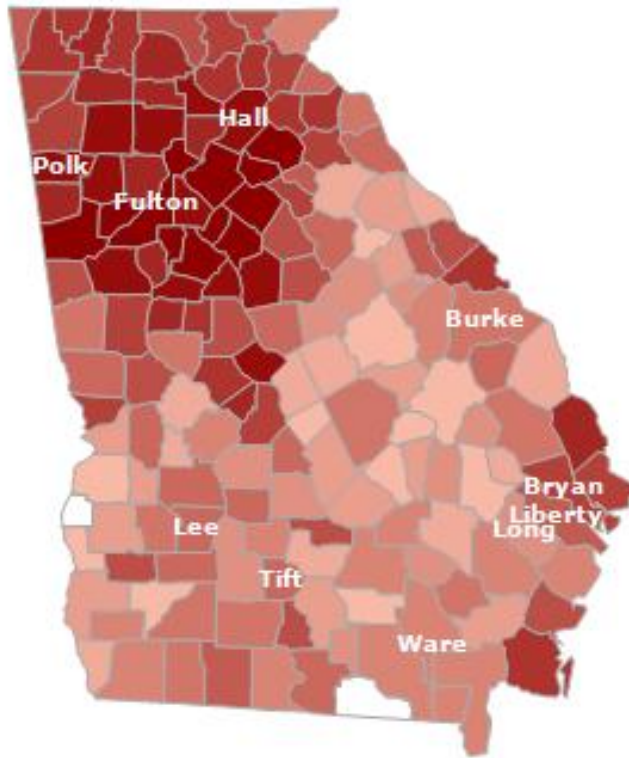


# Georgia Foreclosure Crisis Part Two: *The Road to Reform*



A product of Georgia Watch, the state's leading consumer advocacy group. We impact statewide policy and provide pro-consumer education in the areas of health care, foreclosure, energy efficiency and fair utility rates, predatory lending and identity theft.

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## EXECUTIVE SUMMARY

In early January 2010, Georgia Watch released the report *Georgia Foreclosure Crisis: The Rippling Effects of Foreclosure*, which detailed the ominous foreclosure crisis that has enveloped our state's housing market. The report examined the causes and effects of the crisis on Georgia's economy and residents, and how it will likely get worse before improvements are seen.

Among the key findings were:

- By the end of 2009, 13 percent, or one in eight, of the state's mortgage-holders was at least 30 days behind on their loan<sup>i</sup>;
- Fulton, Gwinnett and DeKalb Counties deliver the highest number of foreclosure notices in the state with a combined average of 21,865 per month<sup>ii</sup>;
- There were 25 bank failures in Georgia in 2009, the most in the nation;
- Approximately one in four or 377,000 of Georgia's 1,573,628 mortgages are "underwater"; and,
- Georgia families will lose \$13 billion in home equity between 2009 and 2010 as the result of neighboring foreclosures pulling down overall property values.

As foreclosures continue to escalate, lawmakers in Georgia currently have the opportunity to pass sensible mortgage reform that would protect communities from a similar crisis in the future. In 2009, a coalition of organizations, including the Georgia Family Council, AARP Georgia, the Catholic Archdiocese of Atlanta and Georgia Watch, helped craft and support a foreclosure and loan origination reform bill based largely on reforms in Ohio, North Carolina and Maine. Sponsored by Senator Bill Hamrick (R-Carrollton), Senate Bill 57 would:

- Ban prepayment penalties on subprime loans;
- Ban broker "yield spread premiums" or kickbacks on subprime loans and FHA loans;
- Designate brokers as agents of borrowers, with fiduciary responsibilities; and,
- Require that lenders verify that the borrower has the ability to repay subprime loans, including income verification.<sup>iii</sup>

Now, during the 2010 session, Georgia Watch encourages lawmakers to pass the common-sense underwriting standards within SB 57. In addition to looking at the need for mortgage reform in Georgia, this report will largely focus on the timeline of SB 57 in 2009, while examining two other states, New York and North Carolina, which have enacted similar provisions to give borrowers peace of mind and prevent housing crises in the future.

