



“Observations on Housing, Lending, and Foreclosure Prevention”

**Eric S. Rosengren
President & Chief Executive Officer
Federal Reserve Bank of Boston**

***Citizens' Housing and Planning Association (CHAPA)
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I want to thank you for inviting me to join you this evening for the Citizens' Housing and Planning Association's 41st Annual Dinner and Meeting.¹ And I want to applaud CHAPA for its longstanding, proactive commitment to affordable housing and community development.

I especially admire the ways in which you bring together and leverage the interests of all parties with a stake in housing. This approach is no doubt challenging, but in it lie the roots of your success. As recent events in housing and financial markets have shown us, comprehensive solutions that engage many stakeholders can make for long

days, tough conversations, and complex negotiations – but can also make for workable solutions that make a difference.

Lately I have had occasion to say that these are the times when you need a central bank. I would add tonight, in all sincerity, that these are times when you also need a CHAPA.

As you all know, economic and financial conditions have deteriorated recently, and while the housing and financial markets are most impacted, there is little doubt that the effects are spilling over to the rest of the economy. However, now with appropriate and determined policy actions underway, I believe much of the spillover can be mitigated and the economy can return to growth that is closer to potential next year. To that end, I believe that policymakers should maintain a focus on three key areas, which I'll mention briefly.

First, it is essential that liquidity for companies is maintained, or more accurately, is re-established. It is really in every citizen's interest that firms – particularly our most creditworthy ones – not face uncertainty over whether they will be able to continue to finance themselves with short-term debt. In fact, firms with top credit ratings can be critical stabilizers during difficult times, as they should be in a position to continue to invest and ultimately help the economy maintain employment levels.

In this regard I am very pleased to point to recent steps policymakers have taken to restore well-functioning short-term credit markets. Actions taken include the establishment by the Federal Reserve of liquidity facilities for money market funds,

primary dealers, and issuers of commercial paper; the U.S. Treasury's recent steps such as providing temporary insurance for money market funds and the plan to invest capital in banks to free up lending; and the FDIC's guarantee on senior debt and non-interest-bearing transaction accounts of banks.²

In a speech at the University of Wisconsin last week,³ I spoke in some detail about issues of liquidity and liquidity-risk concerns. But as we gather tonight, I can say that I believe appropriate and powerful actions are now in process, so that while it will take some time for markets to return to normal, problems should moderate going forward.

My second observation is that financial firms need to have the financial strength to continue to lend to creditworthy borrowers. Making sure that banks have sufficient capital to continue to lend is vital, because access to credit is critical for households and businesses.

The policy actions taken earlier this week, building on those of recent months, should insure that banks have sufficient capital to continue lending, preventing more significant problems. It is very likely that these policy actions will mitigate some of the problems that have been rippling out from capital-constrained banks.

My third broad observation for policy focus involves the housing market – it needs to reach bottom and potential homebuyers need to gain the confidence to return to the market. By this I mean that individuals shopping for homes need to be confident that appropriate financing is available for home-ownership. Individuals need to be more confident in housing transactions proceeding normally because institutions and markets

with a role in such transactions are functioning well. And individuals need to feel that there is the potential for housing prices to rise.

It is this third broad theme, concerning the housing market, which I would like to expand upon this evening. I plan to offer a few thoughts on the background to current housing problems, make some observations on the issue of connecting lenders with borrowers, share some early results from a large foreclosure-prevention event we helped organize at Gillette Stadium, and end with a few concluding remarks.

I. Background on Current Housing Problems⁴

I'm sure most of you at a CHAPA event would agree that the causes of current housing problems are complicated and multifaceted. Yet despite the complexity of the issues, there are some observers who look for easy answers. Some have focused on lenders and lax underwriting standards; others have focused on profligate borrowers.

However, neither of these simple "black and white" explanations seems consistent with the facts – including the reality that just over half of all recent (2006-2007) foreclosures in Massachusetts have been suffered by *prime*, not subprime, borrowers – borrowers that did not need lax underwriting standards to qualify, and who did not have undue leverage since they qualified as prime borrowers.⁵

This is a good example of the complexity and nuance that surrounds the situation. So the explanations that assign blame in only one corner seem to me to fall short. This is an important point, because if we misdiagnose the causes of the crisis, we could misdirect the remedies.

In this regard, allow me to make just a brief comment on a matter of some debate in recent news reports and opinion pieces. Some, unfortunately, see the crisis and say that regulators pushed lenders to extend bad loans in previously underserved areas. The Boston Fed's position has long been – despite some determined mischaracterizations – that some flexibility in underwriting criteria may be appropriate *if the borrower's willingness and ability to handle the debt can be affirmed*, and such flexibility is considered in a consistent and fair manner across applicants.

