FOREWORD

*Governor David A. Paterson**

I. INTRODUCTION

By now, most Americans have heard of the "subprime mortgage crisis." Subprime mortgages – loans to borrowers with less than prime credit – allowed millions of Americans to touch the dream of home ownership, but at terms that too often proved unsustainable. Some of these loans had affordable initial "teaser" interest rates that have since "adjusted" to unaffordable levels. Other borrowers had more exotic loan products such as interest-only loans that offered very low monthly payments, but did not build equity. Still others were victims of unscrupulous mortgage brokers who conspired to inflate home values in order to increase the fees they received from mortgage lenders, which all too often are tied to the size of mortgage loans. And, of course, some borrowers lied about their income and assets in order to obtain loans for which they were not qualified.

At the same time, Wall Street wizards bundled these loans and then sliced and diced these new collateralized debt securities for sale in the financial markets. No longer did your neighborhood bank own your mortgage: now your mortgage was bundled with hundreds or thousands of others; these bundled loans were divided into tranches and sold to investors who were promised various levels of risk and reward. Because there is no clear "owner" of your note and mortgage, your loan is now managed by a mortgage servicer charged with collecting your payments and protecting the interests of the investors who own your loan.

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* David A. Paterson became New York's 55th Governor on March 17, 2008. Governor Paterson was elected to represent Harlem in the New York State Senate in 1985, and became the minority leader of the New York State Senate in 2003. In 2007, he was elected as New York's first African American Lieutenant Governor. He earned his bachelor's degree in History from Columbia University in 1977, and completed his J.D. at Hofstra Law School in 1982. Governor Paterson and his wife, Michelle Paige Paterson, have two children, Ashley and Alex.

The early impacts of these practices seemed quite positive: rates of home ownership increased and housing values skyrocketed. Still, many observers predicted the crisis we now face. The combination of predatory lending terms and overoptimistic borrowers has led to skyrocketing foreclosure rates for subprime loans. The glut of housing on the market has depressed housing values to the point where many borrowers now owe more than their homes are worth. It is harder than ever to refinance onerous mortgages or to avoid foreclosure by selling the house, and too many borrowers are simply abandoning their homes and walking away. Subprime mortgage lending has now become a full-fledged financial crisis.

Earlier this year, I signed comprehensive legislation to help homeowners facing foreclosure, stabilize subprime mortgage lending and provide additional oversight of key sectors of the mortgage industry.[1] New York's banking and insurance regulators have been key players in efforts to stabilize many of the industries hardest hit by the current economic maelstrom. Our housing agencies have been helping borrowers access the counseling and other services they need. And, my inter-agency Halt Abusive Lending Transactions (HALT) Task Force has been coordinating state efforts to monitor this crisis and provide assistance to at-risk borrowers.[2] These steps are a good start, but it is clear that no state can fully address a crisis that has now taken on global proportions.

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[1] 2008 Governor's Program Bill No. 44-R, Chapter 472 of the Laws of 2008 (codified as amended in scattered sections of the Banking, Real Property Actions & Proceedings, Penal, Civil Practice Rules & Procedures, and General Obligations Laws of the State of New York).

[2] Press Release, N.Y.S. Executive Chamber, HALT Task Force Expands Efforts to Address Subprime Lending Crisis (Nov. 8, 2007). *See also* State of New York Banking Department, HALT - Halt Abusive Lending Transactions & Mortgage Fraud, http://www.banking.state.ny.us/cshalt.htm (last visited Nov. 13, 2008).

