

# **Foreclosures in Missouri: Causes, Consequences, and Solutions**



## **A White Paper Based on the Missouri Homeownership Preservation Summit**

Jefferson City, Missouri

January 14, 2010

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## Table of Contents

Executive Summary.....	4
Introduction and Acknowledgments .....	5
The Foreclosure Problem in Missouri .....	7
The Foreclosure Rate .....	7
Geographic Distribution of Foreclosures .....	8
Subprime and the Foreclosure Crisis .....	10
The Future of Mortgage Delinquencies .....	11
The Future of the Economy and Foreclosures .....	12
The Role of Fraud .....	16
Definition of Mortgage Fraud .....	16
Extent of Mortgage Fraud .....	17
Examples of Mortgage Fraud .....	18
The Spillover Effects of Foreclosures .....	19
Declining Property Values .....	19
Social Disorder and Crime .....	20
Local Government Fiscal Stress.....	20
Role of Foreclosure Counseling .....	22
Impact of Foreclosure Counseling.....	23
Federal Government Policy.....	23
The Role of State Policies in Missouri and Suggestions for Reform .....	26

State Foreclosure Timelines .....	26
Regulation of Mortgage Brokers.....	27
High Cost Regulation .....	29
State Support for Foreclosure Prevention .....	29
Missouri State Policies on Foreclosures.....	30
Breakout Sessions .....	34
Education and Outreach Policy and Practice .....	34
Residential Lending Policy.....	36
Foreclosure Prevention and Counseling .....	38
References .....	40



## Executive Summary

This White Paper on Foreclosures in Missouri summarizes the findings from the Missouri Homeownership Preservation Summit (hereafter referred to as the Summit), a statewide conference on the foreclosure crisis held January 14, 2010, in Jefferson City. The White Paper presents data on where we are now in the foreclosure crisis, what caused it, where we are heading, and what we can do in the future to address the issue. Relative to other states, Missouri's foreclosure rate ranks near the middle. Nevertheless, Missouri's foreclosure rate is at historically high levels and will probably remain there for at least several years. Research shows that minority and urban core areas in Missouri have suffered the highest rates of foreclosure but more recently many outlying suburban areas have been hit with equally high rates of foreclosure. The dominant cause of foreclosures is subprime loans that borrowers did not understand and were not able to sustain. Fraud is also a cause of foreclosures.

The White Paper also summarizes the evidence on the negative spillover effects of foreclosures on surrounding property owners, local governments, families, and neighborhoods. The substantial spillover effects justify greater efforts by the public, private, and nonprofit sectors in Missouri to prevent foreclosures and minimize their effects. Missouri has taken vigorous action to address foreclosure fraud, but has done relatively little in other areas to address the foreclosure crisis. The report presents a number of policy options to deal with the present foreclosure crisis and ensure that it does not happen in the future. Among the recommendations are that the state lengthen the foreclosure process, strengthen mortgage broker regulation, toughen regulation of high-cost loans, increase resources for foreclosure counseling, and appoint a "Missouri Homeownership Preservation Task Force" to gather facts on the issue and make recommendations to the governor and the legislature.

## **I. Introduction and Acknowledgments**

On January 14, 2010, over 100 people attended the Missouri Homeownership Preservation Summit in Jefferson City to learn about the foreclosure crisis and to discuss policy options that can prevent foreclosures today and create an environment for sustainable homeownership in the future. Summit participants included key stakeholders such as elected officials, community leaders, financial industry professionals and non-profit housing agency staff.

The Missouri Homeownership Preservation Network (MoHPN) is a network of housing counselors in Missouri that helped sponsor the conference in Jefferson City in January. Member agencies are located in Bowling Green, Cape Girardeau, Columbia, Kansas City, Springfield, St. Joseph, and St. Louis.

In the morning sessions, presentations by Federal Reserve economists, the U.S. Attorney's office, the Missouri Attorney General's office, and other experts examined current foreclosure trends and future scenarios, the causes of the rash of foreclosures, including subprime lending and fraud, the spillover effects of foreclosures, and policy responses. At lunch, the keynote speaker, Diane Standaert from the Center for Responsible Lending, gave a comprehensive overview of how the foreclosure crisis developed and made recommendations on how to prevent this crisis from happening again. In the afternoon participants engaged in policy discussions about what is being done to address the current foreclosure crisis and talked about promising programs, policies, practices and legislation that could help state and local community leaders address the foreclosure crisis and preserve homeownership in Missouri.

It should be noted that the ideas presented in this White Paper are not necessarily those of any of the sponsors but represent an effort to sum up the best thinking and proposals of those who attended the conference. Any omissions or errors are the responsibility of the authors and the Public Policy Research Center.

The format of the White Paper is designed to summarize key findings from presentations made at the Summit. This paper does not provide the full detail in the reports made at the Summit, nor does it report the Summit's full recommendations. Where graphs and other data are used in the White Paper, we include a link to the relevant Summit presentation. Readers interested in a complete picture of Missouri's foreclosure crisis are encouraged to go to the website of the Missouri Homeownership Preservation Network (MoHPN) at [www.missourihomenetwork.org](http://www.missourihomenetwork.org). The website includes both the full PowerPoint presentations of the speakers at the conference, as

well as video of the conference proceedings. Additionally, the reference section includes documents and reports that provide further background on foreclosures.

We hope that future housing summits will be convened to share information and engage key Missouri stakeholders in policy discussions that lead to action that will put Missouri on the forefront of promoting and creating sustainable homeownership and quality, affordable housing.

### Acknowledgements

The Summit was convened by the Missouri Homeownership Preservation Network (MoHPN), a network of non-profit housing agencies formed in 2007 whose mission is “to preserve family and neighborhood assets by reducing foreclosures in the State of Missouri.”

The MoHPN is very grateful for the generous support and technical assistance of the Summit sponsors, including the Des Lee Collaborative Vision (UMSL), the Federal Deposit Insurance Corporation (FDIC), Federal Reserve Bank of Kansas City, Federal Reserve Bank of St. Louis, Greater Kansas City Local Initiatives Support Corporation (LISC), Local Investment Commission (LINC), Metro St. Louis Foreclosure Intervention Task Force and NeighborWorks America. Finally, MoHPN wishes to thank Debbie Irwin, the State Coordinator of the network and the Foreclosure Task Force Coordinator at Beyond Housing in St. Louis, Missouri, who served as the principal organizer of the Summit and without whom the Summit would not have occurred. Debbie also provided valuable input in the preparation of this report. We would also like to thank Becky Pastor for her valuable work producing the final report.

## II. The Foreclosure Problem in Missouri

Presentations at the Summit identified:

- where Missouri and the U.S. currently stands in the foreclosure crisis;
- what prompted the foreclosure problem;
- what the future holds for Missouri residents and policymakers

### *For more information*

Kelly Edmiston, Senior Economist, Federal Reserve Bank of Kansas City [\[link\]](#)

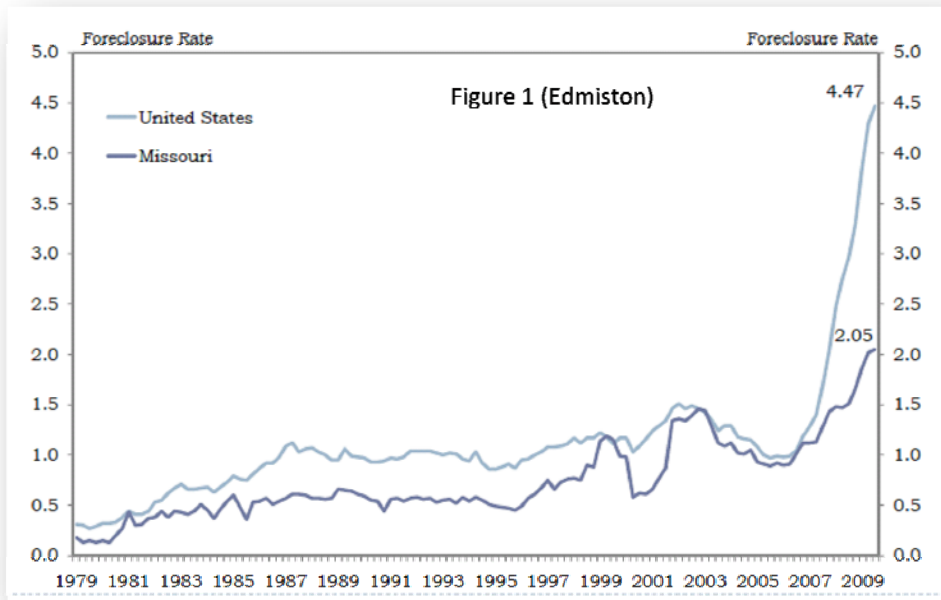
William Emmons, Assistant Vice President and Economist, Federal Reserve Bank of St. Louis [\[link\]](#)

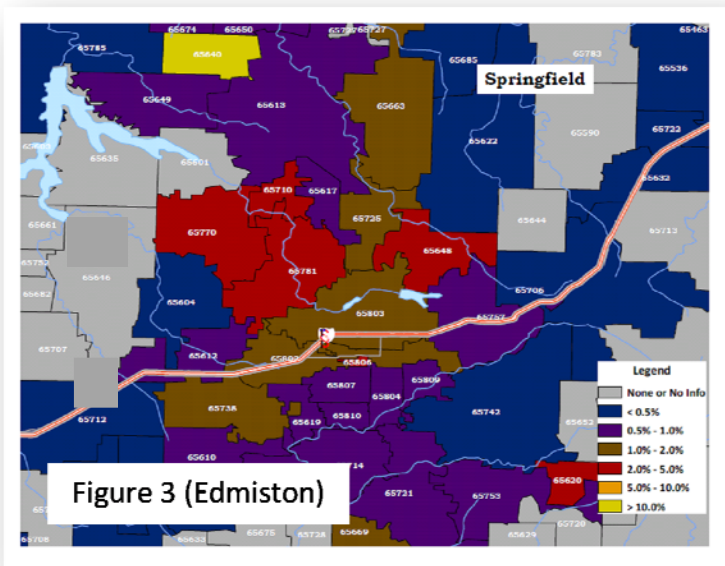
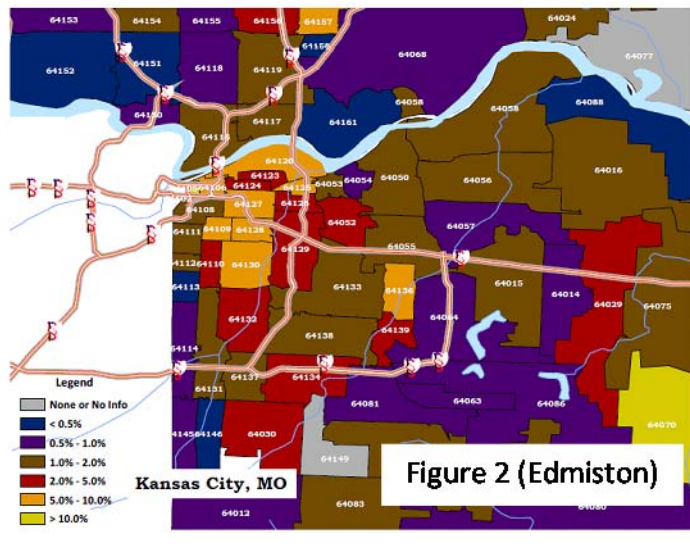
### A. The Foreclosure Rate

As Figure 1 shows, Missouri's foreclosure rate is lower than the foreclosure rate for the nation as a whole. The graph represents

the percentage of all outstanding mortgages that are in some stage of the foreclosure process. In the third quarter of 2009, 2.05 percent of all mortgages in Missouri were threatened by foreclosure, compared to 4.47 percent for the U.S.; Florida has the highest foreclosure rate—13 percent.