We have not, and do not, advocate for irresponsible or poorly underwritten lending. That perspective, however, is *not* at odds with advocating that the various participants in housing markets continue to strive for fair access to credit, appropriately extended. Nor is it at odds with our belief that responsibly underwritten loans to borrowers in low- and moderate-income areas – including those whose credit situation is considered “subprime” but can document their ability to afford the loan – are welcome and indeed crucial.

To return to my discussion of the present situation, I know that most of you here tonight are seeing the toll that foreclosures are taking – particularly in low-and-moderate-income and minority communities and areas like Dorchester, Lawrence, Chelsea, and Worcester. Such communities are bearing the brunt of foreclosures in terms of volumes and rates.

I would like to make a few observations on foreclosures in general. Foreclosures are cyclical, meaning they are much more likely to occur when the economy is in a downturn and when housing prices are declining. **Slide 2** shows the delinquency rates for

residential mortgages at New England financial institutions. Not surprisingly, the last time that housing prices were falling and the unemployment rate was rising significantly, we saw a significant number of delinquencies.

To expand on this I would add that foreclosures, with their extraordinary toll on individuals, neighborhoods, and the broader housing market and economy⁶ – not to mention the lender or investor in many cases – usually have two common threads. *First*, foreclosure is much more likely if house prices are declining, since when prices are rising (especially if rapidly) a homeowner whose situation sours can sell the house rather than see the house foreclosed.⁷ *Second*, studies attribute the majority of foreclosures to certain unfavorable “life events” such as divorce, a spike in out-of-pocket healthcare costs stemming from an illness or injury in the family, or a loss of a job or income stream. Some such events are more likely during a period of elevated and rising unemployment rates. Unfortunately, in the current environment we have been experiencing both a decline in home prices and rising unemployment rates – conditions where we might expect elevated foreclosures.

Slide 3 shows that areas with the most significant declines in home prices, such as Florida, Nevada, and California, are also areas that have experienced very significant rates of foreclosure. This is also true for states in the Midwest that have been particularly impacted by the downturn in the auto industry.

Clearly, matters have been aggravated by developments for borrowers and lenders in the marketplace for home loans.⁸ For borrowers, it became much more common to borrow with little or no money down. Such borrowing is more risky, and would be

expected to result in more foreclosures during an economic downturn. In addition, low- or no-documentation loans expanded.

It has also become increasingly easy to refinance homes or take out a home equity (“piggyback”) loan⁹. In fact, many (about 70 percent) of the subprime foreclosures in Massachusetts came on homes that were originally purchased with prime loans – for many of these loans, owners had refinanced into subprime mortgages before defaulting.¹⁰ This suggests room for improvement in terms of informing and educating borrowers on the risks of homeownership, borrowing, and various financing arrangements. I would add, somewhat parenthetically, that in some markets many of the homes in foreclosure are investor-owned, or are second homes.¹¹

Significant innovations in mortgage lending occurred as the industry evolved – and some of these innovations have exacerbated recent problems. Mortgages that used to be held at local banks are now frequently originated by mortgage companies that reach out to borrowers through brokers, and then sell the mortgage to be part of a security backed by many mortgages.¹²

While some mortgage companies and brokers clearly acted in good faith, under such “originate to distribute” arrangements there was less direct incentive to insure that the mortgage was a sustainable product for the borrower than, for instance, with a loan a bank planned to hold in its portfolio. Certainly concerns about reputation in some cases exerted discipline – especially in situations where brokers depend heavily on word-of-mouth to generate leads – but there were significant countervailing forces at work. Lenders were rewarded for volume, and brokers were frequently rewarded for both

volume and higher interest rates. Too often in the unregulated sector, brokers' customers ended up in loans with high fees and unsustainable terms.

Many mortgage brokers had little or no regulatory oversight. Most of the subprime lenders active in this state were not federally regulated depository institutions, and most have failed.¹³ In short, there is a role for increasing the incentives for lenders, and those that broker loans, to place homebuyers in mortgages that they can sustain.

II. Connecting Distressed Borrowers with their Lenders

In today's mortgage environment, the continuing relationship with the borrower – that is, the collecting of mortgage payments and the handling of delinquencies and foreclosures – is generally handled by servicing organizations under contract to the individuals or entities investing in the securities that are backed by the mortgages.

Sometimes the same organizations are both loan originators and servicers. It is important to recognize that in their servicer capacity these organizations are still working for the investors.

A persistent complaint among distressed borrowers has been their inability to reach informed representatives of the loan servicers, to discuss and resolve their payment problems.¹⁴ In many accounts, borrowers report repeated efforts to reach servicers' representatives and describe the frustration of "bouncing around" a telephone maze without being able to reach someone with the information and authority to discuss their situation. Interestingly, we also hear complaints from loan servicers as to how difficult it is to reach and engage troubled borrowers. They highlight repeated mailings to troubled borrowers and the difficulty in finding phone numbers to reach some borrowers.

