

AUGUST 2008

# SUBPRIME CRISIS

A COMPREHENSIVE ANALYSIS FROM A SYSTEMS THINKING PERSPECTIVE



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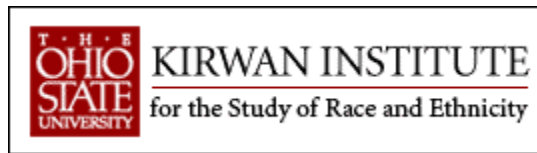
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## **Subprime Crisis**

### **A Comprehensive Analysis from a Systems Thinking Perspective**

#### *A. Introduction*

The subprime crisis is one of the largest threats to the creation and accumulation of wealth the United States has seen in decades. Systems thinking and knowledge of structural racialization help us understand the ways in which past behaviors, choices, and deregulation created the “perfect storm” for this crisis. The subprime crisis’ origins trace back to vast national deregulation beginning in the early 1980s. However, the effect on African American families reaches even further into history. This paper will examine the events which ushered in the subprime crisis and lead to the loss of billions of dollars of African American wealth. It will discuss the effects of the crisis, ranging from the effects on homeowners to the effects on the credit market. Finally, it will discuss potential solutions to the crisis. In this paper, all elements are combined into a model of systems thinking analysis.

We begin with an explanation of the systems approach. A system is an interdependent group of agents working together as a whole. Systems thinking and analysis focus on the relationships between parts (organizations, actors, etc.) in a system. Systems thinking stresses that one must not view the world from a linear perspective, where one action “causes” another. Instead, we must see that in an interdependent system, there is no simple causation, but rather a web of decisions and feedback whereby decisions by one actor modify other decisions and create systemic evolution.

These modifications are mechanized by feedback loops. In systems theory, there are two forms of feedback: positive and negative. A negative feedback loop is self-correcting. Negative feedback is a system response to external inputs to maintain the status quo in the same way that a thermostat pumps cool air in response to outdoor heat to maintain room temperature. On the other hand, a positive feedback loop is self-reinforcing; the more it works, the more it will continue to work. A savings account is an example of such feedback; the more money one has in the account, the more interest one will earn, and the more interest one earns will increase the amount of money (and interest) in the account. Unchecked by negative feedback, a positive loop will grow to the point of becoming unstable. We see this most prominently in the housing bubble explanation below.

Systems theory also brings our attention to the idea of emergence. Linear thinking tends to study system components as separate and distinct from one another, assuming that if we know each part, we will understand the system. Emergence is the idea that the whole is greater than the sum of its parts. You cannot, for example, study the housing bubble of the late nineties separately from securitization and expect to understand the subprime crisis. All of these factors working together in relation to one another brought us the circumstances that allowed for the subprime crisis.

As we attempt to understand the subprime crisis, it is important to keep a systems perspective in the background. Perhaps one of the greatest benefits of this perspective is the ability to understand why simple solutions may backfire. A systems perspective allows us to take all, or at least many, factors into account when envisioning solutions in order to get a clearer idea of where and when to intervene effectively.

## *B. The Origins of the Subprime Crisis*

### *i. The Crisis Began with Deregulation*

The subprime loan was made available as a result of deregulation throughout the 1980s and '90s. This deregulation was initiated by the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA),<sup>1</sup> which preempted state usury ceilings during a time of record high interest rates. A usury ceiling is a cap on the interest rate a lender may charge on borrowed money. When interest rates increased in the late 1970s and state usury ceilings did not rise with them, lenders were unwilling to originate loans. Thus, low usury ceilings prevented lenders from making profitable loans during times of high interest. DIDMCA's preemption allowed lenders to charge a high interest rate despite the state's cap.

Two years after DIDMCA passed, the Alternative Mortgage Transaction Parity Act (AMTPA)<sup>2</sup> was signed into law. AMTPA preempted state statutes that regulated alternative mortgage transactions, such as those with balloon payments, variable rates, and negative amortization. Similarly to DIDMCA, volatile market conditions, rising interest rates, and lenders' difficulty in making fixed interest prompted AMTPA's passage.

