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"The Effect of Subprime and Alternate Mortgage Instruments on the Economy, Housing and the Land Records Industry"

Keynote Address

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Good afternoon and thank you for inviting me to speak at the 2012 PRIA Winter Symposium here in our nation's capital Washington, DC. Today is the second of your three-day-conference so by now brain capacities are close to reaching overload. I am very honored to contribute, hopefully significantly, to that overload.:-)

I was asked to speak about The Effect of Subprime and Alternate Mortgage Instruments on the Economy, Housing, and the Land Records Industry. My remarks have three parts.

First, I will talk about the consequences of subprime and alternate mortgage instruments on the economy and housing.

Second, I will talk about the effect of subprime and alternate mortgage instruments on the land records industry.

Third, I will advocate for a land recording system that is

* prompt

* reliable

* intelligent, and

* accessible.

In other words, I will advocate for a land recording system that is PRIA (prompt, reliable, intelligent, and accessible).:-)

Let’s start with the consequences of subprime and alternate mortgage instruments on the economy and housing.

Subprime and alternate mortgage instruments have been around for more than a decade. Some did not perceive them as a problem as long as the economy was doing well and house price appreciation was strong.

However, subprime and alternate mortgage instruments were a problem. They encouraged borrowers to overleverage themselves with unaffordable and unsustainable mortgage credit and those loans inflated the house price bubble to a dangerous and unsustainable level. The house price bubble peaked in the summer of 2006 and precipitated the start of the collapse of the housing market and then the financial markets and ultimately the economy as a whole.

A high proportion of subprime and alternate mortgage instruments have ended in foreclosure. The **first** generation of foreclosures, lasting from early 2007 to about mid-2008 was caused by many borrowers unable to refinance their unaffordable subprime and alternate mortgages.

This was especially true for those mortgages with an upward interest rate adjustment. And for those mortgages that were tied to a house in a mortgage market that experienced a decline in price.

The **second** generation of foreclosures, starting from about mid-2008, was caused by borrowers unable to refinance or pay down their mortgages due to job loss or a cut in their pay.

Another cause was the dramatic collapse in home prices that has led some borrowers to strategically default because their homes have lost more value than many borrowers feel they will ever recover. Home prices nationally have fallen by more than a third and in some states that figure exceeds more than 50 percent.

The consequence is that many borrowers are underwater in their mortgages—meaning that they owe more than their homes are worth. It is estimated that the share of mortgages that are upside down is between 25 to 38, percent depending on whose data is being cited.

But even at the lower proportion, that's a major problem for the real estate market.

Although the National Bureau of Economic Research determined in June 2009 that the recession is technically over, the economy has not returned to normal. An improving economy is necessary to get us out of the foreclosure crisis.

Some studies give me reason to be hopeful about the economy improving, for example, the current unemployment rate of 8.3 percent. The Job Openings and Labor Turnover Survey release from the Bureau of Labor Statistics published early last month shows that the number of job openings had increased by 258,000 by December last year to 3.4 million. The ratio of unemployed workers to job openings was 3.9-to-1 in December, down from its peak of 6.9-to-1 in the summer of 2009.[1]

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[1] http://www.epi.org/publication/job-seekers-ratio-improves-highest-rate/

Nevertheless, the total number of unemployed workers in December last year was 13.1 million. And this number does not include those workers who have given up looking for work. The share of those who have been unemployed for over six months has hovered around 45% for more than a year.[2]

Whereas the unemployment rate for non-Hispanic Whites has been high, African Americans are about twice as likely to be unemployed as non-Hispanic Whites.

As we know, most unemployed people, regardless of color, do not spend much in the economy and do not contribute to an increase in consumer confidence, both of which are needed to boost our economy and to get us out of the economic and the foreclosure crises.

[2] http://w3.epi-data.org/temp2011/BriefingPaper324_FINAL%20%283%29.pdf

These days, the Government Accountability Office is conducting a study on the harm of the recent financial crisis on the U.S. economy, local governments, and family households. I estimate that the price tag of the financial crisis will be huge. It might have 15 zeros – a quadrillion.

Now, let me talk a little bit about the consequences of subprime and alternate mortgage instruments on housing.

