, 2008, http://money.cnn.com/2008/11/14/news/economy/fdic_bair/index.htm?postversion=2008111416 (accessed January 5, 2009).

modification because it was the second they were applying for. Their first modification was short-term and not affordable. When it expired, they found themselves in the same position they were in months before, facing foreclosure.

In Detroit, Michigan, an NHN counselor was finally able to obtain a loan modification for his client, the victim of a brutal beating who fell behind in her mortgage payments while waiting for approval for disability income. It took ten months of negotiations with the servicer and the involvement of the State Attorney General to secure the modification because the property was sent to foreclosure while the case was still in the loss mitigation process.

When the foreclosure crisis began, most NHN clients who were struggling to pay their mortgages found themselves in a foreclosure situation largely because their home loans were predatory or unaffordable from the start. Now, the faltering economy is further complicating the situation for multitudes of people. This nation's millions of hardworking Latino families are confronted by a dangerous combination of unaffordable home loans, declining home values, the threat of job loss and/or reduced income, and increased consumer expenses. Many are using their credit cards to make ends meet—setting up yet another potential bubble in the credit market. While financial institutions have access to TARP funds to shore up their balance sheet, working families are being left without a financial safety net.

The program has failed two of the objectives laid out in the legislation: to reduce the number of foreclosures and loosen the credit markets. These goals are not only critical to helping struggling Latino homeowners avoid financial disaster, but to helping our national economy to recover. TARP has failed to fulfill these goals in three specific ways:

- **Foreclosure rates continue to rise.** The Treasury's shifting strategy under TARP, rejection of the concept of purchasing troubled assets, and flagrant disregard for Congress's intended purpose of the legislation are well-documented. Upon passage of EESA, the Treasury had at least two meaningful foreclosure prevention strategies available. The department could have aided homeowners directly through the purchase of whole loans, or indirectly by making the modification of troubled loans a condition of receiving TARP funds; a number of viable variations on these concepts have since been developed. Instead, the Treasury has employed the very kind of piecemeal approach they advocated against when developing a strategy to bolster financial institutions. Rather than create and implement a systemic and cohesive approach to loan modifications, the Treasury has relied on voluntary loan modification programs that have proven ineffective and on sporadic commitments made by financial institutions applying for funding.[8] In the meantime, the market continues to make its own

[8] For a thorough discussion of the Treasury's approach to foreclosure mitigation, see U.S. Government Accountability Office, *Troubled Asset Relief Program: Status of Efforts to Address Defaults and Foreclosures on Home Mortgages*, presented by the U.S. Government Accountability Office (GAO) before the Subcommittee on Financial Services and General Government, Committee on Appropriations, U.S. Senate, December 4, 2008. According to GAO's testimony, the Treasury applied routine and vague contract language to TARP agreements in which companies would agree to make use of existing programs to the extent possible to modify mortgages. Contracts lacked specific benchmarks, expected outcomes, or measures of accountability regarding mortgage modifications. Moreover, existing modification programs have been inconsistent and ineffective. FHA Secure, which was intended to help 80,000 homeowners, has helped only 4,100 delinquent borrowers refinance since September 2007. Hope for Homeowners was intended to provide loan modifications for 400,000 families and has

case for an improved foreclosure prevention strategy. According to recent projections from Credit Suisse, foreclosures rates will continue their record-setting rise during the coming four years, while a spike in unemployment could worsen the situation.[9] Moreover, the evidence to date shows that anything short of a systemic loan modification tied to borrower affordability is unsustainable.[10]

- **The flow of credit to impacted communities has not increased.** Another stated goal of EESA and TARP was to get banks back into the business of lending. While there were initially mixed reports on the extent to which additional credit is currently available, the Federal Reserve Districts report decreased lending and tightened credit standards as contributing to the weak economies in their regions.[11] Access to affordable and safe financial products is critical to building wealth in Latino and other underserved communities, however, consumers are faced with severe obstacles to obtaining credit. Credit card companies have reduced card limits and raised interest rates, student loans are drying up, and flexible mortgage products have disappeared. Not only does this result in less consumer spending overall, but it also prevents qualified homeowners from purchasing excess housing stock. Housing counseling agencies and credit unions have experienced a sharp decrease in the number of creditworthy families for whom they can secure financing. With few families able to qualify, we are concerned that banks and servicers will sell significant numbers of REO properties, in bulk, to investors and speculators.

- **TARP lacks transparency and a mechanism for public accountability.** That the Treasury appears not to have a reliable record of how financial institutions are using funds allocated under TARP is a cause for serious concern.[12] In a recent poll conducted by the Associated Press, 21 bank recipients declined to account for how their funds have been spent. Clear disclosure of the distribution, uses, and impact of the funds is necessary not only because the money is taxpayer dollars, but also because the funding and authority to distribute were granted with a clear public purpose. Information obtained through a number of publicly available data sources, such as Home Mortgage Disclosure Act, Community Reinvestment Act, and Survey of Consumer Finances, is often used to hold institutions accountable, inform public policy, and develop new lending tools. Civil rights institutions, for example, have used these data both to hold financial institutions accountable for unethical practices such as redlining and predatory lending and to encourage investment in underserved communities. The lack of public disclosure, along with the absence of demonstrable impact, jeopardizes the integrity and, ultimately, the success of the entire TARP initiative.

