The Foreclosure Freefall in Florida: An Affordable Housing Perspective

By Gladys Schneider
Florida Housing Coalition

Introduction

It has been called a "tsunami of foreclosure" nationwide and Florida is among five states at the epicenter. Expected to crest in 2008-09, the worst is yet to come with most experts blaming the crisis on weakening the economy domestically as well as negatively affecting institutional trading and the international banking industry. It is estimated that over two million homes in America will go into foreclosure by 2008-09. It seemed like a fairy tale as Florida's homeowners and real estate investors watched home prices skyrocket from 2003 to 2006. Construction was booming and lines formed for pre-sales at condominiums and subdivisions. For homeowners, their equity ballooned, causing many to treat their homes as ATM machines, drawing out cash for home improvements, investing in second homes, and consumer spending. New homeowners jumped into the game, able to obtain financing from hybrid type mortgages with adjustable rates. Investors played a flipping game, buying homes with equity only mortgages, expecting to sell at a profit a few weeks or months later as values continued to spiral upward. Websites such as www.condoflip.com flaunted the reckless market where homes were purchased sight unseen by investors using online mortgage and real estate products. Vacant land was also gobbled up with most vacant lots in the huge pre-platted subdivisions of the 1970's being traded at least once during the 2003-2006 period.

Financing for the real estate bubble came from a favorable credit market. Interest rates were low which made purchasing more attractive. Mortgage backed securities increased the secondary market for mortgages, providing more credit. Lenders were encouraged to be lenient with buyers, overlooking their actual income and ability to repay. The subprime mortgage market, serving those with lower credit rating and with looser lending criteria, offered exotic products, such as the 2/28 adjustable rate mortgage, Hybrid Arms and Option Arms. A low fixed teaser rate was in effect for the first two years, which was reset to a much higher amount that increased monthly payments by over 30 percent. Prepayment penalties of up to 15 percent of the loan principal were in effect during the low interest period, severely discouraging a refinance to avoid the interest rate reset. The predatory nature of these loans led them to buyers with poor credit and lower ability to repay once the rates reset. According to the Center for Responsible Lending, there is a preponderance of subprime and predatory loans among minority communities and within inner city areas.

The high volume of these mortgages began to reset in 2006 and 2007, leaving thousands of buyers in homes they were unable to pay for or sell. The perfect storm occurred when home appreciation ground to a halt and lenders tightened credit. At the same time, the construction boom flooded the market with vacant inventory, dooming the upward price of homes and limiting the ability to sell. Since the loans had already been sold into the secondary market, there were no original lenders to negotiate with and foreclosure ensued.

The negative effects of the foreclosure crisis carry over into many sectors. Local governments will see a decline in the tax base as values fall and economic production will suffer due to construction, spending and employment slowdowns. In Florida, where housing starts have fallen from 272,000 in 2005 to just 90,000 in 2008, the potential change in property taxes will be a projected loss of $589 million. State sales taxes will be reduced by $148 million or more. On a local level, neighborhoods that saw the most speculation will suffer with empty homes boarded up with for sale, for rent and public notice signs dotting the streetscape. The clustering of foreclosures leads to further decline in property values and damages the quality of neighborhoods. Unemployment has been gradually increasing but the trend is becoming clearly evident with the precipitous drop in construction. Even school districts are seeing a drop in enrollment as families relocate to find work. (Global Insight, The Real Estate Bubble)

The National Response.

The national response began on September 20, 2007, when the Federal Reserve Chairman, Ben Bernanke testified before the House of Representatives Committee on Financial Services on subprime mortgage lending and mitigating foreclosures. In his statement he urged cooperation among holders of mortgage backed securities and loan servicers, as well as federal action to encourage the Federal Housing Administration to "collaborate with the private sector to expedite the refinancing of creditworthy subprime borrowers facing large resets." To prevent inflation and loosen credit, the Fed has made minor reductions in the prime interest rate. (Testimony, Chairman Ben S. Bernanke, Subprime Mortgage Lending and Mitigating Foreclosures, Before the Committee on Financial Services, U.S. House of Representatives, September 20, 2007).

- **Massachusetts passed a 60-90 day delay on foreclosures to allow a review for predatory or unfair treatment. The state also entered into an agreement with the largest subprime lender in the state to immediately stop foreclosures until the Attorney General is provided with documentation. The state has also banned predatory foreclosure rescue schemes. The Boston Bar is providing training for pro bono lawyers willing to assist homeowners facing foreclosure. The Massachusetts legislation is specifically restricted to foreclosures of primary residences where the mortgagor owns no other real estate.**

- **In New York, a one year moratorium has been proposed on court ordered foreclosures.**
  Buffalo, NY is requiring banks holding foreclosed properties to maintain them to protect neighborhood appearance and property values.

