Virginia's Evolving Foreclosure Problems:

Rural Foreclosures and Mortgage Servicing Errors Are Adding New Troubles to an Already Difficult Situation

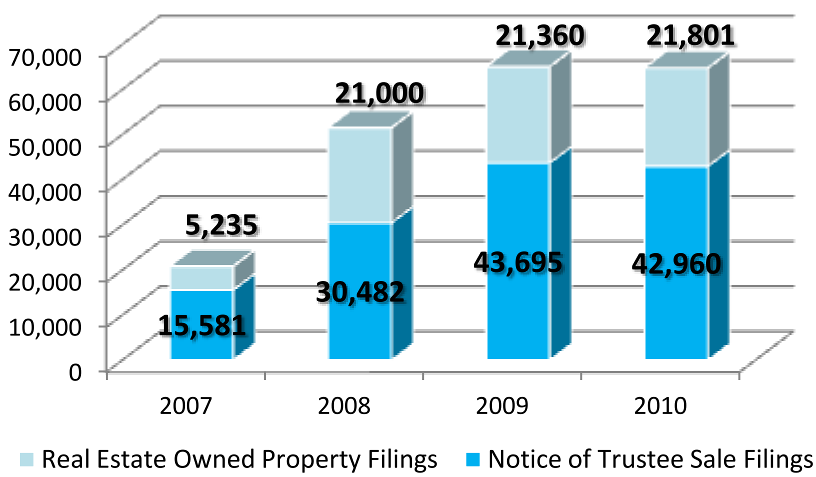
Key Findings

- In 2010, the largest increase in foreclosure filings occurred in rural Virginia
- Foreclosure filings eased slightly at the end of 2010, mostly because of moratoriums from large national lenders so they could sort out mortgage servicing issues.
  - Without these moratoriums that were put in place, Virginia would have seen the largest number of foreclosure filings since the beginning of the Great Recession.
- Since 2006, there have been over 200,000 foreclosure filings in Virginia and more than 60,000 in 2010 alone.
- Foreclosure rates in rural areas have nearly doubled since 2008, while rates in urban areas have remained fairly consistent.
- High foreclosure volume has revealed some significant mortgage servicing issues. A survey of housing counselors has found significant servicing issues statewide.
- In 2009, nearly four out of every five mortgage loans were sold to an investor – the highest rate since at least 2004. Since 2004, more than sixty percent of mortgage loans have been sold to an investor within one year of origination.
  - This further complicates the mortgage recordation process and may create mortgage servicing issues in the future that may lead to more faulty foreclosures.

INTRODUCTION

Despite an economy that is slowly moving towards recovery, foreclosures continue to weaken Virginia's communities. Rising foreclosure filings in rural Virginia and mortgage servicing errors across the state are adding new troubles to an already difficult situation. In 2010, there were more than 64,000 foreclosure filings in the Commonwealth (chart 1) – with the largest increases in filings occurring in rural Virginia. Together with increased mortgage servicing errors, this finding changes the way that we must respond to the foreclosure crisis.

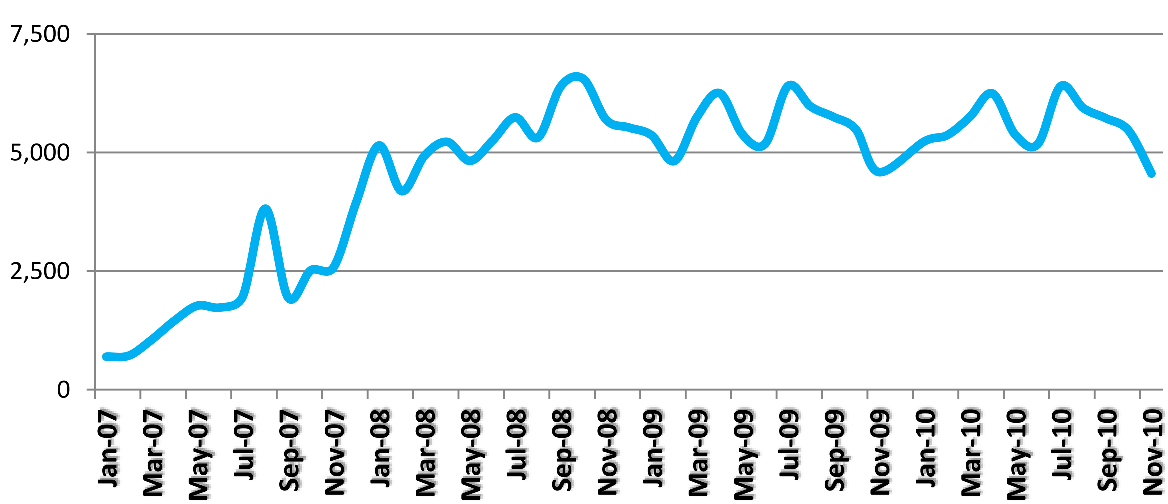
Chart 1:
Annual Foreclosure Filings in Virginia by Type, 2007 to 2010



Source: RealtyTrac, Inc.[1]

Though foreclosures eased slightly in the last few months of 2010 (chart 2), this was largely a result of moratoriums on foreclosures as lenders came under increased scrutiny regarding the validity of foreclosures (misapplied payments, lost paperwork, not honoring loss mitigation agreements etc). Without these moratoriums, Virginia would have seen the highest number of foreclosure filings since the beginning of the Great Recession.

