Special Report

Keeping People in Their Homes: Policy Recommendations for the Foreclosure Crisis in Michigan

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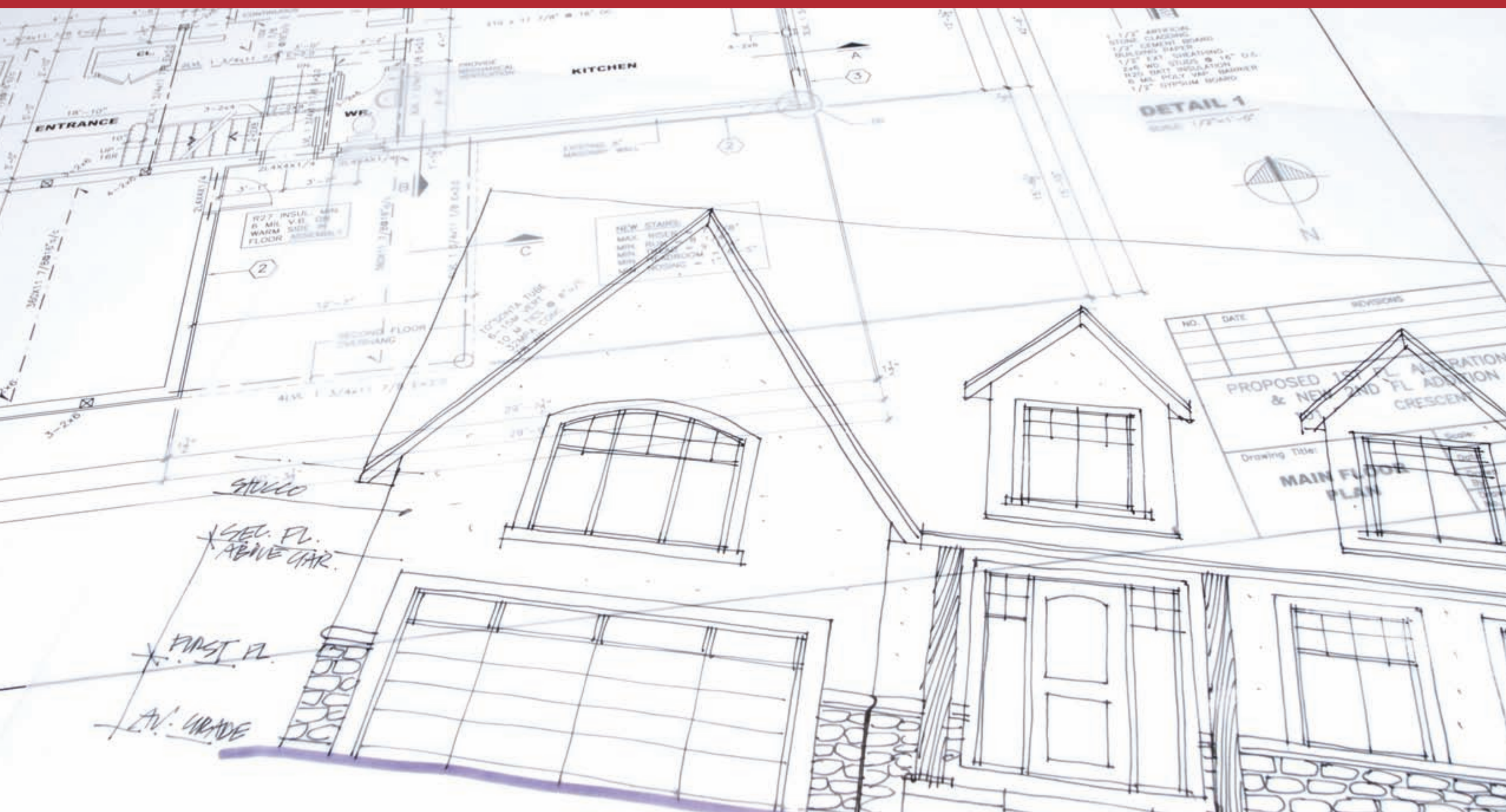

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Ideas grow through thoughtful and scientific analysis of top-priority consumer, public policy, and credit union competitive issues. Researchers are given considerable latitude in their exploration and studies of these high-priority issues.

Progress is the constant replacing of the best there is with something still better!

— Edward A. Filene

The Institute is governed by an Administrative Board made up of the credit union industry's top leaders. Research topics and priorities are set by the Research Council, a select group of credit union CEOs, and the Filene Research Fellows, a blue ribbon panel of academic experts. Innovation programs are developed in part by Filene i^3, an assembly of credit union executives screened for entrepreneurial competencies.

The name of the Institute honors Edward A. Filene, the "father of the United States credit union movement." Filene was an innovative leader who relied on insightful research and analysis when encouraging credit union development.

Since its founding in 1989, the Institute has worked with over 100 academic institutions and published hundreds of research studies. The entire research library is available online at www.filene.org.

Robert D. Manning, PhD

Robert D. Manning is research professor and director of the Center for Consumer Financial Services and past Caroline Werner Gannett Chair of the Humanities, Rochester Institute of Technology. Author of the widely acclaimed *Credit Card Nation: America's Dangerous Addiction to Credit* (2000), which received the 2001 Robert Ezra Park Award for Outstanding Contribution to Sociological Practice, Dr. Manning is a specialist in the deregulation of retail banking, consumer finance, comparative economic development, immigration, and globalization.

A frequently invited expert before U.S. Congressional Committees, Dr. Manning's research has influenced public policy debate on the statutory regulation of retail banking and consumer debt in the United States and other countries. In January of 2008, Dr. Manning testified at the Senate Banking Committee's hearing on "Examining the Billing, Marketing, and Disclosure Practices of the Credit Card Industry, and Their Impact on Consumers." He has also served as an expert witness in numerous lawsuits against the credit card industry. A documentary based on his research, *In Debt We Trust: America Before the Bubble Bursts* at www.indebtwetrust.com, was released in March 2007. Dr. Manning's popular website includes research, public policy analyses, and educational programs at www.creditcardnation.com. Dr. Manning is also a member of the Filene Fellows Program.

William E. Jackson III, PhD

Dr. William E. Jackson III is a professor of finance, a professor of management, and the Smith Foundation Endowed Chair of Business Integrity in the Culverhouse College of Commerce at the University of Alabama. Before joining the University of Alabama faculty, Dr. Jackson was a financial economist and associate policy advisor in the research department at the Federal Reserve Bank of Atlanta. At the Atlanta Fed, Dr. Jackson conducted original research on financial markets and financial institutions. He was also an advisor to the bank on the making of monetary policy in the United States. Previous to his position at the Atlanta Fed, Dr. Jackson was an associate professor of finance at the Kenan-Flagler Business School of the University of North Carolina at Chapel Hill. His academic areas of expertise are financial intermediation and industrial economics.

Dr. Jackson's research focuses on the role financial markets and financial institutions play in making the modern economy more efficient and productive. Specific areas of research include corporate governance, business ethics, entrepreneurial finance, monetary policy and macroeconomics, industrial economics, financial markets and institutions, corporate finance, financial literacy, and public policy.

Dr. Jackson earned his BA in economics and applied mathematics at Centre College, his MBA in finance at Stanford University, and his PhD in economics at the University of Chicago. His research has been published in some of the leading academic journals in the areas of empirical economics, management, and financial institutions and markets. His articles have appeared in the *Review of Economics and Statistics,* the *Journal of Money, Credit and Banking,* the *Review of Industrial Organization,* the *Journal of Banking and Finance, Management Science,* the *Journal of Small Business Management,* and *Small Business Economics Journal.*

Dr. Jackson is currently an associate editor of one of the premier small-firm research journals, the *Journal of Small Business Management.* In July 2004, he provided expert testimony before the U.S. House of Representatives on the deregulation of credit unions. In 2005 and 2006, he served as founding special issue editor for the *Journal of Small Business Management.* The special issue was titled "Small Firm Finance, Governance, and Imperfect Capital Markets." Dr. Jackson is also an inaugural member of the prestigious Filene Fellows Program.

Mark C. Meyer

Mark C. Meyer is the CEO of the Filene Research Institute, a consumer finance, academic based, think tank headquartered in Madison, Wisconsin.

Mark joined the Institute in January 2003, starting an open-source revolution in credit unions. He founded the prestigious Filene i[3], a group of next generation credit union leaders focused on identifying and launching transformative financial products, services, and business models relevant to consumers.

An internationally recognized credit union expert, Mark's opinion and research have been cited in dozens of publications, including *The Wall Street Journal,* and he has contributed to *National Public Radio.* He has lectured to hundreds of audiences across North America, Asia, and Europe. He has served as an advisor to the U.S. Department of the Treasury.

Mark has authored market-leading reports on innovation, consumer behavior, and financial services needs of young adults. Mark also serves as secretary on the Board of Directors for Summit Credit Union, the largest credit union in Wisconsin.

Prior to his work at Filene, Mark served as an attorney at Montgomery, Little & McGrew in Denver, Colorado; Vice President and Legal counsel at Arizona State Credit Union; and Assistant Vice President at the CUNA Mutual Group.

Mark received his JD from the University of Nebraska College of Law and his BS in Business Administration from Northern Arizona University. He is licensed to practice law in Arizona and Colorado.

George Hofheimer

George Hofheimer is the chief research officer for the Filene Research Institute, where he oversees a large pipeline of economic, behavioral, and policy related to the consumer finance industry.

George has authored numerous papers on consumer finance topics, and is a frequent presenter at national and international trade events on executive development, technology, governance, and strategic planning topics.

George has worked closely with the faculty at Harvard Business School, the Wharton School, Cornell University, Oxford University, UC-Berkeley, London Business School, and Arizona State University to develop curricula and research for the benefit of the consumer finance industry.

Prior to joining the Institute in 2005, George was vice president/chief learning officer of the Credit Union Executives Society (CUES). Prior to his career in consumer finance, he worked for a variety of public and private enterprises in the former Soviet Republic of Uzbekistan, including the U.S. Peace Corps, Price Waterhouse, American Councils for International Education, and the U.S. Trade and Development Agency.

Currently he is the vice chair of the board of directors at Willy Street Grocery Cooperative, a $17 million natural foods store.

He earned a BBA and MBA from the University of Wisconsin-Madison.

Executive Summary

In late 2008, the Michigan Credit Union Foundation (MCUF) requested a research report addressing the impact of the current mortgage foreclosure crisis in Michigan. Specifically, MCUF requested a report that:

- Identified the major factors contributing to the rise of mortgage foreclosures.
- Investigated the economic impact of the current mortgage foreclosure crisis.
- Assessed the effectiveness of current federal and state programs to reduce the number of foreclosures.
- Formulated a series of public and private sector policy recommendations to stem the flow of future foreclosures.

A variety of research methodologies were employed to accomplish these tasks including in-person and telephonic interviews with lenders and other topical experts, extensive review of secondary data sources, and periodic discussions with MCUF staff.