When home mortgages were held by local community banks, the banks were often in a position to know the borrower personally, and were well aware of how to contact the borrower should payment problems emerge. But today, loans may be originated by a broker who has no involvement with the borrower once the loan has closed. Frequently the loan servicer is located in another part of the country.

In sum, while economists like me have tended to assume that borrowers have a strong incentive to discuss their payments problems and the possible options for renegotiating terms, and that lenders have a strong incentive to avoid costly foreclosures, in practice getting borrowers and lenders together has proved to be surprisingly difficult (see **Slide 4**).

It was this observation that led the Federal Reserve Bank of Boston to want to hold a large, well-publicized foreclosure-prevention workshop. There are significant economies of scale to such an event. Large events can draw representatives of all the major servicers (many of whom have to fly in), so borrowers are less likely to be disappointed by their servicer not attending. There are also economies of scale in advertising the event and using a large venue with easy access and adequate parking and public transportation arrangements. Large events are also advantageous for the loan servicer, because they can reach a large number of their troubled borrowers in a particular geographic location.

Fortunately, Robert Kraft, Josh Kraft, and the New England Patriots Charitable Foundation were willing to provide Gillette Stadium, home of the New England Patriots football team, as the site for a major foreclosure-prevention event in August (see **Slide 5**). We had a variety of other invaluable co-sponsors and supporters: the Hope Now Alliance

helped bring in the loan servicers, and Neighborworks America helped bring in the housing counselors, some of whom work for organizations affiliated with CHAPA and some of whom may be here tonight. Many of your organizations helped us get the word out about the event. I want to thank everyone for working with us.

Outreach to borrowers was critical. The loan servicers that participated sent 27,000 letters to their borrowers in New England who were 60 days or more past due. The Boston Fed sent out over 50,000 postcards (**Slide 6**) to borrowers who took out subprime loans – developing the mailing list from publicly available information from the Registry of Deeds that was compiled by the Warren Group. We simply encouraged the recipients to consider attending the event if they would find it helpful to speak directly to their servicer, and to meet with a foreclosure prevention counselor if they chose. For additional outreach, with the help of our co-sponsors we placed numerous radio interviews and ads in English, Spanish, and Portuguese. In part we focused on areas with high incidence of foreclosures.

The event itself needed a big venue (**Slide 7**). We hosted 20 servicer organizations, which sent 80 loss-mitigation representatives. Most of them remained busy until late into the night, well after the formal close. In addition, we had the vital participation of some 20 counseling agencies that sent 50 counselors and legal aid representatives. They also worked tirelessly and stayed well after the close. In addition there was a large contingent of volunteers from Neighborworks, Fannie Mae, and the Federal Reserve Bank of Boston who pitched in to help the event run quite smoothly, considering its complexity and size.

III. Preliminary Results

The event attracted over 4,000 members of the public, representing 2,167 borrowers. While there was a significant wait to see some servicers, 60 percent of the surveyed attendees took advantage of the counseling services while waiting. Some servicers had the capacity to make loan modifications on the spot, while others could only collect information, assess the borrower's situation in person, and get back to the borrower after the event.

If one assumed that the mortgage crisis was isolated to one demographic slice of the country, the scene that day told a very different story. The borrowers who made the trek to Gillette seemed to be from all walks of life, and all races and ethnicities. The scene was both poignant and illuminating. Notably, the first lot to fill up at the beginning of our event was the handicapped parking area. We saw people of all ages with health concerns and physical ailments.

It is still too early to statistically analyze the ultimate, long-term impact of the event for distressed borrowers, but there are some indicative results that I can share with you this evening. **Slide 8** shows the results we at the Boston Fed have compiled to date for borrowers that attended. We signed up just under 400 of the borrowers that attended to be contacted for phone interviews, which we began conducting in the week following the event. The initial results show that about 39 percent of the people were still waiting to hear definitively from the servicer, about 37 percent had been told that the servicer would not make any adjustments, and about 24 percent had received some modification in their loan terms.

Furthermore, where there was a modification, the type of adjustments varied (see **Slide 9**). Of those we surveyed who had their loan modified, 62 percent had a permanent reduction in their interest rate, 42 percent had a temporary reduction in their payment, and 6 percent had a reduction in principal. In addition, about half of these borrowers were offered a repayment plan to make up for the late payments. By the way, it is worth noting that the event occurred in the middle of August, before the terms of the new “Hope for Homeowners” (H4H) program were announced by the Federal Housing Administration (FHA) on October 1.

We are now re-contacting the borrowers (the 39 percent) who were waiting to hear from their servicer about possible loan modifications, and we very much hope that round of calls will show additional progress. Of course, we also need more time to pass before we can analyze whether people who attended the event, or people who received loan modifications as a result, experience a significantly lower rate of foreclosure than those who did not attend.