II. THE SCOPE OF THE PROBLEM

The statistics are frightening: according to RealtyTrac,[3] which monitors troubled mortgages across the nation, by the end of the second quarter of 2008, one out of every 171 homes was in some stage of mortgage foreclosure.[4] The rate of troubled mortgages increased 13% over the previous quarter, and 121% over the same period last year.[5] Some of the hardest hit states are in the western part of the country: in Nevada, one in forty-three home loans was in trouble; in California it is one in sixty-five, and in Arizona it is one in seventy.[6] Nationwide, 739,714 home loans had foreclosure filings during the second quarter alone, and most analysts expect the rate of foreclosures to grow.[7]

New York has fared better than some other states, ranking 30th in the nation for mortgage foreclosures.[8] Nevertheless, more than 16,000 home loans in this state entered some stage of foreclosure in the second quarter of 2008 alone, an increase of more than 11% over the previous quarter and of 61% over the same period last year.[9] Some parts of this state have been hit harder than others, including particular pockets of the New York metropolitan area and some of our upstate cities – urban areas that were already experiencing tough economic challenges.[10] And these statistics mask the devastating impact that a series of foreclosures or abandonments can have on a block, a neighborhood, or a community.

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[3] *See* RealtyTrac, http://www.realtytrac.com (last visited Nov. 13, 2008) (providing a comprehensive analysis of the state of foreclosures around the nation, as well as a resource for buyers, sellers, and lenders).
[4] Press Release, RealtyTrac, Foreclosure Activity up 14 Percent in Second Quarter (Jul. 25, 2008).
[5] *Id.*
[6] *Id.*
[7] *Id.*
[8] *Id.*
[9] Press Release, RealtyTrac, *supra* note 4.
[10] For example, in the Poughkeepsie/Newburgh/Middletown area of New York's Hudson Valley, the rate of foreclosures has increased 423% over the prior year. *Id.* In the Albany/Schenectady/Troy area, 1 in 356 mortgages is in foreclosure, an increase of 276% over the same period last year. *Id.* In the Queens neighborhood of Far Rockaway, mortgage foreclosure rates are running at over 16%, and over 15% of all home loans in the neighborhood are adjustable rate mortgages that reset between April 2008 and September 2009. *Id.*

While the current housing crisis may have its roots in irresponsible mortgage lending practices, it has now permeated all sectors of the global economy. No one seems to know how many home loans have gone bad, but it is all too clear that the investment vehicles secured by these mortgages are as troubled as the underlying home loans.[11] The widespread failure of these assets has exposed a web of interconnected – and highly leveraged – financial transactions that now seem to be falling like a house of cards. In recent weeks, we have seen dramatic bank failures and precipitous declines in financial markets around the world. Congress was forced to approve a $700 billion federal bailout plan intended to restore liquidity to global financial markets.[12] It seems that each day another facet of this crisis is exposed, and financial regulators in Washington and around the world are forced to try new rescue efforts to shore up financial institutions and investor confidence.

To be sure, there are myriad factors at play in this global economic downturn – and there will be plenty of finger pointing for years to come – but there is no doubt that the securitization of questionable mortgage loans played a seminal role. Recent attention has focused on the investor side of this equation, but the core problem remains: unsustainable securitized mortgage loans. The current global economic downturn is propelling this crisis on the ground: as our economy contracts, more and more homeowners are having trouble making ends meet. It is harder to sell homes and to obtain mortgages for new ones. And it is not just homeowners anymore: renters are being hit as foreclosures of commercial properties force innocent tenants out of their homes.[13]

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[11] *See* Joseph Schilling, *Code Enforcement and Community Stabilization: The Forgotten First Responders to Vacant and Foreclosed Homes*, *infra* at 101 (discussing the unique problems associated with local policy makers' lack of foreclosure data).

[12] Emergency Economic Stabilization Act of 2008, Pub. L. No: 110-343, 122 Stat. 3765 (2008).

[13] *See* Vicki Been and Allegra Glashauser, *Tenants: Innocent Victims of the Nation's Foreclosure Crisis*, *infra* at 1 (providing an in depth analysis of the problems faced by tenants when their landlords enter foreclosure).