Our research indicates that the extraordinary rise of residential mortgage foreclosures was the culmination of a series of unprecedented economic events that created an unsustainable period of economic expansion. The overall effect of these events has been the most serious threat to the safety and soundness of the United States financial system since the Great Depression. Policymakers, economists, and other experts concur stabilizing the housing market—by reducing the number of foreclosures that has soared to historic highs—is the key to reversing this downward economic spiral and revitalizing the American economy.

In 2008, various state, federal and private sector initiatives were instituted to mitigate the foreclosure problem. Our analysis suggests that the vast majority of these programs failed to effectively address the problem on a long-term, sustainable scale. Therefore, this special report proposes a series of recommendations which aim to balance the sometimes divergent goals of all stakeholders involved in the foreclosure debate. We present these proposals as either legislative responses or public/private sector initiatives. These proposals are elaborated upon in greater detail in the final section of the report, and represent an *a la carte* catalog of ideas to consider.

<u>Legislative Responses:</u>

- **Streamline and reform** the home foreclosure process.
- Standardize shared-equity **loan modification** programs.
- Require **lender accountability** for mortgage modifications.
- Strategic and judicious use of consumer bankruptcy to **encourage "good faith"** mortgage modifications.
- Establish a mortgage modification database to **discourage exploitation** of the proposed loan modification system by unscrupulous consumers.

<u>Public/Private Sector Responses:</u>

- Encourage formation of **local and state working groups** for homeownership assistance and advice.
- Establish responsible debt relief programs that allow financial institutions to assess the future debt capacity of highly indebted households **and formulate realistic work-out plans for secured and unsecured loans.**
- Convene **local debt summits** to assess local housing trends and identify appropriate resources for homeowner assistance.

- Create a **consumer hotline to assist homeowners** in locating investors that control the financial terms of their mortgages.

With increasing corporate bankruptcies and accompanying job losses, the residential foreclosure crisis is a top priority of financially distressed households, community leaders, public policymakers, and business executives. As we finalize this report, a flurry of legislative proposals and private sector initiatives are being debated over how to ease the foreclosure crisis, help families keep their homes, and stabilize the banking sector. We hope this report will contribute to the urgent debate and ultimately help alleviate the serious and complex housing situation in Michigan and the United States.

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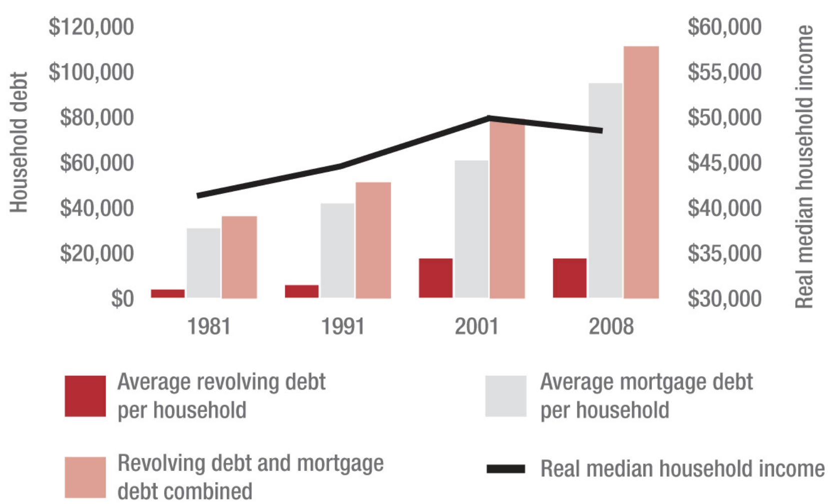
CHAPTER ONE:
Assessing the Current State

For the previous eight years, the United States' economy has experienced one of the most dramatic boom-bust cycles in history, fueled largely by the housing market. The state of Michigan has been especially hard hit with job losses, declining property values, and mortgage foreclosures.

The Economy on Steroids: How We Got Here

Unlike the past three business cycle recessions (1981–1982, 1990–1991, 2001), the ongoing 2008 consumer-led recession is distinguished by unprecedented levels of household debt, declining family income, and sharply reduced household wealth. Indeed, in the aftermath of these previous recessions, real household income increased significantly (18.5%)—from $41,724 in 1981 to $49,455 in 2001—whereas, it has actually declined slightly (-1.1%) to $48,931 in 2008. Similarly, housing prices increased during the last two recessions (5.6% in 1990–1991 and 6.3% in 2001) whereas, they have fallen at least 12% in 2008.

Figure 1: Average Household Debt vs. Median Household Income in Current and Past Recessions (in 2008 Dollars)



Overall, United States economic recoveries during this twenty-year period were largely financed by employment growth, increased real income, and a sharp rise in household debt. Significantly, revolving (credit card) debt jumped much more rapidly than home mortgage debt during the 1980s and 1990s. For example, after adjusting for inflation, average revolving household consumer debt jumped from $3,500 in 1981 to $6,700 in 1991 and then to $16,100 in 2001 while average mortgage debt jumped from $29,200 in 1981 to $42,500 in 1991 and then to $60,600 in 2001. With soaring housing prices, weakening loan underwriting standards, and easy home equity extraction, the United States housing bubble period (2001–2006) witnessed the dramatic growth of mortgage debt and plummeting home asset values. For example, in real 2008 dollars, average household mortgage debt soared from $60,600 in 2001 to $94,500 in 2008 while revolving debt increased marginally, from $16,100 to $16,300, respectively. Between 2001 and 2006, over $350 billion (B) in credit card debt is estimated to have been paid off through mortgage refinances and home equity loans.

Figure 2: Consumer-Led vs. Business Cycle Recession (Non-Percentage Debt Figures are in 2008 dollars)

Economic variable	July 1981 - Oct. 1982	July 1990 - Jan. 1991	April - Oct. 2001	Dec. 2007 - Dec 2008
Average quarterly real GDP percent change (annualized)	-2.10%	-2.53%	0.08%	0.75%
Overall S&P 500 change	-8.02%	-3.43%	-16.69%	-35.99%
Yearly change in housing starts	-2.03%	-14.99%	2.17%	-46.99%
Real median household income change (annual)	-0.96%	-2.87%	-2.18%	-2.59%
Foreclosure rates	n.a.	0.94%	1.46%	2.97%
Vacancy rates	1.50%	1.70%	1.65%	2.83%
Median existing house price change (annual)	n.a.	5.55%	6.31%	-9.00%
Avg. quarterly increase in unemployment filings	623,800	655,500	500,500	851,000
Avg. quarterly change in bankruptcy filings	n.a.	3.20%	-0.53%	8.92%
Avg. quarterly change in consumer debt (not including mortgage debt)	1.09%	0.20%	1.49%	0.47%
Avg. quarterly change in revolving debt	2.08%	1.96%	0.05%	0.87%
Estimated avg. revolving debt household balance (nominal figures)	$1,500	$4,100	$13,100	$15,700
Estimated mortgage debt per household (nominal figures)	$12,500	$27,250	$50,500	$94,500
Credit card charge off rates	n.a.	3.68%	5.25%	5.45%
Credit card delinquency rates (past due 30 days)	n.a.	5.24%	4.92%	4.85%

Like an athlete on steroids, the United States economy experienced a precariously fragile yet incredibly robust economic expansion over 2001–2006 that was based on unsustainable access to credit. Indeed, as the household consumer savings rate dropped from over 8% in the mid-1980s to near zero at the end of the 1990s, residential housing values soared to extraordinary heights; average housing prices slowly rose from about $48,000 in 1950 to $99,000 in 1990 and then soared to about $150,000 in 2000 before peaking at about $228,000 in 2005. As Fannie Mae and Freddie Mac diluted their underwriting standards and expanded their market share through the widespread packaging and resale of loans through securitized asset-backed securities (peaking at over $5 trillion (T) of the $10T residential mortgage market in 2008), homeownership rates reached a historic high of almost 69%. In the process, the sizzling United States housing market created an enormous increase in "paper" asset wealth for middle-class Americans that fueled the dramatic growth of unsecured lines of credit that underlies the perilous credit card "bubble." Not incidentally, the massive increase in United States consumer debt—from almost $8T in 2001 to over $14T in 2008—was increasingly financed by foreign investors; the United States share of global savings peaked at nearly 65% in 2005, and has already fallen below 50% in 2008 as countries with balance-of-trade surpluses are redirecting their liquidity to national economic stimulus projects.

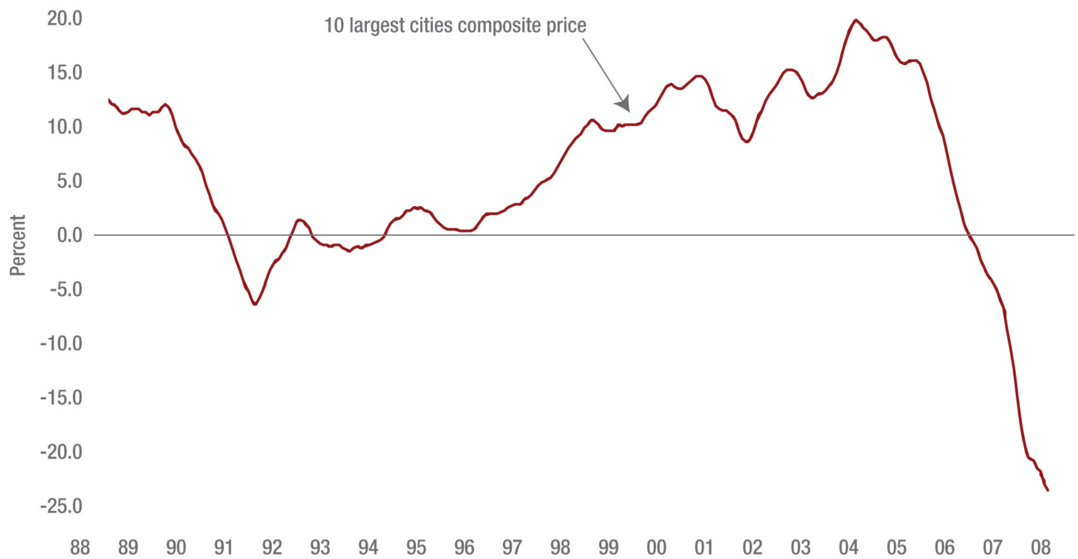
Furthermore, both consumer mortgage and credit card loans increasingly featured adjustable rate terms in the 2000s that have stretched household debt capacity to its limits, as monthly minimum payments continue to rise, whereas, the value of household assets continues to decline. Today, with the virtual disappearance of home equity loans and the sharp cut-back in bank card lines of credit, the collapse of the "double financial bubble" has left the majority of American households maxed out on their credit, with debt levels that they can not possibly repay in-full given the current trends of declining household income and wealth. Additionally, the rising debt service of American households has dramatically reduced consumer discretionary spending. This has rippled throughout the United States and global economies in 2008 and 2009. In the process, it has triggered the sharp reductions in macro-economic growth and rising unemployment rates that are the primary forces shaping the ongoing consumer-led recession in the United States. As a result, with over 2.3 million (M) foreclosures in 2008, millions of Americans are confronting the stark reality that they may lose their homes and even their jobs in 2009.