By the late 1990s, the effects of deregulation were beginning to become apparent. With increasing availability of alternative mortgage products, first-time buyers with low credit scores were able to purchase homes. The mortgages they purchased were categorized as subprime, meaning they had high interest rates, low or negative amortization, high broker and origination fees, prepayment penalties, and balloon payment schedules. The deregulation aimed at opening the housing market to low income, low credit score borrowers had actually paved the way for the risky and expensive loan products that created today's foreclosure crisis. Because of DIDMCA and AMTPA, the subprime mortgage lender emerged. By 2006, subprime lenders held 20% of the mortgage market.

### *ii. Securitization Made Subprime Loans Possible*

Subprime lending is financed by the securitization process. Securitization involves brokers and lenders packaging subprime loan debt into mortgage backed securities (MBS). The MBS are rated and bought by investors who seek high-risk, high-payout investments, and whose money finances more subprime loans. Because subprime loans are more costly to the borrower and many include prepayment penalties, an investor will receive a higher payout over the course of repayment than with a traditional 30-year fixed rate mortgage. The higher payout made subprime loans more appealing to investors than prime loans, despite the risk that was supposed to be involved.

A second feature of subprime securitization involves the spreading of the risk that subprime loans created for the lender. Once originated, the lender could pass the risk of default to investors on Wall Street. The mortgage note was held by a servicer, who assumed the responsibility of demanding payments from the borrower and distributing them to the investors. In many cases, these MBS were held by foreign investors, which spread the risk of massive foreclosure beyond the borders of the United States. In the event of foreclosure, the originator was not responsible for the loss, which then belonged to investors and was managed by the servicer.

Subprime lending and securitization became popular on Wall Street. Hedge funds and risky investors not only provided funding for loans by investing, but came to demand more subprime loan packages as time went on. Demand for subprime MBS caused many brokers to seek new subprime borrowers, rather than wait for borrowers to apply. In efforts to create new loans, mortgage brokers

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<sup>1</sup> Pub. L. No. 96-221, 94 Stat. 132 (codified in scattered sections of 12 U.S.C.).

<sup>2</sup> 12 U.S.C. § 3801 (2008).

originated loans with little or no documentation for borrowers who had no stable source of income and little savings.

The increased demand for subprime loan securities and the elimination of risk to investors created an environment where subprime loans were originated without regard for borrowers' ability to pay. Loans were packaged as quickly as they were originated, and new loans were secured with funding from the stock market demand. Increased targeting of likely subprime borrowers, many of whom were minority borrowers, created a perfect storm for the crisis.

### *iii. Discriminatory Lending Caused More Adverse Effects for Minorities*

The brunt of the crisis is born by low income, minority communities. African American borrowers are estimated to lose between 71 and 122 billion dollars in wealth, while Latino borrowers will lose 76 to 129 billion.<sup>3</sup> Due to the effects of housing discrimination, redlining, and urban disinvestment, minority borrowers were targeted for subprime loans as investor demand increased.

In the early half of the twentieth century, the Home Owners Loan Corporation and the Federal Housing Authority (FHA) insured private sector loans. These federally backed instruments used redlining, local control, and overt discrimination to make it very difficult, if not impossible, for African Americans to qualify for mortgages. Until 1949, the FHA encouraged the use of restrictive covenants banning African Americans from certain neighborhoods. The government would rank communities in terms of their eligibility for federally-financed or insured loans. Under these guidelines, the FHA actually refused to lend money to whites if they moved to African American neighborhoods. Private lenders adopted policies conforming to these guidelines, and this system became part of the "free" market. Thanks to the FHA, no bank would insure loans in low-income African American neighborhoods, and few African Americans could live outside of them.

The effects of redlining and housing discrimination placed many low income minorities in impoverished inner-city communities. These communities were targeted by subprime lenders. This practice is known as "reverse redlining." Motivated by Wall Street's demand for subprime loans, these lenders would serve minority communities as the only visible mortgage lenders in the area. Because traditional lenders were historically absent from low-income minority communities, subprime lenders had market dominance.<sup>4</sup>

These subprime lenders relied on asymmetric information to deceive minority borrowers into believing they only qualified for subprime loans, even in cases where the borrowers would have qualified for prime loans.<sup>5</sup> In 2006, African Americans were 31 – 35% more likely to receive a subprime loan than were similarly situated white borrowers.<sup>6</sup> Past and, it appears, present discrimination, coupled with a high demand for subprime loans by investors, made it increasingly likely that African American and minority borrowers would suffer the earliest and the most from the crisis.