Part of the reason for the lower rate in Missouri is that the state did not experience the extreme housing bubble that many areas in the nation did, especially Florida and California. Additionally, Missouri has not had the severe drop in housing prices since the collapse of housing





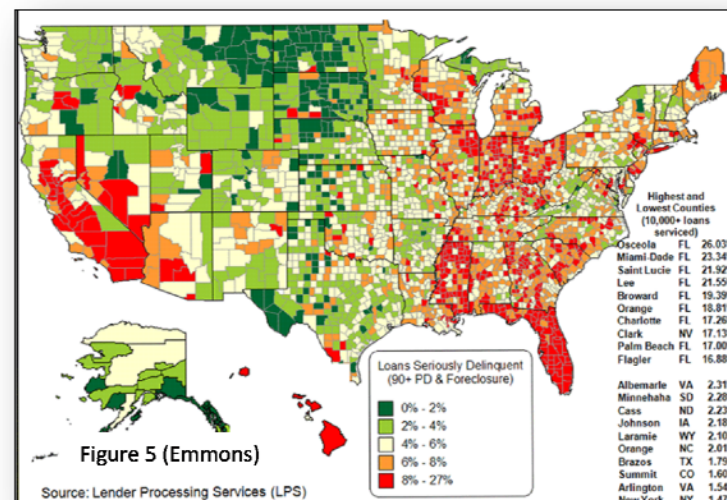
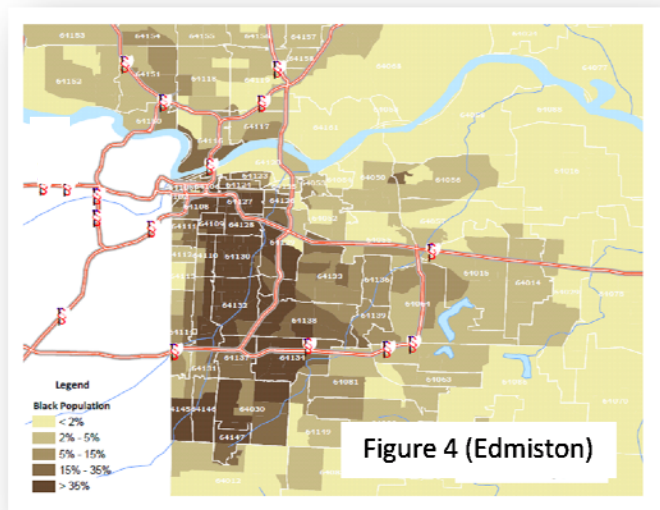
markets began in 2008. Housing price declines are a significant cause of foreclosures, because when the value of the home drops below the value of the mortgage, then the homeowner cannot sell the home to pay off the mortgage and avoid foreclosure.

Although the foreclosure rate in Missouri is lower than the nation, it is at unprecedented, historically high levels. In fact, today it is about *four times* the rate that prevailed through most of the 1980s and 1990s.

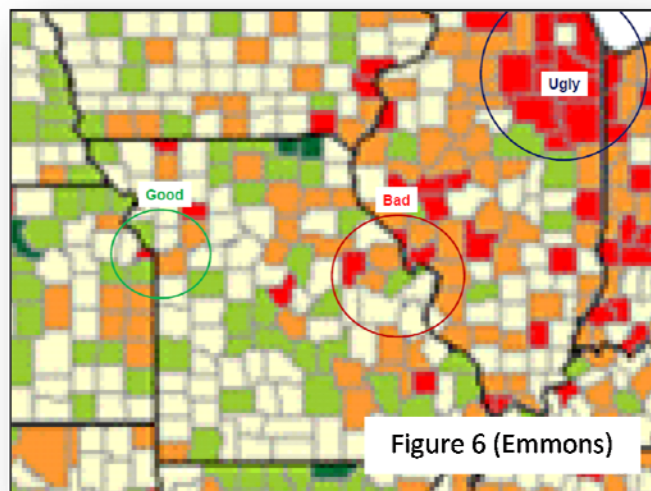
## B. Geographic Distribution of Foreclosures

The foreclosure problem has not affected all parts of Missouri equally. Figures 2 and 3 show foreclosure rates by zip code in the Kansas City and Springfield metropolitan areas, using foreclosure data from 2009. The rates vary significantly from below 0.5 percent to greater than 10 percent. The zip codes with the highest rates are found in the center of the regions, usually in either the center city of the region or in the region's urban county.

Figure 4 shows that the geographic clustering of foreclosures overlaps with areas with the highest percentage of African Americans. The pattern of high foreclosure rates in minority and low-income areas is well-documented. In many cases, mortgage brokers aggressively marketed subprime (high-cost) loans to minority neighborhoods. Subprime lending is closely associated with foreclosures, meaning that many African American and other minority borrowers who received subprime loans have had to cope with mortgage default and foreclosure.



Foreclosures across the United States have followed a similar pattern; some counties have suffered more from foreclosures, and other counties have had relatively low foreclosure rates. Figure 5 shows the mortgage delinquency rate in October 2009; the rate is computed as the total number of first mortgages seriously delinquent as a function of all loans outstanding. Missouri is in the middle of the crisis, not as hard hit by delinquencies as some states but worse off than others. Figure 6 shows a zoomed-in snapshot of the map focusing on Missouri and Illinois. This snapshot shows that Kansas City is doing pretty well. By contrast, the St. Louis metro area has some high rates of delinquency. However, neither is as bad off as Chicago.



Another way of looking at the geographic distribution of loans is how the foreclosure rate is spread across a metropolitan area. Figure 7 shows the foreclosure rate in counties in the St. Louis Metropolitan area, including counties on both the Missouri and Illinois sides of the Mississippi River. Although the foreclosure problem initially hit the inner counties - including

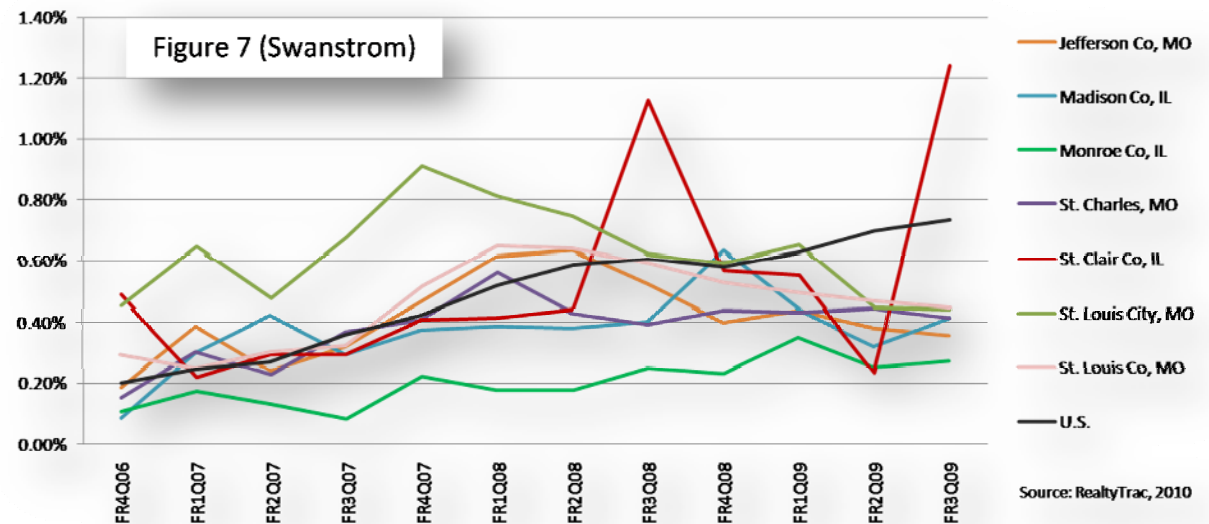


the City of St. Louis, St. Louis County and St. Clair County - the hardest, the foreclosure problem has spread out to the suburbs. Until the end of 2008 St. Louis City had a significantly higher foreclosure rate than the outlying counties, but since then it has been comparable to the outlying counties.

The conclusion to be taken from all of this data is that foreclosures are no longer predominantly an urban problem, but a problem that affects smaller cities, suburbs and fast-growing counties on the edge of metropolitan areas.

### C. Subprime and the Foreclosure Crisis

Extensive research has established that the primary mover in instigating the foreclosure crisis was the explosion of sub-prime lending, particularly in minority and lower-income communities. (For a summary of this research, see U.S. Department of Housing and Urban Development, 2010.) This subprime lending emerged in the 1990s as financial institutions and federal policy-makers emphasized homeownership as a major strategy for wealth creation, particularly among households—African-American, Hispanic, female-headed and lower-income—that had



	3 <sup>rd</sup> Qtr. 2006	3 <sup>rd</sup> Qtr. 2009
<b>Share of Mortgages</b>		
Missouri	12.78	9.76
USA	13.56	10.57
<b>Past Due (%)</b>		
Missouri	16.81	29.56
USA	12.56	26.42
<b>Foreclosure Rate (%)</b>		
Missouri	4.05	7.19
USA	3.86	15.35
Source: Mortgage Bankers Association		

**Figure 8 (Edmiston)**

previously not had high homeownership rates.

Figure 8 shows the rate of subprime lending in Missouri and the United States in the top two lines , as well as the percent of loans past due and the foreclosure rate. Data is shown both for the 3<sup>rd</sup> quarter of 2006, when the foreclosure rate was ramping upward, and the 3<sup>rd</sup> quarter of 2009, when the foreclosure crisis was deepening. The rate of subprime lending in Missouri is actually lower than the national average.