Chart 2:
Monthly Foreclosure Filings in Virginia, January 2007 through November 2010

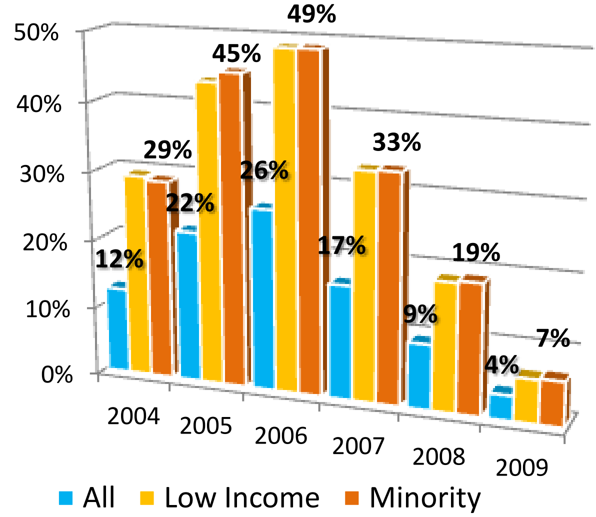


Source: RealtyTrac, Inc.[1]

VIRGINIA FORLECOSURES

Since January 2006, there have been more than 200,000 foreclosure filings in Virginia - increasing to more than 60,000 in 2010. Beginning in 2006, the initial wave of foreclosures hit Northern Virginia due to inflated home values and real estate speculation. Foreclosures have since spread to every corner of Virginia. The next wave was fueled by high cost loans that were disproportionately originated in low-income and minority communities (chart 3). While most of those exotic subprime mortgage loans have run their course (aside from a number of Option-ARM resets that are expected to occur in 2011), the sluggish economy, unemployment, and underemployment have led to another wave of foreclosures.

Chart 3:
Rate of High Cost Lending in Virginia by Community, 2004 to 2009

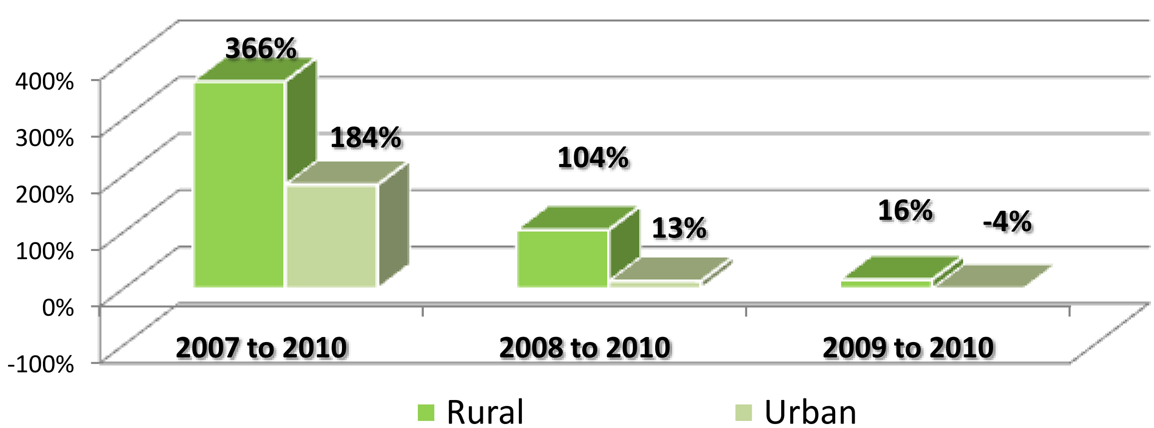


Source: Home Mortgage Disclosure Act data analysis with Lending Patterns software

RURAL VIRGINIA FORECLOSURES: THE NEXT WAVE?[2]

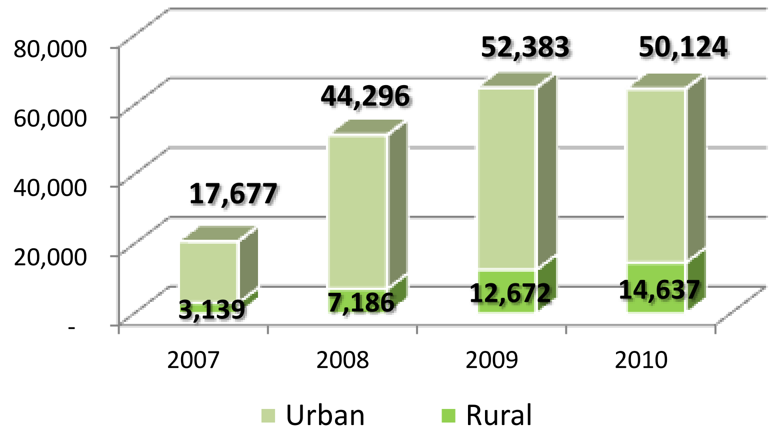
Prolonged unemployment and underemployment across Virginia have exacerbated an already difficult housing crisis. Since 2007, unemployment rates – though below national rates – have increased from 3 percent in 2007 to 6.6 percent in November 2010. Unemployment in rural Virginia, however, increased from 3.3 percent in 2007 to 7.3 percent in November 2010 – compared to 3 percent and 6.3 percent in urban Virginia, respectively. This trend has caused many households to become delinquent in their mortgage payments, fall into default, and eventually into foreclosure. This has become especially apparent in Virginia's rural localities where the foreclosure filings have increased dramatically relative to urban localities since 2007. This is illustrated in chart 4 below.