**Recommendations**

As we begin a new Administration and congressional session, Hispanic families and struggling neighborhoods throughout the country need a bold foreclosure prevention strategy, starting with

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received less than 400 applications. Making matters worse, voluntary efforts by industry have often produced short-term workouts, rather than permanent loan modifications that are sustainable and affordable.

[9] *Foreclosure Update.*

[10] *Analysis of Subprime Mortgage Servicing Performance, Data Report No. 3,* State Foreclosure Prevention Working Group (September 2008) http://www.csbs.org/Content/NavigationMenu/Home/SFPWGReport3.pdf.

[11] *Summary of Commentary on Current Economic Conditions* (Minneapolis, Minnesota: Federal Reserve Bank of Minneapolis, December 2008).

[12] See Cheyenne Hopkins, "Follow the Money? With TARP, That May Not Be So Simple," *American Banker,* December 15, 2008.

a shift in the distribution of the remaining TARP funds. NCLR recommends that, as a basic threshold requirement in the application and approval process, the Treasury mandate applicants to indicate how their proposed allotment of funds will directly serve homeowners struggling to pay their mortgages. Approved recipients must demonstrate how they will ease the burden of foreclosures by increasing lending in the community, redeveloping foreclosed properties, and modifying failing mortgages. Specifically, we recommend that the Treasury:

- **Implement a mandatory systemic loan modification program.** We urge Congress to prohibit the Treasury from tapping into the remaining TARP funds until it implements policies and procedures to address the rising rate of foreclosures, including a mandatory systemic loan modification program. NCLR strongly supports the Federal Deposit Insurance Corporation's (FDIC) "Loan Mod in a Box" proposal. The FDIC program would create a true incentive for banks to participate in the modification program, and it ties loan modifications directly to affordability, two keys to a successful modification program. The FDIC proposal also encourages servicers to work with housing counseling agencies by paying counselors a fair fee for their work. In addition, as a condition for receiving TARP funds, financial institutions should be required to implement a loss mitigation program.

- **Keep homeownership a priority and increase the flow of capital and credit directly to Hispanic communities.** As supporters of homeownership for modest-income Hispanics, we have always recognized homeownership as a long-term investment. We urge Congress to require recipients of TARP funding to increase fair and affordable lending to impacted communities and ensure that REO properties are made available to renters and owners from within the impacted area and sold to owner-occupants. As we seek to restore balance to the mortgage market, we urge Congress to explore every meaningful opportunity to support investment vehicles that increase the flow of capital and credit to Hispanic communities. There are a number of models that could ensure TARP funding reaches those most impacted by the foreclosure crisis, including matched investment pools, CDFI programs, full inclusion of minority- and women-owned businesses, and other existing development tools.

- **Mandate disclosure and accounting of TARP funds.** The Treasury must disclose the recipients of TARP funds, their intended purposes for fund disbursement, measures for impact, and explanations of how the funding will directly mitigate the effect of rising foreclosure rates. Financial institutions should be required to disclose how they have used the funds, where money has been lent, for what purpose, and other criteria critical to determining whether the uses meet their public purpose. In addition, recipients must disclose changes to their own business practices, such as improved loss mitigation practices or investments in impacted communities, made as a condition of funding. NCLR encourages Congress and the Treasury to obtain these disclosures, to the extent possible, from existing recipients as well. Data should be made available on a quarterly basis, at minimum.

While the focus of this hearing is on TARP, this program alone cannot resolve all the issues facing our troubled mortgage and credit markets. NCLR supports a number of other measures that would curb foreclosures and protect vulnerable homebuyers and owners, including:

“Helping Families Save Their Homes in Bankruptcy Act of 2007” (S. 2136), “Home Retention and Economic Stabilization Act of 2008” (H.R. 6076), “Foreclosure Prevention and Sound Mortgage Servicing Act of 2008” (H.R. 5679), “Systematic Foreclosure Prevention and Mortgage Modification Act” (H.R. 7326), and “Credit Cardholders' Bill of Rights Act of 2008” (H.R. 5244). NCLR also continues to be a strong supporter of the U.S. Department of Housing and Urban Development (HUD) Housing Counseling Program. We recommend managing and funding all foreclosure relief services through the HUD program.

While the immediate challenges facing our economy take federal priority for the moment, the future of the American housing and economic sectors is not viable without sound, sustainable solutions. We support comprehensive, anti-predatory lending legislation, a strengthened regulatory structure, a redefined role for the government-sponsored enterprises to reestablish a healthy market in conventional and affordable loans, and new steps to improve financial literacy among vulnerable populations. We look forward to working with this Committee, the Congress, and the new Administration to enact these proposals in the coming months.