We learned a lot with this event. We hope that at future events, more servicers will have the ability to make decisions on the spot or soon after the event. We are eager to see the numbers of borrowers who are still waiting to hear from their servicer on a possible modification go down, and for those decisions to happen more quickly in the future. Also, we will be interested to see whether the newly passed legislation has an effect on the number of borrowers that qualify for permanent reductions in interest rate or changes in principal, relative to what was experienced in August.

Concluding Observations

While it is too early for a full assessment of this one major foreclosure-prevention event, we do know that 24 percent of the attendees we have surveyed already have had the terms of their loan changed – and as we re-survey people, we hope that number will go up. As servicers have become better staffed to work out problems with borrowers, and with new legislative initiatives and other policy developments, we hope that more concrete actions can be taken sooner, thus avoiding preventable foreclosures.

It does appear that bringing borrowers together with servicers and counselors to discuss issues in person has significant advantages, and that large events reap certain economies of scale. For these reasons the Boston Fed is looking to partner on one or more large foreclosure-prevention events in the future. If we can line up a time and place that are appropriate for another such event, we will be making an announcement.

Of course, while foreclosure-prevention workshops appear to be helpful, ideally borrowers and lenders will not wait for these large events before initiating fruitful discussions. Ideally, with new legislative initiatives and the actions recently announced by the U.S. Treasury, more forceful actions will be taken by all participants – actions that in sum will help stabilize the housing market and benefit all its participants.

Thank you.

NOTES:

¹ Of course, the views I express today are my own, not necessarily those of my colleagues on the Federal Reserve's Board of Governors or the Federal Open Market Committee (the FOMC).

² Federal Reserve Chairman Ben Bernanke spoke about these efforts to stabilize financial markets and the economy on Wednesday; his speech can be found at <http://www.federalreserve.gov/news/events/speech/bernanke20081015a.htm>

³ “The Impact of Financial Institutions and Financial Markets on the Real Economy: Implications of a ‘Liquidity Lock’” is available on the Boston Fed’s website at <http://www.bos.frb.org/news/speeches/rosengren/2008/100908.htm>

⁴ I offered a more extensive historical perspective on housing downturns in a January speech available at <http://www.bos.frb.org/news/speeches/rosengren/2008/011108.htm>.

⁵ See pages 5 and 39 of *Subprime Facts: What (We Think) We Know about the Subprime Crisis and What We Don’t* by Christopher L. Foote, Kristopher Gerardi, Lorenz Goette, and Paul S. Willen (Federal Reserve Bank of Boston Public Policy Discussion Paper No. 08-2), available at <http://www.bos.frb.org/economic/ppdp/2008/ppdp0802.htm>

⁶ The Federal Reserve Bank of Boston has been engaged with the foreclosures issue on a number of fronts. Economists and analysts in the Research department have issued a number of carefully researched, illuminating papers on the topic; our Public and Community Affairs department has been analyzing and disseminating foreclosures data, and engaging in outreach and special task forces on the issues. Much of this work, including an interactive website with Massachusetts town-level data showing the interaction between house prices and foreclosures, and quarterly updates of mortgage delinquency data by product, is available on our website, www.bos.frb.org in the “Foreclosure Resource Center” section, with information for the consumer at special site the Bank has set up at theinformedhomebuyer.org.

⁷ See pages 3 and 20 of *Subprime Facts: What (We Think) We Know about the Subprime Crisis and What We Don’t* by Christopher L. Foote, Kristopher Gerardi, Lorenz Goette, and Paul S. Willen (Federal Reserve Bank of Boston Public Policy Discussion Paper No. 08-2), available at <http://www.bos.frb.org/economic/ppdp/2008/ppdp0802.htm>

⁸ I discussed these developments in more detail in a December 2007 speech on “Subprime Mortgage Problems: Research, Opportunities, and Policy Considerations” – available at <http://www.bos.frb.org/news/speeches/rosengren/2007/120307.htm>; and in an October 2007 speech on “Recent Developments in Real Estate, Financial Markets, and the Economy” available at <http://www.bos.frb.org/news/speeches/rosengren/2007/101007.htm>.

⁹ I discussed “piggyback” loans as one of the issues complicating the resolution of housing problems in a May speech available at <http://www.bos.frb.org/news/speeches/rosengren/2008/053008.htm> (“Current Challenges in Housing and Home Loans: Complicating Factors and the Implications for Policymakers”).

