

HERA

housing and
economic
rights advocates

California
Reinvestment
Coalition



February 22, 2014

Comptroller Thomas Curry
Office of the Comptroller of the Currency
Administrator of National Banks
Washington, DC 20219

Chair Janet Yellen
Federal Reserve Board of Governors
20th Street and Constitution Avenue N.W.
Washington, D.C. 20551

Director Richard Cordray
Consumer Financial Protection Bureau
1700 G Street, N.W.
Washington, DC 20552

Director Mel Watt
Federal Housing Finance Agency
400 7th Street, S.W.
Washington, DC 20024

Chair Mary Jo White
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Secretary Shaun Donovan
Department of Housing and Urban Development
451 7th Street S.W.
Washington, DC 20410

RE: Need for immediate federal intervention to mitigate the harmful impacts on local communities of investor purchases of REOs and distressed loans, and to stave off the next financial crisis

Dear Comptroller Curry, Chair Yellen, Director Cordray, Director Watt, Chair White, and Secretary Donovan:

This letter is sent on behalf of the undersigned organizations concerning a serious and still growing problem – the creation of another housing bubble, the displacement of tenant and homeowner households, and the destabilization of neighborhoods as a result of failed and negligent federal policies. Such policies and inaction have enabled Wall Street and other cash investors to outbid first time homebuyers, displace tenants, and alter the fabric of local communities.

We are concerned that families and communities will continue to suffer. In Riverside County, one-third of renters are forced to pay more than half of their income in rent, and there is an increase in poor upkeep and a lack of responsiveness by investor landlords to their tenants.¹ In Los Angeles, housing prices are rising but homeownership is declining as first-time homebuyers are priced out of the market.² In East Palo Alto, one company controls approximately half of the rental housing stock. And in Oakland, neighborhoods are losing long term residents who are displaced by foreclosures and tenant evictions amidst the frenzy as investors seek to gobble up properties.

At the same time, we are poised to experience another crisis if federal regulators fail to recognize and take corrective action to address red flags that are all too familiar: inflated housing prices, the explosion of securitized housing payments, undue challenges facing homeowners unable to secure the lowest priced loan product for which they qualify, and actions of GSEs that are more focused on profit motive than serving their affordable housing mission.

What follows is a short description of the problems we are seeing, followed by a set of recommendations for policy changes and other assistance to begin to address this crisis.

Making Neighborhoods Worse- Preference for Cash Investors and Bulk Sales of REO and Distressed Mortgages

Banks and other home sellers have demonstrated a preference for cash investors that is locking families out of homeownership. Nationally, cash deals made up 32% to 42.1% of home sales in December 2013.³ The failure of banks and investor owners of REOs to properly maintain and repair housing units means that many properties for sale in low income communities and communities of color are too distressed to pass FHA or other property inspections. Bank and investor neglect make these properties unavailable to FHA and other loan borrowers, unfairly closing the market to everybody except cash investors. This has a clear disproportionate impact on protected classes that rely on FHA and other loan products to attain homeownership.

Meanwhile, Fannie Mae and Freddie Mac have engaged in bulk sales of their distressed assets, which can harm neighborhoods without adequate protections in place. The Federal Housing Finance Agency implemented a pilot project in 2012 to address REO disposition, and, in its first transaction, approximately 2500 single-family Fannie Mae REO properties were offered to investors for sale. Many of the properties had tenants. We were, and continue to be, concerned about bidder qualifications and subsequent maintenance by these investor landlords. Furthermore, there has been no transparency regarding the outcome of these deals. And while we applaud the newly introduced Fannie Incentives program for REO purchase by potential owner occupants, we are concerned it will be no more effective than existing “first look” policies which have failed to significantly expand homeownership opportunities for first time homebuyers and others who wish to live in the homes they purchase.

¹ See “Rep. Takano Calls for Congressional Hearings into Rental Backed Securities,” press release and report, January 23, 2014.