Many of my colleagues estimate that we have had about two million foreclosed homes per year since 2007. Based on RealtyTrac data, we have witnessed about 11.2 million foreclosure filings from January 2007 to December 2011.[3] The American Community Survey 2010 estimates that we have about 130 million housing units in our nation. Thus, more than eight percent of our housing stock has been affected by a foreclosure.

[3] NCRC White Paper for 2007 to 2010. 2011: 1,887,777. Total: 11,200,698. http://www.realtytrac.com/content/news-and-opinion

And we are far from having reached the end of the foreclosure crisis. A recent report released by the Center for Responsible Lending argues that and I quote: "the nation is not even halfway through the foreclosure crisis. Among mortgages made between 2004 and 2008, 6.4 percent have ended in foreclosure, and an additional 8.3 percent are at immediate, serious risk" END OF QUOTE.[4]

In fact, the Federal Housing Administration, FHA, which has been used by many borrowers to replace private label securitization after its collapse, has more than 700,000 properties that are seriously delinquent, meaning they are more than 90 days behind in payments.

While the foreclosure crisis has had vast consequences on households of all races and ethnicities, it has had a disproportionate impact on persons of color.

[4] http://www.responsiblelending.org/mortgage-lending/research-analysis/Lost-Ground-2011.pdf p. 3

Researchers at the Pew Research Center calculated the change in median net household worth between 2005, when the house price bubble was at peak and the economy was humming, and 2009, after the house price bubble popped and the economy was in a severe crisis.

They found that non-Hispanic Whites lost 16 percent in median net household worth between 2005 and 2009. In contrast, African Americans lost 53 percent, and Hispanics lost 66 percent during the same time frame.

The Center for Responsible Lending estimated that among recent borrowers, nearly eight percent of both African Americans and Latinos have been foreclosed upon, compared to 4.5 percent of non-Hispanic Whites, controlling for differences in incomes among the groups. These proportions are especially striking considering that the foreclosure rates of African American and Latino homeowners are disproportionately high compared to their share of mortgage originations.

At 46.1 and 47.6 percent, according to the Current Population Survey for the third quarter 2011[5], the homeownership rates for African Americans and Latinos are at their lowest levels in over a decade. Martin Eakes, Chief Executive Officer of the Center for Responsible Lending, expects that the homeownership rate for African American and Latino families will drop even further to a range of 40 to 42 percent in the future. A return to this level of homeownership would wipe out over 15 years of gains in homeownership rates for most people of color.

For most Americans homeownership constitutes a good wealth-building strategy. For lower-income people, regardless of color, homeownership is the **only** wealth-building strategy.

[5] E-mail from Alejandro Becerra, 11/06/2011. 1:09 AM. MS Excel File: Tab 6 data users.

The foreclosure crisis does not only have implications for the long run in terms of wealth building but also in the short run. Homeowners who are foreclosed upon not only lose their homes, they are also most likely on a path of unstable housing in the future.

Their credit ratings decrease, making it difficult for them to purchase or rent another home. Even if they can find a landlord willing to rent to them, many have used up their financial reserves during the foreclosure process, making down payments or deposits difficult.

However, while there are some media stories about those who were foreclosed upon being forced to move in with family or friends, live in their cars, or stay in homeless shelters, there is no public database or municipal record that documents families' next steps following foreclosure.

Nevertheless, several colleagues have studied the neighborhoods people moved to and they have mixed answers. Some move to slightly better neighborhoods although most of these neighborhoods are not the greatest neighborhoods to start with. Others move to worse neighborhoods in terms of neighborhood quality, while others move within their current neighborhood.

What most researchers agree upon, nevertheless, is that people of color, including children, are disproportionately affected by the foreclosure crisis which translates into a move.

While involuntary moves are almost never easy for adults, they are typically very difficult for children, who need consistent routines and stable family structures.

High frequent residential change could result in higher levels of behavioral and emotional problems, increased teenage pregnancy rates, accelerated initiation of illicit drug use, adolescent depression, and reduced continuity of healthcare.

Many studies identify a negative impact on academic achievement and education standards. Whereas many consequences of the foreclosure crisis are already visible, the impact of the foreclosure crisis on graduation rates and academic achievements will take one or two decades or more to materialize.