¹⁰ See page 5 and 39 of *Subprime Facts: What (We Think) We Know about the Subprime Crisis and What We Don’t* by Christopher L. Foote, Kristopher Gerardi, Lorenz Goette, and Paul S. Willen (Federal Reserve Bank of Boston Public Policy Discussion Paper No. 08-2), available at <http://www.bos.frb.org/economic/ppdp/2008/ppdp0802.htm>

¹¹ Some of the more elevated foreclosure rates in Massachusetts are on Cape Cod, where there are many second homes. In Florida and Nevada, there were many investor-owned properties, and these areas have been particularly impacted by foreclosures.

¹² Mortgages were pooled and securitized, then split and re-sold onto the secondary market to investors. Servicing companies act as intermediaries between the borrowers – the person making the monthly mortgage payment, and the ultimate investor. The securities are governed by complex pooling and servicing agreements that vary in terms of what they allow. This makes loan workouts much more complicated. Some allow for flexibility on modifications according to standard servicer procedure, others place caps on the number of loans that can be modified, others still explicitly forbid modifications.

¹³ See the Table in my speech on “Subprime Mortgage Problems: Research, Opportunities, and Policy Considerations” – available at <http://www.bos.frb.org/news/speeches/rosengren/2007/120307.htm>.

¹⁴ An informed and balanced description of these issues was offered in the testimony of Urban Edge’s Mossik Hacobian before the House Committee on Financial Services on September 17. The testimony, at a hearing on “The Implementation of the Hope for Homeowners Program and A Review of Foreclosure Mitigation Efforts”, is available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/hacobian091708.pdf

Observations on Housing, Lending, and Foreclosure Prevention

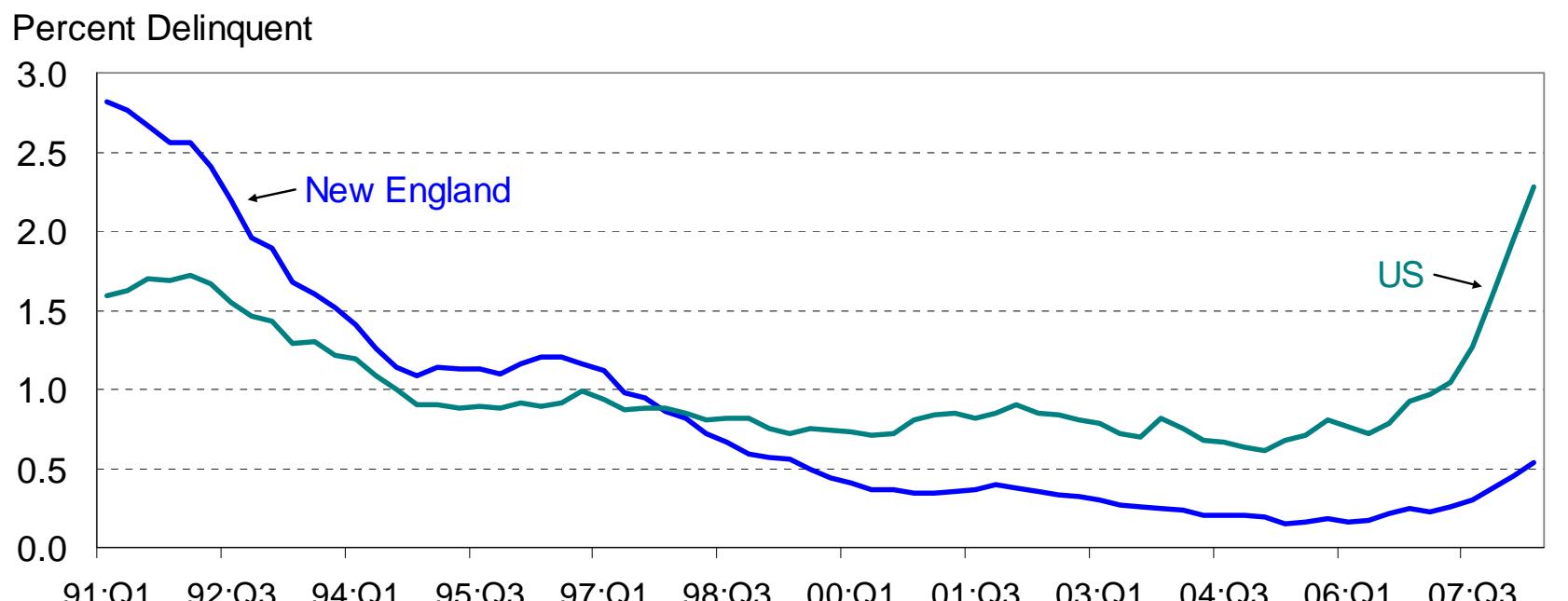
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Citizens' Housing and Planning Association
October 16, 2008



