Summary and Analysis

Foreclosures in North Minneapolis

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On March 6, 2008, the Foreclosure Relief Law Project, a program of the Housing Preservation Project ("HPP"), released its initial study of the foreclosures that had occurred in North Minneapolis in 2005 and 2006. Entitled *Analysis of Detailed Sheriff's Sale Data*, the study focused on zip codes 55411 and 55412, which are the zip codes where approximately 50% of the foreclosures in Minneapolis occurred. These two zip codes also have among the highest percentage of persons of color in the seven-county metropolitan area.

The *Analysis of Detailed Sheriff's Sale Data* study allowed the Foreclosure Relief Law Project to make several important findings:

- The foreclosure rate in 55411 and 55412 was significantly higher than the foreclosure rate in Minneapolis and Hennepin County. Specifically, approximately 4 out every 100 households in these two zip codes had gone through foreclosure in 2006. In comparison, only 1 out of every 100 households in Minneapolis and only 0.67% out of every 100 households in Hennepin County had gone through foreclosure in 2006.

- In 55411 and 55412, approximately 25% of all foreclosed mortgage loans were less than a year old from the time of the origination to the date of the Sheriff's Sale, and approximately 70% were less than two years old at the date of the Sheriff's Sale. The significant number of foreclosures that occurred within a year of origination suggests that the underwriting of the mortgage loan was deficient, the mortgage loan was originated in reliance upon false information, or both.

- Since approximately 70% of the loans in the 55411 and 55412 zip codes went into default in less than two years, this timing suggests that assumptions made in creating many foreclosure mitigation and counseling programs may be incorrect. Specifically, many programs seek only to freeze a "teaser" or initial interest rate as the primary method to avoid default on Adjustable Rate Subprime or Alt-A mortgage loans. An interest rate, however, typically does not adjust on an adjustable rate mortgage until two or three years after the origination. Therefore, even the "teaser" or initial interest rate was unsustainable in the vast majority of mortgage loans originated in the 55411 and 55412 zip codes. Effective foreclosure mitigation and counseling programs cannot simply freeze the initial rate. In these cases, the entire mortgage loan will have to be re-underwritten based on accurate financial information provided by the homeowner.

- 5% of the foreclosures that occurred in North Minneapolis involved people who had three or more foreclosures, and approximately 16% had two or more foreclosures. This statistic suggests that there were many real estate investors or speculators active in the neighborhood, as well as questionable underwriting procedures.

On October 23, 2008, the Foreclosure Relief Law Project released the second report related to foreclosures in North Minneapolis. The second report, entitled *North Minneapolis Originations and Foreclosures,* builds upon the information and data outlined above. This report, however, was a specific attempt to identify the originating lenders of the mortgage loans that resulted in a foreclosure.

Due to the nature of the mortgage lending industry and the method of recording and reporting the "mortgagee" to the Hennepin County Recorder, it is not possible to run a query from the recorder's electronic database and obtain an accurate list of the originating lenders. Specifically, the "mortgagee" or purchaser of a foreclosed mortgage loan is often a trust company or Mortgage Electronic Registration Systems, Inc. ("MERS"). MERS is a Virginia-based company that is paid to be the mortgagee of record as the mortgage loan is securitized and transferred among various entities. The legality of MERS's business practices is currently being litigated in Minnesota, as well as other parts of the country.

In *North Minneapolis Originations and Foreclosures*, HPP contracted with HousingLink to use Optical Character Recognition ("OCR") software and individual sampling to review the actual mortgage filed with the Hennepin County recorder. Once reviewed, a list was created based upon the "lender" on the mortgage document.

The study, *North Minneapolis Originations and Foreclosures*, allowed the Foreclosure Relief Law Project to make the following findings:

- The vast majority of mortgage loans that resulted in a foreclosure were originated through a mortgage broker. Based on a review of the companies identified as the "lender," HPP estimates that at least 80% were originated using a mortgage broker. According to a report issued by the Center for Responsible Lending, a homeowner who used a mortgage broker to obtain a sub-prime mortgage loan pays over $1,000 more the first year, and, due to a higher interest rate, pays an average of $35,000 more over the life of the loan when compared to a homeowner that obtains a sub-prime mortgage through a retail lender or "branch bank."[1] The deep market penetration of broker-originated loans in North Minneapolis indicates a failure of traditional lending institutions to serve this community.

- The prevalence of "table funding" made it difficult, if not impossible, to determine the actual lender in the majority of real estate transactions. "Table funding" is the practice of mortgage brokers originating loans in their own name using a line of credit. The mortgage broker then has a standing agreement with a lending company to immediately purchase the mortgage loan after origination. The combination of table funding and current recording practices mean that the State of Minnesota must require additional information when a mortgage loan is recorded, if it wants to adequately regulate and monitor activities in the housing market.

- Based on this data, the home origination market in North Minneapolis appears to be fractured among multiple lenders and not dominated by a specific lender. However, this study found that BNC, a wholly owned subsidiary of Lehman Brothers, and Ameriquest/Argent comprised approximately 28% of the mortgage loans that resulted in foreclosure.

[1] The Center for Responsible Lending, *Steered Wrong: Brokers, Borrowers, and Subprime Loans* (April 2008).