The Obama Administration has tried to help borrowers who are currently underwater. Those borrowers who have a mortgage that was sold to the government sponsored enterprises (GSEs), meaning Fannie and Freddie, can go through the Home Affordable Modification Program, short for HAMP. This program was established in early 2009 and has the goal to help 7 to 8 million struggling homeowners with a mortgage modification. After a slow and rocky start of this program we will see what the future will bring.

Those borrowers who have a privately secured mortgage might be able to refinance through the very recent $26 billion mortgage settlement with the nation's five largest banks. Over the next two months government officials will chose an administrator to monitor the program. It will probably take at least another six months to notify homeowners and start working on their cases.

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My second point addresses the role of the current land records system in the foreclosure crisis. The current dual land records system has two aspects -- a public system and a private system.

The public land recording system dates back to the establishment of the United States as an independent country and is subject to state regulations and county level recording requirements. This mature and stress-tested system has worked well for more than two centuries. This is good news.

The private land recording system is represented by the Mortgage Electronic Registration System, called MERS, and was founded in 1996, with the goal to have a more effective and efficient mortgage recording system.

Problems with the private land recording system, as opposed to the public recording system, have compounded the market's ability to correct itself because of a host of legal problems, mostly related to MERS.

While the volume of mortgage originations demanded a more efficient land recording processing mechanism, the management and oversight of MERS left much to be desired. MERS was relatively uncontroversial in its early days, but the weaknesses in that system reached epic proportions when the foreclosure crisis hit full force.

The robo signing scandal has been a legal nightmare that has placed potentially millions of legitimate foreclosures on hold. In addition, the robo signing problem opened the door to other improper document handling challenges that remain in legal limbo.

These days, MERS is at the center of several legal challenges disputing the company's right to initiate foreclosures. Confusion over who legally owns properties and who is legally allowed to initiate foreclosure is going to drag out the foreclosure crisis for many years.

Properties in foreclosure limbo cannot be placed on the market. Thus, they will face maintenance and possibly repair issues and thus a decrease in value, making a resale more affordable for the buyer but less profitable for the seller. In many instances, properties may deteriorate to the point where they will be more costly to repair or renovate than comparable sale prices for that area.

Decreases in value of Real Estate Owned, or REO, properties, also affect the value of surrounding homes. Properties in foreclosure limbo also invite illegal activities into the neighborhood, such as stripping properties of valuable materials, vandalizing properties, drug trafficking and other crimes.

Thus, municipalities will have to increase surveillance by the police which will cause an additional strain on already strained municipal budgets. Also, municipalities might have to board up properties, cut the grass and clear the snow, placing a lien on the property which compound further the resale due to the need first to pay off the municipal lien.

There is the argument that properties should be foreclosed and placed on the market as quickly as possible to have a quick resale. This strategy presupposes it will automatically reduce downward pressure on home prices by limiting the amount of deterioration of the property that accompanies vacancies. It also assumes less negative spillover on neighboring properties.

What this strategy also assumes is that there will be a buyer – which might be an unrealistic assumption these days. With a total shadow inventory of 1.6 million units as of October 2011, based on CoreLogic data[6], there is a huge oversupply of houses that, along with a large number of distressed sales, threatens to further undermine the housing market.[7]

Unloading the full shadow inventory on the markets at this time would likely precipitate a further significant decline in home prices.

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[6] http://www.corelogic.com/about-us/researchtrends/asset_upload_file747_13811.pdf

[7] http://www.investopedia.com/terms/s/shadow-inventory.asp#axzz1mqVMGn8j Shadow inventory: properties that are either in foreclosure and have not yet been sold or homes that owners are delaying putting on the market until prices improve. Shadow inventory can create uncertainty about the best time to sell (for owners) and when a local market can expect a full recovery. Also, shadow inventory typically causes reported data on housing inventory to understate the actual number of inventory in the market.

An ideal strategy that can address both problems of returning properties to productive use and stabilizing home values is a rent-to-own initiative, also called lease purchase or lease-to-own.

However, Congress has not been helpful with this strategy. The Consumer Rental Purchase Agreement Act, a rent-to-own legislation, was introduced in the 111^{th} Congress but has not been reintroduced in the new 112^{th} Congress yet.