The National Economy

These courses of events conspired such that currently the United States economy stands at a gaping precipice. Pronouncements from the media, public officials, and industry leaders hint at one of the worst crises in our nation's economic history. The National Bureau of Economic Research (NBER) recently confirmed what most consumers and businesses knew: the United States has officially been in recession since December 2007. This pronouncement, though, masks a much more dire situation; one that hints at a national economic crisis on the order of magnitude of the Great Depression. To wit:

- 2.6M jobs were lost in 2008.
- Broad stock indices fell 38% for the year, erasing over $4T in equity.
- 30 states are currently facing fiscal year 2009 budget shortfalls totaling approximately $30B, and 25 states are reporting FY 2010 shortfalls of approximately $60B.
- The Conference Board's Consumer Confidence Index™ dropped below 40%, its lowest level in recorded history.
- In December, the Case-Shiller Home Price Index showed its largest one-year price drop in history, and has declined over the past 27 months.
- In California, one of the states with the greatest run-up in real estate prices, the median sale price of residential property plummeted by 38% in 2008.
- Latest foreclosure data indicates 2.25M properties were in foreclosure, up from an average annual figure of 1M.

Figure 3: S&P/Case-Shiller Home Price Indices, Annual Home Price Changes over the Past 20 Years



Source: Standard and Poors

The Michigan Economy

If the national economy is standing at the precipice of a financial crisis, then the Michigan economy has already taken a step off the cliff. The state of Michigan is experiencing economic distress more intensely and at a quicker pace than the rest of the country. According to Manisha Singh, State of Michigan Research Economist, "Michigan has been in recession the past seven years." Some other unsettling figures include:

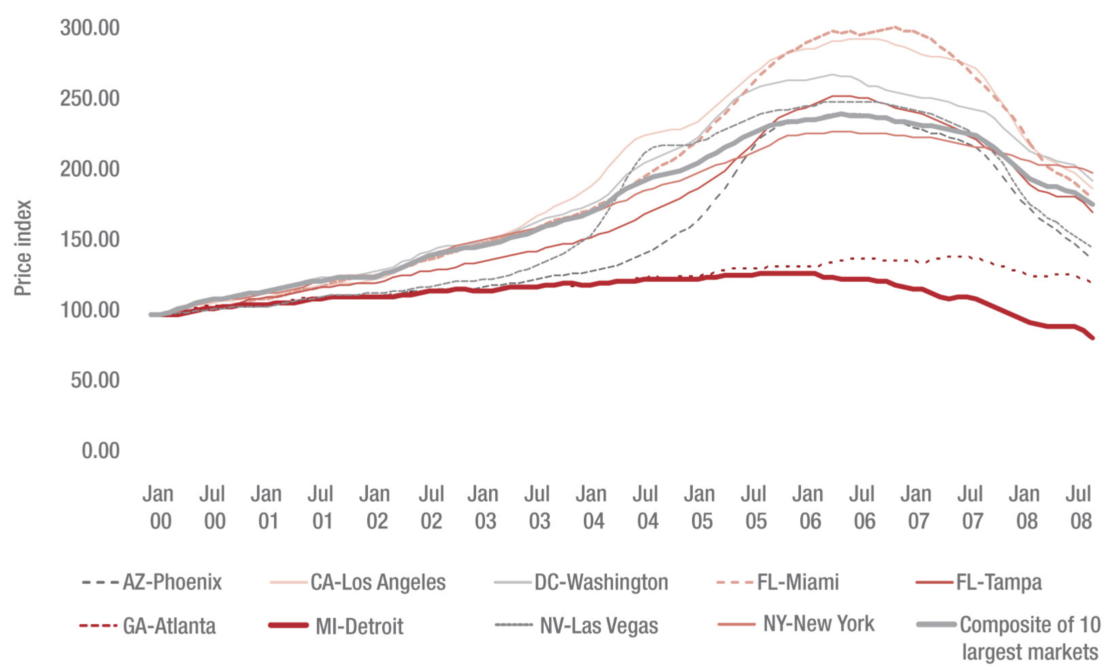
- Unemployment in Michigan now stands at 9.6% (the highest in the United States) with some smaller communities in Southeast Michigan experiencing 23% unemployment.
- According to Fannie Mae economists, Michigan has the lowest employment growth in the United States.
- The embattled automotive industry, a major contributor to the Michigan economy, is facing the prospects of bankruptcy and the direct and indirect loss of hundreds of thousands of jobs.
- Fannie Mae economists report while Michigan has the nation's 2nd highest homeownership rate and the 4th most affordable housing market, it ranks as the state with 7th highest mortgage delinquencies in the United States.
- RealtyTrac indicates Michigan has the 6th highest mortgage foreclosure rate of all United States with 2.35% of all housing units in some stage of foreclosure.

Figure 4: Highest Unemployment Levels (Current) vs. Historical Unemployment Highs, by State (Seasonally Adjusted)

Nov. 2008		Historical high	
State	Unemployment rate (%)	Date	Unemployment rate (%)
Michigan	9.6	Nov. 1982	16.9
Rhode Island	9.3	Nov. 1982	9.7
California	8.4	Feb. 1983	11.0
South Carolina	8.4	Jan. 1983	11.4
Oregon	8.1	Nov. 1982	12.1
District of Columbia	8.0	Mar. 1983	11.4
Nevada	8.0	Dec. 1982	10.7
North Carolina	7.9	Feb. 1983	10.2
Georgia	7.5	Jan. 1983	8.3
Alaska	7.3	July 1986	11.5

Source: Bureau of Labor Statistics

Figure 5: S&P/Case-Shiller, House Price Index, Selected Areas, (Indexed, 2000=100)

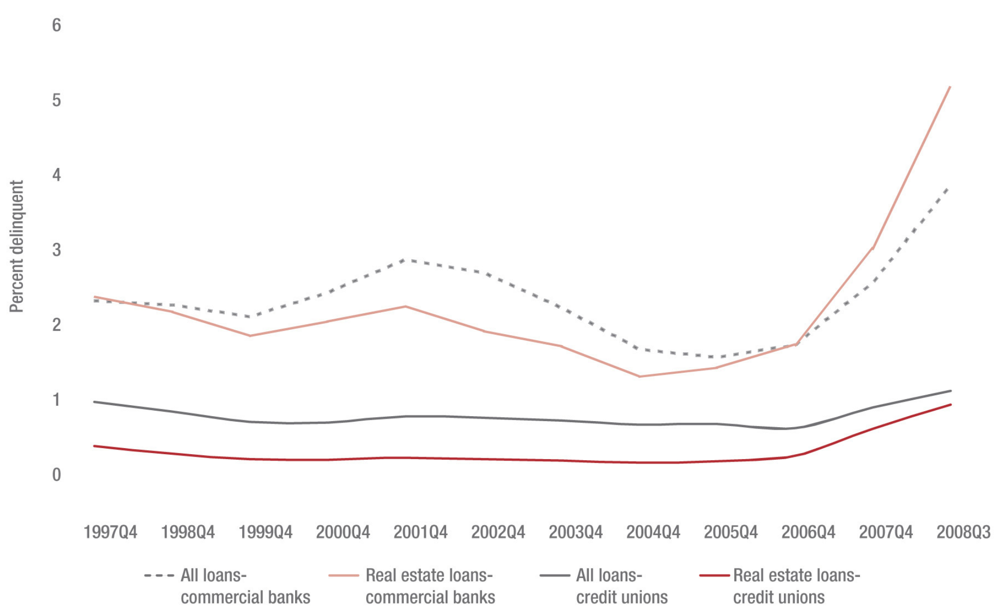


Source: Standard and Poors

Foreboding Times

In isolation, these dismal indicators point to challenging economic times; collectively, they point to a foreboding economic crisis that could be worse than the 1981–1982 recession and even approach the economic dimensions of the Great Depression in the early 1930's. The downstream effects of these trends have already led to a series of negative consequences which will likely deepen the current economic situation for the foreseeable future. For instance, consumer spending, which represents as much as 70% of gross domestic product (GDP), is unlikely to return to the heady spending days of the early 2000's. This consumer retrenchment will likely contribute to higher unemployment levels and a general contraction in the previous growth sectors of the United States economy. Additionally, most lenders are reluctant to part with their capital due to increasing consumer and commercial delinquencies (see Figure 6) and other external factors.[1] This credit tightening has obvious implications for consumers as they struggle to meet daily living needs and long-term obligations, such as mortgages and auto loans. Commercial entities are also impacted by a lack of credit in much the same ways as consumers, especially small businesses and young entrepreneurs.

Figure 6: Commercial Bank vs. Credit Union Loan 60 Day Delinquency Rates (1997–Present)



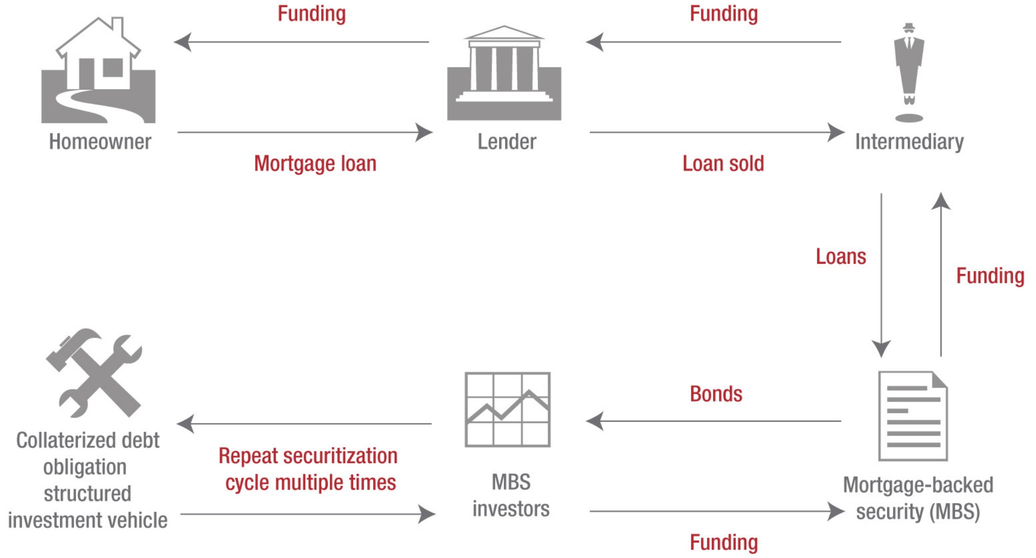
Source: CUNA and FDIC

[1] Credit unions seem to be the exception to this trend due to their long-running risk adverse management practices, high levels of capital, and lower delinquencies than commercial banks. Evidence of this difference is the recent nationwide "Invest in America" initiative, which provides $80B of liquidity to finance the purchase and lease of GM and Chrysler vehicles.