Delinquency Rates on Residential Mortgage Loans at Commercial and Savings Banks

1991:Q1 - 2008:Q2

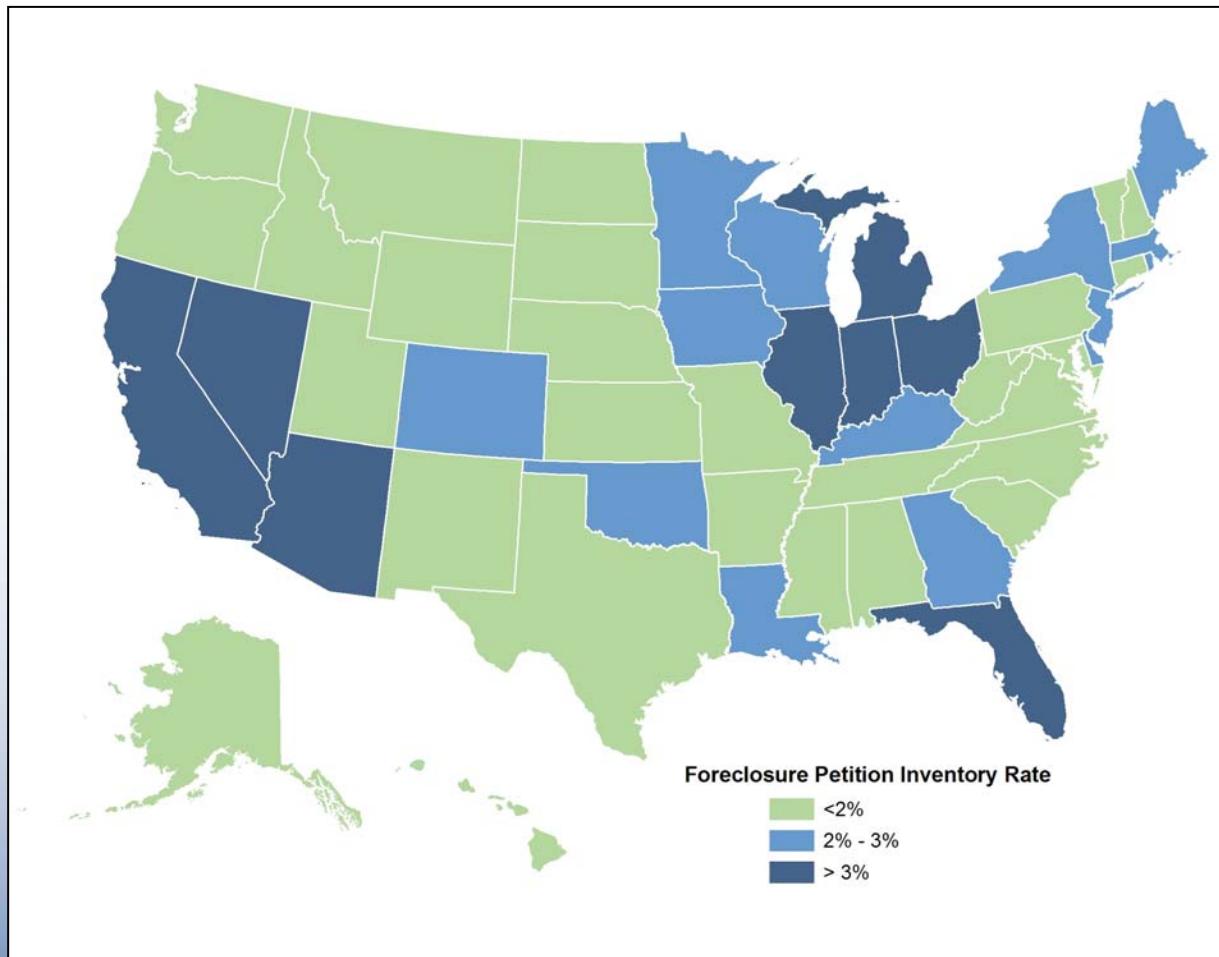


Note: Delinquent loans include loans 90 or more days past due and loans in nonaccrual status.

Source: Commercial and Savings Bank Call Reports

Share of Loans in the Foreclosure Process

As of June 30, 2008



Source: Mortgage Bankers Association National Delinquency Survey / Haver Analytics

Foreclosure Prevention Workshop

Purpose:

- Help troubled borrowers connect with servicers
- Help servicers connect with difficult to reach borrowers

Activity:

- Borrowers meet one-on-one with their servicer
- Borrowers could meet one-on-one with foreclosure prevention counselor if they so chose (and many did)
- Borrowers could hear financial-education workshops:
 - Understanding Credit; Budgeting; Short Sales

Many Contributors

- Federal Reserve Bank of Boston
- Kraft family & New England Patriots Charitable Foundation
- HOPE NOW Alliance
- NeighborWorks America
- FANNIE MAE
- MBTA
- Mortgage Relief Fund Banks & Mass. Bankers Association
- National Association of Realtors
- The Warren Group
- Elected Officials

Get Help to Save Your Home

Please Alert Anyone You Think May Be Interested

WHAT

Work out a plan for your mortgage.