Third, allow me to advocate for a land recording system that is

A prompt

B reliable

C intelligent, and

D accessible.

In other words, I will advocate for a land recording system that is PRIA (prompt, reliable, intelligent, and accessible).:-)

A: Prompt: currently, the public land records system uses paper, film, electronic data distribution and online storage to store, distribute, and transfer data. Converting the current system to online storage, like MERS, would increase the promptness of recording and would also help analysts to get a fast grasp at foreclosure patterns and the factors that affect foreclosures. It would also help local, regional, state, and federal policymakers designing effective and efficient programs that prevent foreclosures or help borrowers who are delinquent. It would help them to design these programs faster.

B: Reliable: the public land records system is more than two centuries old and has been through quite a bit of stress testing. It has been reliable – and this is what a land record system should be. The robo-signing scandal has shown that MERS has had some reliability issues. MERS could have been successful if the originators had been required to transfer the “wet ink” copy in a timely manner and if notary representatives had been required to actually review documents prior to signing.

C: Intelligent: only online storage allows prompt data analysis by trusted competent individuals. Geographic Information Systems, or GIS, help with analyzing foreclosure patterns and identifying what types of neighborhoods are most or least affected by foreclosures. Establishing and improving GIS data analysis systems will assist with intelligent analyses.

D: Accessible: I suggest that public land recorders team up with local and regional academics and extension agents to allow them access to anonymous data for analysis purposes. These experts could be sworn into confidentiality similar to the Special Sworn Status model of the U.S. Bureau of the Census.

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Today is March 1, 2012 and we are in the fifth year of a foreclosure crisis that has ravaged this wonderful country. I need to say these things to keep my hard earned U.S. Green Card.:-)

We live in a developed country with a good data information infrastructure. Most offices have computers. We have sophisticated software to analyze the foreclosure crisis. Surprisingly, the data situation about foreclosures is still surprisingly poor.

While we have publicly accessible anonymous data based on the Home Mortgage Disclosure Act, called HMDA, these data allow researchers only a glimpse right after a mortgage was originated.

In order to conduct analyses over the life of a loan, researchers have to purchase proprietary data from vendors such as Lender Processing Services, short for LPS.

As the vast majority of researchers in the public and non-profit sectors do not have expense accounts, we have to write grant proposals and then submit these grant proposals to foundations and other supporters.

If I could get my hands on a data set, it would enable me to conduct a range of research on the on-going health of the housing market, hoping that the foreclosure crisis will end eventually.

If we had had the opportunity to provide evidence faster on what factors affect foreclosures we could have informed policy makers faster. Time is of the essence in foreclosure research. Online systems are a good strategy to make timely research happen.

In conclusion, we need a land recoding system that is PRIA – prompt, reliable, intelligent, and accessible. While some of my suggestions are low-cost and not politically controversial, others are very high-impact, but also relatively high-cost and/or politically difficult to enact. Allow me to suggest two potential source of funding. Well, kind of.

First, the Making Home Affordable Program, short for MHA. The MHA was created by the Financial Stability Act of 2009. The program is intended to encourage loan servicers and investors to modify eligible first-lien mortgages so that the monthly payments of homeowners who are currently in default or at imminent risk of default will be reduced to affordable and sustainable levels. The Making Home Affordable Program received $29.9 billion.

Due to many challenges, it is unlikely that the program will reach the updated intended goal of helping 7 to 8 million homeowners.

Although the extension of HAMP was just announced, it seems that there might be unused funds at the end of the extension. These funds could be invested in a prompt, reliable, intelligent, and accessible land recording system that would benefit us all. Unfortunately, Treasury states that they are incapable of reprogramming the use of funds. PRIA could encourage them to allow the reprogramming of unused funds at the end of the extension to invest in our public land recording system.

The second source of potential funding could have been the recent $26 billion mortgage settlement of 49 states with the nation’s five largest banks. Unfortunately the agreement is already final. Future efforts by PRIA could focus on obtaining funds to support the public land recording system.

In conclusion, the current economic and foreclosure crises have shown that we need an excellent land recording system. This will prevent another massive fallout in the near and distant future. And with that, I conclude my remarks and open it up for questions.