### *iv. The Housing Bubble Burst*

The housing bubble in the United States grew alongside the stock and dot com bubbles of the late 1990s.<sup>7</sup> High stock wealth induced families to spend more of their new disposable income and save much

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<sup>3</sup> ELLEN SCHLOEMER, CENTER FOR RESPONSIBLE LENDING, LOSING GROUND: FORECLOSURES IN THE SUBPRIME MARKET AND THEIR COST TO HOMEOWNERS, 16 *tbl.*6 (2006).

<sup>4</sup> Cassandra Jones Havard, *Democratizing Credit: Evaluating The Structural Inequities of Sub-Prime Lending*, 56 *SYRACUSE L. REV.* 233, 246-7 (2006).

<sup>5</sup> *Id.* at 251.

<sup>6</sup> DEBBIE GRUENSTEIN BOCIAN ET AL., CENTER FOR RESPONSIBLE LENDING, UNFAIR LENDING: THE EFFECT OF RACE AND ETHNICITY ON THE PRICE OF SUBPRIME MORTGAGES 17 (2006).

<sup>7</sup> Dean Bake, *The Housing Bubble and the Financial Crisis*, 46 *REAL WORLD ECON. REV.* 73, 73 (2008).

less.<sup>8</sup> This "consumption boom" was largely focused on housing. The increase in demand for housing had multiple effects. First, the value of housing increased, which in turn increased demand for housing and jump-started the bubble.<sup>9</sup> Second, the supply of housing decreased and more housing had to be built to meet the rising demand.<sup>10</sup> The rising housing prices created an expectation that housing values would continue to rise, leading home buyers to pay more for housing than the housing was actually worth. This self-fulfilling cycle continued until the median price of housing outgrew median incomes, peaking in about 2005.<sup>11</sup> When the growth became unsustainable in 2006, the housing bubble "burst." The previous rapid increases were followed by substantial decreases in home prices, which translated into mortgage debt that greatly exceeded the property's value.

### *C. The Effects of the Crisis*

#### *i. The Effects on Minority Borrowers were Greater than Other Groups*

Communities with high concentrations of minorities were hit hardest by the foreclosure crisis. After decades of redlining practices that deprived urban communities of credit and denied loans to minorities, financial institutions flooded these same communities with loan products that drained residents of their wealth. Subprime loans are three times more prevalent in low-income neighborhoods than in high-income neighborhoods; they are five times more likely in African American neighborhoods than in white neighborhoods.<sup>12</sup> Subprime lenders targeted these communities in order to satisfy demand for subprime securities – a process known as reverse-redlining or predatory lending. Because low income minority areas were historically excluded from the traditional lending markets, subprime lenders were able to saturate these communities with subprime loans.<sup>13</sup> The minority borrowers were more willing to agree with the terms of such loans due to lack of access to prime loans or traditional financial options. Additionally, lenders steered African American borrowers with prime credit to take out subprime loans through both intentional discrimination and discriminatory impact created by their policies. For example, companies authorized their loan officers, brokers, and lenders to include subjective discretionary charges and interest rate markups that were unrelated to objective credit characteristics. Thus, the terms of the loans for minorities would have classic characteristics of subprime loans due to the subjectivity involved.

The effects of the crisis extend beyond homeowners. Renters in African American communities have been forced to relocate when the rented homes were foreclosed upon. In Cuyahoga County, Ohio, nearly 30% of foreclosures were on renter occupied units.<sup>14</sup> Unlike homeowners, renters receive little, if any, notice that their homes will be foreclosed upon since they are often unaware of pending financial trouble. Because the bulk of foreclosures and subprime loans occur in areas with a large proportion of minorities, it is likely that the renters affected are minorities as well. Renters faced with foreclosure incur high costs, including lost security deposits, increased rent at new locations, moving and storage costs, and property costs. The average cost for a renting family ousted through foreclosure is more than \$2,500.<sup>15</sup> It is estimated that renting families experienced a total loss of \$10 million because of foreclosure filings.<sup>16</sup>

Due to the disparate effect on minorities, the subprime crisis threatens to increase the racial wealth gap. Homeownership is one of the primary ways families create wealth in America. African American

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<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> *Id.* at 74.

