

Congress of the United States
Committee on Oversight and Government Reform

Failure to Recover: The State of the Housing Markets, Mortgage Servicing
Practices, and Foreclosures

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TESTIMONY OF LEGAL SERVICES NYC

Good morning. My name is Meghan Faux and I am the Deputy Director of South Brooklyn Legal Services. In collaboration with Bedford-Stuyvesant Legal Services and Brooklyn Legal Services Corporation A, I have prepared this testimony on behalf of Legal Services NYC.

First, we would like to thank the Committee on Oversight and Government Reform for holding this hearing and, in particular, Congressman Towns for this invitation to testify and his leadership in addressing the foreclosure crisis. We have many challenges now and ahead of us, and we thank you for your partnership in the pursuit of justice.

Legal Services NYC (LS-NYC) is the nation's largest provider of free civil legal services to the poor. For more than 40 years, we have provided expert legal assistance and advocacy to low-income residents of New York City. Each year, our 19 neighborhood offices together serve tens of thousands of New Yorkers—including homeowners, tenants, the disabled, immigrants, the elderly and children.

LSNYC is also the oldest and largest provider of foreclosure prevention legal services in New York. For more than a decade, we have challenged abusive lending and home sale schemes—from redlining to subprime lending to loan mod scams. Starting in 2008, with support

from state and federal funding programs, LS-NYC significantly expanded our homeowner rights programs. We now operate six dedicated foreclosure prevention projects with more than 45 attorneys and paralegals working in some of the hardest hit neighborhoods across Brooklyn, Queens, Staten Island and the Bronx. To date, we have assisted more than 6,000 families at risk of losing their homes.

We are honored to be here today to testify about the critical issues facing low-income homeowners in New York. In this testimony, we will be discussing three issues: (1) the current impact of foreclosures in the communities we serve; (2) servicer practices that have exacerbated and prolonged the foreclosure crisis and increased the likelihood of wrongful foreclosures; and (3) reforms we believe will shape a healthier and more just economic recovery for homeowners and all of New York State.

I. THE FORECLOSURE CRISIS CONTINUES TO JEOPARDIZE THE SAFETY AND STABILITY OF COMMUNITIES ACROSS OUR CITY AND STATE.

New York City neighborhoods continue to endure a catastrophe as record numbers of families face losing their homes. In NYC, the economic downturn and rising unemployment have deepened a crisis initially caused by subprime lending. For years, low-income and communities of color were aggressively targeted for abusive, unaffordable mortgages, including adjustable-rate mortgages, stated-income loans, payment-option adjustable rate mortgages and equity-based lending with exorbitant default rates. These abusive loans have significantly higher default rates than prime loans, putting minority homeowners at a substantially increased risk of losing their homes. As the foreclosure crisis deepened, and the economy declined, record numbers of homeowners fell into foreclosure due to unemployment and underemployment. For most of our clients, **the proximate cause of default is an economic hardship, but the more**

fundamental problem is often a high-cost mortgage loan that leaves little to no room for even a temporary setback. We now face a new wave of new foreclosures as the full impact of predatory loans made during the subprime boom of the last decade hits, just as families struggle with less income, higher debt and smaller safety nets.

The Federal Reserve Bank recently reported that New York City had among the highest foreclosure rates in the United States, with 10% of all mortgages in foreclosure or seriously delinquent and an additional 4% between 30 and 90 days past due. In 2011, more than **69,000 pre-foreclosure** notices were sent out to New York City homeowners; more than two-thirds of these notices were sent to homeowners in communities of color.

In Brooklyn alone more than **27,000 mortgages defaulted** last year while tens of thousands of foreclosures were still pending. **In some Brooklyn and Queens communities we serve, 1 in 3 homeowners are in default.** The areas most decimated by foreclosure filings are the predominantly African-American and Hispanic communities that suffered from a predominance of subprime and predatory lending: Canarsie, East New York, Flatlands, Brownsville, Bushwick, Crown Heights, Bedford Stuyvesant, and Flatbush. (See map of pre-foreclosure filings in New York City created by the Neighborhood Economic Development Advocacy Project).

Our advocates see both the terrible individual impact of foreclosures, as well as the disastrous consequences for the neighborhoods affected. **Over 90% of our clients are people of color, and many are elderly or single heads of household.** More often than not, multiple generations live within the home, as do tenants, for whom foreclosures mean the loss of affordable rental housing. Even one foreclosure—let alone thousands—creates a costly ripple effect. Walking through the beautiful tree-lined streets of Brooklyn neighborhoods like Bedford

Stuyvesant—a community where families once bought homes and stayed for their whole lives—we now see vacant, deteriorating houses, increased crime, drastic home value loss and disappearing affordable rental housing.