² See Laura Gottesdiener, “The Empire Strikes Back: How Wall Street Has Turned Housing Into a Dangerous Get-Rich Quick Scheme – Again,” citing a Los Angeles real estate broker noting that from October 2012 to October 2013, home prices rose 20% but the homeownership rate dropped, and that “all of his buyers – every last one of them – were besuited businessmen. And weirder yet, they were all paying in cash.”

³ See Krista Franks-Brock, “Despite Fewer Foreclosure Starts, Distressed Sales Rose in 2013,” *DSNews*, January 23, 2014, which indicates 42.1% of sales were cash deals, and *December Existing-Home Sales Rise, 2013 Strongest in Seven Years* (2014) National Association of Realtors, at <http://www.realtor.org/news-releases/2014/01/december-existing-home-sales-rise-2013-strongest-in-seven-years>, which indicates 32% were cash deals.

Though the GSEs as conservatees have an obligation to exercise fiscal due diligence, they also have a mission to serve low and moderate income communities, with a particular eye to the needs of vulnerable communities of color. Mass sell-off of properties to investors does not meet that mission or fair housing obligation.

FHA is also engaging in sell-offs under its Distressed Asset Stabilization Program (DASP). We are concerned that homeowners have been dropped out of the protections of FHA loss mitigation. Attorneys at HERA have served clients who were not given proper access to required FHA loss mitigation options before being moved into DASP. By not making sure servicers have engaged in proper loss mitigation, FHA has left its borrowers open to abuses that result in displacement. As currently designed, FHA bulk sales may, in fact, be more likely to lead to foreclosure, not household or neighborhood stabilization. Though foreclosure sale of these properties is delayed by agreement with HUD for six months following transfer through DASP, specific loss mitigation protocols are not specified by HUD for the subsequent servicer. Perhaps in response to congressional pressure, FHA has prioritized removal of distressed assets from its portfolio rather than taking the time to make sure servicers are respecting loss mitigation protocols.

Continuing REO bulk sales under current economic conditions ultimately amounts to market interventions that make investor predation a federally-sponsored event. This repeat offense of looting the most vulnerable communities of our nation dangerously functions to widen race and class inequalities in future years, calling into question the federal commitment to furthering fair housing. A rationale for bulk sales was to stabilize the market. But now, with prices rising and institutional and smaller investors pouncing on distressed properties and loans, the market no longer needs stabilization. It is our neighborhoods that need stabilization.

The New Housing Bubble- Artificial Inflation of Home Prices

Mortgage servicers and investors have withheld REO inventory from the market to ensure demand exceeds supply and to artificially drive up prices for prospective homebuyers.⁴ The problems with this form of market manipulation are several. Homebuyers who want to live in the property as their primary residence are under water as soon as they sign on the dotted line to buy the home, as the valuation of the home is based on an artificially inflated valuation of the property. This is akin to the pre-crash inflated appraisal problem, with the same effect of putting homeowners into homes that were immediately worth less than what they owed, trapping them until their home value actually rises. Additionally, the withholding of REO inventory has rapidly driven up rental prices to a level that is unaffordable to low and moderate income households and has increased over-crowding. Foreclosed-on homeowners have become renters, increasing demand on the rental side, while renters have been artificially prevented from freeing up rental stock by becoming homeowners due to the withholding of REO stock. In other words, the crush of former homeowners entering the rental market, without renters having the chance to successfully enter the homeownership market, exacerbates the demand for a limited supply of housing for renters. The Bay Area has experienced a supposed rise in equity that is remarkable, to say the least.⁵ The artificial increase in rental prices has also come as a result of the preference of servicers/investors for cash and bulk buyers, and new forms of Wall Street financing that facilitate this model, discussed further below.

⁴ Though inventory is decreasing, the problem remains, and it is not spread evenly across the U.S. See *CoreLogic Reports US Foreclosure Inventory Down 34 Percent Nationally from a year ago*, (Jan. 9, 2014), CoreLogic at corelogic.com. We also note that there is a need for further analysis of the issues, as CoreLogic's report acknowledges that its calculations are an estimate.