<sup>11</sup> *Id.*

<sup>12</sup> U.S. DEP'T. OF HOUS. & URBAN DEV., *UNEQUAL BURDEN: INCOME AND RACIAL DISPARITIES IN SUBPRIME LENDING IN AMERICA* (2000).

<sup>13</sup> Jones Havard, *supra* note 4, at 233.

<sup>14</sup> DAVID ROTHSTEIN, *POLICY MATTERS OHIO, COLLATERAL DAMAGE: RENTERS IN THE FORECLOSURE CRISIS* 13 (2008).

<sup>15</sup> *Id.* at. ii.

<sup>16</sup> *Id.*

borrowers stand to lose 71 to 122 billion dollars in wealth because of the subprime crisis. Racial bias of subprime lenders accounts for a 40% difference in losses between whites and African Americans. As a result of the subprime/foreclosure crisis, homeownership rates for African Americans are on the decline.

### *ii. The Subprime Credit Market's Resulting Credit Crunch*

The credit market is likely to respond with tighter lending standards, fewer warehouse subprime mortgage lines, fewer subprime lenders, and greater self-regulation and reformation, most of which will be driven by the securitization market to the extent that it still exists. There may be an urge to proactively modify loans that would likely result in default. The increased pressure from the government and consumer groups, combined with new subprime lending standards, will decrease lenders' willingness to lend to nonprime borrowers and investors' willingness to participate in subprime loan securitization. The result has been and will continue to be a "credit crunch" for subprime borrowers. The result will decrease availability of subprime lending, which in turn, will decrease homeownership among low-income or minority borrowers.

### *iii. The Circular Decline in Housing Value*

When the housing bubble began to deflate in 2006, borrowers saw a sharp reduction in the value of their homes, and found themselves in a position of "negative equity," or a mortgage debt that far exceeded the value of the mortgaged home. Because homeownership is the single most important source of wealth, this meant many Americans experienced a dramatic loss in personal wealth. The decline in home prices has cost American homeowners more than 4 trillion dollars in wealth, and, as previously noted, has cost African Americans alone between \$71 and \$122 billion.<sup>17</sup>

The decrease in home values not only caused homeowners, but also communities, to lose wealth. As a result of foreclosure, surrounding house values have declined. Neighbors matter when it comes to putting a value on homes. Appraisers use comparable sales data to calculate the value of a home, which lenders require for selling and refinancing. Comparable sales in neighborhoods plagued by foreclosures reduce the value of all the homes, which places homeowners in a position where selling is not a pleasant option. Also, borrowers become unable to refinance at lower rates, which can cause even more foreclosures.

## *D. Solutions to the Crisis*

### *i. Media and Attorney Advocacy Solutions*

The most prominent narrative in the media is the moral hazard debate, which consists of the view that people have to be held accountable for their own actions. In other words, the borrowers chose to take out the loans with terms they could not afford. However, this narrative only arouses public resentment and does little to address the crisis. The flipside of this debate emphasizes lenders' seductive techniques to lure borrowers into loans with "too-good-to-be-true" credit lines and incomprehensible mortgage offers. The media should focus on the flipside rather than the moral hazard.

Attorneys and advocates should focus on creating new narratives to combat the common attitudes toward the crisis. Instead of focusing on the fact that borrowers were irresponsible in obtaining subprime loans, attorneys should focus on the tactics of lenders and investors, emphasizing the targeting of minority borrowers and communities. This perspective will help avert the opinion that we are condoning irresponsibility and reveal discrimination's role in the crisis. Attorneys could circulate such narratives by engaging in practices that will inform the public, such as town hall meetings, news reports, etc. Drafting

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<sup>17</sup> CENTER FOR RESPONSIBLE LENDING, *supra* note 3.

informative articles for publication in magazines and newspapers will provide this information to the public. Attorneys at philanthropic organizations can put information on their websites to raise public awareness. Public advocacy of a solution will pressure politicians to continue support of efforts to alleviate the effects.

Attorneys can reach beyond traditional legal paradigms to help foreclosing families by making legal services more available to people who have been or are dealing with foreclosure. A contingency fee could provide legal services to homeowners who cannot afford attorneys due to their financial situations. Law firms could provide incentives to their attorneys participating in pro bono work on behalf of homeowners facing foreclosure. This enhanced access to legal services could prevent some foreclosures, place some people back in their homes, or provide money to homeowners who were wrongly induced into subprime loans.