While it is difficult to quantify the full cost of foreclosure, we know that foreclosed homes sell for about 25% or more below fair market value, negatively affecting neighboring property values. These lowered property values lead to significant losses to the tax base of counties, towns and cities. Our colleagues from the Empire Justice Center recently reported that, if foreclosures are not prevented, New York City will sustain a \$7 billion decline in property values—and more than \$133 million reduced tax revenues—in the coming years.

This crisis is far from over; its impacts are startling; and the need for continued vigilance and aggressive government response is as acute as it has ever been.

II. SERVICERS MUST BE ACCOUNTABLE FOR FAIRLY AND PROMPTLY NEGOTIATING AFFORDABLE AND SUSTAINABLE LOAN MODIFICATIONS WITH HOMEOWNERS.

Our economic recovery and neighborhood stability continue to be jeopardized by the unscrupulous practices of lenders and their servicing agents. As homeowners struggle with debt that often far exceeds the value of their properties, lenders are refusing to negotiate affordable modifications. The consequences of these refusals are severe. Homeowners are being unfairly denied long-term sustainable modifications, tenants are losing affordable rental housing and neighborhoods are falling further into decline. While we are encouraged by the pending settlement among the states' attorneys general, the federal government and five major national servicers which provides some relief to underwater homeowners and, if enforced, will curb many of the systemic servicing abuses, that settlement does not address FHA, Fannie Mae or Freddie

Mac loans, leaving the vast majority of the country's distressed homeowners at the mercy of the wrongful foreclosure and servicing practices that prompted the national mortgage investigation in the first place. We believe that the federal government must continue to play a constructive role in ensuring that the abuses addressed by that settlement are not allowed to remain the norm for these mortgages. Aggressive monitoring and enforcement of the agreements and regulations governing mortgage servicing are essential to our economic recovery.

Now, more than four years into the foreclosure crisis, deliberate delays and improper denials, despite violating clear regulations, remain the servicers' primary response. Below I outline the most problematic servicing practices that increase the likelihood of wrongful, unnecessary foreclosures and forestall any hope of stabilizing our economy and rebuilding our communities. For the most part, these practices are the same problems that homeowners have been encountering for years. Despite countless investigations, regulations, and initiatives, our offices have seen little change in the day-to-day practices of servicers. Servicers' refusal, whether intentional or not, to implement systems to fairly and properly evaluate homeowners for home retention options have been exceptionally costly to both individual families and to the broader community when avoidable foreclosures are not prevented.

Unnecessary Delay. The largest part of our foreclosure defense work is representing homeowners in settlement conferences mandated by New York's judicial foreclosure process. New York courts are required to hold settlement conferences in all residential foreclosure cases to determine "whether the parties can reach a mutually agreeable resolution to help the [homeowner] avoid losing his or her home."

Remarkably, even in the context of court-supervised mandatory settlement conferences governed by a statutory duty of good faith, mortgage servicers routinely delay the process and

effectively refuse to negotiate loan modifications or other home saving solutions, imposing a substantial drain on judicial, advocate, and homeowner resources. Banks and lenders still routinely violate federal and state regulations as well as the provisions set forth in the settlement conference procedures, often without consequence. Conferences require an extraordinary commitment of time and resources for each case; our offices average between 6 and 8 appearances across twice as many months before a resolution can be reached. During the negotiation process, lenders repeatedly ask for additional or updated documentation that has already been provided or is not required under the modification guidelines. Lenders rarely review the application within the timeframes required under the HAMP guidelines or New York State's servicing regulations and often fail to provide a complete explanation when denying a loan modification. These delays, and plaintiffs' refusal to provide accurate, complete information to the borrower, make it difficult to negotiate effectively at the conferences and ensure that homeowners' applications are properly reviewed. **In addition, the ubiquitous, long delays are costly to homeowners who continue to accrue interest and fees on their loans, making it more difficult to structure an affordable modification.**

Unexplained and Excessive Fees. Payment histories are almost universally incomprehensible and servicing fees are rarely explained. Homeowners routinely get statements assessing hundreds, if not thousands, of dollars in fees to their account labeled "other" or "miscellaneous" fees. When our advocates request clarification of the fees, it often takes months to obtain an adequate explanation. Homeowners without an advocate have little hope of obtaining any justification of the fees. **Our offices have uncovered unreasonable or inaccurate fees charged to homeowners accounts ranging from a few thousand dollars to tens of thousands of dollars.**

Improper Denials. Despite clear federal and state regulations, servicers continue to send homeowners inaccurate and confusing modification denial letters. Acceptance also Servicers still fail to state the primary reason for the denial or fail to provide the inputs used in evaluating the application. Many of our clients receive multiple and often inconsistent letters within days of each other – one client received six letters in a 48 hour period – making it virtually impossible to determine if they were properly reviewed for a home retention option. Servicer error is often the root cause of the initial denial: they frequently miscalculate income or the amount owed or use inaccurate home value data. While our advocates can often get such errors corrected, these protracted delays are costly to homeowners and can make it impossible to negotiate an affordable modification because of the increased debt adding up with each month of delay. And of course most homeowners do not have access to an advocate who can insist on getting such errors corrected.

