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Deepening Credit Crisis — Legal Developments

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This month, the U.S. Department of the Treasury concluded a seven-month study of the country's economic difficulties stemming from the housing crisis associated with subprime lending. Treasury issued a report analyzing the causes of the economic downturn and recommending policy changes to avoid such a situation in the future. In this advisory, we step back to reflect on the bigger picture and inventory various efforts by government and the private sector.

Treasury's concise report can be found online at: http://treasury.gov/press/releases/reports/pwgpolicystatemktturmoil_03122008.pdf.

While it should be noted that the situation is in flux and new programs are being rolled out weekly, some initiatives now on the table include the following:

Federal Initiatives

The **Mortgage Reform and Anti-Predatory Lending Act,** introduced by Congressman Brad Miller, would encourage the states to establish a Nationwide Mortgage Licensing System and Registry (NMLSR) for the residential mortgage industry. It would also amend the Truth in Lending Act to **establish a duty of care standard** for residential mortgage loan originations.

The **House Financial Services Committee,** led by Chairman Representative Barney Frank, is developing a proposal to **induce mortgage lenders to write down their current mortgage obligations to current market values** in exchange for the Federal Housing Administration facilitating the refinancing of such loans.

The **Foreclosure Prevention Act of 2008,** introduced by Senate Majority Leader Harry Reid, would, among other things, **allow bankruptcy judges to modify interest rates** on subprime, adjustable and other non-traditional home mortgage loans and extend the time frame that debtors have for repayment, to allow for long-term restructures. The bill would also modify the use of qualified mortgage bonds and temporarily increase the volume cap for certain housing bonds.

The **GSE Mission Improvement Act,** introduced by Senator Jack Reed, would require Fannie Mae and Freddie Mac to purchase or securitize mortgages in underserved markets. The GSEs would be required to lead the industry in developing loan products and flexible underwriting guidelines to **facilitate a secondary market for loans** for housing for very-low to moderate income families.

The **HOPE for Homeowners Act of 2008,** sponsored by Senator Chris Dodd, would create a new program within FHA to **back FHA-insured mortgages to distressed borrowers.** The new mortgages offered by FHA-approved lenders will refinance abusive loans at a significant discount for homeowners facing difficulty meeting their mortgage payments.

The **Department of Housing and Urban Development ("HUD")** reports that its **FHASecure program,** which offers refinancing for some subprime loans, will help approximately 300,000 families this year. There have also been internal discussions at HUD about creating a large-scale program to help sell foreclosed homes at a discount in cities with large numbers of problem loans. HUD has also established, in partnership with the **Department of the Treasury, the HOPE NOW Alliance,** made up of counselors, servicers, investors and other mortgage market participants with the intention of facilitating effective solutions between at-risk borrowers and their lenders and increasing the efficiency of the mortgage industry.

The Office of the Comptroller of the Currency is urging Congress to restore the original scope of the **public welfare investment authority,** which authorized investments in **distressed middle-income areas** until the 2006 amendments.

In a speech before the National Association of Affordable Housing Lenders on February 12, 2008, **Comptroller of the Currency John C. Dugan** called for an amendment to the **Community Reinvestment Act** regulation to provide **CRA consideration for community development investments in middle-income communities** that are distressed as a result of mortgage foreclosures and related economic factors affecting the area; Dugan also suggested **extending the CRA to cover non-banks** which provide financial services similar to banks. The proposed revised Interagency Questions and Answers published on July 11, 2007 in the Federal Register focus on foreclosure prevention, noting, "Three revisions are intended to encourage institutions to work with homeowners who are unable to make mortgage payments by highlighting that they can receive CRA consideration for **foreclosure prevention programs** for low- and moderate-income homeowners."

The **Comptroller of the Currency** is also requiring large national banks that service mortgages to provide monthly reports of mortgage data. The purpose of the reporting requirements is to develop a better understanding of the current lending market. The Comptroller will provide analyses of the data to state agencies as well.