The lack of confidence and market liquidity means less lending and higher credit standards for even the most qualified borrowers – including state and local governments. Municipalities across the nation routinely float notes and bonds to meet short-term cash-flow needs and to finance long-term capital investments. These days, though, the market for sound municipal bonds has all but disappeared. Here in New York, one of our state financial control boards, which exist to improve access to municipal credit markets, had a previously confirmed bond offering collapse overnight.[14] New York City, a well-regarded municipal borrower, recently had trouble with a routine general obligation bond offering: the City was unable to market the full offering and was forced to pay significantly higher interest on the bonds it did manage to sell.[15] The State of New York Mortgage Agency, which provides capital mortgage financing for low-income homebuyers, was forced to cancel a long-planned $250 million bond offering.[16] And, many of our state and local government entities that sold auction rate securities – securities with variable interest rates that regularly are reset through auction sales – must now pay significantly higher interest rates on these debts. Similar scenarios are being repeated across the country; higher borrowing costs at a time of economic contraction reduced property-related tax revenues, as well as growing rates of foreclosures and abandonment.[17]

Soft municipal bond markets not only make it difficult, if not impossible, for state and local governments to conduct business as usual, but they also limit the tools we have available to intervene in this housing crisis. New York, like most other states, uses federal private activity

[14] *See* Matthew Spina, *Control Board is Forced into a Detour: Turns to Poloncarz in Urgent Borrowing*, BUFFALO NEWS, Sept. 26, 2008, at D1.
[15] *See* Jack Herman & Christine Albano, *New Issuance Slows to a Crawl in September*, BOND BUYER, Oct. 1, 2008, at 1; Mary Williams Walsh, *Under Strain, Cities Are Cutting Back Projects*, N.Y. TIMES, Oct. 1, 2008 at Al.
[16] *See* Patrick McGeehan, *State Discount Mortgage Unit Moves to Increase Interest Rate,* N.Y. TIMES, Oct. 2, 2008 at B1.
[17] *See* Alan Weinstein, *Current and Future Challenges to Local Government Posed by the Housing and Credit Crisis*, *infra* at 260 (discussing the problems faced by local governments as a result of the credit and housing crisis).

tax-exempt bonding authority, also known as "volume cap," as an incentive to encourage private investment in the construction and preservation of affordable housing. The federal American Housing Rescue and Foreclosure Prevention Act of 2008 ("Foreclosure Prevention Act")[18] created $11 billion in additional volume cap for states to use exclusively for the construction, preservation or purchase of affordable homes, and made other changes to expand the utility of this resource. However, the market for tax-exempt bonds has collapsed, and we can only hope that the market will rebound in time for this additional volume cap to make a difference.

Similarly, New York and other states rely heavily on federal Low Income Housing Credits (LIHC) as a source of capital for affordable housing.[19] In its simplest form, this program allows affordable housing developers to claim a federal tax credit against their federal tax liabilities every year for ten years. More often, though, syndicators market LIHC credits to investors, who purchase future tax credits at a discount in exchange for up-front cash that helps finance affordable housing projects. The Foreclosure Prevention Act temporarily increased each state's LIHC allocation by 10%, and made other administrative and programmatic changes to strengthen the program.[20] At the same time, though, the current economic downturn means that fewer and fewer potential tax credit investors have profit-driven tax liabilities to offset, and the losses that many investors have absorbed will be carried forward on tax returns for years to come. It is becoming increasingly difficult to find investors willing to inject capital into affordable housing projects and, as a result, the pay-in price for LIHC credit equity has declined markedly.

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[18] Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 2305, 122 Stat. 2654, 2854 (2008) ("The Foreclosure Prevention Act of 2008" is one of many titles assigned to this bill.).
[19] 26 U.S.C.A. § 42 (West 2008). *See also* U.S. Department of Housing and Urban Development, http://www.hud.gov/offices/fheo/lihtcmou.cfm (last visited Nov. 13, 2008) (providing an explanation and overview of low income housing credits).
[20] Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 2305, 122 Stat. 2654, 2854 (2008).

These examples give just a taste of the breadth, depth and challenges of the subprime mortgage crisis. Here in New York, the challenges are even more daunting. As the home of major players in our global economy, New York State is especially sensitive to troubles in the financial markets. Fully 20% of the State's overall tax revenues can be traced to the financial services sector.[21] The economic turmoil over the past year has led to sharp declines in those revenues, and the worst is yet to come. Despite mid-year budget cuts, we are currently projecting a $1.2 billion deficit by the end of our 2008-09 fiscal year unless further mid-year budget cuts are made.[22] The forecasts for 2009-10 and beyond are even bleaker: we are currently projecting that up to 40,000 jobs will be lost in our financial services sector, and each of these job losses could trigger the loss of three additional jobs.[23] Unless dramatic action is taken, we face a cumulative deficit of at least $24.4 billion over the next three years.[24] New York State, just like households across the state and the nation, will have to make painful cuts in order to live within our means.