Chart 4:
Percent Change in Foreclosure Filings, Urban and Rural Virginia Localities



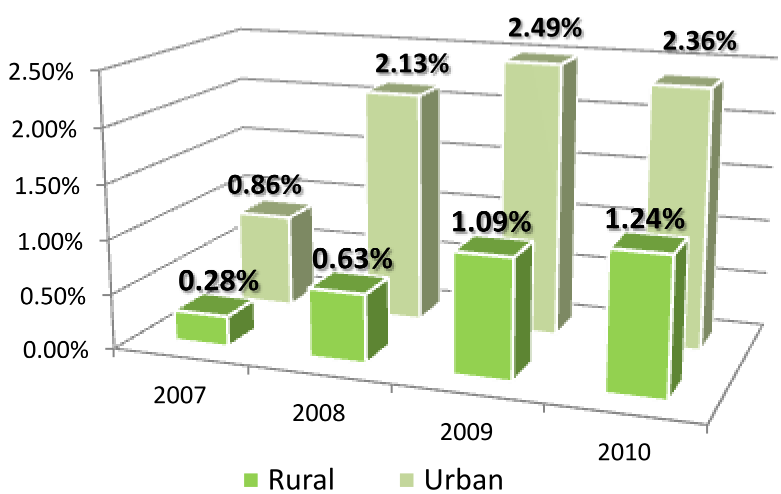
Source: HOME analysis of RealtyTrac, Inc. data

Chart 5:
Urban versus Rural Foreclosure Volume, 2007 to 2010



Source: HOME analysis of RealtyTrac, Inc. data

Chart 6:
Urban versus Rural Foreclosure Rates, 2007 to 2010



Source: HOME Analysis of RealtyTrac, Inc.[1] data

The increase in foreclosure volume in rural Virginia – though still greater in urban areas (chart 5) – presents a unique challenge. Since the foreclosure crisis began, many foreclosure prevention resources have focused on our urban and suburban areas, despite the growing concerns for rural communities. Foreclosure rates in rural areas have nearly doubled since 2008, while rates in urban areas have remained fairly consistent during that time – even decreasing slightly from 2009 to 2010.

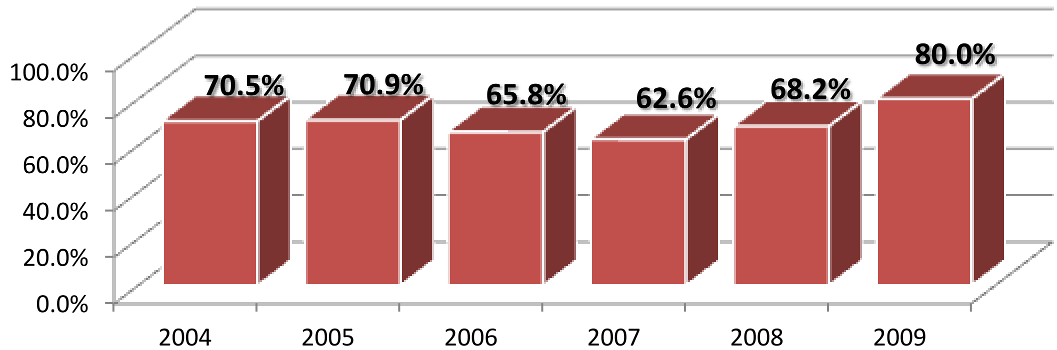
In addition to high foreclosure volume, significant mortgage servicing issues have emerged (misapplied payments, etc). These have contributed to the increase in foreclosures and present yet another emerging challenge in Virginia that must be addressed.

IMPACTS OF FORECLOSURE VOLUME AND A COMPLEX RECORDATION PROCESS

It is no longer simple to keep track of who owns a home's deed of trust. Mortgage lenders keep the Note when a homeowner takes out a mortgage and are supposed to keep it in a secure location as proof of ownership. Were this the case, lenders would have no problem proving they owned the property during foreclosure proceedings. Unfortunately, the age of exotic financial instruments, during which loans are packaged into mortgage backed securities and sold to investors, has resulted in lengthy and tangled paper trails. Consequently, in many instances, banks and mortgage lenders have been unable to produce the Note to a mortgage when foreclosing on a property. This has created ambiguity and contributed to wrongful foreclosures.

Documents that used to sit safely in the bank's vault have become portable, with no official means of recording who actually holds the mortgage Note to the property. This practice was predominantly found among the larger national lenders that made risky loans. Most local and smaller banks did not engage in such lending. As the data below shows (chart 7), the practice of packaging and selling mortgages on Wall Street only took a brief pause during the Great Recession and has resumed with fervor in 2009. Because of this, Virginia's homeowners should expect the current confusion and ambiguity in the mortgage and foreclosure process to continue.