However, the rate of subprime loans past due in Missouri exceeded the past due rate in the U.S. in both the third quarter of 2006 and the third quarter of 2009; in 2009, almost 30 percent of subprime loans in Missouri were past due. Although subprime lending has fallen in the past few years, these high interest-rate loans are still a major cause of the foreclosure problem.

#### D. The Future of Mortgage Delinquencies

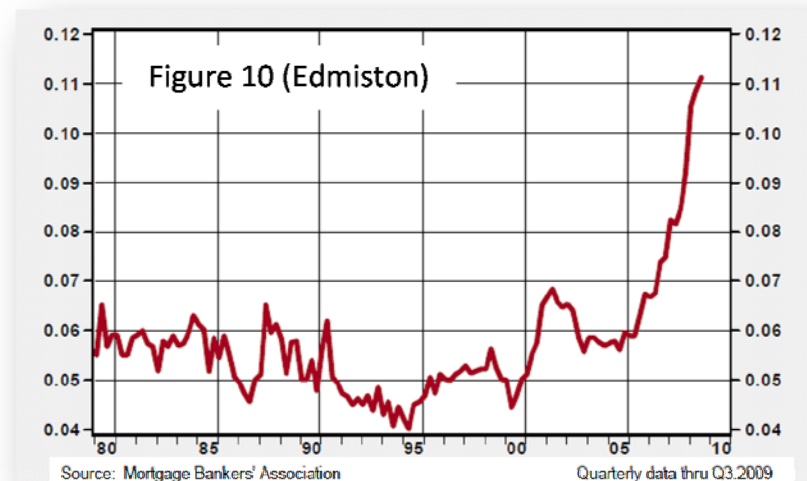
The high and rising rate of mortgage delinquencies suggests that the problem of foreclosures will not go away any time soon. As Figure 9 shows, the proportion of mortgages in Missouri that are more than 30 days delinquent is 9.4 percent, about the same as the nation as a whole. This remains, however, an extraordinarily high delinquency rate.

However, as Figure 10 shows, the share of Missouri first-lien mortgages either delinquent or in foreclosure has risen rapidly since 2005 and is continuing to rise. This is dangerous

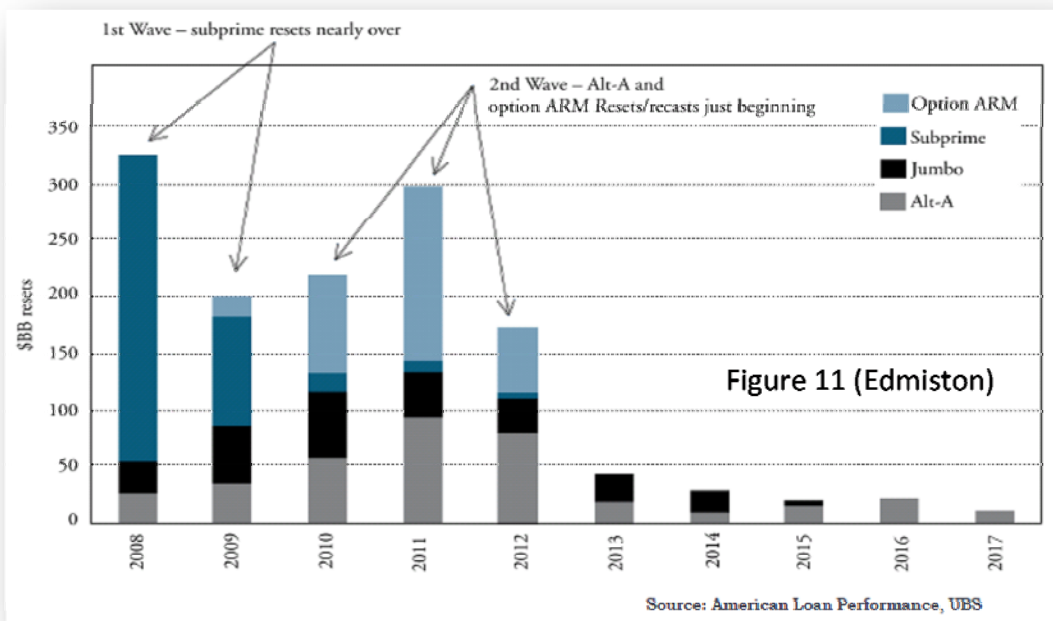
**Figure 9 (Edmiston)**

Status of Mortgage Pool	Missouri	USA
Delinquent 30 days	4.05	3.79
Delinquent 60 days	1.78	1.77
Delinquent 90 days +	3.59	4.38
<b>TOTAL PAST DUE</b>	<b>9.41</b>	<b>9.94</b>
Foreclosures Started	0.91	1.42
In Foreclosure Process	2.05	4.47
<b>SERIOUSLY DELINQUENT</b>	<b>5.62</b>	<b>8.85</b>

Source: Mortgage Bankers Association







trend that will continue into the foreseeable future. A large number of Missourians are behind on their mortgage payments and face the threat of foreclosure.

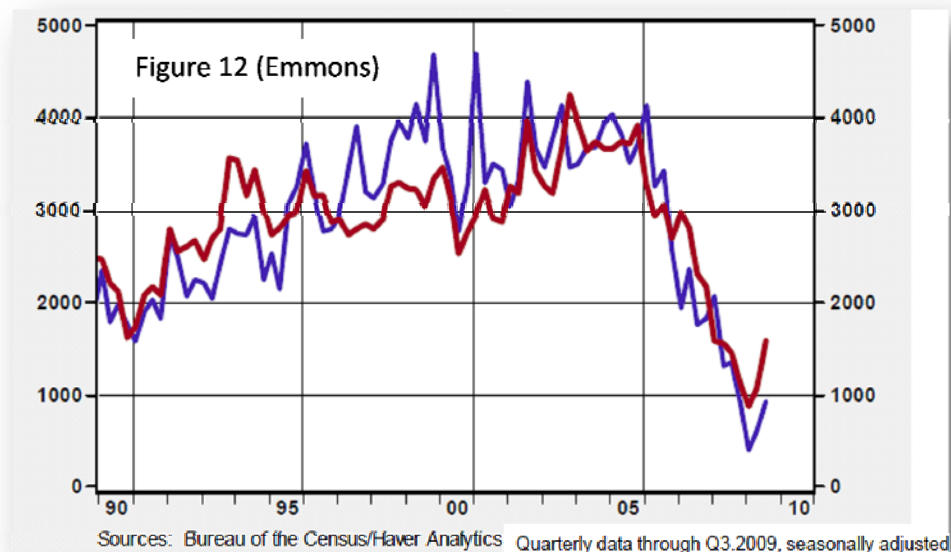
Another factor that does not bode well for foreclosures in Missouri is that there will be a new wave of mortgage rate resets on Alt-A and Option ARMs. Subprime loans tend to reset interest rates to higher levels after two years. Given that the peak time of subprime lending was 2005-2006, resets for them peaked in 2008 and have gone down since then. This can be seen on Figure 11, with the high peak subprime rate resets in

2008 and declining afterwards. Still in the future are the Alt-A loans—loans whose level of risk and interest rates are worse than A-paper, or “prime loans”, but better than “subprime” loans. The peak of resets on Alt-A loans will be 2011.

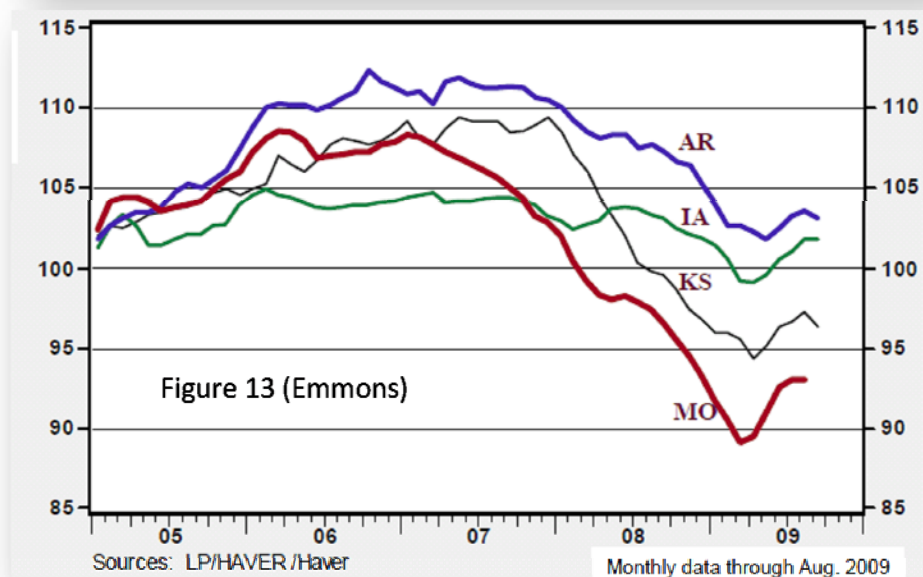
Option ARMs are loans that give borrowers choices of payment methods in the early years of the loan, usually including a payment option that results in “negative amortization,” which means that the amount paid does not even cover interest and the amount owed continually goes up. Option ARMs typically reset after five or six years and these resets will peak in 2011. Interest-rate resets on Alt-A and Option ARM loans will push more families into foreclosure.

#### E. The Future of the Economy and Foreclosures

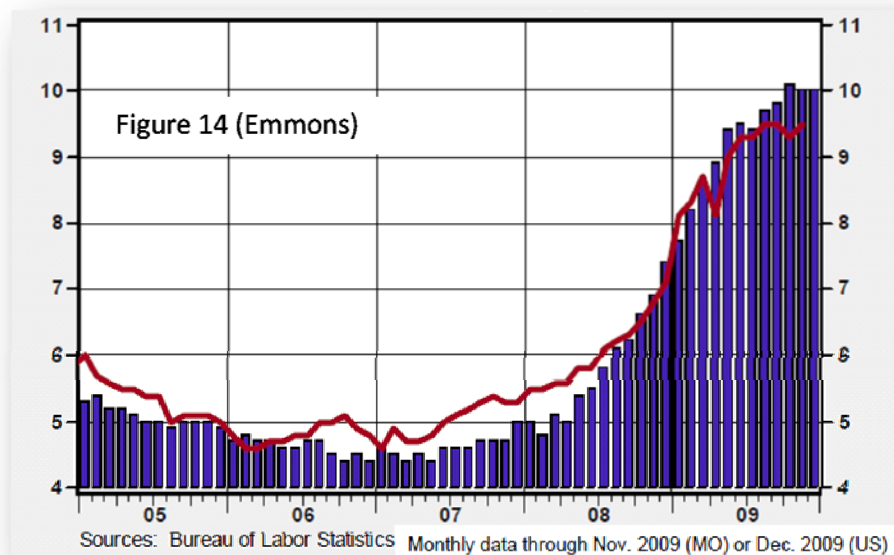
The future of foreclosures in Missouri will depend on how long the current recession lasts. One aspect of that is the current recession in the home-building industry. An up-tick in the home-building industry would indicate that housing markets had begun to



rebound, housing prices stabilized, and lenders had returned to a healthy level of confidence in their lending. Figure 12 shows the number of new housing units in both the Kansas City Metropolitan Area (in blue) and the St. Louis Metropolitan Area (in red) through the 3<sup>rd</sup> quarter of 2009. The homebuilding industry in the St. Louis and Kansas City metro areas suffered a massive decline beginning in 2005. Recently, the industry enjoyed a modest recovery, but it has still not reached anywhere near the number of housing starts it recorded in the 1990s and early 2000s.