III. ADDRESSING THE FORECLOSURE CRISIS IN NEW YORK

A. Protecting Borrowers Facing Foreclosure

At its core, this crisis revolves around mortgage foreclosures and the ripple effects those foreclosures have on our communities and our financial systems. While the immensity of the problems we are currently facing is systemic and overwhelming, it is important to remember that home foreclosures represent displaced individuals and families that have hit rock bottom.

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[21] N.Y.S. DIV. OF THE BUDGET, EXECUTIVE, 2008-2009 EXECUTIVE BUDGET BRIEFING BOOK 1 (2008).
[22] N.Y.S. DIV. OF THE BUDGET, PRELIMINARY ANALYSIS OF RECENT BUDGET DEVELOPMENTS 1 (2008) [hereinafter D.O.B., PRELIMINARY ANALYSIS]. *See also* N.Y.S. OFFICE OF THE COMPTROLLER, THE FINANCIAL INDUSTRY CRISIS – IMPACT ON THE NEW YORK STATE BUDGET (2008).
[23] D.O.B., PRELIMINARY ANALYSIS, *supra* note 22, at 5.
[24] Press Release, N.Y.S. Executive Chamber, Governor Paterson Reopens Budget Process (Jul. 30, 2008).

We have heard time and again that borrowers do not know where to turn for help when they find themselves behind on their mortgage payments, and many mortgage servicers have recounted their unsuccessful efforts to work with borrowers to address mortgage issues. I understand the fears that paralyze some borrowers: they know they don't have the money to catch up on their home loans and understandably believe that talking to their lender will be pointless or, worse, will speed eviction from their homes. Still, it is clear that communication between borrowers and servicers is essential to address the individual loan situations that together have created a global financial crisis.

Here in New York, we have taken a multi-pronged approach to bridge the communication gap between lenders and borrowers. First, we have significantly expanded the availability of housing counseling services for troubled borrowers. Our 2008-09 budget included $25 million in new funding to provide counseling and legal services to subprime borrowers facing default,[25] and New York's Banking Department has also used funds recovered from prior enforcement actions to finance these essential services.[26] On the federal level, a 2008 appropriation of $180 million for housing counseling services administered by NeighborWorks America has been supplemented by an additional $180 million for foreclosure counseling and legal services under the recently enacted Foreclosure Prevention Act.[27] Together, these funds help assure that services are available when borrowers seek help.

Second, we are seeking to assure that borrowers can avail themselves of the services they need. Under my subprime lending legislation,[28] which was enacted earlier this year,[29] we now

[25] Press Release, N.Y.S. Executive Chamber, Governor Patterson Announces Request for Proposals to Assist Homeowners Facing Mortgage Default and Foreclosure (June 19, 2008).
[26] Press Release, State of New York Banking Department, Governor Paterson Announces Additional New York State Grants to Fight Foreclosure Crisis (Sept. 24, 2008).
[27] Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 2305, 122 Stat. 2654, 2854 (2008).
[28] 2008 Governor's Program Bill No. 44-R, Chapter 472 of the Laws of 2008.

require lenders and mortgage loan servicers to provide pre-foreclosure notices to subprime borrowers at least ninety days before commencing foreclosure proceedings.[30] These notices must include the names and phone numbers of housing counselors in the borrower's area that have been approved by the Federal Department of Housing and Urban Development or by New York's Division of Housing and Community Renewal.[31] Our goal is to encourage borrowers to get the help they need, while assuring them that there is sufficient time to resolve their loan problems before any foreclosure can proceed.