Chart 7:
Percent Change in Foreclosure Filings, Urban and Rural Virginia Localities



Source: Home Mortgage Disclosure Act data analysis through Lending Patterns software

MAJORITY OF HOME LOANS IN VIRGINIA ARE MADE BY LARGE LENDERS

In Virginia, more than sixty percent of mortgage loans are sold to an investor within one year of origination. Of all the loans originated from 2004 to 2009, more than half (52 percent) were originated by the nation's largest lenders (those banks with more than $10 billion in assets). While many believe that the days of banks securitizing and selling mortgage loans to third party investors are over, in 2009, four out of every five mortgage loans were sold to an investor - the highest rate since at least 2004 (chart 7).

BORROWERS CAN DO VERY LITTLE TO CHOOSE A SERVICER[3]

The market has been unable to correct many mortgage servicing error issues, due in large part to the inability of the borrower to choose their servicer. Borrowers cannot shop for a loan based on the quality of the servicing and they have virtually no ability to change servicers. The servicer works on behalf of the bond issuer and, by extension, the investors who own the mortgage-backed securities. The servicer does not have a customer relationship with the borrower. When entering into a mortgage transaction, borrowers cannot specify or request that a particular servicer be responsible for their loan. If their servicer provides poor or even abusive service, the borrower has no exit strategy other than to refinance the loan. Even then, there is no guarantee that the refinanced loan will not be assigned to the same servicer.

SURVEY OF HOUSING COUNSELORS FINDS SERVICING ERRORS ARE STATEWIDE ISSUE

In the fall of 2010, a survey was sent to the Virginia Association of Housing Counselors to better understand the landscape of foreclosure activity across the state. The survey was completed by 40 housing counselors or employees of housing counseling-related organizations.

The most alarming finding involved loss-mitigation agreements. Respondents reported that foreclosure loss-mitigation agreements that had been approved were oftentimes not honored due to lack of communication between the mortgage servicer and the trustee. This miscommunication was compounded if servicing responsibilities were transferred to a different servicer. Overall, the survey found that more communication and responsiveness on behalf of the banks *and* the homeowners would help foreclosure prevention activities be more successful. Issues with mortgage servicers were also common, and a sizeable majority of respondents felt that independent third-party mediation would make foreclosure prevention efforts more successful.

The survey questions and results are summarized as follows:

- To the best of your knowledge, in the past year, what percentage of your foreclosure prevention clients have had issues with their mortgage servicer (misapplied payments, lost paperwork etc.) that have contributed to a foreclosure situation?
    - **25 percent indicated more than 41 percent**

- Fill in the blank. On average, from the time the homeowner gets their first foreclosure notice, the foreclosure process for my clients is taking _____________.
    - **55 percent indicated less than 90 days**

- Agree or disagree. Loss mitigation activities would be more successful if the mortgage servicer would be more responsive.
    - **92 percent indicated they *agree* or *strongly agree***

- Agree or disagree. Loss mitigation activities would be more successful if the BORROWER would be more responsive.
    - **69 percent indicated they *agree* or *strongly agree***

- Agree or disagree. An independent third party mediator (not related to the courts) would be beneficial in helping a homeowner avoid foreclosure.
    - **78 percent indicated they *agree* or *strongly agree***

- Agree or disagree. From the time the homeowner gets their first foreclosure notice, trustees are foreclosing too fast on homeowners, thus decreasing the opportunities for a homeowner to pursue loss mitigation activities.
    - **60 percent indicated they *agree* or *strongly agree***

- How often does this happen? A homeowner is going through a loss mitigation process and is close to having a loan modification approved. However, before the loan modification or loss mitigation activity is complete, the trustee moves ahead with a foreclosure sale.
    - **87 percent indicated *sometimes* (37 percent), *frequently* (39 percent), or *very frequently* (11 percent)**

