Assumptions, Mistakes, Successes, and Moving Forward: An Empirical Analysis of Foreclosures in North Minneapolis and Foreclosure Policies

CURA Housing Forum
Friday, December 18, 2009
Thanks and Disclaimers...

- Thank you to Professor Prentiss Cox and Professor Myron Orfield at the University of Minnesota Law School and Professor Jeff Crump. Some of the data presented here today and cited in my paper on this topic was compiled by them, but the analysis and errors are mine.

- Thank you to the Kirwin Institute on Race for the Study of Race and Ethnicity at Ohio State University for providing a research grant to write this paper and allowing me to serve as an advisory board member.
A story...
TRUTH-IN-LENDING DISCLOSURE STATEMENT

CREDITOR: BNC MORTGAGE, INC.
P.O. BOX 19656
IRVINE, CA 92623-9656

BORROWERS: 

ADDRESS: 
CITY/STATE/ZIP: MINNEAPOLIS, MN 55411
PROPERTY: 

ANNUAL PERCENTAGE RATE
The cost of your credit as a yearly rate.

AMOUNT FINANCED
The amount of credit provided to you or on your behalf.

TOTAL OF PAYMENTS
The amount you will have paid after you have made all payments as scheduled.

<table>
<thead>
<tr>
<th>PAYMENT SCHEDULE</th>
<th>AMOUNT OF PAYMENT</th>
<th>PAYMENTS MADE TO DATE</th>
<th>NUMBER OF PAYMENTS</th>
<th>AMOUNT OF PAYMENTS</th>
<th>PAYMENTS MADE TO DATE</th>
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</thead>
<tbody>
<tr>
<td>11,213 $ 713.361.72</td>
<td>$ 222,155.30</td>
<td>$ 935,517.02</td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

DATE: 02/20/2006

PRELIMINARY [ ] FINAL [X]

LOAN NO.: HIN019963

Type of Loan: 40/30 2 YEAR

DEMAND FEATURE: [X] This loan does not have a Demand Feature. [ ] This loan has a Demand Feature as follows:

VARIABLE RATE FEATURE: [X] This Loan has a Variable Rate Feature. Variable Rate Disclosures have been provided to you earlier.

SECURITY: You are giving a security interest in the property located at 

ASSUMPTION: Someone buying this property [X] cannot assume the remaining balance due under original mortgage terms [ ] may assume, subject to lender’s conditions, the remaining balance due under original mortgage terms.

FILING / RECORDING FEES: $ 70.00

PROPERTY INSURANCE: [ ] Property hazard Insurance in the amount of $ 0.00 with a mortgagee clause to the lender

[ ] Property hazard Insurance in the amount of $ 0.00
**ANNUAL PERCENTAGE RATE**
The cost of your credit as a yearly rate.

| 11.213 % | $ 713,361.72 |

**FINANCE CHARGE**
The dollar amount the credit will cost you.

| $222,155.30 |

**AMOUNT FINANCED**
The amount of credit provided to you or on your behalf.

| $935,517.02 |

**TOTAL OF PAYMENTS**
The amount you will have paid after you have made all payments as scheduled.

**PAYMENT SCHEDULE**

<table>
<thead>
<tr>
<th>NUMBER OF PAYMENTS</th>
<th>AMOUNT OF PAYMENTS</th>
<th>PAYMENTS ARE DUE monthly BEGINNING</th>
<th>AMOUNT OF PAYMENTS</th>
<th>PAYMENTS ARE DUE monthly BEGINNING</th>
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<td>03/01/2036</td>
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<tr>
<td>801</td>
<td>Loan origination fee</td>
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<td>Mortgage insurance application fee</td>
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<td>815</td>
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<td>1100</td>
<td>Government recording and transfer charges</td>
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</table>
A story as an illustration...
Non-Bank Lender owned by Wall Street Investment Firm

Person of Color in North Minneapolis

Rented part of house to elderly family member

Undisclosed/Wrongly Disclosed Mortgage Terms

Exorbitant broker and closing fees

Mortgage failed within a year
Assumptions, Mistakes, and Successes
Assumption and Mistake #1: The Foreclosure and Economic Crisis Is Over
$15-$30 billion of ARMs will adjust per month every month until 2012
National Foreclosure Rates
Unemployment Rate