- **In Ohio, local sheriffs have been asked to give homeowners a 60 day foreclosure abatement on auctioning the homes they occupy. A similar effort allows homeowners to remain in their homes as renters or tenants at will. This prevents clusters of vacant homes that become a public safety hazard.**

- **The City of Baltimore, filed suit against Wells Fargo Bank for predatory and discriminatory lending. The city claims that the bank was steering minority home buyers into high-cost subprime loans.**

- **In Cleveland, the city filed against 21 banks claiming that subprime lending in inner city neighborhoods has created a nuisance and damaged property values and city tax collections.**

The Joint Economic Committee of the U.S. Congress prepared a report in October, 2007 with a broad overview of the problem with specific recommendations. The study clearly showed that the subprime mortgages were the source of the foreclosure problem. Between 1998 and 2007, prime fixed rate mortgages had a fairly steady rate of foreclosure of two percent. Adjustable rate prime mortgages had a slightly higher rate of 4 percent. The subprime fixed rate mortgages fluctuated from 8 percent to 15 percent and down to 10 percent by 2007. But the subprime adjustable rate mortgage foreclosure rate grew steadily upward from 14 to 16 percent. The report noted that in Florida there were 708,195 outstanding subprime loans with a third quarter estimate of 157,341 subprime foreclosures, or 22 percent. The fact that the majority of resets started in 2007 and 2008 indicates that there will be an even higher percentage of foreclosure among this loan category. By the 3rd quarter the report estimated that the cumulative loss in property value in Florida was over $12 billion and the cumulative loss in property taxes was $89 million.

The report recommendations include increased funding for counseling, statutory reform and streamlined conversion to FHA loans. An important reform that affordable housing providers consider a standard practice is that the federal government should require lenders to determine that the borrower has the ability to repay a loan at the fully-indexed rate and assume fully amortized payments. (The SubPrime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got Here. Report and Recommendations by the Majority Staff of the Joint Economic Committee. Sen. Charles E. Schumer and Rep. Carolyn B. Maloney. October, 2007.)

The U.S. Treasury responded with a three part plan to counter the expected 1.8 million interest rate resets among subprime mortgages. The first part is mortgage counseling through the HOPE NOW alliance to avoid preventable foreclosures. The HOPE NOW alliance has grown to include as members 90 percent of the subprime servicing market including the major non-profit mortgage counseling organizations, trade associations and investors.

HOW FLORIDA HOUSING PROGRAMS BUCK THE FORECLOSURE TREND

Lee County Housing Development Corporation has built over 200 homes for very low and low income buyers. Applicants must complete a homebuyer training course plus undergo any credit rebuilding needed to qualify for a first mortgage from a financial institution. All loans are fixed interest with reduced closing costs. Foreclosure rates among these homeowners is almost nonexistent.

Second, the mortgage industry is encouraged to develop new products that will enable people to stay in their homes. An example already implemented is the FHASecure program which allows eligible borrowers to refinance into FHA loans. Congress passed the Mortgage Forgiveness Debt Relief Act, which prevents borrowers who receive a reduction in their interest rate and debt to avoid having to pay income taxes on the relief.

Third, a systematic streamlining process is envisioned that will help borrowers quickly navigate a workout solution that follows a loss mitigation strategy for the mortgage industry. This streamlining walks a fine line with abrogating the contracts among investors in mortgage backed securities, who use a strategy for mortgage modifications provided by the American Securitization Forum. This system is a myriad of complications both operationally and financially as loan originators must be located to help fast track troubled homeowners into refinancing, rate freezes and term modifications. (Remarks by Treasury Secretary Henry M. Paulson, Jr. on Housing and Capital Markets before the New York Society of Securities Analysts, January 7, 2008)