## INTRODUCTION

As outlined in the report *Georgia Foreclosure Crisis: The Rippling Effects of Foreclosure*, the impetus of the housing crash was irresponsible lending that took place over the past decade. Misguided lending was spurred by a number of different factors, including demand for mortgage-backed securities by Wall Street investors; but typically began with mortgage brokers and lenders who originated high-interest, subprime home loans.

Mortgage brokers and lenders often steered borrowers into these costlier loans with attractive introductory rates, while taking advantage of specific mechanisms to facilitate overcharging such as yield spread premiums (YSP), or kickbacks. In recent years, subprime lenders and brokers saturated the growing subprime market with hazardous mortgages that had "exploding" adjustable interest rates.<sup>iv</sup> What resulted were borrowers defaulting on loans at record speed, creating an epidemic of foreclosures that has harmed families, communities and the global economy.

In order to prevent similar housing crises in the future, reforms to the mortgage industry must be enacted. To date, at least 30 states have some sort of predatory lending law, with the strongest laws in Arkansas, California, Illinois, Massachusetts, New Jersey, New Mexico, New York, North Carolina, South Carolina, and West Virginia. State anti-predatory lending laws include provisions such as restricting the amount of fees that may be applied to a loan, restricting prepayment penalties on subprime loans, and banning excessive loan flipping.<sup>v</sup>

This report examines preventative measures that have passed specifically in New York and North Carolina, and the influence these laws have on Georgia's own policies. In order to prevent a similar economic crash and housing crisis in the future, it is imperative that Georgia legislators pass reform that will curb subprime lending and hold brokers, lenders and borrowers alike, accountable for their business transactions.

## **ACTS TO FOLLOW – North Carolina and New York**

Though a large number of states had anti-predatory lending laws, many found that during the housing boom predatory lenders found ways to sidestep existing laws with new mortgage instruments. Therefore, many states amended existing laws or enacted new statutes to address the current housing crisis and combat hazardous lending tools.

### **North Carolina**

In 1999, North Carolina enacted the first "anti-predatory lending law," which took aim at abusive mortgage practices designed to charge borrowers unnecessary or exorbitant fees or direct borrowers into high cost loans. North Carolina's anti-predatory law was directed toward mortgage lenders that fell just below the standards set by the 1994 Federal Home Ownership Equity Protection Act (HOEPA).<sup>vi</sup>

North Carolina enacted HB 1817 in 2007 to limit mortgage brokers' ability to collect yield-spread premiums and charge prepayment penalties; require lenders to consider the ability of borrowers to repay; and protect homeowners from abusive mortgage servicing companies that misapply mortgage payments, charge illegal fees, and mishandle escrow accounts.<sup>vii</sup> The legislation also strengthened the 2001 Mortgage Lending Law with new language clarifying that a broker's duties go beyond simply connecting a borrower with a lender that will make a loan and include more disclosure.

### **New York**

New York Governor David Paterson signed the Foreclosure Prevention and Fair Lending Act into law on August 5, 2008, amid the housing crisis. The Act added prohibitions to New York's existing anti-predatory lending law,<sup>viii</sup> which was similar to North Carolina's law, but also added a ban on teaser rates with duration of 6 months or less. The law also prohibits negative amortization, in which a borrower is allowed to make

payments lower than the amount of accrued interest with the unpaid interest increasing the principle balance. Additionally, New York’s Fair Lending Act added stipulations to provide direct foreclosure relief to those in the midst of losing their homes, including mandating settlement attempts.<sup>ix</sup>

Until recently, mortgage loans were almost always a good thing for families, but when the aggressive marketing of reckless loans became routine in the subprime market, too many loans became destructive not only for the families that received them, but ultimately for the entire economy. Looking to New York and North Carolina as examples and passing common sense reforms will reinstate the benefits of homeownership with mortgage loans that are fair, sensible and sustainable for Georgia.

## GEORGIA’S MORTGAGE REFORM

Dangerous lending practices and loose underwriting in the subprime market will cause approximately 350,000 Georgia families to lose their homes to foreclosure between now and 2012. Many of these families are trapped in "exploding" adjustable rate mortgages (ARMs) that are due to raise monthly payments to potentially unaffordable levels. In fact, hundreds of thousands of families face rate increases at the same time that their homes are worth less than the balance on their mortgage; one in every four mortgage holders is “underwater”. Few of these homeowners will be able to sell or refinance, leaving them trapped in a precarious financial situation.