## *ii. State and Local Action*

Increasingly, state and local governments have taken action responding to the foreclosure crisis through a combination of municipal litigation and anti-predatory lending bills. Baltimore and Cleveland initiated public nuisance suits against prominent lenders last year for targeting their communities through predatory lending. These cases may have an important role in providing meaningful, timely relief for a large number of homeowners who are in default or on the verge of default. In addition, over 25 states have initiated anti-predatory lending legislation triggered by North Carolina's successful legislation enacted in 1999 and 2000. However, state legislation is limited due to federal anti-predatory lending statutes preempting state action.

The Baltimore complaint, in particular, stresses the racialized impact of predatory lending. Two-thirds of the foreclosures associated with Wells Fargo lending were in census tracts with over 60% African American populations, while less than 16% were in tracts with less than 20% African American residents.<sup>18</sup> The complaint asserts that Wells Fargo's disproportionately high African American foreclosure rate is the result of reverse redlining, and the bank "has been, and continues to be, engaged in a pattern or practice of unfair, deceptive and discriminatory lending activity in Baltimore's minority neighborhoods."<sup>19</sup> The Baltimore complaint seeks legal and equitable relief under the Fair Housing Act of 1968, seeking actual and punitive damages for the injuries caused by the foreclosure crisis, declaratory relief, and enjoinder of further discriminatory lending.<sup>20</sup>

In contrast, Cleveland seeks relief under public nuisance theory. The Cleveland complaint asserts that the subprime crisis has hit the city especially hard. Between 2002 and 2007, the number of foreclosures in Cleveland increased from fewer than 120 to over 7,500.<sup>21</sup> In 2007, an average of 20 residents per day experienced foreclosure.<sup>22</sup> Cleveland has lost property tax revenue, suffers strained police and fire budgets due to vacant homes, and has lost more than \$462 million in home value.<sup>23</sup>

In addition to municipal suits, states have enacted various anti-predatory lending laws. In 1999, North Carolina enacted the Prohibit Predatory Lending Act,<sup>24</sup> which went beyond previous federal bills to provide protections for prospective and current homeowners within the state. The legislation targets and prohibits many features of subprime loans, including most prepayment penalties, the practice of repeatedly refinancing an existing home loan to collect fees and strip equity (loan flipping), and upfront insurance premiums tied to a mortgage. Under this law, high cost home loans cannot include fees in the principle, and loans cannot be originated without the borrower speaking to a consumer counselor. In

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<sup>18</sup> Complaint at 2, *Mayor of Baltimore v. Wells Fargo Bank*, No. L08 CV 062 (D. Md. filed Jan. 8, 2008).

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* at 38.

<sup>21</sup> Complaint at 23, *City of Cleveland v. Deutsch Bank and Trust*, No. CV-08-646970 (Oh. Com. Pl. filed Jan. 10, 2008).

<sup>22</sup> *Id.*

<sup>23</sup> *Id.* at 25.

<sup>24</sup> N.C. Gen. Stat. § 24-1.1E, 24-10.2 (2000).

addition, balloon payments, negative amortization loans, and loans made without consideration of the borrower's ability to repay are banned for high cost loans. States have used the North Carolina legislation as a model for new anti-predatory bills, impeded only by certain preemptive federal statutory provisions.

### *iii. Federal Executive Action*

In 2007, the Bush Administration launched a temporary program called FHA Secure,<sup>25</sup> which modified the Federal Housing Assistance (FHA) program by providing additional flexibility in its underwriting guidelines. In effect, the program opened the door to refinancing for borrowers with good credit histories who cannot afford their mortgages after reset. FHA Secure gives borrowers with non-FHA adjustable rate mortgages the ability to refinance into FHA insured loans. Under the program, a lender will not automatically disqualify a borrower because he/she is late on a payment. The lender may also offer the borrower a second mortgage, covering the difference between the value of the original mortgage and what is owed. Through the refinancing, homeowners can expect to pay lower monthly payments.