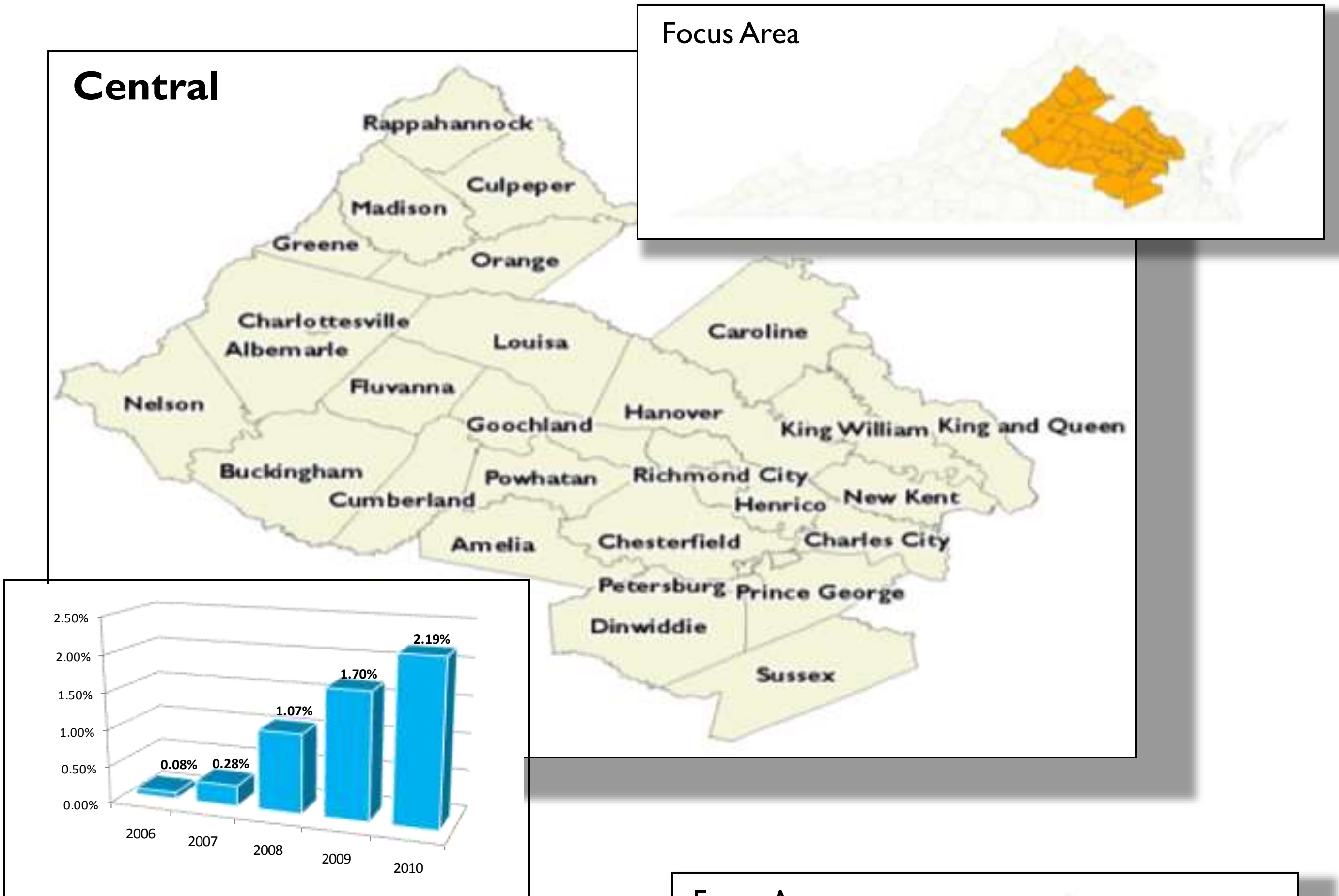
- How often does this happen? A homeowner goes through a loss mitigation process and has a loan modification approved. The loan is then SOLD to another servicer and the NEW servicer does not honor the terms of the loan modification.
    - **72 percent indicated *sometimes* (37 percent), *frequently* (39 percent), or *very frequently* (11 percent)**

CONCLUSION

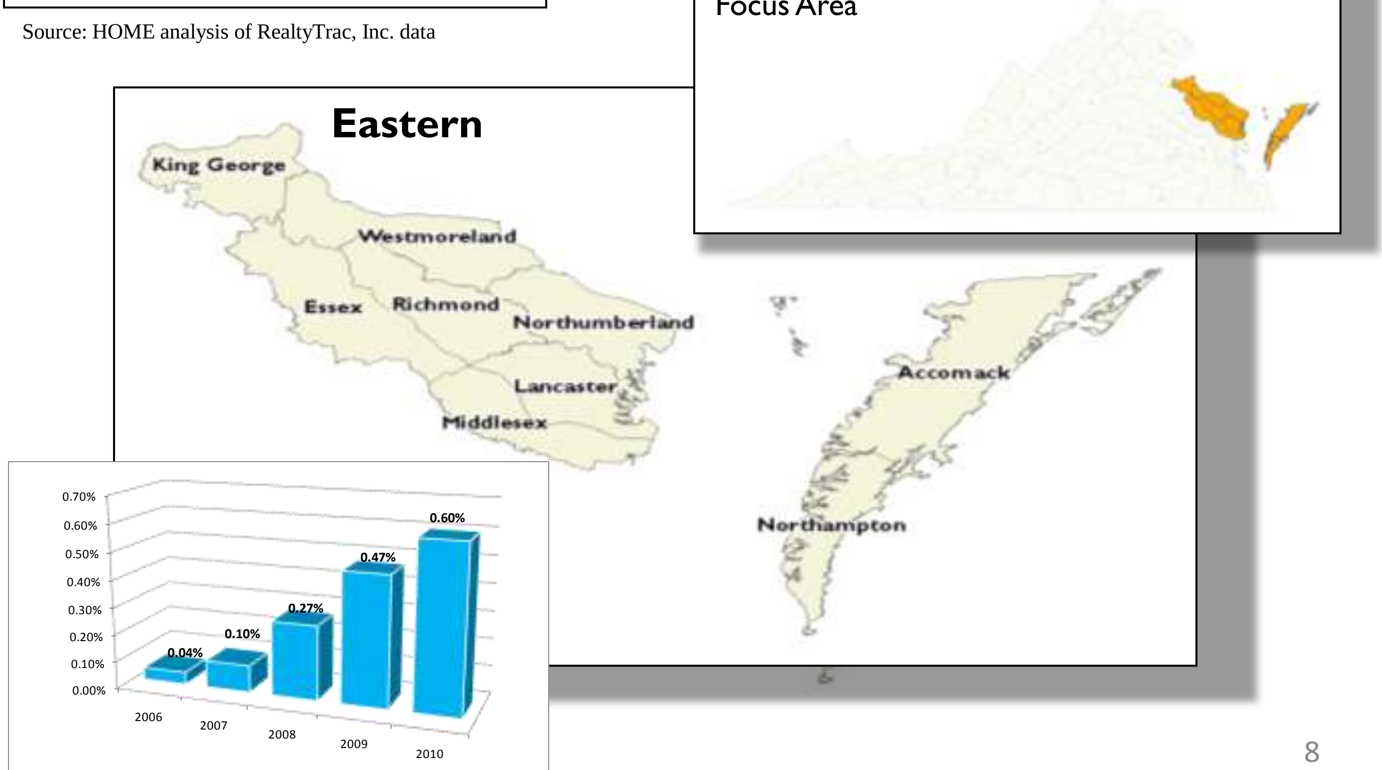
Despite strong efforts by the former and current governors and legislators to respond to the housing crisis, Virginia must respond to the evolving challenges faced by homeowners in the Great Recession. As foreclosures increase, especially in Virginia's rural communities, the public and private sector must mobilize appropriate resources necessary to mitigate foreclosures to the greatest extent possible. As foreclosure volume increases in all corners of Virginia, the complex mortgage recordation process has produced noticeable increases in mortgage servicing errors, which causes many families to go into foreclosure despite staying current on their mortgage payments. These mistakes can and must be avoided so that more homeowners do not fall victim to unnecessary and erroneous foreclosures.