The Housing Market

The catalyst which caused the chain reaction of the current economic crisis was the overheating and subsequent collapse of the housing market. Aside from the direct effects on the household construction and retailing banking sectors, the booming housing economy has tentacles in consumer spending, financial markets, business, and government revenues. Figure 7 is a simplistic illustration of these tentacles, and also demonstrates how certain assumptions (e.g. housing prices will continue to increase) can have disastrous impacts on a wide range of players. Once the chain in this process breaks (e.g. a homeowner does not pay his or her loan), the ripple effects are felt throughout the world. Or as Ben Bernanke, chairman of the Federal Reserve Bank, recently stated, "The housing market remains central to the economic and financial challenges that we face." Before we address potential remedies to the housing market collapse, it is important to explore the important impact of foreclosures in this discussion.

Figure 7: A Simplistic View of the Mortgage Funding Process



Source: Adapted from Roberto G. Quercia, Director of Center for Community Capital at the University of North Carolina at Chapel Hill

Foreclosures

More than 2.3M homeowners faced foreclosure hearings in 2008, an 81% jump from 2007. Furthermore, foreclosure activity is at its highest point in 30 years according to the Mortgage Bankers Association. Traditionally, foreclosures are precipitated by unexpected life events (death of spouse, job loss, illness, etc.) that are associated with a sharp decline in household income. Today, however, the recent wave of foreclosures is largely driven by major fluctuations in the housing market, lack of equity in the home, a bleak employment outlook, and the extension of unscrupulous mortgage loans by so-called subprime lenders. In addition to the loss of household assets and decline in neighborhood housing values, foreclosures have tremendous human and economic impacts on individual families, as well as their larger communities.

In 2008, approximately 2,700 families lost their homes **every day** through foreclosure proceedings. The psychological impact and future economic squeeze of this stressful experience on families is tremendous. Additionally, recent studies indicate that for each foreclosure, the value of properties in a one-mile radius declines by a percentage point. For the state of Michigan, recent estimates put that lost value at $2.3B resulting in a potential loss of $30M in tax revenues. Other insidious effects of the foreclosure crisis include higher crime rates, abandoned property, fewer public services, declining schools, and generalized neighborhood blight.

"The big jump in December [2008] foreclosure activity was somewhat surprising given the moratoria enacted by both Freddie Mac and Fannie Mae, along with programs from some of the major lenders and loan servicers aimed at delaying foreclosure actions against distressed homeowners. Clearly the foreclosure prevention programs implemented to-date have not had any real success in slowing down this foreclosure tsunami."

- James Saccacio, chief executive officer, RealtyTrac

The impacts on the economic side are just as personal and painful. For financial institutions, a foreclosed property typically only returns 50–60% of the value of the original mortgage amount. These losses reduce available capital for future consumer and commercial lending opportunities. Additionally, the large number of homes in foreclosure creates an excess housing supply in an already soft housing market that further depresses housing prices in many communities.

Everyone involved in the housing debate (consumer advocates, lenders, and policy makers) agrees that it is essential to prevent future foreclosures and minimize the number of current foreclosures. In support of this sentiment, a number of state, federal and private initiatives have been instituted to combat the foreclosure situation. As you will note, however, few interventions made during 2008 were particularly effective in dealing with this national crisis. Figure 8 is a description of the most prominent housing initiatives and an analysis of the effectiveness of each program.

Figure 8: An Overview and Analysis of Foreclosure Prevention Policies and Proposals

Proposal/Plan	Description	Notes
Hope for Homeowners	Lenders agree to take a loss on the loan, and the government pays off the existing mortgage and refinances into FHA loan.	Part of the July housing stimulus bill. Effective from Oct. 1, 2008 - Sept. 30, 2011. The government estimated that 400,000 would be helped; 357 people have signed up so far.
FHA Secure	Bush administration program was designed to allow homeowners with good credit who had fallen behind on payments to refinance into FHA loans when their loans reset to higher rates.	While officials estimated that it could help some 80,000 delinquent borrowers avoid foreclosure, HUD terminated the program effective Dec. 31, 2008. As of Dec. 18, 2008, some 4,100 delinquent borrowers had used the program since Sept. 2007.
FDIC modification plans	The government would share in losses resulting from re-defaults on modified mortgages and pay $1,000 to loan servicers for each completed modification.	Adapted from the model used to modify delinquent IndyMac loans. Federal Reserve Chairman Ben Bernanke proposed this plan in a recent speech. Spearheaded by FDIC Chair Sheila Bair.
Private sector modification plans	JPMorgan Chase, CitiMortgage, and Bank of America have each announced voluntary loan modification initiatives. Other banks have also been doing modifications.	The 14 largest national banks and thrifts modified nearly 73,000 loans in the first quarter and an additional 114,000 in the second quarter.
NCUA's CU HARP	Under CU HARP, credit unions borrow from the Central Liquidity Fund (CLF) and invest the funds in corporate credit union debt guaranteed by the National Credit Union Share Insurance Fund (NCUSIF). The objective of the CU HARP program is to provide struggling homeowners with a break on their mortgage interest rate.	As of January 2, 2009, the CLF funded $164M in advances under the CU HARP.
Save the Dream: Michigan State Housing Development Authority (MSHDA)	Much like the Hope for Homeowners national program above but focused on delinquent homeowners in Michigan.	Interviews with credit union executives and MSHDA staff indicated the program was more a "public awareness campaign" than a large-scale foreclosure remediation program.
Proactive forbearances by credit unions	Credit unions interviewed for this research project identified actions taken with individual borrowers to prevent foreclosure without public assistance.	Not scaleable. Success rate is uncertain based on the small number of interviews we conducted.
Various state initiatives	States across the United States are implementing a variety of foreclosure prevention policies; some examples include: North Carolina House Bill 2623 and California State Bill 1137.	Too early to determine effectiveness of programs, but foreclosure delay programs seem to be ineffective while coordinated state-level work with mortgage services is more effective.
Helping Families Save Their Homes in Bankruptcy Act of 2009*	Bill proposes giving bankruptcy judges the power to reduce the interest rates and principal amounts of home loans—known as a "cram down" provision.	Introduced earlier this year by Rep. John Conyers Jr., supporters include the National Association of Home Builders and Citigroup. Still, many lenders oppose this bill.
Government shares modification costs*	Government shares the cost when the borrower's monthly payment is reduced.	Also proposed by Bernanke, this plan would require the government to incur costs in all modifications not just in re-defaults.
Government purchases delinquent mortgages*	Government buys delinquent mortgages in bulk and refinances them into FHA mortgages.	Another Bernanke proposal. It could take more time to implement but has potential to reach more borrowers than the other programs.

Source: December 31, 2008 Wall Street Journal and authors' interviews
** = Proposals not yet implemented.*

Summary

This chapter provides a high-level review of the macro-economic forces, lender policies, and consumer debt trends that have contributed to the current economic crisis. An economy on financial steroids, propelled by liberal monetary policies and easy access to credit, fueled a run up in housing prices and spawned a consumer-driven economic expansion. When the housing bubble eventually burst, the economy in Michigan (and elsewhere) faced soaring job losses, a credit crisis, and a record number of foreclosures. The result is one of the most severe economic crises the United States has ever experienced. One of the keys to solving this economic crisis is a proactive and effective strategy for decreasing the number of home foreclosures. Despite efforts by the public and private sector in 2008 to develop such proposals, residential foreclosures remain at record levels and continue to rise. In the next chapter, we quantify and segment the Michigan mortgage market.

CHAPTER TWO: Sizing Up the Residential Mortgage Market in Michigan

The residential mortgage market in Michigan can be categorized into four distinct segments based on who owns the mortgage and the credit worthiness of the borrower. By segmenting and classifying the dimensions of the Michigan market, we can present a more nuanced perspective of the foreclosure problem in Michigan and develop appropriate interventions and potential remedies.

The Michigan Mortgage Market

In May, 2008 before the Michigan State House Banking Committee, Freddie Mac Deputy Chief Economist Amy Crews-Cutts estimated the total number of residential mortgages in Michigan at 1,656,834. June Call Report data compiled by the FDIC and NCUA shows that Michigan's 161 federally insured banks/thrifts held approximately $27.9B in first lien mortgage loans, while credit unions held approximately $9.5B for a total of $37.4B. Assuming an average mortgage balance of $120,000, approximately 311,622 first mortgage loans are held in portfolio by Michigan's banks and credit unions. This constitutes approximately 19% of all Michigan's first mortgage loans. We also estimate banks chartered outside of Michigan account for approximately 10% of the total or roughly 165,000 mortgages, based on national data that indicates banks, savings banks, and credit unions account for approximately one-third of all residential mortgages.

Figure 9: Estimated First Mortgages in Michigan (June 2008)

	% of Total	Amount (,000)	Total # of loans
Commercial bank/ thrift	14.0%	$27,869,681	232,247
Credit unions	4.8%	$9,525,002	79,375
Out of state banks	10.0%	$19,882,008	165,683
Total portfolio loans	**28.8%**	**$57,276,691**	**477,306**
Estimated pooled loans	**71.2%**	**$141,543,389**	**1,179,528**
Total residential loans	**100%**	**$198,820,080**	**1,656,834**

According to the Federal Reserve Board of Governors, the vast majority of the remaining first mortgage loans are held by investors in securitized investment pools. Furthermore, the Office of Federal Housing Enterprise Oversight (OFHEO) provides approximations for the percentage of pooled loans serviced by government sponsored entities (GSEs), like Freddie Mac and Fannie Mae, and those serviced by commercial entities.

Figure 10: Estimated Characteristics of Pooled Mortgages in Michigan (June 2008)

	% of Total	Amount (,000)	Total # of loans
Government sponsored entities	41.1%	$58,174,333	484,786
Commercial servicers	58.9%	$83,369,056	694,742
Estimated pooled loans	**100.0%**	**$141,543,389**	**1,179,528**

Additionally, we provide estimates in the table below on the breakdown of prime and subprime loans, using assumptions from Freddie Mac, the Federal Reserve, and other academic sources listed in the appendices. Subprime in this context refers to the characteristics of the borrower and not necessarily the characteristics of the loan provided.

Figure 11: Estimated Number of Prime vs. Subprime Mortgages in Michigan (June 2008)

	# Subprime loans	# Prime loans
Commercial bank/thrift	23,225	209,023
Credit unions	7,938	71,438
Out of state banks	16,568	149,115
Subtotal held in portfolio	47,731	429,575
Government sponsored entities	48,479	436,307
Commercial servicers	69,474	625,268
Subtotal pooled	117,953	1,061,575
Total	**165,683**	**1,491,151**

Figure 12: Estimated Characteristics of Subprime Loans in Michigan (October 2008)

Characteristics	
Average interest rate	8.96%
Average balance	$120,473
Average loan age (in months)	40
Average FICO score	604
Percentage with a 2nd lein at origination	16.9%
Percentage current	48.3%
Percentage 30–59 days deliquent	11.7%
Percentage 60–89 days delinquent	6.4%
Percentage >90 days delinquent	12.3%
Percentage in foreclosure	5.8%

Source: First American CoreLogic, LoanPerformance data, U.S. Census Bureau, and Federal Reserve Bank of New York

Segmenting Policy Responses

The estimates on the previous page, and other assumptions, allow us to classify mortgages into four broad segments. Each of these segments may require different foreclosure prevention interventions because of: (a) the differing likelihood of borrower default; and (b) the owner of the loans. [2]

- ***Segment 1: Prime Mortgage Loans Held by Depository Institutions***
  This segment represents about 430,000 loans, or approximately 26% of all mortgages in Michigan. Although this group of mortgages is considered the most stable of the four segments with the highest equity values, we need to consider future external economic trends (unemployment, decrease in housing values, etc.) and the impact these factors will have on consumer behavior. Indeed, our research suggests that as many as one-third of these mortgage holders may currently be in a negative equity position. We also estimate that approximately 10,000 loans are delinquent and 2,000 more are in some stage of foreclosure.