During the first three months of operation, FHA Secure received more than 120,000 applications and helped 35,000 homeowners refinance their loans. Although FHA Secure was designed for consumers who would not qualify for FHA insurance, more than 98% of the assisted borrowers would have qualified for FHA products in 2007. Only 541 targeted borrowers were aided. As of June 2, 2008, FHA Secure helped 200,000 homeowners avoid foreclosure by refinancing their mortgages through FHA. In just the past three months, the effects of FHA Secure were significant, as it insured twice as many loans during this time as it did in the first three months of the program. As more and more homeowners learn about the positive changes they can make using the FHA's 30-year fixed, prime rate financing, the number of Americans that have been helped by the program continues to increase.

In addition, Bush directed secretaries Paulson and Johnson to collaborate with lenders, servicers, investors, and mortgage counselors to initiate the HOPE NOW Alliance.<sup>26</sup> HOPE NOW assembles these members of the private sector to voluntarily address the foreclosure issue. Participants in the alliance seek to reach out aggressively to potentially at-risk, credit-worthy homeowners to help them rework their mortgages. This group agreed on a set of industry-wide standards to help homeowners by: (1) refinancing existing loans into private mortgages; (2) moving them into an FHA secure loan; or (3) freezing their current interest rate for five years. However, the freeze excludes anyone that is more than thirty days late at the time the mortgage would be modified or more than sixty days late at any time within the previous twelve months. It also excludes anyone who cannot afford the loans at the introductory rate. The interest freeze covers anyone with an ARM resetting in 2008, but leaves out anyone capable of making the mortgage payment at the reset rate. HOPE NOW also provides a 24-hour counseling hotline.

Approximately 545,000 subprime mortgage holders were helped the second half of 2007. Fourteen HOPE NOW servicers responsible for more than 33.3 billion home loans, as of September 2007, provided the data. With the help of HOPE NOW, the mortgage industry is helping more than 160,000 families a month keep their homes by either modifying their loans or by developing more realistic payment plans. Since the summer of 2007, the industry overall has reworked more than one million mortgages to help homeowners stay in their homes.

### *iv. Federal Legislative Actions*

Over the last year, Congress has introduced a variety of proposals designed to address the crisis, from increased funding for housing counseling and consumer education to empowering bankruptcy judges to unilaterally change the terms of existing mortgages to bail-out distressed borrowers. Federal and state regulators are following suit with guidance and restrictions on some prime lending. There has been an increase in litigation related to the subprime lending market based on discriminatory predatory

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<sup>25</sup> Press Release, White House Office of the Press Secretary, Fact Sheet: New Steps to Help Homeowners Avoid Foreclosure (Aug. 31, 2007), <http://www.whitehouse.gov/news/releases/2007/08/20070831-4.html>.

<sup>26</sup> *Id.*

lending, an increased call for “suitability standards” in mortgage lending, and more non-consumer law suits, such as investors suing issuers, lenders suing brokers, and investors suing lenders.

Recently, the Housing and Economic and Recovery Act<sup>27</sup> became law. This comprehensive legislation includes the Federal Housing Finance Regulatory Reform Act, The Hope for Homeowners Act, and the Foreclosure Prevention Act. The Federal Housing Finance Regulatory Reform Act provides regulation for government sponsored entities such as Fannie Mae and Freddie Mac and the Federal Home Loan Banks. This regulator will have the authority to establish capital standards, prudential management standards; enforce its order through cease and desist authority, civil money penalties and the authority to remove officers and directors; restrict asset growth and capital distributions for undercapitalized institutions; put a regulated entity into receivership; and review and approve new product offerings of the enterprises. This act raises loan limits of Fannie Mae and Freddie Mac to enhance the affordable housing component of the GSE’s mission. This act creates the new Housing Trust Fund and Capital Magnet Fund financed by annual contributions from the enterprises.

The Hope for Homeowners Act creates a temporary, voluntary program within FHA to back FHA-insured mortgages to distressed borrowers. The new mortgages offered will refinance the loans at significant discounts. In return, homeowners will share future appreciation with the FHA. Only owner occupants who are unable to afford their mortgage payments are eligible for the program. Investor properties will not qualify. Participants must have a mortgage debt-to-income ratio greater than 31% as of March 1, 2008. The program will begin on October 1, 2008, and end on September 30, 2011. It is paid for using part of the Affordable Housing Trust Fund, and the GSE bill provides a further 2 billion dollar cushion for the government by establishing a reserve fund at the Treasury over ten years. If the program costs less than projected, the unused funds are returned to the Affordable Housing Trust Fund. If the program more than pays for itself, any excess savings are dedicated to reducing the national debt.