Together, these issues have presented significant obstacles to a timely economic recovery. These issues have an acute impact in rural localities that have suffered job loss and budget problems more severe than their urban counterparts. Virginia's fragile economic recovery depends on the resources mobilized, policies changed, and these issues being fully resolved.

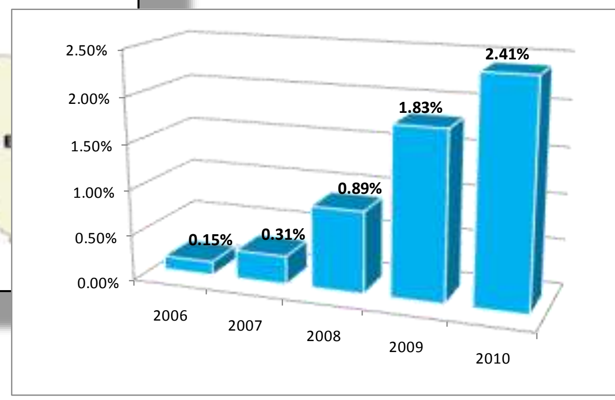
Appendix: Regional Foreclosure Rates, 2006 to 2010[4]



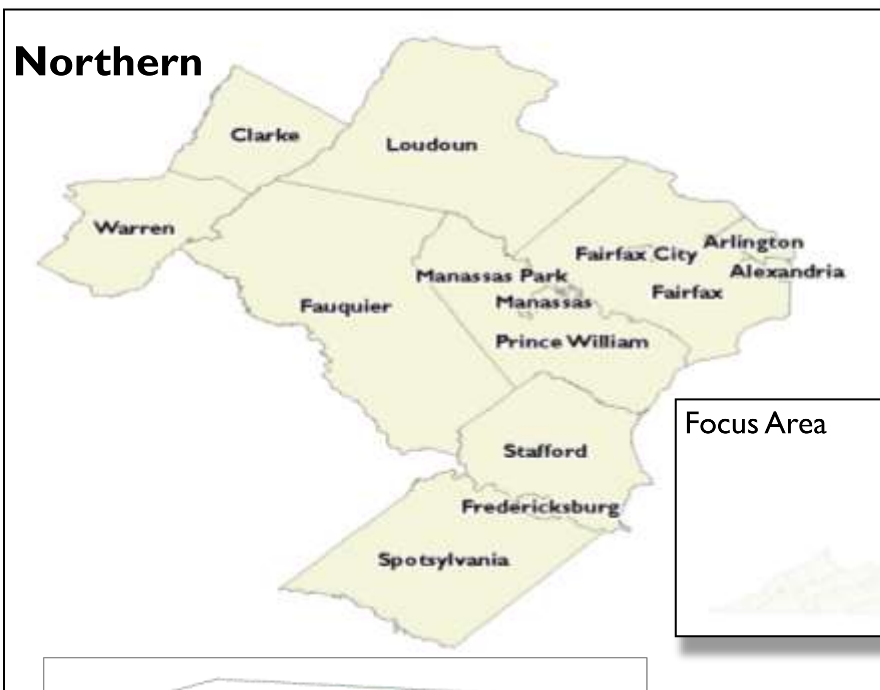
Source: HOME analysis of RealtyTrac, Inc. data