- ***Segment 2: Subprime Mortgage Loans Held by Depository Institutions***
  This segment includes almost 50,000 loans, or approximately 3% of all mortgages in Michigan. Fannie Mae estimates that approximately 14,000 of these loans are delinquent and approximately 5,000 are currently in some stage of foreclosure. External economic factors will likely exacerbate the deterioration of this segment of home mortgages. On a positive note, these loans tend to be in the portfolio of depository institutions which increases the likelihood of a positive, consumer-lender workout should the need occur.

- ***Segment 3: Prime Mortgages Pooled with Servicers***
  This segment represents the largest category of mortgages at just over 1M loans, or approximately 64% of all mortgages in Michigan. Although these mortgagees are prime loans, external economic factors will likely erode the performance of this segment due to the generalized decline in the financial health of the borrowers. Our research estimates that approximately 55,000 delinquent loans with about 5,000 in some stage of foreclosure. Foreclosure remediation policies for this group are likely straightforward as the majority of these loans were purchased by GSEs.

- ***Segment 4: Subprime Mortgages Pooled with Servicers***
  This segment includes close to 120,000 loans, or approximately 7% of all mortgages in Michigan and is the likely the most problematic to deal with once a property goes into foreclosure. Approximately 35,000 loans are delinquent and 12,000 are in some stage of foreclosure. Foreclosure remediation policies for this segment are the most complex and worrisome because of the difficulty in identifying the ownership structure of individual mortgages and the insolvency of many investors such as hedge funds and private equity firms.

Summary

This chapter provides a rough estimation of the size and a risk assessment of the four principal residential mortgage segments in Michigan. This analysis allows us to classify these four distinct categories so that private and public entities can devise and implement appropriate interventions for stemming the flood of home foreclosures. In the next chapter, we present a series of proposals for future discussion and potential implementation.

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[2] Another important segmentation consideration may be geography. Appendix 3 lists specific Michigan communities severely impacted by foreclosures.

In-Depth: Credit Unions in Michigan

Over the last ten years, mortgage lending has become a significantly greater portion of the credit union lending portfolio. Additionally, credit unions avoided the practices of many lenders leading up to the real estate bust. As a result, credit union mortgage loans are performing above the commercial banking sector. One reason is that credit unions that sought to compete with commercial lenders and underwrote mortgages in conformance with Fannie Mae and Freddie Mac's eroding standards, sold the riskiest mortgages to GSEs or to lenders that repackaged them into "pooled" asset-backed securities, which limited their financial risk.

Figure 13: Characteristics of Michigan Credit Union First Mortgage Portfolio (September 2008)

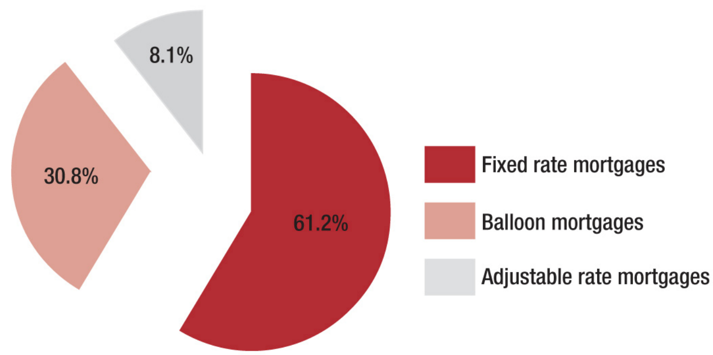


Figure 14: Real Estate Lending as a Percentage of Total Michigan Credit Union Loan Portfolio (1998-Present)

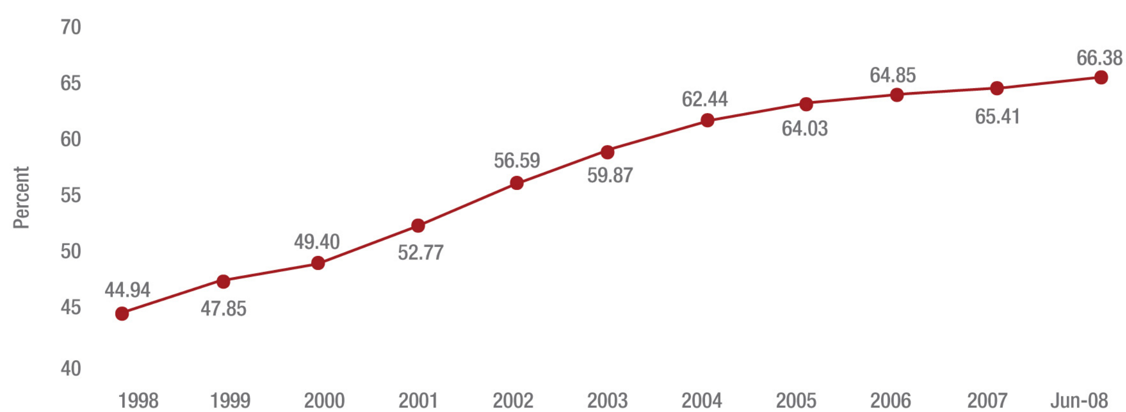
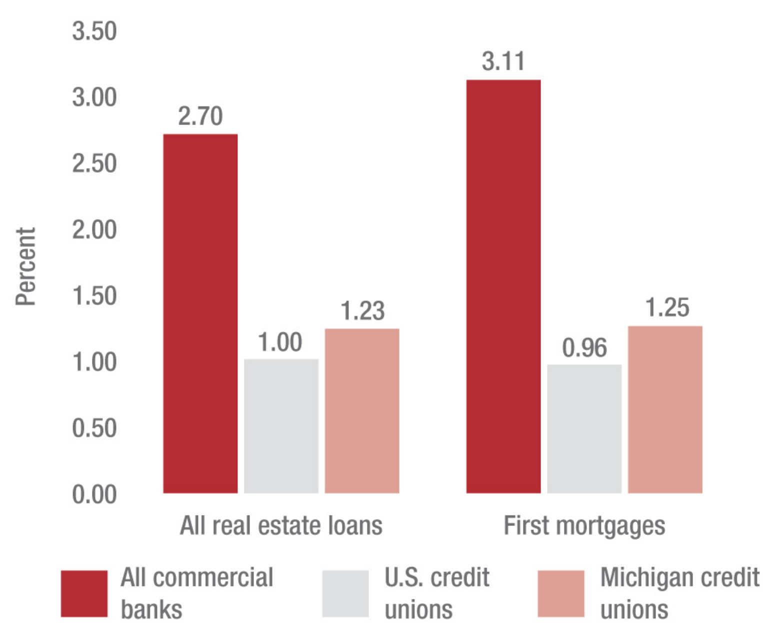


Figure 15: Delinquency Rates on all Real Estate Loans, 60-Day (Credit Union) and 90-Day (Bank) Delinquencies (September 2008)



CHAPTER THREE:
Crafting Public and Private Solutions

Although the economic and housing picture currently looks fairly bleak, a series of focused and well-thought-out proposals can contribute to a more positive situation for all stakeholders: lenders, consumers, regulators, and policy makers. These difficult times, though, call for creative and aggressive tactics.

Introduction

The previous two chapters paint a stark picture. Historic forces culminated in a historically unprecedented wave of home foreclosures and precipitous residential price declines. Currently, almost everyone involved in the purchase, sale, or finance of a house is experiencing economic pain. Lenders are facing the prospect of foreclosures, loan losses, and challenges to the viability of their institutions. National and international investors are reporting record losses and abruptly withdrawing from primary and secondary real estate markets. Consumers are experiencing a deteriorating job market, dwindling equity in their homes, and record levels of household debt. Regulators are observing the failure of once healthy financial institutions and the prospect of new and far-reaching safety and soundness tools. Finally, policymakers are hearing from all of these constituents that "the situation went terribly out of control, and something has to be done to solve the crisis immediately."

"If you're looking at a way to get to the bottom of the economic problems in our country, it is the housing foreclosure problem. We've got to address that."

Senator Christopher Dodd, Chairman, Senate Banking Committee

Therefore, these challenging economic conditions require a series of innovative public and private initiatives to ensure that the housing and associated foreclosure crisis does not further weaken the United States economy. Indeed, the Obama Administration, the 111th U.S. Congress, the Federal Reserve and state legislatures across the United States have made foreclosures one of their top priorities in 2009. Needless to say, this topic will remain extremely fluid as the marketplace tests and refines the best solutions to these problems. Our contribution to this discussion includes ten proposals that attempt to balance the needs of all the major stakeholders: lenders, households, community leaders, banking regulators, and policymakers, while recognizing that bold moves are necessary in both the short- and long-term. Finally, it is also important to recognize that these proposals are considered an *a la carte* menu of recommendations. While complimentary to each other, they do not represent a synchronized set of inter-locking policies. We do not list these recommendations in any specific order.

Proposal #1: Reform and Streamline the Home Foreclosure Process as Supervised by Federal Regulators

Summary: The hodgepodge of state foreclosure regulations would be replaced with a federally regulated, streamlined system based on judicial foreclosure. Borrowers would receive a maximum of 12 months, from mortgage default to end-of-redemption period, to make the necessary financial arrangements for retaining their home. Lenders would be required to transfer title from borrower within 60 days and assume all homeowner costs/responsibilities upon the completion of the judicial process. Monthly status reports on mortgage delinquency foreclosures would be submitted to respective federal regulatory agencies and would include sales price for future evaluation.

The home foreclosure process features a multitude of negative impacts on affected homeowners, financially strained lenders, tax starved communities, overburdened federal and local courts, and struggling investors. The lengthy time and uncertain outcome of the foreclosure process serves to exacerbate the current housing crisis by increasing the likelihood of homeowner neglect, and the often "stripping" of fixtures and appliances, home abandonment, vandalism, declining local housing prices, shrinking capital reserves for lending, greater litigation and bankruptcy filings, and rising losses to lenders/investors. Reforming the hodgepodge of state foreclosure regulations in an effort to develop a streamlined, federally-regulated system would enhance the efficiency of the process, improve data collection for evaluation and monitoring, and offer a more equitable outcome to borrowers and lenders.