The plan has been criticized as "too little, too late," particularly by the Center for Responsible Lending. The CRL estimates that only 7% of holders of subprime mortgages will qualify for the program. Hundreds of thousands of 2/28 ARM's made in 2005 will have already reset and will not be eligible for a modification. Also, those who have already fallen behind in their payments will not qualify as the program is only for those loans not in delinquency. Finally, the plan is in effect voluntary. Lenders and services have had the opportunity to modify mortgages yet according to a Moody's Investor Services study, only 1 percent of resetting subprime mortgages had been modified through July of 2007. There is little to guarantee that those borrowers who receive modifications will not lose the equity in their homes due to pre-payment penalties or be put into another bad loan. There remains the business as usual incentive for servicers, lawyers and lenders to reap the profitable fees generated from the foreclosure process. (Statement of Center for Responsible Lending in Response to President Bush's Plan to Address Foreclosure Crisis, December 6, 2007)

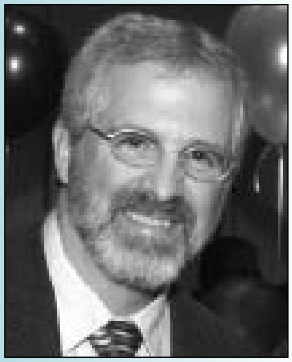
The Florida Experience.

Florida's foreclosure rate has landed it second in the nation. Florida has experienced foreclosure filings for over 200,000 properties in 2007, according to Realtytrac, a company that publishes the largest database of foreclosure properties. Realtytrac, the foreclosure data provider for the Wall Street Journal's Real Estate Journal, estimates that when year end activity is collected, it is likely that 14,000 homeowners will have lost their Florida homes to foreclosure sales. Florida's foreclosure rate ranks it second highest in the nation, based on November activity, with one foreclosure filing for every 282 households. In comparison, the U.S. rate was one foreclosure for every 555 households.

How has this Affected the Affordable Housing Industry

Two questions emerge for the Florida situation. How many of the foreclosures are for non-homesteaded, that is investor owned properties? And to what extent are the foreclosures affecting subsidized homes- properties purchased with some type of program assistance such as SHIP, HOME, or HOP? The use of best practices among SHIP and other affordable subsidized housing including homebuyer counseling and the use of prime, fixed rate mortgages protected these homeowners. Data from some areas indicate that investor properties are the majority share of the foreclosures. For example, of the 1,441 foreclosures filed in Lee County in December, 2007, 433, or 31 percent, were for primary, homesteaded residences. This doesn't lessen the painful losses experienced by those households who lose their homes. (News-Press, January 9, 2008)

During the bubble, residential prices increased over 80 percent in Florida while incomes remained relatively flat. Florida's affordable housing providers watched land costs spin out of reach while at the same time previously subsidized homes were sold off as buyers cashed in on the bounty. While subsidies were repaid and recaptured, the returns were no longer adequate to subsidize new buyers. Many communities resorted to shared equity mortgages



"Foreclosure calls to us have skyrocketed in just three months. We are now getting up to 50 new calls a day from families facing foreclosure. Just shy of 100% of those calls are from families we did not counsel or train or finance. In most cases, when a family is properly trained, counseled, and financed, they do not go into default. The best foreclosure prevention initiative is pre-purchase training and counseling. Our comprehensive homeownership services now include foreclosure intervention clinics geared toward quick collection of family data for negotiation with the lender."

Arden Shank
Executive Director & President
Neighborhood Housing Services

"Like most housing counseling agencies we have seen a marked increase in foreclosure clients from 2006 to 2007. We have experienced a 222% increase during that time period (148 foreclosure clients in 2006, 328 in 2007). The majority, if not all of these homeowners have not had the benefit of pre-purchase counseling or first time homebuyer education. According to our figures, the foreclosure clients that have received either homebuyer education or pre-purchase counseling is less than 1% of our total foreclosure clients. This statistic validates the effectiveness of pre-purchase education and counseling. Since the inception of our foreclosure program we have provided services to 1,168 area residents."

Gregg Schwartz
President & CEO, Tampa Bay CDC

and community land trust models to preserve the affordable housing inventory.

Foreclosure rate increases among SHIP subsidized homes is not expected to mimic the national trend. Most first mortgages with SHIP assistance have fixed interest rates and are not part of the subprime market. The pre-purchase homebuyer counseling process that is commonplace with the SHIP program gives the SHIP homebuyer a better understanding of mortgage responsibilities.

CONCLUSION

While foreclosure is always a reality in the homeownership business, the typical causes are unexpected medical expenses or loss of employment. Just as Florida has weathered its share of natural disasters, it will recover from the subprime mortgage crisis eventually and with significant intervention. The good news is that the assisted inventory is minimally affected, due to the best practices followed by the state's affordable housing providers, both public and private.