Third, we now require a mandatory settlement conference whenever a residential foreclosure action is commenced.[32] Under New York's new subprime law, the court must schedule a mandatory settlement conference within sixty days of the filing of proof of service of a residential foreclosure complaint.[33] The plaintiff, or a representative with full authority to settle the matter, must appear at the conference, either in person or by phone or video-conference.[34] Courts are further directed to evaluate each *pro se* homeowner for "poor person" status,[35] which would allow the court to waive certain procedural requirements or even appoint counsel.[36] Again, our goal is to assure that every effort is made to reach a mutually agreeable resolution of each home loan default, and thus avoid foreclosure whenever possible.

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[29] Press Release, N.Y.S. Executive Chamber, Governor Paterson Signs Comprehensive Reforms to Address Foreclosure Crisis (Aug. 5, 2008).
[30] N.Y. REAL PROP. ACTS. LAW § 1304 (West 2008). A "subprime home loan" is defined under New York law as a home loan that, when fully indexed, has an annual percentage rate that exceeds the average commitment rate for loans of comparable duration in the northeast region by more than 1.75 percentage points for a first lien loan, or by more than 3.75 percentage points for a subordinate lien loan. N.Y. BANKING LAW § 6-m (c) (West 2008).
[31] N.Y. REAL PROP. ACTS. LAW § 1304 (1).
[32] N.Y. C.P.L.R. § 3408 (West 2008).
[33] § 3408 (a).
[34] § 3408 (c).
[35] § 3408 (b).
[36] N.Y. C.P.L.R. §§ 1101-1103 (McKinney 1997) (establishing the procedure whereby a party in a civil action may apply to the court for "poor person" status, which absolves the party of having to pay court fees, entitles the party to free transcripts of the proceedings, allows the party to submit type-written briefs and appendices on appeal and places assignment of an attorney within the discretion of the court). However, should a poor person recover a

Together, these changes to our state's foreclosure procedures assure that borrowers are afforded every opportunity to work with lenders and loan servicers to modify onerous loan terms and get back on their feet. However, these measures can only go so far; lenders and mortgage servicers must also be willing to work with borrowers to modify the terms of these loans. In particular, mortgage servicers, who generally act as agents for the investors who hold various slices of mortgage securities, have often proved reluctant to modify loan terms. In some cases, this reluctance may stem from fears of liability to the investors they serve. But, it is also true that some servicers do not have much stake in the success or failure of any particular loan they service and can collect hefty fees when defaults become foreclosures. This calculus must change, whether through realization on the part of investors that avoiding foreclosure is in their long-term interest, federal action to incentivize write-downs and other loan modifications, or both.

B. Stabilizing Mortgage Lending

New York has also taken concrete steps to stabilize mortgage lending in our state. Our new subprime lending law not only addresses the needs of borrowers facing foreclosure, it also added critical protections to help avoid similar crises in the future. Expanding upon New York's existing predatory lending statute,[37] the new law prohibits many predatory lending practices that have been pervasive in the subprime lending industry. Among other measures, these new prohibitions bar prepayment penalties, abusive yield spread premiums, option adjustable rate

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judgment in the relevant action, recovery is submitted to the court clerk and is only distributed by court order. § 1103.

[37] N.Y. BANKING LAW § 6-l (McKinney 2008).

mortgages that can cause principal balances to increase, loan flipping, and negatively amortizing loans.[38]

Our new law also establishes strict underwriting standards to assure that subprime borrowers can afford their loans. Most notably, New York now requires subprime mortgage lenders to make reasonable good-faith determinations of borrowers' ability to repay their loans, including the principal, interest, taxes, insurance, assessments, points and fees, based upon the borrower's income, employment status and other financial resources.[39] Not only will these new underwriting standards protect future subprime borrowers, but they should also give confidence to the secondary mortgage markets that subprime loans originated in New York are "good" loans that can be repaid.

In addition, New York's new law will, for the first time, require mortgage brokers to act in the best interest of borrowers. Mortgage brokers – who play decisive roles in the loan origination process – typically viewed themselves as agents of mortgage lenders, not borrowers. Many of these brokers, who too often had financial incentives to promote more costly loan products, steered borrowers into loans they could not afford. Now, brokers will be required to: (1) act in the borrower's interest; (2) act with reasonable care, skill and diligence; (3) act with good faith and fair dealing; (4) not accept, give, or charge any undisclosed compensation; (5) disclose all material facts known to the broker that might reasonably affect the borrower's rights and interests; and (6) diligently work to present a range of loan products for which the borrower likely qualifies and that are appropriate for the borrower's circumstances.[40] These new standards will go a long way toward ensuring that borrowers enter into loans that are appropriate for their particular circumstances.