In this proposed federally regulated system, judicial foreclosures are preferred so that lenders are required to file lawsuits against delinquent homeowners. Also, this proposal would eliminate the wide variation in individual state specified "redemption" periods that can currently extend the homeowners' right of uninterrupted residence after the completion of the foreclosure proceedings for an additional 9–12 months. This generates higher litigation expenses for lenders and may provide some homeowners with the legal incentive to initiate foreclosure proceedings if their residence is not sold at auction. As a result, a maximum of 12 months is proposed—from default to foreclosure—that would enable households to make the necessary financial arrangements with their lenders/investors to retain their homes.

An increasing problem, however, is the decision of national lenders and investors not to assume ownership responsibilities for the foreclosed properties in some communities. This action accelerates neighborhood blight, declining home values, shrinking tax revenues, and mounting financial costs to local governments that must maintain or demolish the homes. As a result, it is proposed that lenders/investors be required to transfer the property title from the borrower within 60 days of the foreclosure and assume all maintenance costs and responsibilities upon the completion of the judicial process. Furthermore, lenders would be required to report on a monthly basis on the status of their delinquent and foreclosed properties to their respective federal and/or state regulatory agency. This information would include the sale price of the properties after abandonment or foreclosure.

- This proposal is a federal legislative policy with requisite support from states.
- This proposal is most suitable for mortgages in segments 2 and 4, but with potential implications to all mortgagees.

Proposal #2: Implement <u>Limited</u> Discretionary Authority for Federal Bankruptcy Courts to Modify Most Problematic Mortgage Loans

Summary: Households that are unable to identify or communicate with the "holders" of their mortgages should be counseled as to the federal and state laws governing foreclosure and the utility of strategic bankruptcy filings for the purpose of retaining their homes. Financial and counseling support, such as preparing a household budget and court supervised repayment plan, in preparation of a Chapter 13 filing should be provided through local organizations.

The national campaign to encourage substantive modification of unaffordable consumer mortgage loans has been largely unsuccessful through the end of 2008. Initial efforts to promote voluntary mortgage modifications have led families, confronting imminent foreclosure, to accept modifications that do not significantly improve the financial terms of their loans. Further complicating the voluntary modification of mortgages is the difficulty in identifying institutions that "hold" the loans or the complex arrangements by which mortgages have been assigned to different investment *tranches*. In many cases, these securities limit or preclude loan modifications and, thus, may force homeowners into foreclosure proceedings. Consequently, homeowners are finding that their only option for suspending foreclosure and eviction is to file for consumer bankruptcy protection. This action enables consumers to "stay" the foreclosure proceedings while the federal bankruptcy court assesses the feasibility of the households' budget and repayment plans.

The mortgage lending and investing communities are clearly concerned over the implications of the proposed 2009 mortgage "cram down" legislation, and have special concern about the impact of the discretionary authority of U.S. Bankruptcy Judges to unilaterally impose a more equitable and realistic mortgage modification during the bankruptcy filing process. In most cases, the court is loathe to intervene unless the lenders/investors are unwilling to negotiate in good faith and work with the borrower to retain their homes. Additionally, the court may be the only option for families to identify the holder of their mortgage and to commence negotiation of a loan modification before the foreclosure process is completed. Lastly, the objective of the court is to balance the economic interests of creditors with the financial ability of the consumer to satisfy their financial obligations.

Therefore, this proposal would limit the authority of bankruptcy judges to amend certain mortgage loan agreements secured by a principle residence; loans with negative amortization; or loans that the court reasonably determines to be fraudulent, or abusive, or made with no reasonable underwriting standards and expectation a borrower could repay the loan. **Ultimately, the goal of the proposed new law is to accelerate the voluntary negotiation of mortgage modifications, before the bankruptcy petition is presented to the bankruptcy court.** This proposal could hasten the pace of mortgage re-negotiations and eventually lead to fewer Chapter 13 bankruptcy filings to avert home foreclosures. In the process, it could improve local housing markets by reducing foreclosures, the glut of houses for sale, and essentially raise the "floor" of regional housing prices.

- This proposal is a federal legislative policy with requisite support from states.
- This proposal is most suitable for mortgages in segments 2 and 4, but with potential implications to all mortgagees.

Proposal #3: Use Chapter 7 Bankruptcy as a Strategy to Retain Principal Residences

Summary: Households that have high levels of unsecured debt and are unable to obtain a mortgage modification should be counseled about the ramifications of a Chapter 7 filing as a strategy to "stay" (suspend) foreclosure proceedings and retain possession of their homes. The discharge of unsecured debt payments could enable filers to make higher mortgage payments.

As recently as 1980, homeowner equity in principal residences averaged 70%. Today, early 2009, it has plummeted to an historic low of nearly 43% and continues to shrink as regional housing markets continue to decline. This is primarily due to the weak underwriting standards of the 2001–2006 housing bubble period, when many new home purchases featured small (if any) down payments, interest- and option-only monthly payments, easy equity extraction (home equity loans, lines of credit, cash-out refinancing), and consolidation of other consumer loans into home mortgages. Together with federal and state homestead exemptions provided to Chapter 7 filers and at least a 10% property transaction cost for sale of household residence (higher in less active housing markets), at least two out of five homes would not be required by Federal Bankruptcy trustees to be sold due to the negative asset value generated by a forced liquidation. This is a striking phenomenon since the primary reason for filing a Chapter 13 bankruptcy traditionally is to prevent the foreclosure of the filer's principal residence.

As a result, rising numbers of the most financially stricken households that are unable to obtain a significant reduction in the interest rate and principal balance on their mortgages, will be eligible to file a Chapter 7 bankruptcy that will discharge their unsecured credit card, medical, home equity, and other unsecured debts. This option is particularly relevant to homeowners with exotic mortgage loans. After the bankruptcy, these households will be able to use the "free" cash flow from these discharged debts to service their mortgage payments. With a lower debt-to-income ratio and the inability to file for consumer bankruptcy over the next ten years, they may be able to refinance their home mortgage at a lower monthly payment in the near future. **Ultimately, the goal of this proposal is to accelerate the voluntary negotiation of mortgage modifications, before the bankruptcy petition is presented to the bankruptcy court.**

- This proposal is a public and private sector initiative which leverages existing laws and regulations.
- This proposal is most suitable for mortgages in segments 2 and 4, but with potential implications to all mortgagees.

Proposal #4: Utilize and Standardize Shared-Equity Agreements as an Incentive to Encourage Loan Modifications.

Summary: Development of "shared-equity" forbearance agreements between loan holders and mortgagees that would limit the financial losses arising from voluntary mortgage modifications. Lenders would share in the capital gains arising from the future sale of the principal residence up to a limit of the debt forbearance. Special attention should be paid to establishing proper incentives for lenders to participate in these loan modification programs, and standardizing such programs across all lending and servicing institutions.

We recommend a system that provides appropriate incentives for lenders to participate in loan modification programs. One strategy for encouraging lenders to offer loan modifications is a market incentive that shares the risk and financial gain arising from a rapidly established and stabilized housing "price floor." Lenders, including federal agencies, will more likely offer and subsidize interest and principal rate reductions if they can share in any price appreciation of the refinanced properties when they are sold in the future. This could assume the form of a separate debt forbearance contract, rather than a debt concession, that could be formalized through a property lien filed by the lender (including government agencies). This action would require that an agreed upon portion of the net capital gains accruing from the future sale of the residence be distributed to the lien holder up to a maximum of the agreed upon mortgage debt forbearance. For example, if a $300,000 mortgage principal was reduced to $240,000 in 2009 and the home was sold for $280,000 (after transaction expenses) in 2019, then the homeowner would be liable to distribute a portion of the net capital gains (e.g., 25% up to a maximum of $60,000) or in this case a total of $10,000. A similar agreement could be based on modifying the mortgage loan through a below market interest rate or combination of principal reduction and reduced finance rate. Lenders would need to examine the tax and accounting implications of this voluntary policy.

The overriding principal here is that, if lenders are not offered the proper incentives, voluntary loan modification programs will be very unlikely to succeed. Additionally, lenders are much more likely to participate in loan modification programs that are standardized (nationally) across lenders. This standardization might also help to reduce the transaction costs associated with establishing a "healthy" market in these modified mortgages, or their components, at a later date.

- This proposal is a voluntary private sector initiative with public sector policy support.
- This proposal is most suitable for mortgages in segments 2, 3 and 4, but with potential implications to all mortgagees.

Proposal #5: Establish Lender Accountability for Consumer Requests for Mortgage Modifications

Summary: Lenders that receive TARP funds and other public subsidies should be required to regularly report on the performance of their mortgage portfolios and their success in working with borrowers to retain their homes and secure equitable loan modifications.

Financial institutions that receive TARP funds and other federal subsidies should be required to submit monthly reports on the delinquent loans in their mortgage portfolios to their respective federal regulatory agency: OCC, FDIC, NCUA, and the OTS. This would include delinquencies, home abandonment, completed loan modifications (specifying interest and/or principal reductions), time required to complete loan modifications, number of requested mortgage modifications, reasons for loan modification rejections, rejected loan modifications, and home foreclosures (completed and in process). These reports would distinguish between subprime and prime/Alt A mortgages and the portfolio status of the loans (pooled asset-backed security, CDO, held in traditional real estate portfolio). Also, lenders would be required to submit a "paper trail" for the mortgages that they originated, repackaged and sold to investors, and continue to be paid as servicer of the mortgages. These requirements would be independent of the institutions' lending and reporting obligations under the Community Reinvestment Act (CRA).

In an effort to discourage frustrated homeowners from filing for bankruptcy protection, mediators should be assigned and compensated by lenders to review rejected applications for loan modifications. Institutional benchmarks would be established for these key mortgage performance categories and lenders should be held accountable for their performance through restrictions on future disbursement of federal loans and other public subsidies. Federal regulators should solicit evaluations from borrowers as well as community associations to determine institutional responsiveness to applications for mortgage modifications and recommendations for improving the process.

Mediators should be assigned and paid by these lenders to review loan modifications that are rejected by banks. Benchmarks that are not achieved by these banks could result in delays in future disbursement of federal loans and other public subsidies.

- This proposal is a federal legislative policy with requisite support from states.
- This proposal is most suitable for mortgages in segments 2, 3 and 4, but with potential implications to all mortgagees.

Proposal #6: Establish a Database of Mortgage Borrowers that Received Loan Concessions

Summary: Establish a database that would monitor mortgage borrowers. Consumers should not be granted more than one tax free mortgage write-off (e.g., "short-sale') in a three-year period and should not be allowed more than two mortgage write-offs in a seven-year period unless they enter into a "shared equity" agreement with the lender/investor.

We propose the establishment and management of a database of home owners that have been granted mortgage write-offs (forgiven debt) and have been relieved of IRS tax liabilities (2007 Mortgage Debt Relief Act). This information would be available for 7 years (comparable to a Chapter 13 Bankruptcy filing). The objective is to encourage responsible borrowing by limiting the ability of consumers to "game" the mortgage lending process by providing this information for use in future mortgage underwriting decisions. Households would be limited to two mortgage loan concessions on principal residences in a seven-year period and a cumulative total of two IRS tax relief decisions on forgiven mortgage debt. The latter would include first and second mortgages and home equity loans. This information could be used to assess the risk of the borrower and potentially result in additional fees, higher interest rates, and/or greater down payment. Lenders would require all borrowers that receive a debt concession be compelled to take a workshop(s) on a range of financial education topics before finalizing the debt concession.