Figure 8: United States Unemployment Rate (1980-present)
Assumption and Mistake #2: Lenders Act Rationally
“Why would a lender do something that is not in its own best interest?”
Rise of the Non-Bank Lender and Wall Street Investment Firms...
Traditional Banking Model

CONSUMER

BANK

Money is Loaned To Consumer

Interest and Principal is Repaid To Lender

SOLD

House

Piggy Bank
The New Model

MORTGAGE SECURITIZATION FLOW CHART

1. Lender Originates Loan (hundreds of thousands of dollars)
   - Mortgage is originated by lender
2. Mortgage is sold to a special purpose vehicle (SPV)
   - SPV securitizes the mortgage
   - The mortgage is then repackaged into a trust
3. Various tranches are sold as RMBS to investors
   - RMBS: Residential Mortgage-Backed Securities
4. SPV: Special Purpose Vehicle

SPV
- Investors, often the original lender, purchase low-risit RMBS or normal mortgage and use a CDO manager to pool these interests into a trust and convert to CDOs:
  - CDOs: Collateralized Debt Obligation

CDOs: RANKED, RATED, AND SOLD TO INVESTORS
- CDOs are ranked and rated and sold to investors
  - A, BBB, AA, AAA

Important risk factors to consider:
- Prepayment risk
- Call risk
- Structured finance risk
- Credit risk
- Market risk

Mark Zandi, PhD, Foreclosure Relief Law Project, St. Paul, MN (August 2008)
Rise of Sub-Prime Lending...
Chart 2: Subprime Mortgage Market Growth and Share of Total Market, 1994-2006

Source: Agora Financial; Inside Mortgage Finance
Dramatic Change In Lending Patterns and Underwriting

2006

- Conform: 33.0%
- Jumbo+: 17.0%
- Subprime: 22.0%
- Alt-A: 18.0%
- Home equity: 10.0%
Assumption and Mistake #3:

Lenders Properly Underwrote Loans
Assumption affects how we modify loans and counsel homeowners.

Initial efforts were focused on teaser rate adjustments and freezing adjustable rate mortgage interest rates.
Toxic Mortgages... Quick To Fail

- The mean number of months from the date of origination to the date of foreclosure was approximately 21 months for mortgage loans originated in North Minneapolis, meaning that most borrowers were foreclosed upon within two years of origination.

- 26% of the foreclosed mortgage loans were foreclosed upon less than a year after origination, which meant that the foreclosure process began, at most, nine months after origination.
Assumption and Mistake #4:

Mortgage Servicers Act Rationally
A study released by the Federal Reserve Board in Boston found that less than 8% of seriously delinquent loans received any loan modification.

More than 51% of modified mortgages resulted in a higher monthly payment; which the vast majority re-defaulted within a year.

The difference between the amount that a lender purchased a property for at the Sheriff’s Sale auction, typically the amount owed on the mortgage loan, and the later sale price was usually a loss of $65,039 (average) or $77,424 (median). As a percentage, the lender later sold the properties for a loss of 25% (average) to a loss of 49% (median).
Assumption and Mistake #5:

Focus just on homeowners
The findings of a University of Minnesota study were that over 60% of the properties that were foreclosed upon were non-homesteaded, exceeding the proportion of rental property in the neighborhood.

Yet, the vast majority of initial foreclosure prevention efforts, both local and national, were designed only to help homeowners with little or no mention of renters.

Assumption and Mistake #6: Misappropriation of Resources Away From Areas of Greatest Need
By far the largest recovery program created by the federal government, relating to the vacant and abandoned houses created by the foreclosure crisis, is the Housing and Economic Recovery Act of 2008. Specifically, the section of this Act relating to the creation and distribution of National Stabilization Program (“NSP”) funds.

Approximately $6 billion of NSP grants were distributed to states across the country, and the states were then required to give “priority emphasis and consideration to those...areas with the greatest need.”

North Minneapolis and certain neighborhoods in Saint Paul have unquestionably been the State’s most negatively impacted areas by almost any measure, but, based upon the formula developed by the State of Minnesota, at least $9 million of Minnesota’s $17 million NSP award was automatically directed to other areas of the state. ($9 million/$100,000 = 90 houses)

In fact, the State of Minnesota created its own factor (not suggested or authorized by Congress) to create a formula that is “balancing the distribution of funds between the Twin Cities metro area and Greater Minnesota.”