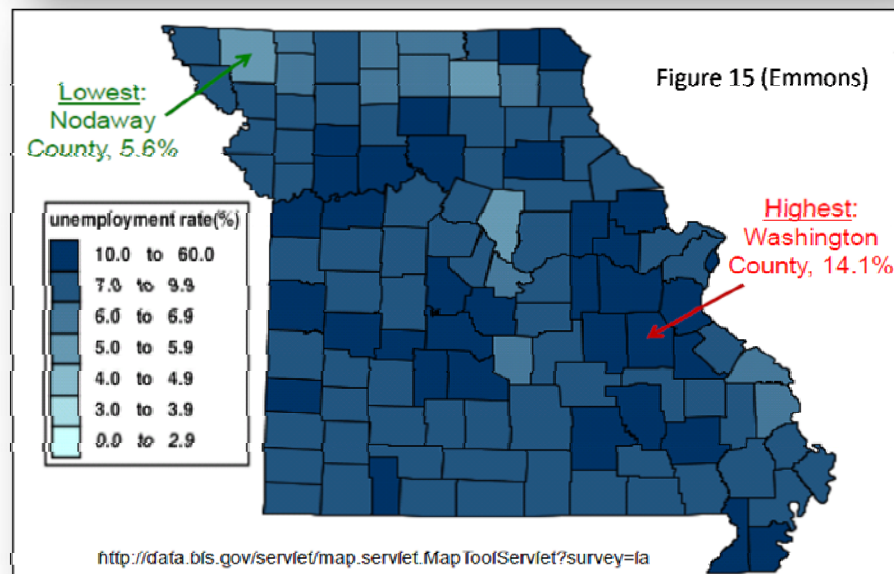


The drop in housing starts reflects the stark drops in Missouri home prices, shown in Figure 13. The graph shows an index value (with all areas set at 100 in December, 2004) for home prices in Missouri compared to Arkansas, Iowa and Kansas. As the next graph shows, Missouri housing prices have been consistently lower than Kansas, Iowa, and Arkansas. All Midwestern states suffered a significant drop in prices driven by the foreclosure crisis and subsequent recession. Prices ticked back up in 2009, but with a large inventory of unsold homes, driven partly by foreclosures, home prices and the homebuilding industry will take a number of years to return to the levels they enjoyed before the foreclosure crisis hit.

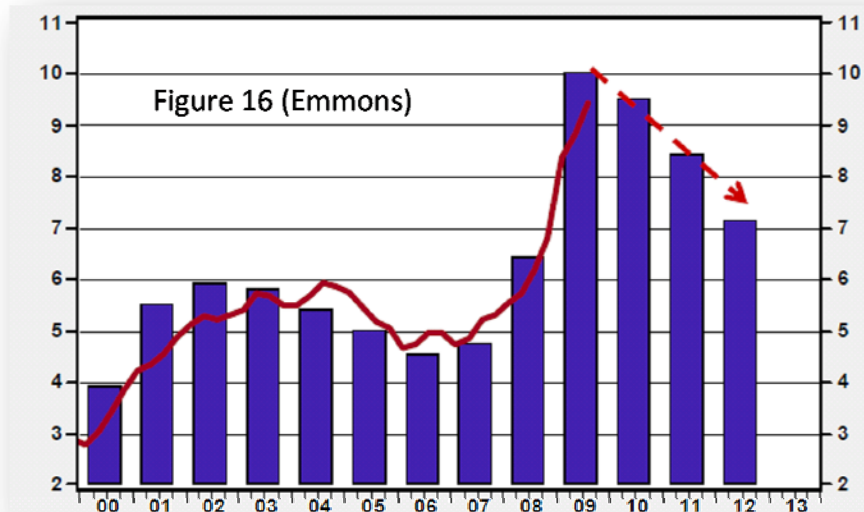


Another aspect of future economic performance that will impact foreclosures is unemployment. At the beginning of the foreclosure crisis, subprime lending was the major cause of foreclosures. The toxic assets caused by the high rate of foreclosures ricocheted through the economy causing a major recession. The decreased economic activity caused by foreclosures in turn drove up foreclosures. Now, however, the rising level of unemployment is increasing the economic stress of families and in turn increasing the number of foreclosures.

Figure 14 shows that the unemployment rate in Missouri (in red) has almost doubled since the beginning of 2007, rising from less than 5 percent to over 9 percent. The national unemployment rate (in blue) has similarly doubled over the last two years, exceeding the rate for Missouri. In February 2010 the unemployment rate in Missouri stood at 9.4 percent, slightly lower than the national rate of 9.7 percent.



Additionally, as shown in Figure 15, the unemployment rate varies from county to county in Missouri. Nodaway County, in the north-west corner of the state, has an unemployment rate of 5.6 percent; Washington County, on the outskirts of the St. Louis



why we should expect the foreclosure rate to remain high in Missouri for many years to come.

region, has the highest unemployment rate at 14.1 percent. Counties with high unemployment rates include not just the counties around the State's major urban areas of St. Louis, Kansas City and Springfield, but rural counties as well. Because unemployment will increase the economic stress on Missouri's families, counties with higher unemployment rates will be at a greater risk for foreclosures and so may have foreclosure rates that increase significantly in the future.

Finally, while the unemployment rate is expected to decline in 2010, this decline will be very slow and, as shown in Figure 16, the unemployment rate will be very high in future years. In 2012, Missouri's projected unemployment rate (in red) will still be at historically high levels, as will be the U.S. rate (in blue). This high unemployment rate is another reason

### III. The Role of Fraud

The increase in Missouri foreclosures is related to subprime lending, marketing of “exotic” loans to racial minorities and low income homebuyers, and fraud perpetrated by some mortgage bankers, lenders and real estate professionals. The conference provided information on the extent of mortgage fraud in Missouri, what state and federal leaders are doing about it and some of the emerging trends related to “foreclosure rescue scams.”

#### A. Definition of Mortgage Fraud

According to Linda Marshall, Senior Litigator with U.S. Attorney, mortgage fraud is “the material misstatement, misrepresentation, or omission relied upon by an underwriter or lender to fund, purchase or insure a loan.” According to the Federal Bureau of Investigations (2008), 20 percent of this fraud is “fraud for housing or property”—in other words, fraud committed by a homeowner in an application for a loan. That means 80 percent of the fraud is “fraud for profit”—fraud committed by a real estate, lending or mortgage officials as a part of a real estate transaction. This could include fraud committed by real estate agents, appraisers, brokers or lenders.

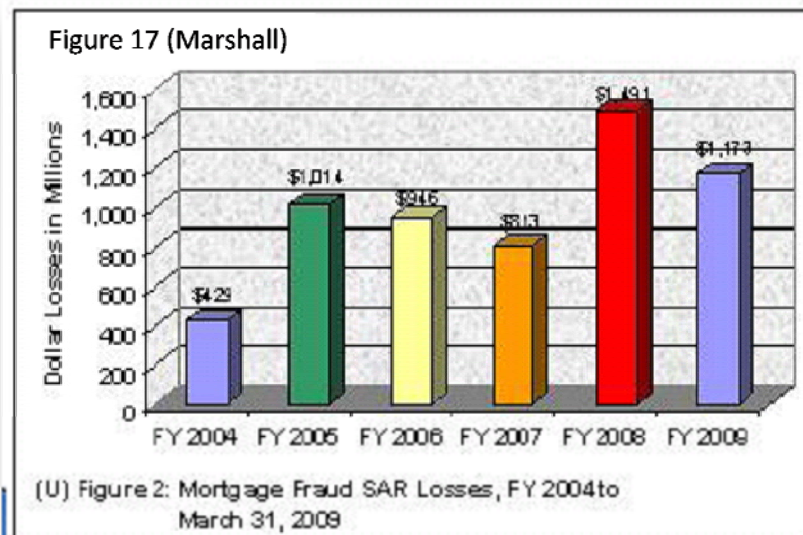
In the case of “fraud for housing,” the perpetrator is usually the homeowner. The fraud generally involves a single loan and misrepresentations, including alteration of income or property value, misrepresentation of the source of the downpayment or misrepresentation of debt. Generally in these cases the borrower seeks housing or cash from a loan; often the borrower intends to repay the loan.

By contrast, “fraud for profit” generally involves

#### ***For more information***

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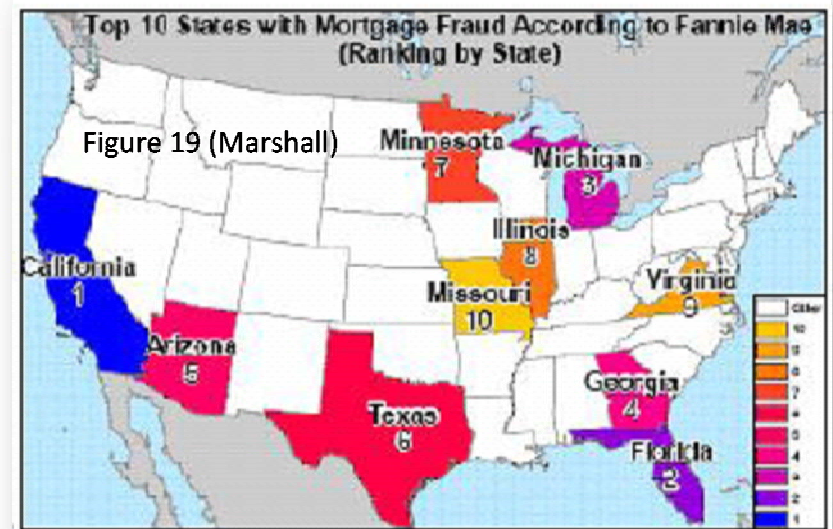
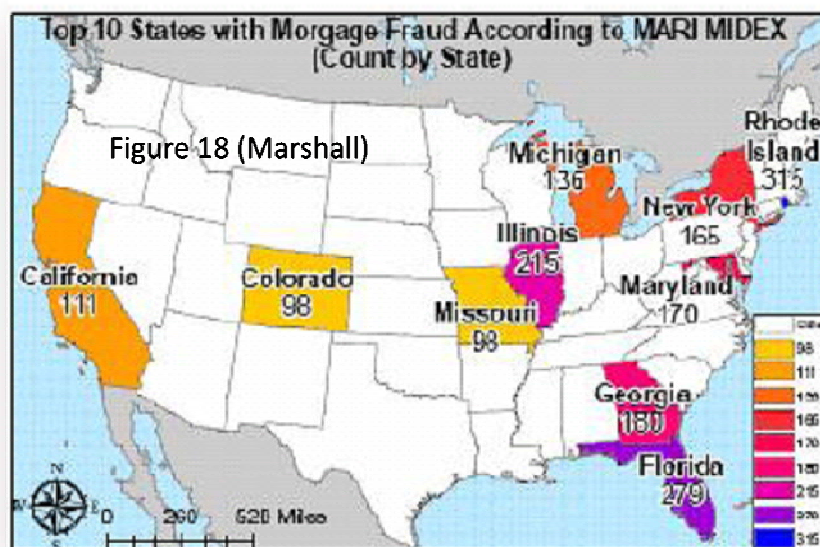


industry professionals and therefore represents some form of collusion by industry insiders, sometimes across multiple institutions. Fraud for profit often involves multiple loan transactions and multiple misrepresentations; participants are frequently paid for their participation. Borrowers are largely unaware of the scheme and often receive no benefits from the fraud; indeed, the fraud is often a prelude to mortgage default or foreclosure.