### Numbers make a case for Georgia reform

Foreclosure Projections 2009-2012	Statewide lost home equity	Number of past due mortgages (Q3 2009)	Increase in foreclosure Q3 2006-Q3 2009	“Underwater” Mortgages (owe more on mortgage than home is worth)
<b>348,343</b>	<b>\$13.1 billion</b>	<b>277,723</b>	<b>143 %</b>	<b>1 in 4</b>

Source: Center for Responsible Lending<sup>x</sup>

## Enacted Legislation

### Senate Bill 531

On May 13, 2008 Governor Sonny Perdue signed Senate Bill 531 into law. The bill, strongly championed by sponsors Senator Bill Hamrick and Senator Nan Orrock, increases the notice to a homeowner before a lender can foreclose from 15 days to 30 and introduces elements of fairness to the foreclosure process.<sup>xi</sup>

Prior to the enactment of this legislation, Georgia law required a certified letter giving notice of a foreclosure sale to be sent to a homeowner 15 days prior to a scheduled foreclosure. An advertisement must run in a newspaper four weeks prior to the foreclosure, which has meant that the legal advertisement could begin running before a homeowner received notice of the foreclosure. Many of the legislators who supported SB 531 felt that out of fairness, a homeowner should receive notice before the advertisement is published; claiming 15 days was not a sufficient time, therefore changing it to 30.

## Senate Bill 141

A coalition of organizations, including the Georgia Family Council, AARP Georgia, the Catholic Archdiocese of Atlanta and Georgia Watch, helped craft and support a foreclosure and loan origination reform package in 2009.

Senate Bill 141, was originally part of Senate Bill 57 in 2009, but was split off and individually enacted.<sup>xii</sup> SB 141 requires holders of foreclosure deeds to file them with local governments within 90 days; a more timely system for filing deeds makes it easier for local governments to identify the owners of a foreclosed property. This is important to protect communities from increased crime and falling real estate values that often accompany vacant properties and unkempt houses, the direct consequences of foreclosure.

## Proposed Legislation

While the subprime market represents just 13 percent of all outstanding loans in Georgia, subprime foreclosures accounted for 40 percent of the total number of Georgia foreclosures in the first quarter of 2009.<sup>xiii</sup> The following bills will be on the table during the 2010 legislative session and will help prevent many of the lending abuses that led to the current economic crisis and the high rate of subprime default foreclosures.

### Senate Bill 57: Georgia's Fair Lending Act

In 2009, Senator Bill Hamrick proposed Senate Bill 57, the most crucial piece of legislation regarding the housing market crash currently pending in the Georgia House of Representatives' Judiciary Committee. The bill would add new provisions to Georgia's current Fair Lending Act that would reform the mortgage industry's lending practices to make loans less prone to failure. All of the key provisions in SB 57 have passed in other states.

#### *SB 57 Provisions:*

- **Define "subprime" loan in the Code**  
Some standards for subprime loans may not make sense for all home loans. Making policy changes that target subprime loans, those that led to the current economic crisis, can have a big impact without effecting traditional mortgage underwriting.
- **Establish a clear ability-to-repay and underwriting standard for subprime loans**  
The most basic lending standard has been all too absent, as up to half of all subprime loans awarded, were done so without income verification. When income verification is absent from the review process, it is impossible to determine a borrower's ability-to-repay.
- **End prepayment penalties**  
Prepayment penalties are extra charges on the borrower that kick in if the loan has been paid off ahead of schedule. This phenomenon discourages families from getting ahead when they have the financial means to do so. Georgians should never be penalized for paying debt off early. A subprime loan should be a bridge to better financing, not an anchor to high cost debt.

- **Limit kickbacks to mortgage brokers**

Any mortgage reform legislation should address the direct financial incentives (often called “yield-spread premiums” or YSPs) that mortgage brokers and other originators utilize to steer borrowers to more expensive loans or unsuitable products. Studies by Harvard,<sup>xiv</sup> the Department of Housing and Urban Development, and the Center for Responsible Lending have shown that subprime brokered loans are more expensive, more likely to enter foreclosure, and more likely to have prepayment penalties than loans made directly by a lender. The Federal Reserve recently concluded that disclosures alone were insufficient in addressing the problem of these payments.<sup>xv</sup>

- **Mortgage brokers as agents of the borrower**

Brokers should only recommend loans that are suitable for the borrower. Not doing so equates to a higher risk of default. To ensure that brokers are steering their customers to the best loan, SB 57 declares that a mortgage broker is the agent of the borrower and has duties to act in the interest of the borrower.