This “balancing” is irrelevant to the goal of targeting funds to areas of greatest need, like North Minneapolis, and ignores the reality of the foreclosure crisis.
VACANT BUILDINGS IN SAINT PAUL

Vacant Buildings - 1995 - 2006
Violations
- No major code violations
- Some code violations
- Many serious problems

Source: Saint Paul Council Research Center
Community impact three years later

2700 Penn Ave. N.  
2717 Penn Ave. N.  
2720 Penn Ave. N.  
2724 Penn Ave. N.

SOURCE: CPED, Part of presentation originally given by Melissa Manderschied and Elizabeth Ryan, Residential Foreclosures: A Wake Up Call For Real Estate Attorneys (Hennepin County Bar Association, April 26, 2007).
Tracking 100 Minneapolis foreclosures

- The median time from the date of the foreclosure Sheriff’s sale to the date that the property sold to another party was 484 days.

- Assuming a six month redemption period, it took a lender approximately 304 days or ten months for a property to be sold.
Tracking 100 Minneapolis foreclosures

- 83% of the foreclosed properties had 911 calls post-Sheriff’s Sale.

- The average number of 911 calls was eight, while the median was five calls per property.

- The vast majority of 911 calls (74%) occurred after the end of the redemption period when the property was under the control and ownership of either the mortgage loan servicing company or the person who bought the property from the mortgage loan servicing company.
Watch-out for inequitable distribution of stimulus funds....

- Rather than stimulus funds for transportation being spent where people live (two-thirds of the country lives in large metropolitan areas) urban areas received less than half of transportation stimulus dollars
Assumption and Mistake #7: Race has nothing to do with it
Race by census track

Legend

- Counties Value: 17.6%
- 1.7 to 8.1% (109)
- 8.2 to 12.6% (111)
- 12.7 to 17.5% (57)
- 17.6 to 33.4% (62)
- 33.5 to 50.6% (54)
- 50.7 to 94.3% (31)
- No data (8)

Note: Census Tracts with "No data" had fewer than 25 mortgage borrowers.
Subprime lending by census track

Institute on Race and Poverty, Communities in Crisis: Race and Mortgage Lending In The Twin Cities at p. 32 (February 2009)
Foreclosures by census track

Institute on Race and Poverty, Communities in Crisis: Race and Mortgage Lending In The Twin Cities at p. 30 (February 2009)
A CONCENTRATION OF FORECLOSURES
Homes Currently in Foreclosure As Of December 2006 in North Minneapolis
Assumption and Mistake #8: The Community Reinvestment Act Did It
“They Gave your Mortgage to a Less Qualified Minority.”

In her article, Ms. Coulter argues that the foreclosure and economic crisis was caused by “political correctness being forced on the mortgage lending industry in the Clinton era.” She then posits that banks were forced to ignore credit scores and lend based on “nontraditional measures of credit-worthiness, such as having a good jump shot or having a missing child named Caylee.”

The most high-risk lending occurred through non-bank lenders that were not even covered by the Community Reinvestment Act.

Estimates are that three-quarters of the sub-prime loans that were originated during the real estate boom were originated by non-bank lenders that were not subject to the Community Reinvestment Act and our study of foreclosures in North Minneapolis was consistent with estimate.
Most Foreclosures In North Minneapolis Are From Loans Originated By Non-Bank Lenders

- BNC Mortgage and Argent/Ameriquest originated approximately 29% of mortgage loans foreclosed upon in 2006.

- Over 80% of foreclosed North Minneapolis mortgage loans were originated by lenders who rely heavily, if not exclusively, on “independent” mortgage brokers facilitating loan transactions for non-bank lenders.
Successes...

- Passage of new laws
  - Minnesota Anti-Predatory Lending Act
  - Improved Foreclosure Notices
  - Increase In Renter Protections
- Inter-Governmental Partnerships
- Funding For Housing Counselors
Bending Toward Justice...

- Determine “Where We Are” and “Assert our Dignity and Worth”
- Identify the basic challenges and structural impediments
- Develop a program and commit to a path of structural change