On the federal level, mortgage fraud is investigated by the FBI, and prosecuted by the U.S. Attorney. While punishments and restitution can pose a significant disincentive, the ability to prosecute is hampered by requirements for evidence and the requirement that the crime met specific thresholds in terms of the losses.

#### B. Extent of Mortgage Fraud

Figure 17 shows the reporting of mortgage fraud activity by financial institutions to the FBI. FY 2008 losses were just above \$1.4



billion, an increase of 83.4 percent over FY 2007. This loss can be compared to a total of \$41 million in losses to banks from robberies, burglaries and larcenies. Moreover, losses in the first half of FY 2009 due to mortgage fraud exceeded losses in the same period the year before by \$208 million.

States vary in the degree to which mortgage fraud has been a problem. Figure 18 shows the top ten states with mortgage fraud, according to an index computed the Mortgage Asset Research Institute (MARI). Missouri tied with Colorado for the 9<sup>th</sup> spot, just behind states that saw excessive housing price appreciation right before the emergence of foreclosures. A similar ranking by Fannie Mae, shown in Figure 19, places Missouri 10<sup>th</sup>, just behind Illinois and Virginia.

### C. Examples of Mortgage Fraud

Figure 20 and 21 show an example of mortgage fraud from Linda Marshall, Senior Litigator with the U.S. Attorney's Office. The first picture represents the view of the house from the street-line. The property was appraised for \$250,000 as a part of a loan transaction. The second picture shows the view of the house from the back.



#### IV. The Spillover Effects of Foreclosures

Spillovers are the effects of foreclosures on those not involved in a foreclosure. Large negative spillover effects justify policy interventions to protect the public. As Figure 22 shows, foreclosures have had huge negative spillover effects on investors and the economy more generally. We do not discuss these spillovers. Here we emphasize that foreclosures impose costs not just on homeowners, who suffer a loss of wealth and access to credit, and lenders, who often must write down the value of property, but also on neighboring property owners, local governments, children and families.

As noted earlier, foreclosures are unevenly distributed across Missouri, with low-income and minority neighborhoods hit the hardest. This means that the spillover effects of foreclosures are also unevenly distributed. The uneven distribution of the spillover effects of foreclosures is another reason for policy intervention. It is simply unfair that some people bear few burdens from foreclosures while others suffer substantial burdens – even though they themselves never went into foreclosure.

##### *For more information*

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### Spillover Effects of Foreclosures

Homebuyer



Lender



Neighboring property owners, local governments, children, families



Investors, ratings agencies, etc.

##### A. Declining Property Values

Scholarly research has consistently found a negative impact on the market value of homes located within approximately 1/8 of a mile (660 feet) of a foreclosure. A study of St. Louis County foreclosures between 1998 and 2007 found a drop of about 1.0 percent in the sales prices of properties located within 1/8 of a mile of a foreclosure (Rogers and Winter, 2009). In a study of Chicago, Immergluck and Smith (2006A) found a drop in market value within the 1/8 of a mile radius that varied from 0.9 percent to 1.8 percent.



Using the conservative Immergluck and Smith (2006A) estimate (0.9 percent), the Center for Responsible Lending (CRL) (2008) estimated the effects on property values of foreclosures. Based upon 33,000 foreclosures in Missouri in 2009, CRL estimates that an additional 1,066,438 properties experienced devaluation, with a total loss in property value of over \$1.5 billion. CRL further estimated that additional foreclosures through 2012 will cause an added \$5.8 billion drop in Missouri property values.

#### B. Social Disorder and Crime

By creating involuntary moves, foreclosures disrupt the community fabric and deplete social capital. Children are in many ways the most disturbing innocent victims of foreclosures. When they are pulled out of one school and put in another, their learning is disrupted. According to one estimate, 1.952 million children were impacted by foreclosures as a result of subprime loans made in 2005-2006 (Lovell & Isaacs, 2008). They estimate that 33,900 children were impacted by foreclosures in Missouri. This imposes huge costs on families, communities, and schools. Frequent residential moves can increase violent behavior in high school by 20 percent and reduce the chance of graduating from high school by more than 50 percent (Rumberger, 2003). Foreclosures can also damage the health of children, negatively affecting diet and body weight. In addition, foreclosures put stress on families, leading to higher rates of divorce, child abuse, and addictive behaviors.

Foreclosures also increase crime. According to the “broken windows” theory, signs of disorder in a neighborhood as small as a broken window that is not fixed encourage crime (Kelling & Coles, 1996). Foreclosures, especially when the home lies vacant and not properly maintained (such as tall grass or trash out front), can create a sense of disorder in a neighborhood that encourages crime. Research has confirmed this connection. A study of Chicago found that for each 1 percentage point increase in the foreclosure rate, the number of violent crimes in a census tract increased by 2.33 percent (Immergluck & Smith, 2006B). We know of no published research on foreclosures and crime in Missouri, although Professors William Rogers and Will Winter of the University of Missouri – St. Louis did preliminary research in the St. Louis region which found a statistically significant correlation between foreclosures and crime (personal communication).

#### C. Local Government Fiscal Stress

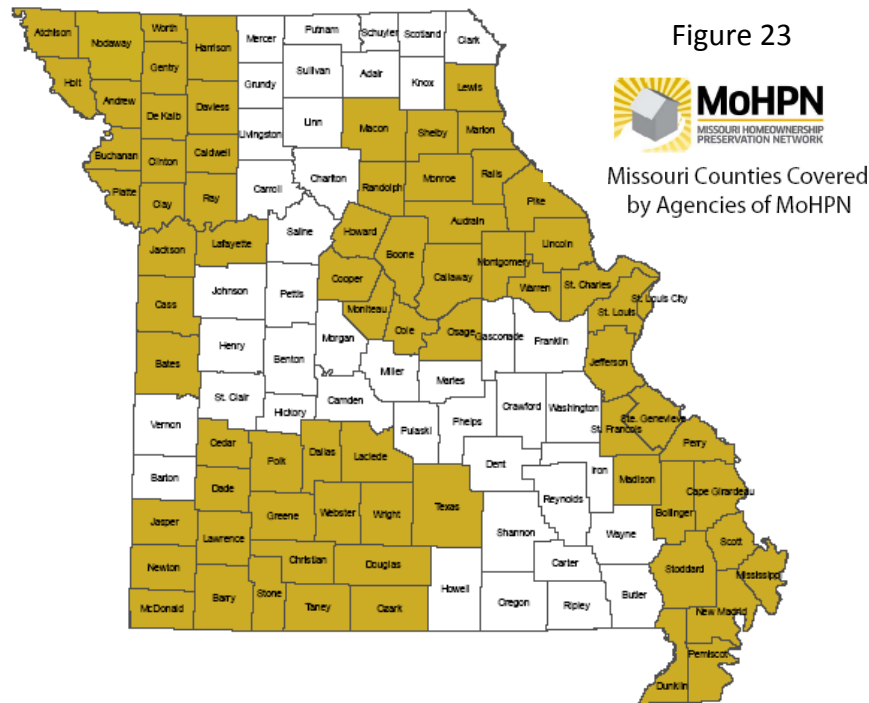
Foreclosures place fiscal stress on local governments in two ways: 1) reducing revenues and 2) driving up costs or expenditure needs. The impact of foreclosures on tax revenues, especially property taxes, is significant. Under the estimates presented above,

St. Louis City and County will suffer a \$628 million drop in home property values due to subprime loans made in 2005 and 2006. Once assessments catch up with declining property values, governments will be forced to increase local tax rates to maintain property tax revenues. Additionally, local governments will have to deal with increased tax delinquencies and failure to pay utilities.

The best scholarly study on extra costs to cities due to foreclosures examined Chicago (Apgar & Duda, 2005), quantifying the costs of foreclosure based on five scenarios. If a property goes into foreclosure and is quickly put back on the market, they estimate it will cost the local municipality only \$430. At the other extreme, if the foreclosure leads to vacancy, abandonment, and fires, the cost to the local municipality can soar to as much as \$34,199. Based on the Apgar and Duda study, the Joint Economic Committee of the U.S. Congress estimated average costs at \$19,227. This is a staggering cost to local governments. One way to think about it is if this “average” cost of foreclosures is applied to just half of the foreclosures in St. Louis County and the City of St. Louis between 2007 and 2009, the result is extra expenses to municipalities in St. Louis County of \$114 million, and \$56 million to St. Louis City.

## V. Role of Foreclosure Counseling

The Missouri Homeownership Preservation Network (MoHPN) is a network of housing counselors in Missouri that helped sponsor the conference in Jefferson City in January. Member agencies are located in Bowling Green, Cape Girardeau, Columbia, Kansas City, Springfield, St. Joseph, and St. Louis (Figure 23). As



HUD-certified foreclosure counseling agencies, MoHPN members deliver some of the most effective programs to prevent foreclosures and minimize their spillovers. These counselors receive weeks of training on how to help homeowners who are facing a foreclosure. They provide free counseling to homeowners who are delinquent or facing foreclosure, helping them with financial planning and to access a variety of loss mitigation options, including loan modifications, assistance in selling their property, and repayment plans. They also refer homeowners to other social service agencies as a part of the counseling.