### *SB 57 at the legislature*

During the 2009 legislative session, SB 57 passed the Senate with little opposition; however, the bill stalled in the House of Representatives, leaving Georgia’s subprime crisis unaddressed for the time being.

### **TIMELINE: SB 57 at the Capitol (2009)**

<b>Jan 8, 09</b>	<b>Jan 09 – Feb 09</b>	<b>Mar 10, 09</b>	<b>Mar 20, 09</b>	<b>Mar 09 – Apr 09</b>
SB 57 is introduced by Sen. Bill Hamrick. In addition to the origination provisions that appear in the current version, this first version also included a renter’s right provision letting the renter remain in a foreclosed home for 60 days, and an equitable remedy for someone who loses their home due to a foreclosure rescue scam. The original bill also included a requirement that deeds obtained through a foreclosure sale be promptly recorded (later split into SB 141 and passed, <i>see page 5</i> ).	The following weeks, Sen. Hamrick kept the bill in his committee while attempting to address stakeholder concerns. Provisions not dealing with origination were split into SB 139, 140 and 141. The underlying bill was changed to reflect the current language ( <i>see page 5</i> ).	After spending time in Rules, SB 57 comes to the Senate floor for a vote. Senator Steve Thompson attempts to amend it to add assignee liability, but it fails on a hand vote. The bill passes 43-9. The bill goes to House Judiciary Committee; Chairman Wendell Willard assigns it to the subcommittee chaired by Rep. Mike Jacobs. Jacobs’ subcommittee wrestles with it for almost two weeks, offering several different versions, one of which fails to pass. What ultimately passes out of subcommittee is similar to the Senate version. It also expands sections applying to all home loans and adds a prohibition combating negative amortization loans.	House Judiciary passes the re-written version of SB 57.	The House Rules committee only met a few times while SB 57 was in their committee. They chose not to send it to the floor for a vote by the full House.

## GEORGIA LEADERS CALL FOR REFORM

Calls for reform are resonating all across the nation and Georgia is no different. Homeowners on the verge of foreclosure are crying out for more recourse, mortgage holders are screaming about high interest loans and consumer advocates are calling for substantive reform. The following media clips were pulled from recent Georgia headlines detailing the ostensible need and want for standard underwriting practices during the process of home loan origination.

“Legislature considers new mortgage rules,” *Atlanta Journal-Constitution*, January 23, 2010<sup>xvi</sup>

*Sen. Bill Hamrick (R-Carrollton), lead sponsor of the mortgage lending bill [SB 57], said changes are needed because subprime mortgage brokers often sold loans that consumers didn't need or couldn't afford.*

*“But the broker certainly benefited,” Hamrick said, “because they got a fee and didn't have to worry about whether the loan got repaid.”*

*Hamrick said his legislation is designed to stop brokers from putting consumers in loans that are lucrative for the broker instead of offering the lowest rate available.*

*“There's too much incentive to take advantage of the knowledge the broker has over the borrower in a lot of cases,” he said.*

“Georgia gets a ‘D’ in housing,” *Atlanta Business Chronicle*, September 29, 2010<sup>xvii</sup>

*“This data from the Scorecard, along with recently released numbers showing over a half million mortgages underwater in our state, is a clear signal that the foreclosure crisis is far from over,” said Georgia Watch Executive Director Angela Speir Phelps.*

“AARP Georgia outlines its 2010 legislative priorities,” *North Georgia Politics*, January 7, 2010<sup>xviii</sup>

*Support SB 57 which works to protect Georgians from abusive lenders and predatory lending practices. SB 57 passed the Senate in 2009.*

*“These priorities were selected after speaking with our members and looking at the key issues likely to come up during the 2010 legislative session,” said Rick D'Arezzo, state president of AARP Georgia. “We are urging all Georgians to join with us and let their legislators know what's important to them as the new session begins.”*