- This proposal is a state and federal legislative policy.
- This proposal is most suitable for mortgages in segments 2, 3 and 4, but with potential implications to all mortgagees.

Proposal #7: Establish a Federal Hotline for Locating Investors of Asset-Backed Securities and CDOs

Summary: Establish emergency hotlines to assist homeowners in locating investors that control the financial terms of their mortgages. Investors that are unwilling to engage in "good faith" negotiations would have foreclosure proceedings suspended and be required to participate in mediation programs.

Most homeowners do not know the specific company that has purchased their mortgage following the origination of their loan. In fact, most are not aware that the servicer of their mortgage is rarely the current title holder of their property. For those households whose mortgages have not been resold or are held in a property portfolio of a credit union, commercial bank, or insurance company, there is little difficulty in identifying and contacting the title holder in order to negotiate a mortgage modification. Unfortunately, most commercially underwritten mortgages have been resold into "pools" of asset-backed securities and complex CDOs that have been purchased by institutional investors, hedge funds, and private equity firms in the United States and throughout the world. In these situations, households may be unable to locate the appropriate investment managers for requesting a loan modification. Or, the investors do not have any interest in changing the terms of individual mortgages in large mortgage portfolios. Also, some servicers receive more fees when a mortgage is being foreclosed than if it is being modified, which limits their financial incentive to assist clients that desperately need to renegotiate their mortgages.

The federal government needs to establish an informational hotline for homeowners who have not been able to identify or effectively communicate with investors that control the terms of their mortgages. Assistance would be provided to home owners for locating the "owners" of their mortgages and initiating loan modification negotiations. Investors and portfolio managers that refuse to negotiate "fair market" mortgage modifications would have their foreclosure proceedings suspended until a mediation hearing could be convened. This would limit the incentive to file personal bankruptcy in order to "stay" home foreclosures and initiate "good faith" loan negotiations.

- This proposal is a public and private sector initiative.
- This proposal is most suitable for mortgages in segments 2, 3 and 4, but with potential implications to all mortgagees.

Proposal #8: Create State and Local "Working Groups" for Home Ownership Assistance

Summary: Immediately organize and pilot "working groups" to serve as a model for local communities and metropolitan areas. The state-wide network of groups would be organized by region and information would flow "up" and "down" on a regular basis to assess progress, identify particularly successful initiatives or strategies, and report on trends such as promising loan modification programs. This network of grassroots-based "working groups" could serve as an informational source for rapidly compiling information for regular state-wide "status reports" on the housing crisis.

We recommend the formation of regional and state-wide "working groups" to serve as information gathering conduits for up-to-date information for homeownership preservation initiatives. These housing advocate "swat teams" would create an informational hotline and clearinghouse at the local level and serve as action groups for explaining available resources (federal, state, local, nonprofit, corporate) to different affected groups, such as first-time homeowners, low-income households, single parents, unemployed, military personnel, subprime loan holders, adjustable rate mortgages, etc. Ideally, local stakeholders would loan staff time to the working group (e.g. credit unions, banks, nonprofits, community groups, faith-based organizations, government agencies), actively engage local communities, and organize mortgage foreclosure abatement programs and awareness raising activities. Please refer to Appendix 3 for a list of Michigan communities most suitable for this recommendation.

These working groups would serve as an organizational intermediary to federal and state programs that would more quickly and effectively direct available resources and information to local community initiatives. In collaboration with community groups and lenders, they could develop proactive programs, such as identifying all adjustable rate mortgage holders in a geographic area; contact these homeowners; identify those still residing in their residences (many leave before completion of foreclosure process); and explain to these homeowners their options to these homeowners before they abandon their homes or face foreclosure/eviction. These groups should also identify rental properties in foreclosure and counsel tenants regarding their options during the foreclosure process. A sample of this program in practice is the Cuyahoga County Foreclosure Prevention Program in Cleveland, Ohio.

- This proposal is a public and private sector initiative.
- This proposal is most suitable for mortgages in segments 2, and 4, but with potential implications to all mortgagees.

Proposal #9: Establish Responsible Debt Relief (RDR) Programs[3]

Summary: Highly- indebted households should be encouraged to receive accurate debt capacity assessments in order to match them with the most appropriate debt management/resolution program. Those eligible for partial payment programs may be able to leverage unsecured debt concessions for a more favorable mortgage and auto loan refinancing.

Many households were encouraged to assume high levels of consumer debt during the recent real estate driven bubble era (2001–2006) that were implicitly "secured" by their soaring home values. Today, this has resulted in "upside down" mortgages and auto loans, "underwater" home equity loans, and other high-interest-installment and unsecured debts. Today, with rapidly falling property values and continuing decline in real household income, the average American household—and the United States consumer-driven economy—is facing a consumer debt "bulge" that cannot be paid in full. Current debt collection practices are based on past, unrealistic assumptions of household income/wealth. These collection practices require new and innovative approaches for matching consumers with the appropriate debt management/resolution program.

The RDR program features a state-of-the-art, consumer debt capacity assessment algorithm for precisely calculating net, after-tax discretionary income for formulating full- and partial-payment as well as bankruptcy plans. It also includes sufficient documentation and household verification plans for regulator approved "work out" programs that, in many cases, do not require the reporting of full-balance "charge-offs" by lenders for as per bank regulator requirements. Most importantly, it provides the most accurate estimate of household repayment capability for unsecured loans, such as credit card and medical debt. The three-year partial-payment plan (20-60%) offers innovative refinance programs, such as 3/27 year mortgages and 3/2 auto loans. That is, consumers in the creditor accepted partial payment plans may be eligible for reduced mortgage and/or auto payments during the initial three-years while paying off their unsecured loans. Then, they can "catch-up" over the remaining years of the loan and pay in-full the outstanding mortgage or auto loan balance with the "free" cash flow that is available after the successful completion of the debt concession plan.

- This proposal is a public and private sector initiative.
- This proposal is most suitable for mortgages in segments 2, and 4, but with potential implications to all mortgagees.

[3] Find more information at www.responsibledebtrelief.org.

Proposal #10: Convene State and Local Debt Summits

Summary: Local and regional stakeholders should convene emergency "summits" to assess local trends and financial conditions for the purpose of developing local financial assistance and education programs that would best serve the needs of their communities.

Loan modifications and foreclosure abatement programs will not be successful without addressing household income interruptions and shortfalls (job loss, underemployment, withdrawal of spouse from labor market due to family demands), as well as broader household debt obligations. Local and regional debt summits and community financial empowerment programs should be organized to discuss trends in household debt burdens, debt collection policies, crisis consumer credit sources, and partial-payment programs. Please refer to Appendix 3 for a list of Michigan communities most suitable for this recommendation.

Local debt summits should also proactively organize household financial-fitness assessments and skill-building programs for consumers. Recipients of mortgage and consumer credit assistance would be required to complete a series of financial education workshops/online modules as a condition for further public assistance. Local summits would also assist in developing informational, financial education, and credit assistance programs that would best serve their local communities. They could also include one-day financial health "check-up" fairs where all attendees would receive a free consumer debt assessment that would serve as a guide to the appropriate debt management counselors, loan modification advisers, financial planners, as well as other specific financial workshops, such as developing a household budget and retirement planning.

- This proposal is a public and private sector initiative.
- This proposal is most suitable for mortgages in segments 2, and 4, but with potential implications to all mortgagees.

Summary

The ten policy options attempt to balance the needs of each stakeholder in the foreclosure discussion. Again, these recommendations do not represent a mandatory set of inter-locking activities. Instead, they represent an *a la carte* menu of options which could be used in isolation or in coordination with other policies or groups. The proposals are summarized in the following table.

Figure 16: A Summary of Recommendations

Proposal	Issue addressed	Mortgage segment	Type
Reform and streamline the home foreclosure process as supervised by federal regulators	Foreclosure process	2 & 4	Legislative
Implement limited discretionary authority for federal bankruptcy courts to modify most problematic mortgage loans	Bankruptcy	2 & 4	Legislative
Use Chapter 7 bankruptcy as strategy to retain principal residences	Bankruptcy	2 & 4	Private and public sector initiative
Utilize and standardize shared-equity agreements as an incentive to encourage loan modifications	Loan modification	2, 3, & 4	Private and public sector initiative
Establish lender accountability to consumer requests for mortgage modifications	Loan modification	2, 3, & 4	Legislative
Establish a database of mortgage borrowers that received loan concessions	Loan modification	2, 3, & 4	Legislative
Establish federal hotline for locating investors of asset-based securities and CDOs	Loan modification	3 & 4	Private and public sector initiative
Create state and local “working groups” for home ownership assistance	Counseling	2 & 4	Private and public sector initiative
Establish responsible debt relief (RDR) programs	Counseling	2 & 4	Private and public sector initiative
Convene state and local debt summits	Counseling	2 & 4	Private and public sector initiative

CHAPTER FOUR:
Conclusion

Historically challenging times demand historically unique responses. This special report provides the background information and policy proposals for helping to reduce the number of foreclosures in the United States and in Michigan. While all stakeholders may not agree with each recommendation, the severity of the current economic situation requires a wide-range of innovative policy responses to the residential housing crisis in order to proceed with other initiatives for revitalizing state and regional economies as well as the larger national economy.

Keeping People in their Homes…When Possible

The first section of this special report explains the causes of the United States' housing market collapse (beginning in 2006) and ongoing foreclosure crisis that have their roots in broader macro-economic and banking sector trends. The second section examines developments in residential mortgage lending and attempts to size and segment Michigan's mortgage market. The third chapter reviews ten foreclosure prevention recommendations and tactics to consider on a legislative and public/private sector basis.

Rarely in history do a series of events conspire to create a true crisis; however, a host of divergent groups agree mortgage foreclosures in the United States and Michigan represent a true emergency situation. The goal of this research was to formulate a series of recommendations to stem the flow of future foreclosures. Unfortunately, developing appropriate and effective recommendations will surely alienate each stakeholder group involved in the foreclosure discussion.

A recent Associated Press article captures the tension of these viewpoints by highlighting the predicament of a recently laid-off GM employee in Saginaw, Michigan who is filing for bankruptcy and will likely lose his home. He states, "I'm living from day to day, hoping to make it through the day. I worry about my family, where we're going to live, how we'll survive." On the other side of the debate, a representative from the lending industry sympathizes with the consumer but maintains his goal is to protect "…the industry against bad public policy."

Through independent research and analysis, this report aims to present a nuanced view of the foreclosure debate. We recognize the historically unique economic times. We recognize the need for a vibrant lending industry. We recognize the distress foreclosures put on state and local government. We recognize the financial hardship of consumers. And we recognize there is no easy answer to the foreclosure debate.

Given all these considerations, we anticipate this report will positively contribute to the debate, and ultimately help alleviate the serious and complex foreclosure situation in Michigan and the United States.

Appendix 1: Research Protocol

The research team conducted primary and secondary research to document the causes and impacts of the foreclosure crisis in Michigan.