⁵ *Bay Area leads in underwater mortgage rebounds*, (Aug. 30, 2013), SFGate, at sfgate.com.

Wall-Street Backed Investment in Rentals and Rent Securitization: Impacts on Tenants and Communities

A new kind of landlord is buying properties in bulk—hedge funds, private equity firms and other companies that have not been in the rental business for very long, do not have an interest in abiding by their legal duties as landlords, and do not calculate any incentive to being good landlords. These investor groups have a focus on turning a dollar, but have no connection to the community in which they are investing.⁶ The continued transfer of capital to investors via REO bulk sales now facilitates the creation of a new rental securitization market that benefits the very industry that caused the subprime loan crisis. And the market is growing to an estimated trillion dollars.⁷ Though Fitch has indicated that it will review the quality of management of assets in real estate secured pools as part of its ratings assessment, it is not clear what type of assessment it will undertake, what effect it will have on management of properties, or whether it will be more accurate than the AAA ratings given to subprime securities just before the financial collapse.⁸ We expect that it will not include an assessment of the type of market control over rental prices that a very large scale player can exercise when it or a handful of investors own a sufficient portion of the rental market in a given area.

Examples of problems that have arisen already that are of concern to us include reports of hedge funds refusing to accept Section 8 vouchers for renters,⁹ the ability of hedge funds to manage the collection of rental payments correctly,¹⁰ and raising rents then moving to quickly evict.¹¹

The significant size of the market makes careful government oversight absolutely essential to the safety and stability of communities. “Today more than 13 million households are renting single-family homes and single family rentals outnumber apartments.”¹² Indeed, the REO-to-rental product could grow to a \$15 to \$20 billion market, according to Moody’s Investors Service.¹³ This bold new securitization of housing payments sounds eerily like the securitization of subprime loans which led to the financial crisis. The Federal Reserve Board has raised

⁶ See *Wall Street Unlocks Profits From Distress With Rental Revolution*, (Dec. 2013), Bloomberg at bloomberg.com. See also, *When Wall Street Builds A Rental Empire*, (Oct. 25, 2013), Huffington Post, at huffingtonpost.com. See Also, *Private Real Estate Market Continues to Feed Investor Appetite*, (Oct. 1, 2013), HousingWire at housingwire.com. See Also, *Who Owns Your Neighborhood- The Role of Investors in Post-Foreclosure Oakland*, Urban Strategies Council at urbanstrategies.org.

⁷ *Single-family rental securitization market boasts near trillion-dollar potential*, (Nov. 2013), HousingWire at housingwire.com.

⁸ We note that while Fitch did not give the recent Blackstone deal an AAA rating, Moody’s, Kroll and Morningstar did so, even though the industry does not have a track record. *RPT-Fitch: Too Soon for ‘AAA’ Rating on Single-Family Rental Securitizations*, (Oct., 2013), Reuters at <http://www.reuters.com/article/2013/10/29/fitch-too-soon-for-aaa-on-single-family-idUSFit67461420131029>

⁹ *Wall Street’s Rental Bet Brings Quandary Housing Poor* <http://www.bloomberg.com/news/2013-08-29/wall-street-s-rental-bet-brings-quandary-housing-poor.html>

¹⁰ <http://www.motherjones.com/politics/2013/11/wall-street-buying-foreclosed-homes>

¹¹ *Charlotte’s Wall Street landlords move quickly to evict*, (Nov., 2013), Charlotte Observer at <http://www.charlotteobserver.com/2013/11/10/4452995/charlottes-wall-street-landlords.html#.Uu4lj1dXSh>.