Most of the funding for foreclosure counseling comes from the National Foreclosure Mitigation Counseling Program (NFMCC), which has been funded by the federal government since 2008, with a total of approximately \$410 million nationwide. The program is

administered by NeighborWorks America, which gives grants to local counseling agencies or networks. The funds are paid to the agencies for counseling individual clients – with payments ranging from \$150 to \$350 depending on the extent of the counseling.

### A. Impact of Foreclosure Counseling

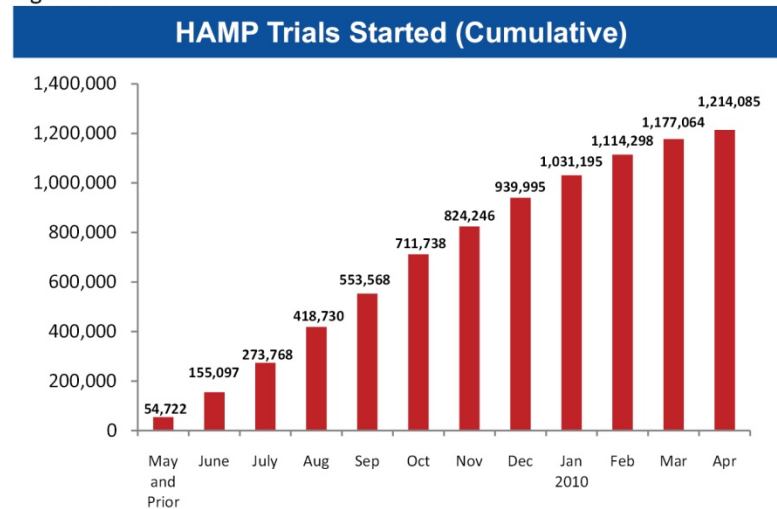
In 2009, the Urban Institute (UI) published preliminary findings of its evaluation of the federally funded NFMC counseling program (Urban Institute, 2009). UI examined approximately 61,000 households that received foreclosure counseling and compared this with another 61,000 households that did not receive foreclosure counseling. They found that the program had modest effects on homeowners who were two to three months delinquent on their loans when they started counseling, but more dramatic effects helping homeowners “cure” an existing default. Counseled homeowners in the foreclosure process were 60 percent more likely to avoid foreclosure than those who had not received counseling. Additionally, the Urban Institute study concluded that loan modifications received by homeowners through the NFMC program resulted in significantly reduced monthly mortgage payments after a loan modification (-\$454), thereby further decreasing the likelihood of future defaults and foreclosures. A recent study of 1,460 foreclosure counseling clients helped by Beyond Housing in St. Louis found that 84 percent of those who sought foreclosure counseling were still owners of record at the end of the study period. Foreclosure counseling matters.

Foreclosure counseling has been supported by local governments and nonprofits in Missouri. In St. Louis, the local television station, KETC, ran a program called “Facing the Mortgage Crisis” that called attention to the problem and helped link homeowners to counseling agencies. Local governments have also provided rescue funds to help financially strapped homeowners modify their loans. Given the proven effectiveness of foreclosures counselors in helping families facing foreclosure, more investment by local governments and nonprofits makes sense.

### B. Federal Government Policy

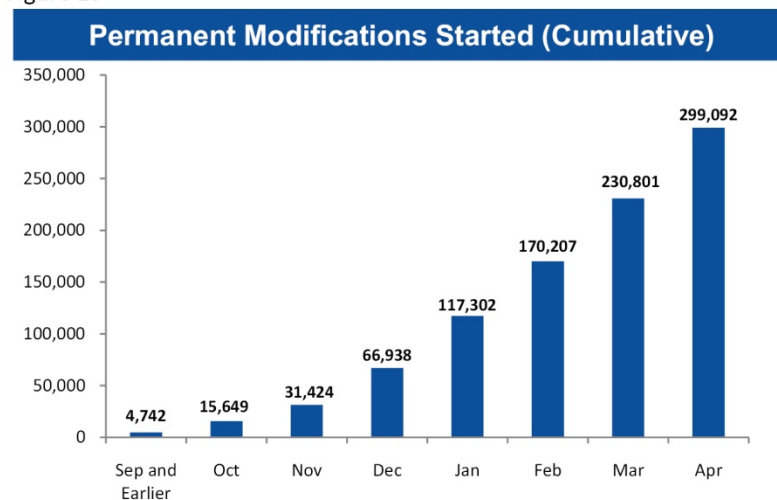
Although outcomes are better for borrowers who see a mortgage counselor, still the number of borrowers who are able to modify into a sustainable loan is small. According to a survey of HUD-certified counselors conducted by the Urban Institute (Urban Institute, 2009B), the top reason why borrowers are not able to achieve successful outcomes is because of a job loss or reduced wages – which makes it very difficult to help people bring their mortgages current and stay in their homes. But the counselors also reported that the second, more serious problem was “slow or no response from servicers.” In fact, six of the seven top challenges to achieving successful outcomes, according to the counselors, were related to working with servicers.

Figure 24



Note: Servicers may enter new trial modifications anytime before the loan converts to a permanent modification.  
Source: HAMP system of record.

Figure 25



In order to address the problem, in March 2009 the Obama Administration launched the Making Home Affordable (MHA) Program, which was designed to help 7-9 million households. Intended to strengthen the ability of homeowners and local counselors to negotiate meaningful mortgage modifications, the program has two main components—a Home Affordable Refinance Program (HARP) for homeowners whose loans are held by government-sponsored entities, and a Home Affordable Modification Program (HAMP) for modifying loans held by conventional lenders. Of the two, HAMP has become the more important program for most local homeowners, and it has also been the more complex and difficult program for the federal government to implement.

The main components of HAMP are:

- *Incentives for investors*: the program provides direct incentives to investors (\$1,000 up front) for modifying a loan;
- *Modifications*: the program supports a variety of modifications to reduce home payments to 31 percent of a homeowner's income, including interest-rate reductions and extensions of the term of the loan.

MHA/HAMP encourages principal reductions, although does not compel lenders to offer them. More recently, the Administration has initiated a program to encourage principal reductions.

As Figures 24 and 25 show, a major problem is that the federal HAMP program is not resulting in permanent modifications as it was designed to do. As of the end of April 2010, nationwide 1,214,085 borrowers were in trial modifications but only 299,092 had received permanent modifications. In Missouri, 7,626 borrowers were active in trial modifications as of the end of April, but only 3,431 had received permanent modifications under the HAMP program (Making Home Affordable, 2010).

Clearly, policy reforms are needed to increase the rate at which loans are modified in order to keep families in their homes. We discuss some actions that can be taken in Missouri in our final section.

## VI. The Role of State Policies in Missouri and Suggestions for Reform

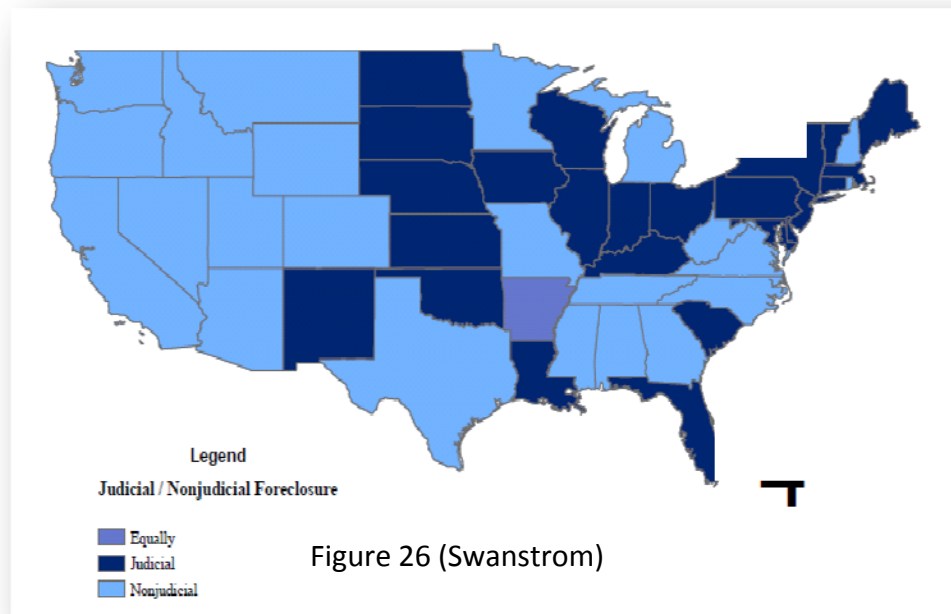
While federal lending policy can significantly impact foreclosures, state policy is also important. State policies addressing foreclosures vary across the states. Missouri could enact policy reforms that would provide better outcomes for the individuals facing foreclosure and the communities in which foreclosures are located.

Participants at the Summit provided general information about state policy, summarized policy in Missouri responding to foreclosures, and provided suggestions for additional reforms.

### *For more information*

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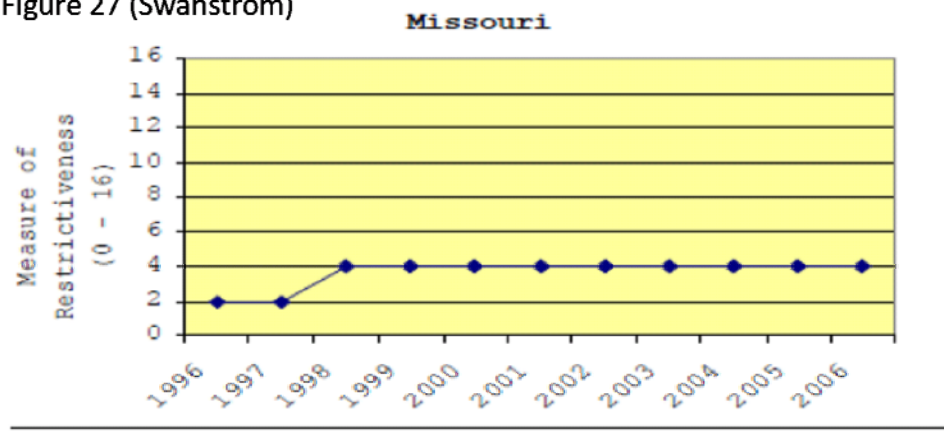


### A. State Foreclosure Timelines

One of the most significant aspects of state policy is whether a state has a judicial or non-judicial process. As shown in Figure 25, Missouri has a non-judicial foreclosure process. Non-judicial foreclosures are processed without court intervention, with the requirements for the foreclosure established by state statutes. In Missouri the foreclosure process can begin when homeowners are just 30 days late with their payments. Lenders do not need to file a lawsuit to foreclose; they are required to simply send a certified letter and publish notices of the sale in a newspaper published in the county where the home is located.

