House Judiciary Committee and Subcommittee on Commercial and Administrative Law
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Chairman Conyers and Subcommittee Chairman Cohen, assembled policy-makers, and members of the audience, I very much appreciate the opportunity to testify on ongoing concerns about the impact of foreclosure and how legislative action might mitigate both the epidemic itself and its aftermath on neighborhoods and homeownership in Memphis and similarly situated cities. My name is Phyllis Betts, and I am the Director of the Center for Community Building and Neighborhood Action (CBANA) in the School of Urban Affairs and Public Policy at the University of Memphis in Tennessee. CBANA's mission is to "link research with action" on behalf of neighborhoods and quality of life issues associated with socioeconomic disparities. Our research on foreclosure has been supported in part by a grant from The Brookings Institution Urban Markets Initiative; we also work closely with The Urban Institute's National Neighborhood Indicators Partnership, where the emphasis is on using local data to better understand local context and drive policy in areas that include housing and foreclosure. Locally, our work on lending, foreclosure, and neighborhoods is supported through our partnership with the Community Development Council of Greater Memphis and the City of Memphis Division of Housing and Community Development.

For the past five years we have worked with the Community Development Council to research and report on lending and foreclosure in Memphis and Shelby County as reported by the Home Mortgage Disclosure Act data and local public records on lending, foreclosure, and residential property sales. We have also carried out a city-wide audit of residential properties – "Neighborhood by Neighbor" -- to identify vacancies, blight, and other issues that are being used to inform allocation of local, state and CDBG resources and drive local policy. This work on housing and neighborhoods is part of our soon to be launched InfoWorks Memphis Community and Neighborhood Indicators, where information on housing and neighborhood issues will be complemented by domains featuring community safety, income and assets, and children and families. We work closely with policy-makers and practitioners in these areas to design "data-driven "interventions to improve quality of life in Memphis and Shelby County and support Mayor AC Wharton's commitment to our being a "city of choice." Our research can be accessed at http://cbana.memphis.edu.

Our research in Memphis sheds light on two issues. 1) There are different paths to foreclosure requiring different intervention strategies, both to staunch the immediate bleeding and to rethink our approach to homeownership policy and mortgage lending as we move forward and 2) the neighborhood effects of foreclosure – vacancy and blight, and the transition of owner-occupied properties to the rental market, call for innovative community development strategies that will be different in Memphis compared to Cleveland, Chicago, Las Vegas, Phoenix and certainly the markets in California and Florida. Based on our research for the Community Development Council, the view on the ground in Memphis reveals:

- 13,000+ foreclosure notifications in 2009: 4% single family homes
- High-foreclosure zip codes 6-8% single family homes (38127, 38128 Frayser-Raleigh; 38115, 38118, 38125, 38141 Fox Meadows, Hickory Hill, Southeast Shelby County)
- 87,000+ foreclosure notifications 2000-2009: 28% single family homes
- High foreclosure zip codes about 40-50% single family homes
- High subprime lending at
- HALF of city zip codes at least 50% subprime lending in peak years 2005-2007
- Subprime loans 2007 snapshot: typical subprime neighborhood 40-50% 30days+ delinquent
- Two of three foreclosure sales are going to investors: homeownership is being eroded
- High foreclosure neighborhoods up to 80% to investors
- Memphis lost 7,000 homeowners from peak in 2005 to 2008 (American Community Survey)
- At least two out of three foreclosure-related (CBANA estimate)
- Target: low moderate income African Americans in low and moderate income predominantly African American neighborhoods
- African American borrowers are two-three times as likely as white borrowers to receive subprime origination
- Two-three times as likely to be <= 80% AMI (low income)
- Two-three times as likely to be low income and have a loan over 3 times loan to value
- Two-three times as likely to be single female-headed household

Based on our research, the foreclosure problem in Memphis is not borrowers "pushing the envelope" to buy "more house" or "using their home equity as an ATM machine" for lifestyle purchases; the recent news about the "walk-away" defaults among high income borrowers do not tell our story. We are talking about borrowers in need of pre-purchase counseling and lenders who did not act in good faith. Where do we go from here? Is it possible to ameliorate the damage that has already been done by stopping foreclosures where low and moderate income borrowers may be in a financial position to sustain homeownership with modified loans? Is it possible to reverse the transition of African American neighborhoods to the rental market? In response to those questions, allow me to interpret our findings by closing with two policy-related points:

1. *The jurisdiction of bankruptcy courts – or the introduction of other legal oversight as may be indicated by Representative Cohen's newly introduced "Preventing Homeowners from Foreclosure Act of 2010"-- to make mortgage modifications happen, should be revisited* with new arguments and renewed efforts coming from this subcommittee. It is clear from the Urban Institute's Analysis of foreclosure mitigation counseling that *too many lenders are not responding in good faith to voluntary persuasion on the part of the federal government to re-write loan terms.*
2. Members of this subcommittee should consider how bankruptcies and foreclosures undermine asset building and neighborhood stability, and work with colleagues on other committees toward new housing policies that incentivize the disposition of foreclosed properties *to owner-occupants rather than investors.*

<u>Making the Case for Mortgage Modifications</u>

There are different paths to foreclosure. In Memphis and other cities with a large low income and African American population, the brunt of foreclosures is related to subprime lending targeting those borrowers and the neighborhoods where they live. In Shelby County, 50% of zip codes had subprime lending rates of 50% or more during the height of the predatory lending boom in 2006. These were predominantly African American neighborhoods. It is no accident that these zip codes are predominantly African American and that 60% of subprime borrowers as late as 2008 have low or moderate incomes at or below $65,000 (up to 120% of the Area Medium Income) while 58% of borrowers – predominantly white -- with incomes over $65,000 have more desirable "prime" loans. (CBANA analysis of 2008 HMDA data.)

Borrowers who may have become successful homeowners given appropriate pre-purchase counseling – including cleaning up credit—were fast-tracked for subprime loans that *failed to include up-front due diligence on the part of lenders.* An unknown number of those loans included fraudulent income data submitted not by borrowers but by brokers and lenders motivated by a high volume and risk-shifting business model. *Lenders who fail to take into account the ability of borrowers to repay loans are not acting in good faith.* When the business model enabled them to shift the risk of bad loans through securitization, the burden of the "moral hazard" is clearly on the shoulders of lenders and the system that disincentivized due diligence. In the absence of due diligence and good faith, the argument against subjecting mortgages to jurisdiction of the bankruptcy court or other judicial intervention falls away. The argument against Chapter 13 cram down modification is based on an undue risk to lenders when the terms of the loan might be "arbitrarily" changed by bankruptcy courts; *perhaps mortgages might be included under a proviso where the absence of due diligence at origination (as evidenced by application and approval documents) triggers bankruptcy court jurisdiction.* Mortgage application records would provide evidence of due diligence or its absence, much as the means-testing of bankruptcy filers under current law is used to determine if filers can meet the terms of a Chapter 13 agreement. For those situations where reasonable loan modifications include only a low probability of a homeowner being able to sustain payments, then the already existing means-testing would preclude a futile modification.

<u>Making the Case for Homeowner-occupants in the Disposition of REO properties.</u>

Preventing foreclosures delivers benefits to homeowners, but also to neighborhoods. The disposition of REO properties in Memphis neighborhoods – and no doubt in similar cities – is changing the character of neighborhoods. In 2009, 24% of single family home sales in Memphis-Shelby County were foreclosure sales, and two out of three foreclosed properties are being sold to investors. In middle income black neighborhoods, the pattern is even more pronounced, with upwards of 40% bank sales. The irony of Fannie Mae and Freddie Mac – where the original vision was to support homeownership -- favoring quick disposition of REO properties to investors should be evident. While this committee has no jurisdiction over the disposition of REO properties, committee members need to understand that when substantial majorities of REO properties are sold to investors we need to rethink our housing policy. The federal government has been working with both carrots and sticks to discourage foreclosure and encourage loan modifications on the part of nationally regulated lenders; perhaps we need to think about how carrots and sticks could be used to discourage sales to investors and encourage sales to owner-occupants. We need to be thinking about how to use CDFI funds, FHA, and federal incentives to credit unions to take to scale lease purchase products being innovated by organizations such as the Community Land Trust Network.

The preponderance of the evidence is clear: lending products sponsored by FHA, Fannie Mae, and Freddie Mac that required pre-purchase counseling and that were offered in collaboration with community development and affordable housing strategies have been successful. Products marketed by brokers and lenders who failed to exercise due diligence and good faith by establishing borrowers' ability to repay loans have *not* been successful. Holding those lenders accountable should include righting those willful practices through judicially supervised mortgage modifications and policy regulations that favor the disposition of REO properties to homeowners. Legislation can be fashioned that distinguishes culpable lenders on a case by case basis if that is the compromise that is necessary to move cases under the jurisdiction of bankruptcy courts or route REO disposition through the National Housing Trust or local land trusts. Voluntary collaboration with housing counselors and homeownership-oriented efforts to dispose of REO properties are not working at the scale that could make a difference for vulnerable families and neighborhoods. More is called for.