The Foreclosure Prevention Act of 2008 modernizes the FHA by increasing the FHA loan limit from 95% to 115% of area median home price. This allows families in all areas of the country to access home ownership through the FHA. This act also assists communities devastated by foreclosures by providing 3.92 billion dollars to communities hit the hardest by foreclosure and delinquency. The block grant funds are used to purchase foreclosed homes at a discount and rehabilitate homes to stabilize neighborhoods, which will stem the losses in home values. This bill also provides pre-foreclosure counseling for families on the brink of foreclosure by providing \$150 billion in funding. In addition, it enhances mortgage disclosure to ensure that consumers are provided with timely and meaningful disclosures in connection with their mortgages and expands the type of loans subject to early disclosures under TILA. It also requires that disclosures be provided no later than seven days before closing.

#### *v. Private Sector Solutions*

The private sector can help in rectifying the subprime crisis by assisting with foreclosure prevention efforts. Private lenders can provide refinancing and work-out options to borrowers who cannot afford their loans. Lenders should evaluate their company policies and eliminate discriminatory lending practices. For example, lenders should set interest rates according to more objective criteria, rather than subjective, which would eliminate implicit bias. Neighborhood location should not factor into determining interest rates or loans offered, as it is not indicative of a borrower’s ability to repay. Additionally, lenders could provide an accounting to each borrower of various fees charged, as well as the reason for the fee. Private lenders could eliminate unnecessary fees to make the origination fee more affordable. Removing pre-payment penalties would provide an incentive for borrowers who are currently in subprime loans to pay off their loan and, thus, avoid the interest-rate reset. Finally, private lenders should eliminate subprime products such as the negative amortizing loans and interest-rate only loans.

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<sup>27</sup> Pub. L. No. 110-289, 122 Stat. 2654 (2008).

## *vi. Philanthropic Solutions*

Philanthropic organizations can assist in the subprime crisis by providing information to the public and other organizations to influence legislative solutions. These organizations are devoted to researching problems and sharing information regarding the solutions. Additionally, philanthropic organizations can collaborate with other entities that benefit from such information.

Philanthropic organizations currently offer loan counseling programs for borrowers at risk of foreclosure. NeighborWorks Center for Foreclosure Solutions provides such a program through its HOPE Hotline initiative. The HOPE Hotline is a toll free call center that directs borrowers to participating HOPE NOW lenders. In 2007, the hotline was helping to prevent around 200 foreclosures a day.<sup>28</sup> Ten percent of the calls resulted in loan workouts.<sup>29</sup>

Due to the limited success of counseling, organizations such as the National Community Reinvestment Coalition have created national partnerships that provide loan workouts and refinancing and help families who face the risk of not being able to repay their high-interest mortgages.<sup>30</sup> This coalition works by providing homeowners with expert mortgage advisors who work on their behalf to achieve a successful loan workout or in securing refinancing.<sup>31</sup> Through this program, the National Community Reinvestment Coalition has helped more than 5,000 borrowers.<sup>32</sup>

Certain organizations may hold positions to supply preventative efforts, such as pre-loan counseling and credit education courses, which would inform borrowers of the risk of certain loan terms. Such organizations also could mitigate the damage to foreclosure victims by providing credit counseling entailing where borrowers should turn next.

## *E. Conclusion*

The subprime crisis is far from over. It is estimated that 1.8 families will experience foreclosure, with 500,000 to 600,000 occurring per year for the next four years due to the subprime crisis.<sup>33</sup> The effect of public and private efforts to help homeowners remains to be seen. A systems and structural racialization perspective can help us understand the institutional and legislative actions that brought the crisis to us, and should be used as a guide when crafting further solutions.

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<sup>28</sup> James H. Carr, *Responding to the Foreclosure Crisis*, 18 HOUSING POL'Y DEBATE 837, 845 (2008).

<sup>29</sup> *Id.*

<sup>30</sup> *Id.* at 846.

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> John C. Weicher, *Focus on the Problem: Subprime Borrowers in Trouble*, 18 HOUSING POL'Y DEBATE 830, 831 (2008).