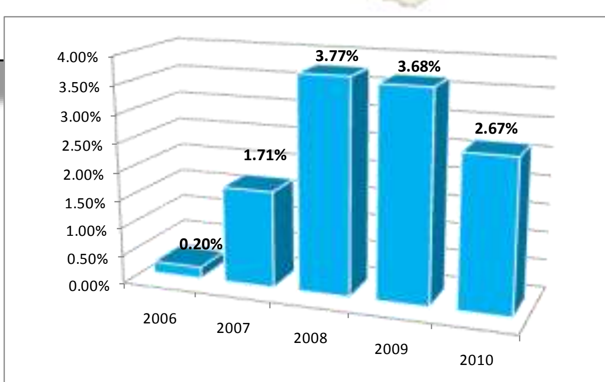


Source: HOME analysis of RealtyTrac, Inc. data

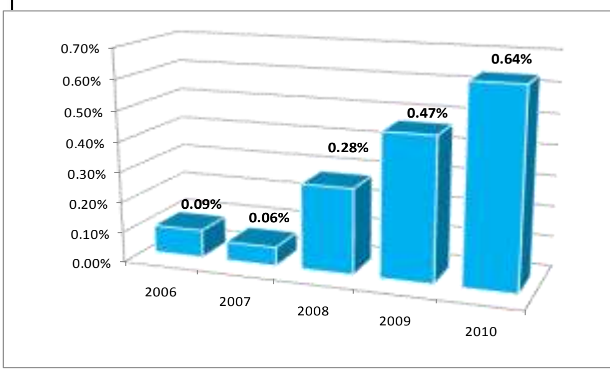


Source: HOME analysis of RealtyTrac, Inc. data

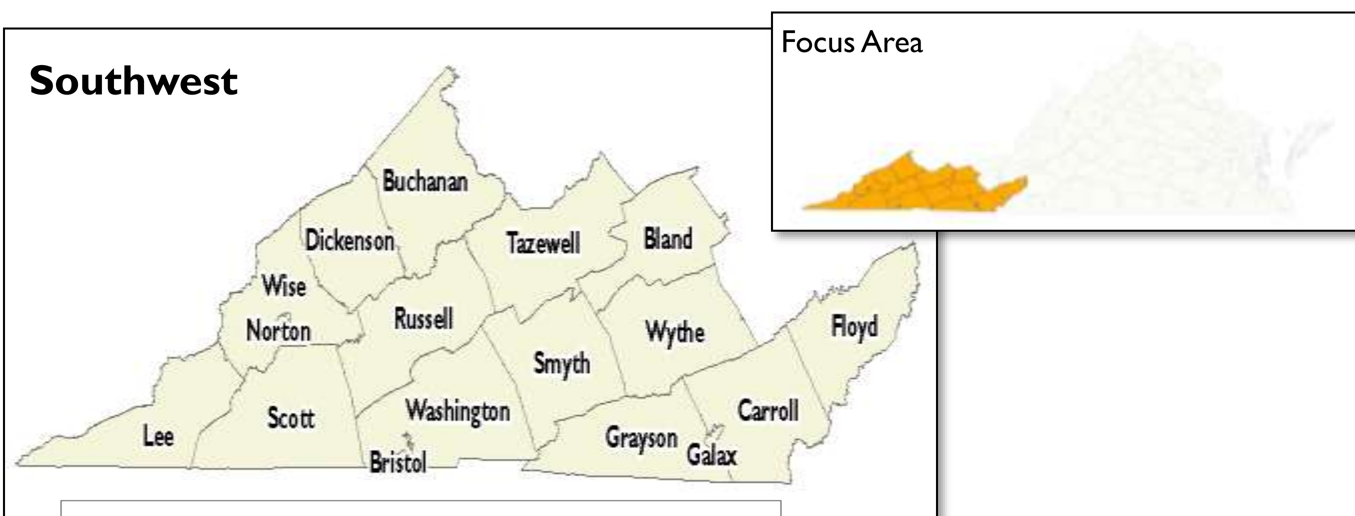


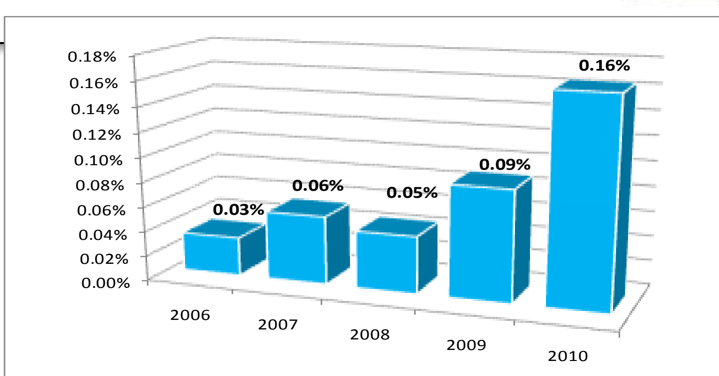


Source: HOME analysis of RealtyTrac, Inc. data



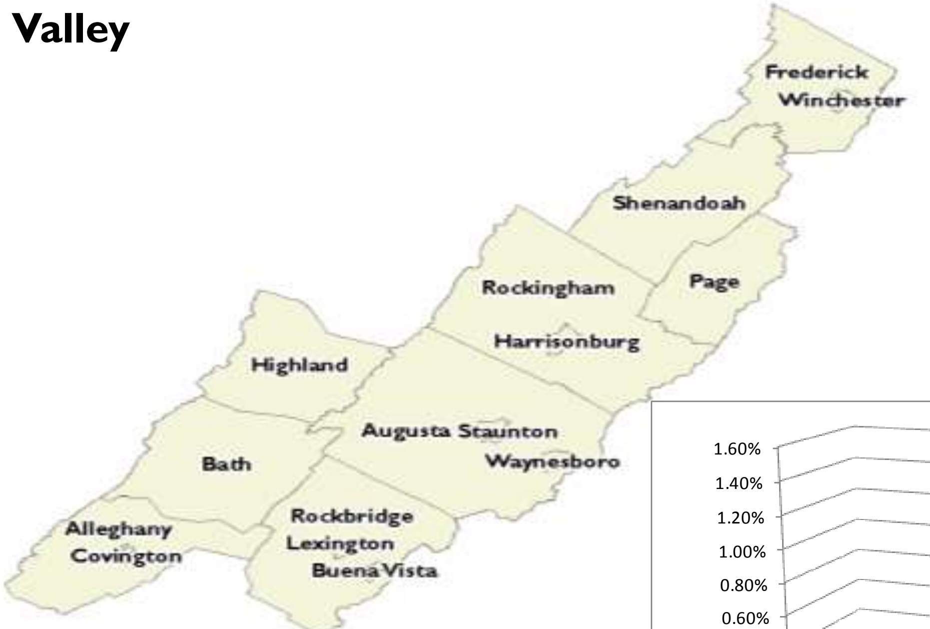
Source: HOME analysis of RealtyTrac, Inc. data