Cutts and Merrill (2008) estimate that states with judicial foreclosure process have an average foreclosure timeline of about 186 days; by contrast, non-judicial states have foreclosure timelines averaging 87 days. Missouri's timeline is 60, one of the fastest foreclosure processes in the nation, tying with four other states in the nation for 5<sup>th</sup> fastest; at the minimum, the foreclosure timeline can be just 38 days from first referral to foreclosure sale (Cutts and Merrill 2008). By contrast, Kansas has an average foreclosure timeline of 130 days and Illinois a foreclosure timeline of 300 days. (It is important to note that most foreclosures in Missouri take considerably longer than 60 days from first notice to sale, however, Missouri's process is still among the fastest in the nation.)

Figure 27 (Swanstrom)



The upshot is that by the time a homeowner seeks help, he or she may have little time to try to raise funds or modify the mortgage. The fast foreclosure process in Missouri has made foreclosure prevention more difficult.

#### B. Regulation of Mortgage Brokers

One aspect of the emergence of foreclosures in subprime lending was the proliferation of mortgage brokers and real estate agents who were only loosely regulated by state governments. Federally regulated lenders were much less likely to engage in subprime and predatory lending than state-regulated mortgage brokers (U.S. Department of HUD 2010). A major cause of foreclosures in Missouri and across the nation was the proliferation of lightly regulated mortgage brokers who aggressively marketed subprime loans to borrowers who could not sustain them. Most subprime loans were made by mortgage brokers, who are regulated by the states and not by the federal government. Pahl (2007) has published a compendium of state mortgage broker legislation for each of the 50 states, with data from 1996 through 2006; Figure 27 shows the scores for Missouri.

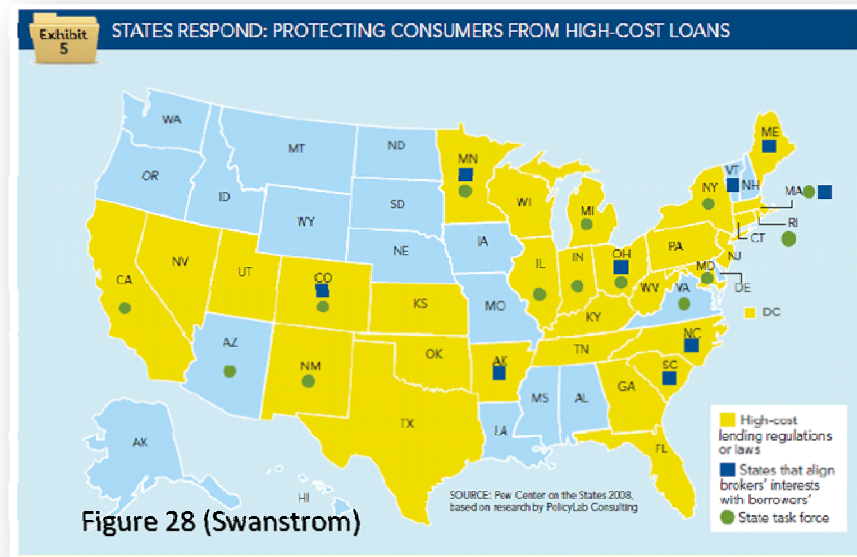


High scores are 9 or above (18 states in 2006), medium scores are 5 through 8 (17 states in 2006), and low scores less than 5 (15 states in 2006). Missouri's scores are consistently in the lowest range for the entire period and show little change over the time when the foreclosure crisis was worsening. In 2006, Missouri was among the 15 states with the lightest regulation of mortgage brokers. In Missouri, for example, mortgage brokers are not required to have "fiduciary responsibility" to act in the best interest of their customers.

As part of the Housing and Economic Recovery Act (HERA) of 2008, the federal government enacted the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE) which established minimum standards for mortgage brokers that the states must meet. These requirements include:

- A license (updated effective July, 2009)
- No previous license revocations
- Charter and fitness requirements, including no serious criminal history, financial stability (net worth at least \$25,000)
- Minimal preliminary and continuing education requirements,
- \$20,000 surety bond.

The law also eliminated numerous exemptions to past federal law. However, the federal standards are only a minimum, or floor. States can and should go further in regulating mortgage brokers in the public interest, as we discuss later.



### C. High Cost Regulation

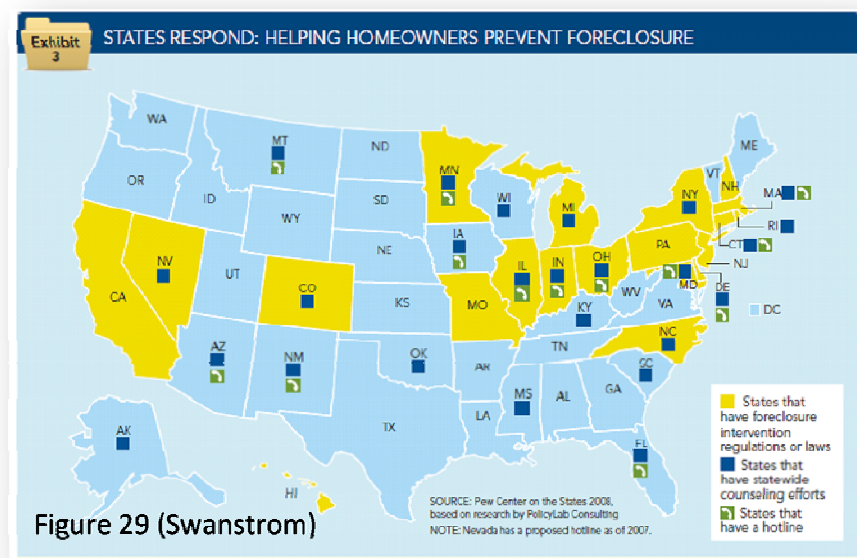
Another way states can reduce unnecessary foreclosures is to regulate subprime lending to make sure that borrowers are not taken advantage of. According to a study by the Pew Center on the States (2008), Missouri has no laws protecting consumers from high-cost loans. Figure 28 summarizes state laws on high cost loans. Even though subprime lending is down in Missouri from its peak a few years ago –partly because investors are wary about purchasing mortgages that so frequently foreclose—additional state laws would reduce the chances that Missouri would face another foreclosure crisis in the future.

### D. State Support for Foreclosure Prevention

Another response by state governments has been their support for foreclosure prevention. Figure 29 summarizes findings from the Pew study (2008) regarding state support for foreclosure counseling. As the map above shows, Missouri has taken some action in this area. In 2007 the Missouri Legislature passed a Mortgage Rescue Fraud law that banned companies that promise to help people avoid a foreclosure from charging their clients before they provide the service. Given the proliferation of mortgage rescue fraud schemes, this is valuable. Missouri could, however, follow the lead of other states which have provided state funding for counseling,

required notification of counseling with foreclosure notices and provided other mechanisms for protecting the rights of owners and renters through the foreclosure process.

Finally, some states have authorized governors and legislators to appoint representatives of the public, private, and nonprofit sectors to a State Foreclosure Prevention Task Force. These task forces have studied the foreclosure issue and made recommendations on how to prevent foreclosures and minimize their spillover effects, giving much-needed statewide visibility to the issue.



### E. Missouri State Policies on Foreclosures

Missouri state policy on foreclosures has mostly involved using existing and new state laws to go after fraudulent practices by lenders, mortgage brokers and other actors in the real estate and lending process. State officials involved in these activities have included the Governor, the Attorney General, various department heads and officials and state legislators. Additionally, state prosecution has been matched by federal prosecution in both the Eastern and Western Districts of Missouri.

#### *1. Missouri Mortgage Fraud Task Force (2007)*

One of the first actions was the creation of a Missouri Mortgage Fraud Task Force. The task force was a part of the Department of Insurance, Financial Institutions and Profession Registration (DIFP) and chaired by Richard Weaver, currently the Missouri Commissioner of Insurance. The task force included members from a variety of state agencies, including the Finance Division, Real Estate Commission, Real Estate Appraisers Commission and Insurance Consumer Affairs Division. Members have coordinated mortgage fraud investigations and written draft legislation.

#### *2. Mortgage Crime Legislation (House Bill 2188 - 2008)*

Among the legislation drafted by the task force and ultimately passed by the state legislature was legislation creating the state crime of mortgage fraud, as a Class C felony crime. Sponsored by Representative David Pearce (R-Bates), the bill made it unlawful for a person, “in connection with the application for or procurement of a loan secured by real estate to”

- make an untrue statement;
- receive a portion of the sale or other consideration in connection with that untrue statement; and
- influence through extortion or bribery the development or review of an appraisal.

The law also strengthened the administrative, investigative and court enforcement policies for Finance, Real Estate and Real Estate Appraisers Commissions and authorized the ability to conduct collective investigations among the various divisions within DIFP.

### *3. Missouri Secure and Fair Enforcement for Mortgage Licensing and Residential Mortgage Brokers Licensing Act (House Bill 382 – 2009)*

Missouri has also followed federal legislation in strengthening its oversight of mortgage brokers and mortgage licensing. Sponsored by Representative Stanley Cox (R-Sedalia), the act brought Missouri into the new national system of mortgage brokers. This included a nationally integrated state-based licensing system (the “Nationwide Mortgage Licensing System and Registry”), built under contract with the Financial Industry Regulatory Authority.

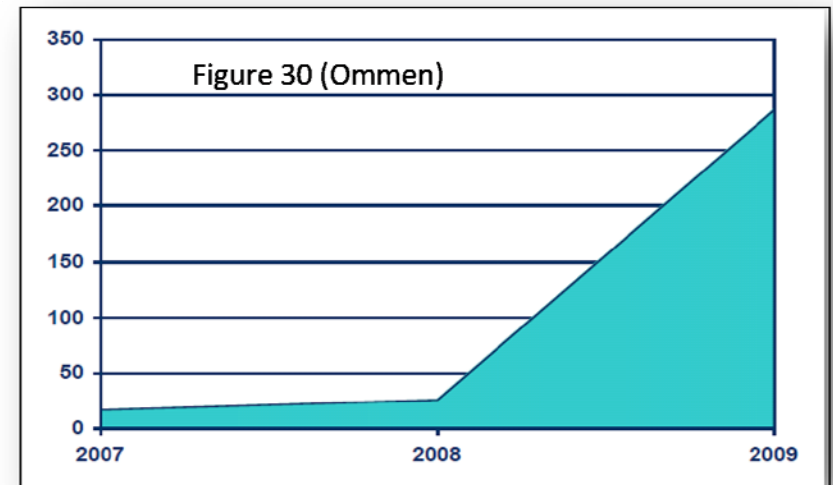
### *4. Enforcement Activities under the Attorney General*

Since his election in 2008, Attorney General Chris Koster has been actively pursuing mortgage fraud, including most recently cases involving so-called “rescue scams.” Much of this prosecution has been under the Missouri Consumer Protection Act, specifically Section 407.020.1 that outlaws “deception, fraud, misrepresentation, unfair practice or concealment, suppression or omission of material fact.” Under the act, violations of the statute are a Class D felony; prosecutors are authorized to pursue a variety of injunctions, consumer restitutions and penalties.