¹² *REO to Rentals, Wall Street Meets Main Street*, (Jan. 5, 2013) Mortgage Professional of America, at mpamag.com, citing to National Multifamily Housing Council tabulations of 2012 Current Population Survey, Annual Social and Economic Supplement, U.S. Census Bureau (<http://www.census.gov/cps>). Updated October 2012.

<http://www.nmhc.org/Content.cfm?ItemNumber=55508>, and to National Apartment Association.

http://www.nahq.org/publications/insider/Pages/nr-SingleFamilyRentalsNowExceedMultifamily_CoreLogicReports.aspx

¹³ Felipe Ossa, “REO-to-Rental Edges toward Conduit Deals,” National Mortgage News, January 24, 2014.

questions about this new process.¹⁴ Republican Senator Johanns during the Janet Yellen confirmation hearing also raised questions.¹⁵ Congressman Mark Takano recently wrote the House Financial Services Committee, calling for hearings and raising concerns about the securitization of rents and the harmful impacts it is having on communities in the Inland Empire.¹⁶We join Representative Takano in calling for hearings to examine the dangers and impacts of securitization of rental income.

And yet the problems are not confined only to the largest investor groups. Tenants Together reports receiving hundreds of complaints from California renters regarding problematic investors of various sizes. Investor landlords act without regard to tenant protections found in the federal Protecting Tenants in Foreclosure Act, our state Homeowner Bill of Rights, and local rent control and just cause for eviction ordinances. There is little to no oversight of investor landlords, and little to no enforcement of federal, state and local laws designed to protect renters from the widespread violations which exist today.

Tightened Lending: Not Making Loans Available to Qualified Homebuyers

Homeowners with excellent credit scores are not getting access to properties to buy. Not only are they frozen out of purchase because of the withholding of REOs, but they are finding lenders unwilling to close on loans they have been approved for.¹⁷ This phenomenon is not new, or a response to new qualified mortgage rules, but appears to represent an on-going reluctance of industry as a whole to make reasonably priced mortgage loans to qualified households. But the new mortgage rules do appear to be providing the industry another excuse for its failure to make credit available to qualified borrowers in low income communities and communities of color.

A further concern is that borrowers who qualify for conventional loans are being steered into costlier FHA loans. While FHA lending is an important source of credit for many borrowers, it should not be a vehicle to charge borrowers more than is appropriate based on their credit profiles. This is not a theoretical concern; one of the nation's largest banks, quietly mailed refund checks to customers for improperly steering up to 10,000 of its customers into FHA loans when they may have qualified for lower cost conventional loans. Customers had to release the Bank from liability in order to cash these checks.¹⁸ Such steering of conventional borrowers into FHA no doubt has a disproportionate impact on borrowers of color who are more likely to be represented among FHA borrowers.

Conversely, there is still a bias against FHA loan products. Home sellers and their real estate professionals should not be permitted to advertise “no FHA” or otherwise fail to consider purchase offers where the borrower is using an FHA loan product.

¹⁴ *Business Investor Activity In the Single-Family Market*, (Dec. 2013), FedNotes, at <http://www.federalreserve.gov/econresdata/notes/feds-notes/2013/business-investor-activity-in-the-single-family-housing-market-20131205.html>

¹⁵ *Janet Yellen Confirmation Hearing (Q&A, Part 2)*, Bloomberg TV, at minute 26, <http://www.bloomberg.com/video/janet-yellen-confirmation-hearing-q-a-part-2-8X~NGIH8QYWMzJzFv8kMg.html>.

¹⁶ Kerri Ann Panchuk, “Are rental bonds driving up the rent?” *HousingWire*, January 23, 2014.

¹⁷ *Lending Standards Tightened in November*, (Dec. 1, 2013), *HousingWire* at housingwire.com.

¹⁸ *Wells Fargo sends refunds to some FHA mortgage customers*, (Oct. 2012), *Los Angeles Times* at <http://articles.latimes.com/2012/oct/26/business/la-fi-wells-fha-refunds-20121027>.