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[38] § 6-m (2).
[39] § 6-m (4).
[40] § 590-b (1).

We have also taken steps to strengthen our oversight and enforcement powers. We will soon be requiring mortgage servicers to register with our State Banking Department and to comply with regulations promulgated by our Banking Board. We have strengthened the ability of both our Banking Superintendent and our Attorney General to enforce our mortgage lending laws and we have established newly-defined crimes of mortgage fraud to make it easier for prosecutors to bring these cases to trial.

C. Helping Our Communities Rebound

While each foreclosure represents a personal tragedy, the scope and scale of the current foreclosure boom has reshaped neighborhoods and communities across the nation. At the same time, each community faces its own unique problems and must find solutions that are tailored to its specific needs. These challenges come at a time when local governments are being squeezed from all sides: they need resources to combat the problems of foreclosed and abandoned homes, but they are losing the property tax revenues that provide core financing for most local government operations. Creativity is essential, but not enough: our local governments desperately need financial help to address the challenges they face.

My administration has been working with municipal and community leaders across New York State to find creative ways to finance localized responses to this crisis. For example, we have awarded grant funds to the City of Buffalo for the demolition of abandoned homes that have blighted many neighborhoods.[41] Working with the City of New York and nonprofit community partners, we have begun a Neighborhood Stabilization Initiative that will purchase and renovate foreclosed homes throughout the City, specifically targeting homes that will have

[41] Press Release, N.Y.S. Executive Chamber, Governor Paterson Awards First "Block-by-Block" Grants (June 12, 2008).

the most significant impact on the viability of individual neighborhoods.[42] Further, we have begun working with community land trusts, which offer real opportunities to return properties to productive use while assuring ongoing affordability for low-income families.

The Federal Foreclosure Prevention Act will provide critical additional funds to stabilize communities impacted by foreclosures. The federal law allocated $3.92 billion in supplemental Community Development Block Grant (CDGB) funds, which will be distributed to states and localities under a formula that takes into account subprime lending, loan delinquencies and foreclosure rates.[43] These funds can be used for a wide range of intervention strategies, including the purchase and redevelopment of foreclosed and abandoned homes, the establishment of land banks, the demolition of blighted structures, and the establishment of financial tools such as "soft" second and shared equity mortgages and loan loss reserves.[44] New York expects that the State and its localities will receive approximately $117 million in additional CDBG funds, which, when leveraged with more than $250 million in additional resources, could be used to restore more than 2,700 properties to productive use and generate 2,300 new jobs.

IV. CONCLUSION

Whether we're talking about the subprime mortgage crisis or the global economic meltdown it has spawned, it seems certain that we have not yet plumbed the full depths of the crisis. It is equally clear that it will take many years for our citizens, communities and financial institutions to recover from the widespread problems we currently face. New York, like every

[42] Press Release, N.Y.S. Executive Chamber, Governor Paterson Announces $25.5 Million to Build and Renovate 396 Affordable Housing Unites (May 7, 2008).
[43] Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 2301, 122 Stat. 2654, 2850 (2008).
[44] *Id.*

other state, must re-evaluate “business as usual” in order to meet the fiscal challenges it now faces, while also continuing to make the strategic investments we need to help climb out of this recession.

But state action is not enough. This crisis has exposed our nation’s failure to exercise proper oversight of its financial institutions, and ongoing federal intervention and oversight will be needed to restore our financial systems to solvency and stability. These interventions cannot simply stabilize financial institutions: this crisis is rooted in unsustainable mortgage loans: I am convinced that we will not recover from the excesses of subprime lending, and the house of debt that was built on those bad loans, until we find ways to help vulnerable borrowers to get out from under these crushing debts.