### *5. Enforcement Activities against Mortgage Rescue Scams*

In April of 2009, AG Koster announced a “zero tolerance” campaign against mortgage scams in Missouri. These scams responded to complaints by consumers that unscrupulous businesses were targeting individuals under the threat of foreclosure and luring them into a variety of scams, leaving them in worse financial condition than they were previously. Analysis by the Attorney General’s office showed that consumers were particularly vulnerable to the scams because

- Foreclosures were continuing to rise;
- Interest rates were low creating an incentive for refinancing; and



- Loan scam companies falsely associate themselves with the federal government's initiatives to help homeowners.

As shown in Figure 30, the number of complaints about rescue scams in Missouri increased dramatically from 2007 to 2009.

#### *6. Consumer Restitution*

The Attorney General has also filed a number of cases in Missouri courts and joined with the Federal Trade Commission and the California Attorney General in obtaining a temporary restraining order in federal court against U.S. Foreclosure Relief and the individuals that ran the operation. This action froze millions in assets and made the funds available for consumer restitution.

#### *7. Other Actions by the Attorney General*

The Attorney General's office is exploring additional measures to deal with foreclosures and foreclosure rescue scams. First, the office is exploring additional state-federal cooperation on the issue; for example, AG Koster testified before the United States Senate in 2009 urging a federal prohibition on high advance fees by foreclosure rescue and mortgage modification operations.

Additionally, the office is exploring whether to change the sanction for violations of foreclosure fraud laws from a misdemeanor to a felony.

#### F. Recommendations for Reform in Missouri

The MoHPN could work with state politicians and other advocacy organizations to build upon the reforms already completed to advance additional state policy to prevent foreclosures and mitigate their effects in local communities. Recommended reforms include:

##### *1. Lengthen the foreclosure process:*

Cutts and Merrill (2008) argue that a foreclosure process around the national average of 120 days is ideal. This might be

called the “Goldilocks standard” – not too long and not too short. A 120-day process gives lenders and borrowers time to modify the loan or find other solutions. If the process is too long, however, borrowers may deliberately fail to make payments in order to save money over the short-run (but pretty much guaranteeing that they will end up in foreclosure in the long run). Some foreclosures could be prevented if Missouri lengthened its foreclosure process.

## *2. Strengthen mortgage brokerage regulation*

Current federal policy represents a minimum level of state regulation; even with recent reforms, Missouri’s regulation remains quite low, meaning that homebuyers may still be vulnerable to predatory lending practices. Missouri could create standards for “fiduciary responsibility” for brokers, mandating that they act in the best interest of their clients. Additionally, Missouri could strengthen a number of federal requirements, including the minimum training and bonding requirements.

## *3. Toughen regulation of high-cost loans*

The state-federal split in regulation of lending created an environment in which subprime and other exotic loans thrived. Missouri could prevent future risky loans by requiring lenders to verify income, ban penalties if a borrower pays off a loan early and encourage consumer education and counseling before a loan is made.

## *4. Increase resources for foreclosure counseling*

Even with substantial state-wide budget issues, prevention of loans makes economic sense, as the costs of counseling and prevention far outweigh the costs of foreclosures. Besides funds for counseling, Missouri could increase its support for programs that help homeowners refinance out of predatory loans, including the Missouri Housing Development Commission program that provides up to \$13,000 for qualified applicants.

## *5. Create a Missouri Homeownership Preservation Task Force*

The legislature could ensure future attention to foreclosures and policy around them by creating a state task force. Made up of representatives from the public, private and non-profit sectors, the task force could conduct research on foreclosures in Missouri and make recommendations for state legislation to prevent them and minimize their costs to the state.

## VI. Breakout Sessions

The Summit concluded with small-group sessions on policy recommendations in three issue areas:

- Education and Outreach
- Residential Lending Policy
- Foreclosure Prevention and Counseling

This section summarizes the discussion and policy recommendations from each group.

### A. Education and Outreach Policy and Practice

Though individual non-profit organizations and local government entities have made efforts to do outreach to homeowners at risk of foreclosure there has not been a comprehensive, continuous statewide effort to reach Missouri homeowners. The key to successful foreclosure prevention outreach is to partner with groups and agencies that can help get information to families that need assistance. The partners should be a “trusted source” of information. Information can be shared in a variety of settings, such as websites, brochures, flyers, trainings for community service providers, radio, TV and print media and through the use of public television as has been successfully done in St. Louis and Kansas City.

Key points in creating a successful outreach strategy include:

- Identify trusted sources of information that can partner with your group or organization;
- Get information to places where people will trust the information and be receptive;
- Utilize a variety of methods including public television, social media, outreach to community service partners (social workers, clergy, non-profit and civic organizations) and elected officials.

Missouri could improve foreclosure prevention outreach to homeowners by:



- Creating a Missouri Housing Policy Task Force using the model of Missouri Housing Partners that used to exist (coalition of non-profit, government and industry partners that worked together to promote homeownership programs);
- Marketing United Way 211 or other hotline numbers across the state as a referral source for foreclosure intervention;
- Providing funding for commercial media advertizing for a state hotline or partnering with media outlets to donate media;
- Continuing partnership with public television stations to educate and inform people about the foreclosure issue and about foreclosure prevention assistance;
- Developing educational materials and programs on the foreclosure problem for outreach to elected officials and consumers;
- Marketing the MHDC refinance program for borrowers with high interest rates.

There is a long list of possible partners for education and outreach campaigns, including:

- Elected officials
- MHDC
- United Way
- Realtor Associations
- Churches
- Libraries
- School social workers
- Career Centers

- Local government entities and court houses
- Local media
- Banker Associations
- Banks and Credit Unions
- Senior Centers
- Foreclosure Attorneys
- Chamber of Commerce

#### B. Residential Lending Policy

At the present time Missouri does not have strong laws to protect consumers when buying or refinancing a house. In addition, many state consumer protection laws have been preempted by federal bank regulators, decreasing the importance of state regulation. Different lending institutions (banks, mortgage banks, private investment banks) have been subject to varying levels of oversight by federal regulators (Federal Reserve Bank, OTC, OCC, SEC). Loan servicers are not regulated.

Missouri does not have a state foreclosure or state housing policy task force, convened by the governor or other statewide elected official. Missouri used to have Missouri Housing Partners, which played some of this advocacy role, but this was eliminated.

While the Missouri Housing Development Commission did develop a program to help homeowners refinance out of subprime mortgages there is not enough money in the refinance program to help all the people that need it (\$3 million for program and up to \$13,000 per qualified applicant). This program does not help people who have defaulted on their mortgage.

Mortgage brokers in Missouri were largely unregulated until passage of the federal SAFE Act and the corresponding Missouri HB382. The Missouri Division of Finance is in charge of enforcement of mortgage broker and loan originator licensing. While staffing levels have increased somewhat, in the past the Missouri Division of Finance did not have enough staff or resources to regulate or investigate the activities of mortgage brokers.

Possible solutions include:

- Establishing fiduciary duty of loan originators (not just mortgage brokers) and loan servicers to act in the best interest of the borrower;
- Creating a private right of action to be able to sue a loan originator if they engaged in abusive lending practices;
- Requiring servicers to give a breakdown of fees incurred during the foreclosure process;
- Convening industry, non-profit, local and state government groups (e.g., Association of Counties, Missouri Municipal League) and advocacy groups to discuss:
  - Enacting regulatory reform
  - Increasing state funding for homeownership
  - Funding the Missouri Housing Trust Fund (MHTF)
  - Creating a fiduciary duty for loan originators
  - Regulating payday lending;
- Developing partnerships between local government groups and MoHPN;
- Developing education materials and programs for outreach to elected officials and consumers;
- Asking MoHPN to take the lead on carrying out actions.

Possible partners that could help institute lending reforms include:

- Local government;
- Municipal organizations;
- Non-profits;

- Mortgage industry representatives;
- Real estate agents and organizations;
- Elected officials.

### C. Foreclosure Prevention and Counseling

Nonprofit housing counseling agency staff encounter many challenges in working with mortgage servicers to find solutions to help homeowners avoid foreclosure. The loss mitigation process takes more time now because of the increased need, increased volume, staffing issues and general system inefficiencies. Working with homeowners and loan servicers is time intensive. There is often not enough time or resources to give homeowners all the help they need.

In addition, loan servicers do not have adequately trained staff to handle requests for loan modifications and other loss mitigation help. Counselors report that loan servicer staff often lack the information or experience necessary to solve problems. Information given to housing counseling staff by servicers is often inconsistent. One department does not always know what the other department is doing and homeowners are often put into foreclosure while the homeowner or housing counselor is trying to negotiate a workout agreement with the loss-mitigation department. Loan servicer loss mitigation guidelines change frequently and vary by factors unknown to the housing counselor such as loan type, investor and servicer financial interests and guidelines.

In addition federal program guidelines have been changing quickly which requires that housing counselors keep up-to-date in order to be able to advocate for their clients. Federal policy on foreclosure prevention is a moving target that up to this point has failed to move enough borrowers into permanent modifications.

Possible solutions to resolve these issues include:

- Increasing funding for non-profit housing counseling services so that more time can be given to homeowners who need the help;
- Providing more training for counselors and more opportunities to share best practices;

- Penalizing loan servicers who do not comply with HAMP, FHA, Fannie or Freddie guidelines for loss mitigation. For example servicers are supposed to process HAMP applications within 30 days and provide a written response. This is not happening. There also appears to be a problem with loan servicers following FHA loss mitigation guidelines. Counselors report many problems in obtaining sustainable work out agreements for homeowners with FHA loans. The federal government backs these loans. There is a question about whether this government guarantee is a disincentive to sustainably modify FHA loans.
- Creating more dialogue and partnership between housing counselors and loan servicers to find solutions;
- Regulating loan servicers to bring more consistency to the loss mitigation process and enforce penalties for non-compliance;
- Requiring loan servicers to modify loans when doing so would prevent foreclosure (and the homeowner has sufficient income to make monthly payments).

Possible partners to achieve these reforms include:

- Elected officials including the president of the United States, U.S. Senators, Congressmen, the governor, state elected officials, mayors, city managers, etc;
- Non-profit housing counselors;
- Loan servicing representatives.

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