Investor Restrictions. Servicers also continue to deny homeowners for modifications because of supposed investor restrictions—claiming that the pooling and servicing agreement or other investor guidelines for the loan prohibit the requested modification—and do not take any meaningful steps to seek a waiver of legitimate investor restrictions, as federal guidelines obligate them to do. Often these investor restrictions do not come to light until months into negotiations, after homeowners have repeatedly provided income documentation and sometimes even completed a trial period modification. When challenged, servicers often cannot provide documentation of the restriction or produce investor guidelines that clearly indicate the modification is permissible.

III. WE NEED AGGRESSIVE ENFORCEMENT OF STRONG SERVICING STANDARDS FOR ALL SERVICERS.

We applaud the recent national settlement with the major banks and look forward to aggressive enforcement of the agreement. While many of the servicing standards in the agreement are commonsensical, servicer compliance would eliminate many of the barriers currently preventing homeowners from obtaining sustainable modifications. More must be done, however, to fully address the foreclosure crisis and stabilize our housing markets. National mortgage servicing standards which apply to *all* banks, not just a select few, are essential to stopping unnecessary foreclosures and re-stabilizing our communities.

National standards must include the following key elements:

- Eliminate the two-track system. Homeowners should be evaluated for a loan modification before a foreclosure is initiated or continued, and that evaluation should be completed before any foreclosure fees are incurred.
- The failure to offer loan modifications to homeowners must be made a defense to foreclosure.
- Net Present Value tests for modifications should be standardized and made available to the public.
- Loan modifications for qualified homeowners facing hardship must be permanent, affordable over the life of the loan, and available without any waiver of a homeowner's legal rights.
- Homeowners denied a loan modification must receive a written notice documenting the NPV inputs, any relevant investor restrictions and efforts to seek a waiver of such restrictions, and explaining the process for seeking review of erroneous determinations. Foreclosure should not commence or continue until such an appeal process has been resolved.
- Homeowners should be provided with access to full documentation of any investor restrictions, as well as all servicer attempts to procure a waiver, upon any denial based on investor guidelines.
- Servicers must be required to seek, and investors should be encouraged to grant, waivers of any restrictions prohibiting modifications.
- Fees to servicers must be limited to those both reasonable and necessary for them to carry out their legitimate activities.

- Force-placed insurance should be replaced by a default reliance on replacing or continuing the existing coverage at a reasonable price.
- Transfer notices and periodic statements should be used to increase servicing transparency.
- Application of payments and use of suspense accounts should be fair and reasonable.

These standards are a necessary step in ending the abusive servicing practices that have exacerbated the foreclosure crisis, but must serve as a floor rather than a ceiling, and must not prevent states from implementing additional protections to address the unique needs of their homeowners and communities.

IV. PRINCIPAL REDUCTION IS A NECESSARY TOOL TO RESTABILIZING OUR HOUSING MARKET.

Principal reduction is a critical loss-mitigation tool that must be embraced if we are to be serious about stabilizing our housing market. Many of our clients have mortgage loans that far exceed the actual value of their homes, some because of rampant over-appraisal during the subprime lending boom and others because of the more recent declines in home value. Yet, in our experience, servicers rarely consider principal reduction in evaluating homeowners for modifications even though it is in the economic interests of the loan investors to do so. As a consequence, many homeowners are left with new principal balances on their mortgages that are tens—if not hundreds—of thousands of dollars in excess of the actual value of their homes and payments that continue to strain their budget.

Principal reduction is in the best interest of investors and homeowners. Existing data on loan modifications show that modifications with principal reductions have lower re-default rates. Principal reduction modifications are more affordable to homeowners who are then better able to navigate a future economic hardship. These modifications also allow families to sell their homes

if they need to move for a job, family or other reason. However, despite the logic and benefit to providing this relief to homeowners, most services refuse. Principal reduction must be mandated for all loans – including those owned by Freddie Mac and Fannie Mae – when it is in the best interest of the investor. Our economic recovery cannot wait any longer.

Thank you for the opportunity to present this testimony.