Conclusion

We respectfully request that your agencies respond immediately and issue any necessary guidance or rules and enforce existing fair housing and other laws so that consumers are better protected in this new landscape as communities struggle to revive themselves from the pain of the foreclosure crisis.

Specifically, we urge that you:

Keep families in their homes.

- FHA and FHFA must ensure that FHA and GSE loss mitigation and loan modification rules are followed.
- FHFA must develop more flexible policies to ensure that the GSEs participate fully in all state Hardest Hit Fund program, including by overturning policies that attempt to require “arm’s length transactions,” and instead to allow states to favor nonprofit CDFIs and other programs that seek to keep distressed homeowners in their homes through use of principal reduction modifications or resale to underwater homeowners at current market value.
- CFPB, FHFA and bank regulators should scrutinize the servicing practices of companies that may have an incentive to improperly foreclose on borrowers in order to funnel properties to affiliated REO to Rental businesses.

End bulk sales lacking adequate safeguards.

- Bulk sales of FHA loans should cease unless loan sales clearly carry FHA loss mitigation requirements and give preference to non-profits that have written commitments to keep existing homeowners and tenants in place.
- FHFA should investigate and provide public data on the impact of the bulk sale program on neighborhoods where bulk sale properties are located. This analysis should consider potential negative fair housing effects of bulk sales programs (e.g. resegregation of communities, locking protected classes out of the homeownership market, etc.).
- HUD and FHFA should release data to the public on the outcomes of bulk sales programs, the purchasers, the deal terms, and neighborhood effects after these sales.
- Bank regulators should likewise prevent banks from engaging in bulk sales of loan products and REO properties without regard to neighborhood impacts. Banks should be incentivized to sell any distressed loan pools and REO properties to nonprofit groups that are mission driven to preserve homeownership and promote community stability.

Promote homeownership.

- FHFA must develop policies for Fannie and Freddie REO properties to prioritize sales to owner occupants or nonprofit organizations.
- HUD should update the FHA 203K program so that the product can be a viable option that allows borrowers to bid on the large number of properties that require substantial repair.
- Bank regulators should ensure that bank REO policies that may favor sales to cash investors do not have a disparate impact on protected classes, and instead should favor REO sales to owner occupants.

Protect tenant rights and promote family stability.

- FHFA, Fannie and Freddie must ensure that the anti-eviction and habitability rights of tenants living in GSE REO properties are respected by all GSE servicers and agents.
- FHFA, Fannie and Freddie should offer 2-year leases to all tenants living in GSE properties that become REOs.

- CFPB must fill the regulatory gap that exists and enforce the PTFA as to all bank and investor landlords, and all regulators must ensure the entities they regulate follow federal, state and local tenant protections to slow the tide of foreclosure-related unlawful tenant evictions. Regulators should require regulated entities to document what happened to the occupants of the properties after foreclosure.
- All regulators must consider how to protect tenants from the same profit making squeeze that lead to unethical and illegal treatment by so many different actors in the mortgage market, from brokers up through executive staff of banks and investment houses. To that end, securitization of income stream should be permitted only if there is full transparency and there are reasonable restrictions on rent increases, so that renters are not displaced by investors who are focused on profit. We suggest that a 1% increase in rent per year (if permitted by local rent control law), with a cap at 5% in any 10 year time period be the maximum permitted. Many of the properties acquired by investors for rental are in low and moderate income communities and communities of color, so unreasonable rent hikes will have a disparate impact on these communities.

Honor fair housing principles.

- DOJ and HUD must investigate the disparate impact on neighborhoods of various practices, including:
 - Whether protected classes of borrowers and neighborhoods are receiving equal access to loss mitigation and loan modification relief (borrowers of color, widows and orphans, disabled borrowers). A recent GAO report has raised the question of whether Limited English Proficient homeowners have received the same level of service by servicers under the HAMP program.
 - The failure to maintain and market properties so that properties for sale will pass property inspections and allow borrowers to compete with cash investors.
 - Industry players and private sellers discriminating against FHA borrowers by failing to accept FHA offers, which has a clear disparate impact on protected classes.
 - The manipulation of shadow inventory by banks and others that artificially inflates housing prices.
 - When investors in properties have achieved the scale of being major players in the rental market or have achieved such a scale in a given community that there is reason to impose more oversight on their activity.