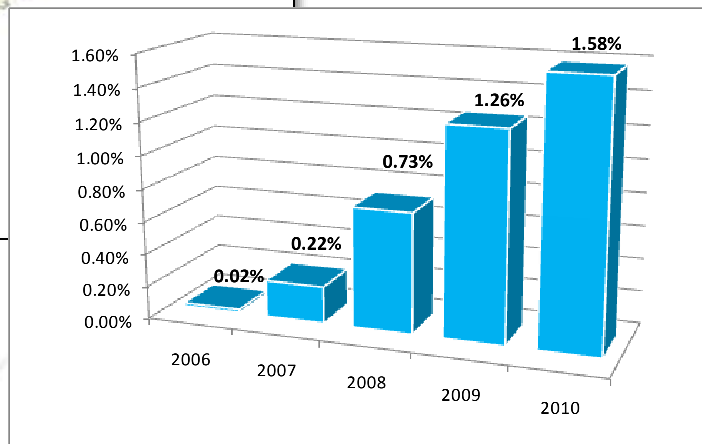


Source: HOME analysis of RealtyTrac, Inc. data

Valley



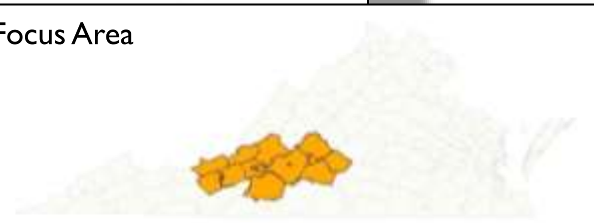
Focus Area

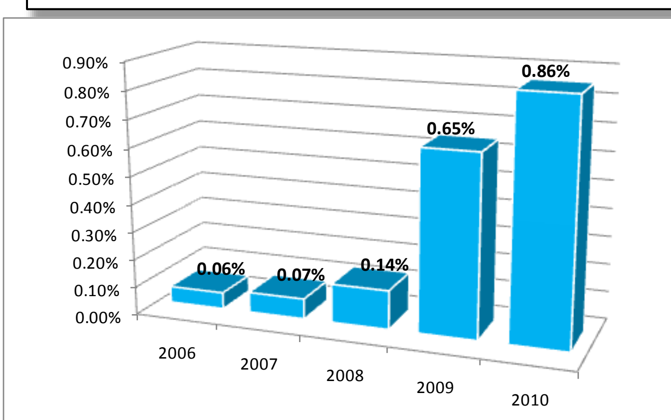


Source: HOME analysis of RealtyTrac, Inc. data

West Central

Focus Area





Source: HOME analysis of RealtyTrac, Inc. data

Notes:

1. RealtyTrac Inc. is a national foreclosure research firm. Though widely cited and one of the largest collectors of foreclosure data in the nation, they have been noted to be limited in their coverage by geography and also inconsistent in their coverage over time. These factors should be considered when reading this report.

2. The definitions for urban and rural localities were adapted from the Virginia Rural Health Plan methodology. This methodology is fully discussed in their 2008 report, *Virginia Rural Health Plan; Supporting Rural Health Through Action* is available at http://www.va-srhp.org/docs/va-rhp-final.pdf. For this report, rural areas are defined as both rural and mixed rural localities and urban areas are defined as both urban and mixed urban localities.

   In summary;

   A rural county is one in which the county's population density is less than 500 people/square mile, and 90 percent of the county population is in a rural area or the county has no urban area with population of 10,000 or more. An urban county is one in which the county's population density is at least 500 people per square mile, 90 percent of the county population lives in urban areas, the county's population in urbanized areas is a least 50,000 or 90 percent of the county population. A mixed rural county is one which meets neither the urban nor the rural county criteria, and its population density is less than 320 people per square mile. A mixed urban county is one which meets neither the urban nor the rural county criteria, and its population density is at least 320 people per square mile.

3. Portions of section '*BORROWERS CAN DO VERY LITTLE TO CHOOSE A SERVICER'* taken from: Porter, Katherine M., Misbehavior and Mistake in Bankruptcy Mortgage Claims. U of Iowa Legal Studies Research Paper No. 07-29; Texas Law Review, Vol. 87, 2008. Available at SSRN: http://ssrn.com/abstract=1027961

4. Regional definitions taken from Virginia Performs, available at: http://vaperforms.virginia.gov/extras/regions.php

For more information, please contact:
Ali Faruk (Director) or Will Sanford (Research Analyst)

Center for Housing Leadership
Housing **O**pportunities **M**ade **E**qual of Virginia Inc. (**HOME**)
626 E. Broad St. Suite 400, Richmond, VA 23219

804-354-0641 | Fax: 804-354-0690