Rainbow/PUSH Atlanta<sup>xix</sup>

*According to Janice L. Mathis, Vice President of Jesse Jackson's Rainbow PUSH based in Atlanta, “We still need systemic, comprehensive reforms. Borrowers with good credit are locked out of the capital markets, tenants are not protected, scammers and banks are stripping equity.”*

## CONCLUSION

The first step to preventing another foreclosure crisis is passing viable mortgage reform that makes the riskiest loans safer for all parties involved in a transaction. The lack of real underwriting standards fed a huge real estate bubble that dealt a serious blow to the economy when it burst. Lawmakers should look at passing best practice policies for servicers and brokers, like those in North Carolina. Once these preventative measures are in place, Georgia legislators and advocacy groups must encourage the passage of direct foreclosure relief, akin to the provisions in New York's Lending Act, to help borrowers who unnecessarily fell victim to the current economic climate.

Without implementing fair lending and home origination underwriting standards the Georgia state legislature would not only be lagging behind the actions of many other states, they would be letting down the people who raise their families and call Georgia home.

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<sup>i</sup> Mortgage Bankers Association, *3Q National Delinquency Survey* (2009)

<sup>ii</sup> Information from Equity Depot (2009) [www.Equitydepot.net](http://www.Equitydepot.net)

<sup>iii</sup> Georgia Fair Lending Act: [http://www.legis.ga.gov/legis/2009\\_10/sum/sb57.htm](http://www.legis.ga.gov/legis/2009_10/sum/sb57.htm)

<sup>iv</sup> "A Snapshot of the Subprime Market," *Center for Responsible Lending* (2007) <http://www.responsiblelending.org/mortgage-lending/tools-resources/a-snapshot-of-the-subprime.html>

<sup>v</sup> "Foreclosure Prevention: Predatory Lending," *NGA Center for Best Practices*, October 21, 2009.

<http://www.nga.org/portal/site/nga/menuitem.9123e83a1f6786440ddcbeeb501010a0/?vgnextoid=9bcc19091b68f110VgnVCM100005e00100aRCRD>

<sup>vi</sup> Ibid.

<sup>vii</sup> Ibid.

<sup>viii</sup> Keefe, Kristen E., "DHCR Regional Meetings: Foreclosure Prevention Services Program," *Empire Justice Center*

<sup>ix</sup> "Foreclosure Prevention and Responsible Lending Act of 2008," *NEDAP* (2008)

<sup>x</sup> "The Cost of Bad Lending Georgia," *Center for Responsible Lending*, (Jan 2010) <http://www.responsiblelending.org/mortgages-lending/tools-resources>

<sup>xi</sup> [http://www.legis.state.ga.us/legis/2007\\_08/sum/sb531.htm](http://www.legis.state.ga.us/legis/2007_08/sum/sb531.htm)

<sup>xii</sup> [http://www.broc.state.ga.us/legis/2009\\_10/sum/sb141.htm](http://www.broc.state.ga.us/legis/2009_10/sum/sb141.htm)

<sup>xiii</sup> Mortgage Bankers Association, *1Q National Delinquency Survey* (2009)

<sup>xiv</sup> Park, Kevin. "Subprime Lending and the Community Reinvestment Act," *Harvard Center for Housing Studies* (2008). [http://www.jchs.harvard.edu/publications/governmentprograms/n08-2\\_park.pdf](http://www.jchs.harvard.edu/publications/governmentprograms/n08-2_park.pdf)

<sup>xv</sup> Chairman Ben S. Bernanke, "Financial Innovation and Consumer Protection" At the Federal Reserve's 6<sup>th</sup> Biennial Community Affairs Research Conference, Washington D.C. (April 17, 2009)

<http://www.federalreserve.gov/newsevents/speech/bernanke20090417a.htm>

<sup>xvi</sup> <http://www.ajc.com/news/legislature-considers-new-mortgage-281590.html>

<sup>xvii</sup> <http://atlanta.bizjournals.com/atlanta/stories/2009/09/21/daily29.html>

<sup>xviii</sup> <http://northgapolitics.com/articleinfo.asp?Link=1702>

<sup>xix</sup> [http://www.rainbowpushatlanta.org/rainbowpushatlanta.org/public\\_html/JacksonPraisesCITIGROUP.htm](http://www.rainbowpushatlanta.org/rainbowpushatlanta.org/public_html/JacksonPraisesCITIGROUP.htm)