Promote transparency.

- SEC and other regulators must ensure there is transparency and appropriate ratings of rental income securitizations to ensure that unsuspecting investors do not unwittingly finance the next financial and housing crisis.

Time is of the essence before we witness further, unnecessary displacement of families and destabilization of communities. After the last crisis, regulators were asked what they had done to prevent the abuses that led to widespread foreclosures, evictions, and community upheaval. The answers provided, and the action taken, were not adequate. We are hopeful that we will not repeat the mistakes of the past.

Should you have any questions about this letter, or wish to discuss these issues further, please contact Maeve Elise Brown of HERA at (510) 271-8443 ext. 307, or Kevin Stein of CRC at (415) 864-3980.

Thank you very much for your attention to these issues and concerns. We have no time to waste in ensuring that neighborhoods are not further destabilized.

Very Truly Yours,

A Community of Friends
Able Works
Action for the Common Good
Advocates for Neighbors, Inc.
Affordable Housing Services, Inc.
Alliance of Californians for Community Empowerment (ACCE)
Asian Inc.
Asian Pacific Policy & Planning Council (A3PCON)
Associated Realist Property Brokers, Inc., a NAREB local chapter in Oakland, CA
Bet Tzedek Legal Services
California Capital Financial Development Corporation
California Coalition for Rural Housing
California Reinvestment Coalition
California Resources and Training (CARAT)
Causa Justa: Just Cause
Center for Popular Democracy
CHISPA
City Heights Community Development Corporation
Civic Center Barrio Housing Corporation
Community Action Human Resources Agency (Eloy, Arizona)
Community Housing Council of Fresno
Community Housing Development Corporation
Community HousingWorks
Consumer Action
Consumer Credit Counseling Services of Orange County
Consumer Credit Counseling Services of San Francisco
Courage Campaign
East Bay Housing Organizations
East Los Angeles Community Corporation
Fair Housing Law Project, Law Foundation of Silicon Valley
Fair Housing Napa Valley
Fair Housing of Marin
Fair Housing Council of San Diego
Fair Housing Council of the San Fernando Valley
Greenlining Institute
Hacienda CDC (Portland, Oregon)
Hello Housing
Home Defenders League
HomeownershipSF
Housing California
Housing and Economic Rights Advocates
Housing Opportunities of Northern DE, Inc.
Inland Fair Housing and Mediation Board
ISAI AH
Massachusetts Communities Action Network
Multicultural Real Estate Alliance for Urban Change

National Asian American Coalition
National Community Reinvestment Coalition
National Consumer Law Center (on behalf of its low-income clients)
National Housing Law Project
National People's Action
Neighborhood Housing Services of Greater Cleveland (Ohio)
Neighborhood Housing Services of the Inland Empire
Neighborhood Housing Services of Silicon Valley
NeighborWorks Sacramento Region
New Economy Project
NID-HCA
Northbay Family Homes
Northern Circle Indian Housing Authority
Novadebt
NPHS, Inc.
Orange County Community Housing Corporation
People's Self Help Housing
PICO National Network
Project LIFT (Houston, Texas)
Public Counsel
Renaissance Entrepreneurship Center
Residential Resources, Inc. (Nashville, Tennessee)
Right to the City Alliance
Rural Communities Assistance Corporation
Sacramento Foreclosure Action Team
Self-Help Enterprises
Shalom Center for T.R.E.E. of Life
Suburban Alternatives Land Trust
Tenants Together
Thai CDC
Unity Council
Vermont Slauson Economic Development Corporation
Ward Economic Development Corporation
Western Center on Law and Poverty