Local Government Initiatives

Maryland – The City of Baltimore is suing one of the largest mortgage providers to Baltimore residents alleging that the lender undertook a practice called "reverse-redlining," whereby African-American neighborhoods were targeted for high-risk loans with heavier fees and surcharges, arguably in **violation of the Fair Housing Act.**

Ohio – Cleveland Mayor Frank Jackson has filed a lawsuit against twenty-one Wall Street investment banks for allegedly creating a public nuisance by irresponsibly buying and selling subprime mortgages. Jackson says the banks created the nuisance through their subprime mortgage business by boosting default rates citywide and destroying entire neighborhoods. The **suit seeks hundreds of millions of dollars in damages** for lost property taxes and to reimburse the city for demolition and other costs related to the subprime foreclosure crisis.

Massachusetts – State Attorney General Martha Coakley is seeking an injunction to bar Fremont Investment & Loan from foreclosing on 500 borrowers. The state wants to review each mortgage to **block foreclosure proceedings** on any loans it considers fraudulent.

Michigan – Dan Kildee, Treasurer of Genesee County, has been reforming the foreclosure process in Flint to ease the staggering population decline. By banding together with county treasurers throughout the state, Kildee helped pass several state laws to shorten the tax-foreclosure process while giving clean title to county governments. New legislation permits counties to form **Land Banks** with the power to purchase, hold or sell real property. Kildee explains that the county holds title until a productive use is found. This may mean integrating the properties into a comprehensive economic development plan, or demolishing vacant homes and selling the land to adjacent owners.

Private Sector And Non-Profit Initiatives

The Center for American Progress and Enterprise Community Partners Inc. have recommended adding a **Great American Dream Neighborhood Stabilization Fund** (GARDNS) based upon a proposal written by Goulston partner David Abromowitz in his role as Senior Fellow at CAP. The GARDNS fund proposal recommends additional Community Development Block Grant money to be used to acquire foreclosed and abandoned properties in hard hit communities and would **leverage development finance resources** such as tax and accounting incentives to investors who could either sell the loans or swap them for subordinate securities from nonprofits (similar proposals have been incorporated into Senate Majority Leader Reid's bill, as well as Congressman Frank's proposal in the form of $10 billion (25% grants and 75% 0% interest loans)).

Enterprise has also suggested **expanding the New Markets Tax Credit** to include loans to or investments in businesses and projects located in low-income areas hit hardest by foreclosures.

An emerging model for protecting low-income borrowers from future foreclosure is the **Community Land Trust** (CLT). In the CLT model, a community-based nonprofit owns the land, low- and moderate-income families purchase the homes and, upon resale, the nonprofit and homeowners share the limited profit. CLTs have shown a very low incidence of foreclosures in a study of thousands of homes on CLT land around the country. See http://www.boston.com/bostonglobe/editorial_opinion/oped/articles/2008/01/23/a_foreclosure_free_option/. Goulston & Storrs has decades of experience working with CLTs and is examining opportunities for community-based organizations with the assistance of governmental and private lenders and investors to reposition foreclosed properties for purchase or rent by low- and moderate-income families.

Countrywide Financial Corp. is **urging its staff to refinance borrowers out of alternative and risky mortgages** so the lender can sell the new mortgages to Fannie Mae and Freddie Mac, insure them with the Federal Housing Administration, or have them guaranteed by the Veterans Affairs Department. The lender has lowered loan-origination fees by one percentage point as well as **waiving prepayment penalties** on existing loans to make refinancing more attractive.

The current economic crisis has been caused in large part to poor government policies and a lack of regulatory foresight. The Center for Responsible Lending has written extensively on this subject, and its findings and publications can be found at www.responsiblelending.org.

Goulston & Storrs will continue to monitor this evolving situation and provide our clients with any helpful material. For further detail on any of these programs, please contact:

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