Primary Research

Primary research included remote and in-person interviews with state and federal legislators, state and federal regulators, trade association executives, academic experts, credit union executives, and members of the legal community (see Appendix 2 for list of interviews). The following are examples of research questions used in credit union participant interviews:

1. General discussion and inquiry on credit unions recent and past experience in mortgage lending. What is the credit union's underwriting criteria that includes variable vs. fixed, 15 vs. 30 years, debt capacity, and review of credit score?

2. Inquiries regarding recent and past experiences in foreclosures. Inquire about the trends they are experiencing at their credit union.

3. What is your credit union doing to mitigate foreclosures amongst your credit union members? What are your practices for pre- and post-foreclosures. How effective are these practices? Specifically:
    - Have underwriting standards changed over the last two years?
    - Differences in originating new loans versus refinance of mortgages?
    - Have you increased or decreased your residential mortgage portfolio over the last two years? Over last year?
    - What proportion of your residential loans do you sell? To Fannie or Freddie?
    - Have you sold any residential mortgages that were pooled into asset-backed securities?
    - What proportion of your residential loans are 15-year mortgages? 30-year mortgages? What proportion of your loans are variable rate and fixed rate?
    - Have these proportions changed over the last two years?
    - What is the average percentage of the home purchase price that is required for a down payment? Has this changed over last two years?
    - What is the HELOC portfolio as a percent of total loan portfolio? What is the maximum HELOC that you offer? Has it changed over the last two years? Have you written off any HELOCs? Has your HELOC policy and underwriting changed over the last two years?

4. What types of "collateral damage" are your credit unions experiencing as a result of member's mortgages at other financial institutions?

5. What are your opinions on effectiveness/ineffectiveness of current policies to help mitigate foreclosures (e.g. Michigan's "Save the Dream", TARP, etc.)? Discuss thoughts on potential policy remedies to mitigate the number of future foreclosures in Michigan (e.g. FDIC's mortgage re-write proposal, RDR, etc.).

The following are examples of research questions used in non-credit union interviews:

1. What is the latest data on foreclosures in Michigan/Nationally?

2. What new policies have been implemented? How effective?

3. What new policies should be implemented? (Get a sense of what is out there for potential solutions.)

4. Assess the impact of foreclosures on the safety and soundness of financial institutions.

5. How receptive are you to new proposals to mitigate FC's (e.g. principle write downs, RDR, etc.)? Get a sense of their comfort level with new ideas.

6. What new collections-related programs have you considered during this challenging economic environment? If none, how long are you willing to wait for the economy to recover before considering innovative collection programs? If you believe that the economy will require at least two years to recover, are you more willing to consider innovative collection programs?

7. What types of loan modifications will you consider? Will you not consider? Why or why not?

8. Would you consider a shared equity agreement as a *quid pro quo* for a principal reduction of home mortgages? Debt concessions for unsecured loans? What conditions would you require to accept the latter?

Secondary Research

Secondary research included a review of existing literature on the foreclosure crisis. This included proprietary sources not widely available to the general public. See References for a full listing.

Appendix 2: Primary Research Interview List

Bankruptcy Trustee-Hagan Law Offices
Kelly Hagan
Acme, MI

Credit Union One
Stephen Grech, Executive Vice President & Chief Products and Services Officer

Detroit Edison Credit Union
Bill Thiess, CEO

DFCU
Mike Kruczek, VP of Lending

DOW Chemical Employees Credit Union
Dennis Hanson, President/CEO

ELGA Credit Union
Karen Church, CEO

Flint Area Schools Employees
Pat Hagadorn, VP of Lending

Harvard University
Eric Belsky, Executive Director of the Joint Center for Housing Studies

Michigan Credit Union League
Dave Adams, President/CEO
Patrick LaPine, Executive Vice President

Michigan Realtors Association
Bill Martin, CEO
Brad Ward, Director of Public Policy

Michigan Schools and Government Credit Union
Pete Gates, CEO
Michael Stocker, VP of Lending
Ed Lindow, Mortgage Manager

MSHDA
Mary Townley, Director of Housing
Jodi Mercer, Program and Business Development Manager.

NCUA
Rodney Hood, Vice Chairman
Gigi Hyland, Board Member

North Central Area Credit Union
Tammy Biggar, VP Mortgages

NuUnion Credit Union
Steve Winninger, CEO

Teresa Mayer, VP Lending

OFIR
Peggy Bryson, Deputy Commissioner, Banking and Trust Division
John Kolhoff, Assistant Director Credit Union Division

Ypsilanti Area Credit Union
Marge Simonson-Young, Executive Vice President
Cindy Stempien, VP of Lending

Appendix 3: Top 100 Foreclosure Communities in Michigan

This dataset furnished by the Center for Housing Policy shows the relative foreclosure needs by zip code in the state of Michigan. The "Intrastate Foreclosure Needs Score" is a state-specific index score which attempts to predict future foreclosure trends. An index score of 100 represents the neediest zip code and corresponding numbers represent relatively severity compared to the top index score.

Using these scores, state and local elected officials, government agency staff, and community leaders can quickly assess relative needs within Michigan and allocate resources accordingly. You will note from the figures below, foreclosure needs are most concentrated in Wayne County (42% of zip codes), Genesee County (12%) and Oakland County (9%).

Zip code	City/Town	County	Intrastate Foreclosure Needs Score
48205	DETROIT	WAYNE	**100.0**
48228	DETROIT	WAYNE	**90.5**
48227	DETROIT	WAYNE	**80.4**
48219	DETROIT	WAYNE	**78.9**
48224	DETROIT	WAYNE	**77.9**
48234	DETROIT	WAYNE	**65.6**
48235	DETROIT	WAYNE	**57.4**
48238	DETROIT	WAYNE	**45.0**
48221	DETROIT	WAYNE	**39.5**
48203	HIGHLAND PARK	WAYNE	**38.9**
48204	DETROIT	WAYNE	**38.0**
48223	DETROIT	WAYNE	**37.6**
48504	FLINT	GENESEE	**37.1**
48213	DETROIT	WAYNE	**33.3**
48141	INKSTER	WAYNE	**24.7**
48206	DETROIT	WAYNE	**22.8**
48601	SAGINAW	SAGINAW	**22.1**
48505	FLINT	GENESEE	**22.1**
48210	DETROIT	WAYNE	**21.0**
48180	TAYLOR	WAYNE	**19.9**
48602	SAGINAW	SAGINAW	**18.7**
48239	REDFORD	WAYNE	**18.5**
48212	HAMTRAMCK	WAYNE	**16.2**
48214	DETROIT	WAYNE	**15.3**
48146	LINCOLN PARK	WAYNE	**15.2**
48507	FLINT	GENESEE	**14.5**

Zip code	City/Town	County	Intrastate Foreclosure Needs Score
48021	EASTPOINTE	MACOMB	**14.2**
48506	FLINT	GENESEE	**13.8**
49442	MUSKEGON	MUSKEGON	**13.6**
49507	GRAND RAPIDS	KENT	**13.5**
48215	DETROIT	WAYNE	**12.7**
48503	FLINT	GENESEE	**12.7**
48089	WARREN	MACOMB	**12.5**
48174	ROMULUS	WAYNE	**11.8**
48342	PONTIAC	OAKLAND	**11.6**
48217	DETROIT	WAYNE	**11.4**
48066	ROSEVILLE	MACOMB	**11.4**
48458	MOUNT MORRIS	GENESEE	**10.0**
49017	BATTLE CREEK	CALHOUN	**10.0**
48209	DETROIT	WAYNE	**9.8**
48186	WESTLAND	WAYNE	**9.4**
48237	OAK PARK	OAKLAND	**9.3**
48240	REDFORD	WAYNE	**8.4**
49022	BENTON HARBOR	BERRIEN	**8.4**
48091	WARREN	MACOMB	**8.3**
48229	ECORSE	WAYNE	**7.9**
48202	DETROIT	WAYNE	**7.7**
48340	PONTIAC	OAKLAND	**7.7**
48341	PONTIAC	OAKLAND	**7.7**
48076	SOUTHFIELD	OAKLAND	**7.5**
48135	GARDEN CITY	WAYNE	**7.3**
48111	BELLEVILLE	WAYNE	**7.3**
48911	LANSING	INGHAM	**7.2**
48075	SOUTHFIELD	OAKLAND	**7.0**
48125	DEARBORN HEIGHTS	WAYNE	**7.0**
48225	HARPER WOODS	WAYNE	**6.9**
48706	BAY CITY	BAY	**6.6**
48198	YPSILANTI	WASHTENAW	**6.5**
48218	RIVER ROUGE	WAYNE	**6.5**
48060	PORT HURON	SAINT CLAIR	**6.4**
48708	BAY CITY	BAY	**6.3**
49203	JACKSON	JACKSON	**6.2**
49120	NILES	BERRIEN	**6.1**

Zip Code	City/Town	County	Intrastate Foreclosure Needs Score
48034	SOUTHFIELD	OAKLAND	**6.1**
48910	LANSING	INGHAM	**6.0**
49444	MUSKEGON	MUSKEGON	**6.0**
49509	WYOMING	KENT	**6.0**
48532	FLINT	GENESEE	**5.8**
48126	DEARBORN	WAYNE	**5.7**
48906	LANSING	INGHAM	**5.7**
48529	BURTON	GENESEE	**5.4**
48185	WESTLAND	WAYNE	**5.4**
48208	DETROIT	WAYNE	**5.3**
48184	WAYNE	WAYNE	**5.3**
48030	HAZEL PARK	OAKLAND	**5.2**
49504	GRAND RAPIDS	KENT	**5.1**
48035	CLINTON TOWNSHIP	MACOMB	**5.1**
48420	CLIO	GENESEE	**5.0**
49548	GRAND RAPIDS	KENT	**4.9**
48207	DETROIT	WAYNE	**4.9**
48127	DEARBORN HEIGHTS	WAYNE	**4.8**
48122	MELVINDALE	WAYNE	**4.8**
49221	ADRIAN	LENAWEE	**4.8**
48439	GRAND BLANC	GENESEE	**4.8**
49015	BATTLE CREEK	CALHOUN	**4.7**
48192	WYANDOTTE	WAYNE	**4.6**
48867	OWOSSO	SHIAWASSEE	**4.5**
49441	MUSKEGON	MUSKEGON	**4.3**
49224	ALBION	CALHOUN	**4.2**
49001	KALAMAZOO	KALAMAZOO	**4.0**
48197	YPSILANTI	WASHTENAW	**4.0**
49202	JACKSON	JACKSON	**3.9**
49503	GRAND RAPIDS	KENT	**3.8**
48195	SOUTHGATE	WAYNE	**3.8**
49201	JACKSON	JACKSON	**3.8**
49014	BATTLE CREEK	CALHOUN	**3.7**
48071	MADISON HEIGHTS	OAKLAND	**3.5**
48846	IONIA	IONIA	**3.5**
48509	BURTON	GENESEE	**3.4**
48915	LANSING	INGHAM	**3.4**
48423	DAVISON	GENESEE	**3.3**

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