Borrowers can talk face-to-face with their lender and local housing counselors.

WHERE

Gillette Stadium, Fidelity Investments Clubhouse, East One Patriot Place, Foxboro, MA – parking lot entrance P1
Free Parking; Free Transportation*

WHEN

Tuesday, August 12, 2008
1:00 PM to 8:00 PM

FOR MORE INFORMATION

Visit www.theinformedhomebuyer.org or call 1-800-882-1600

Borrowers can call the 800 number to learn if their lender will be present and can leave their name, questions, and a callback number to have questions answered.
Se habla español.

IMPORTANT

Borrowers should bring documentation for their income, expenses, debt, and mortgage.

Foreclosure Prevention Workshop

FOR STRUGGLING HOMEOWNERS

Open to the Public



* Free commuter rail from Boston or Providence & shuttle bus to Gillette Stadium. Take Providence/Stoughton line to Mansfield stop. Bring this card and/or invitation letter to qualify for train and bus. Visit www.mtba.com for train schedules.

A Big Event

Servicers – organized by Hope Now

- 20 servicers
 - 80 loss-mitigation reps
 - 27,000 invitations

Counselors – organized by NeighborWorks

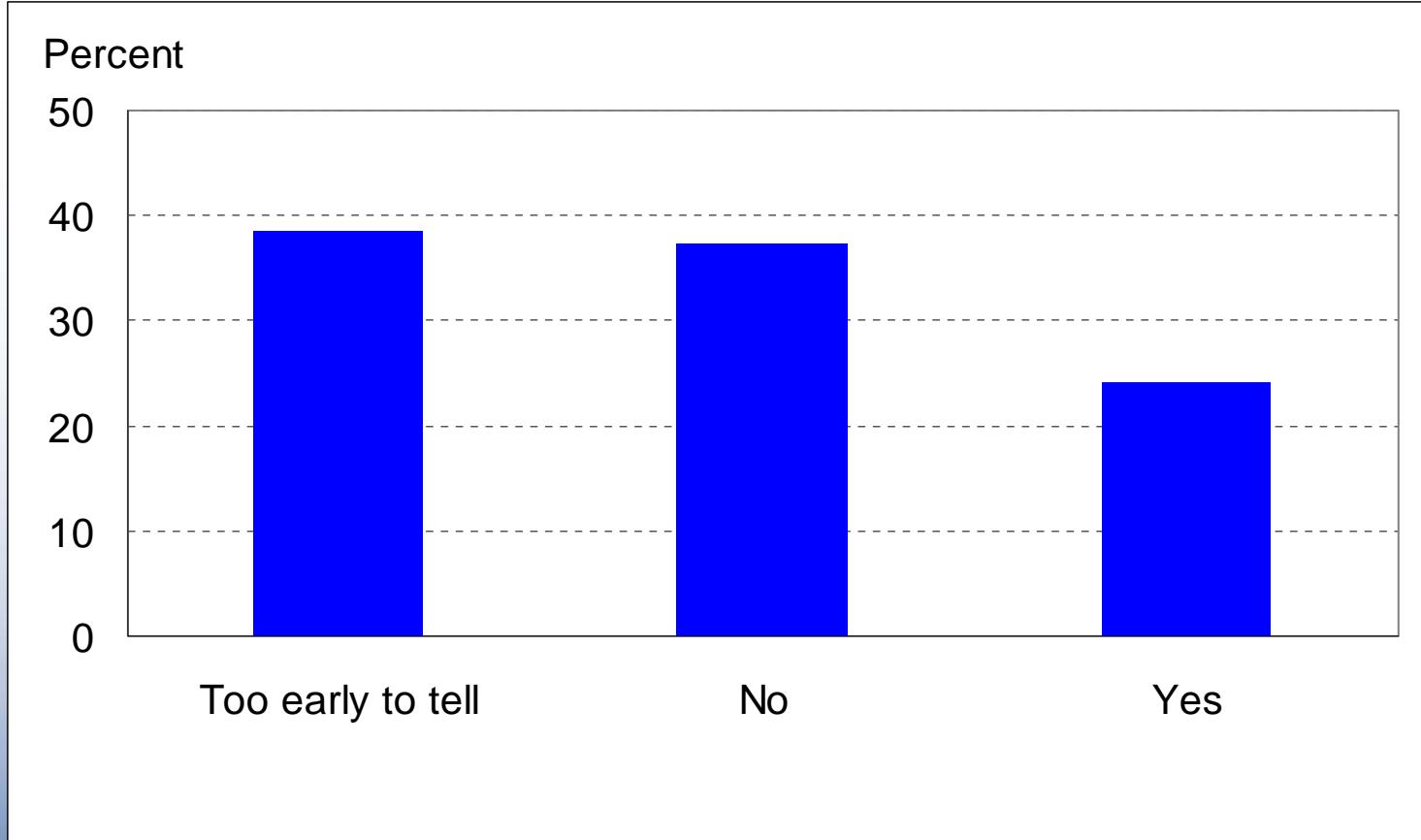
- 20 agencies
 - 50 counselors and legal-aid reps

Volunteers

- 60+ from NeighborWorks, Fannie Mae, and the Federal Reserve
 - Greeters, registration, “runners”

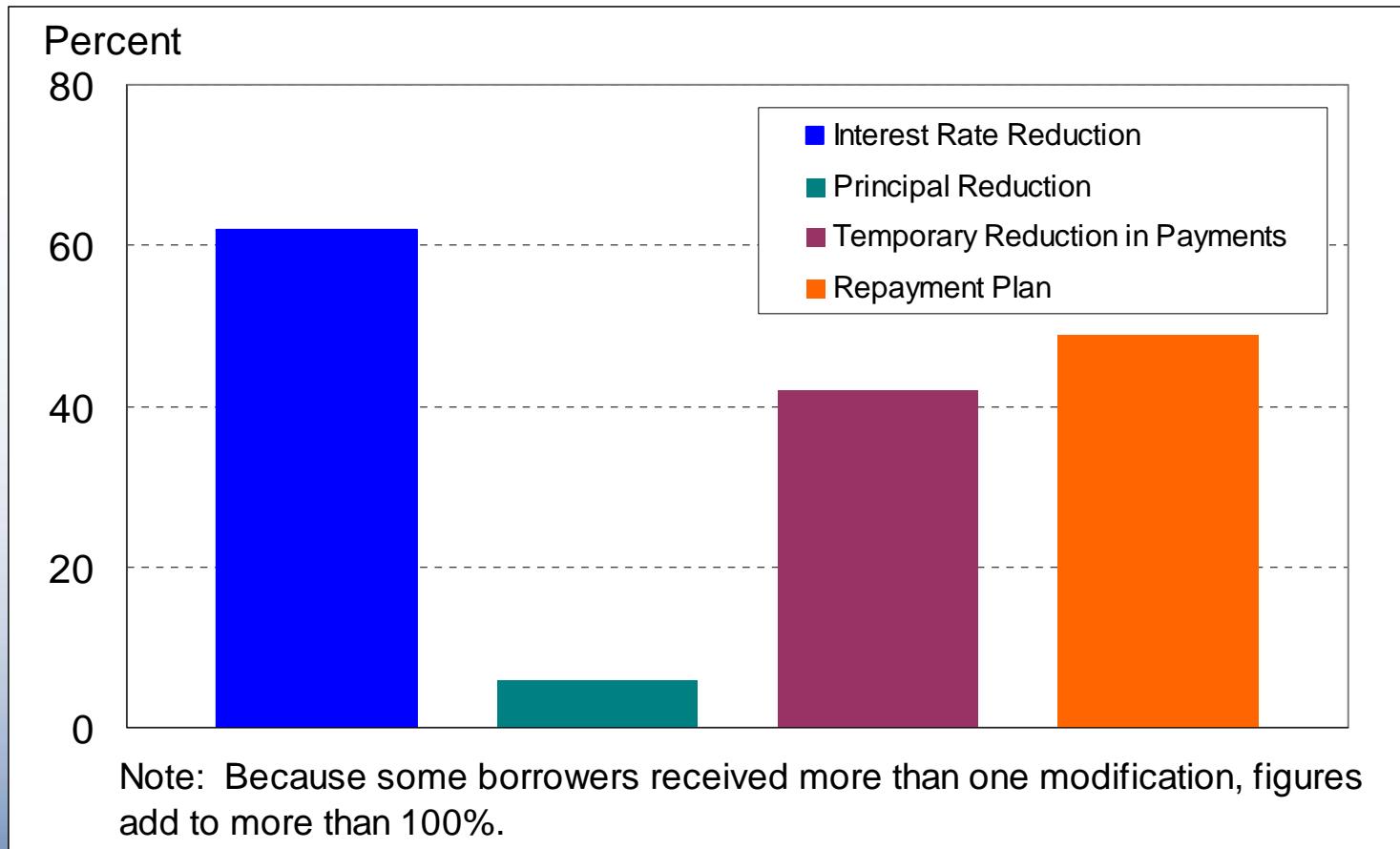
Borrowers – 2,167 (4,000 individuals in total)

Did the Servicer Make a Concession at (or after) the Gillette Stadium Event?



Source: Survey of borrowers attending Gillette event

Of Borrowers Receiving Modifications, Types Reported



Source: Survey of borrowers attending Gillette event