

# Holding Wall Street Accountable for the Subprime Mortgage Crisis in Urban Communities

Stuart Rossman, Director of Litigation, National Consumer Law Center

Larry Schwartzol, Staff Attorney, ACLU Racial Justice Program

Deidre Swesnik, Director of Public Policy and Communications,  
National Fair Housing Alliance

Odette Williamson, Moderator and Staff Attorney,  
National Consumer Law Center



Chelsea Langston

National Association of Consumer Advocates (NACA)



October 22, 2012



## Moderator – Odette Williamson

- Odette Williamson has been a staff attorney at NCLC since July, 1999 where she focuses on foreclosure and elder-related issues.
- Prior to this she was an Assistant Attorney General in the Massachusetts Office of the Attorney General where she concentrated on civil enforcement actions against individuals and businesses for violation of consumer protection and other laws. As an AAG she also served on the Elder Law Advocates Strike Force to combat unfair and deceptive acts against elderly citizens.
- She is co-author of NCLC's Foreclosures, and Foreclosure Prevention Counseling.

## Presenter – Deidre Swesnik

- Director of Public Policy and Communications at the National Fair Housing Alliance. Deidre represents the interests of NFHA and its members before Congress, federal agencies, and the media and coordinates efforts with advocacy and industry groups on housing and civil rights.
- She joined NFHA in 2003 as both its Public Policy Program Director and New Groups Project Coordinator. As New Groups Project Coordinator, she was responsible for the creation of a new full-service fair housing center in Mississippi.

## Presenter – Stuart Rossman

- Staff attorney at the National Consumer Law Center (NCLC) and has served as its Director of Litigation since 1999.
- Stuart is the co-editor of the 7th Edition of the NCLC Consumer Class Actions manual and coordinates NCLC's Consumer Class Action Symposium.
- After 13 years of private trial practice in Boston, Stuart served as Chief of the Trial Division and Chief of the Business and Labor Protection Bureau at the Massachusetts Attorney General's Office from 1991-1999.
- Currently serves on the Board for the NACA.
- He is also a member of the adjunct faculty at the Northeastern University School of Law and Suffolk University School of Law.

# Presenter – Larry Schwartztol

- Staff attorney, ACLU Racial Justice Program
- Larry's work focuses on litigation and advocacy involving foreclosure and predatory lending as well as the school-to-prison-pipeline.
- Previously, Schwartztol was a staff attorney in the ACLU's National Security Project, where he litigated cases involving foreign intelligence surveillance, ideological exclusion of foreign scholars, and the government's search authority at airports and the U.S. border.
- He has also served as a visiting researcher in the Center on National Security and the Law at Georgetown University Law School.



## Why Responsible Mortgage Lending Is a Fair Housing Issue

February 2012

By

Daniel Lindsey, Diane E. Thompson, Alys Cohen and Odette Williamson  
National Consumer Law Center<sup>®</sup>

# Holding Wall Street Accountable for the Subprime Mortgage Crisis in Urban Communities



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# Overt Historical Discrimination

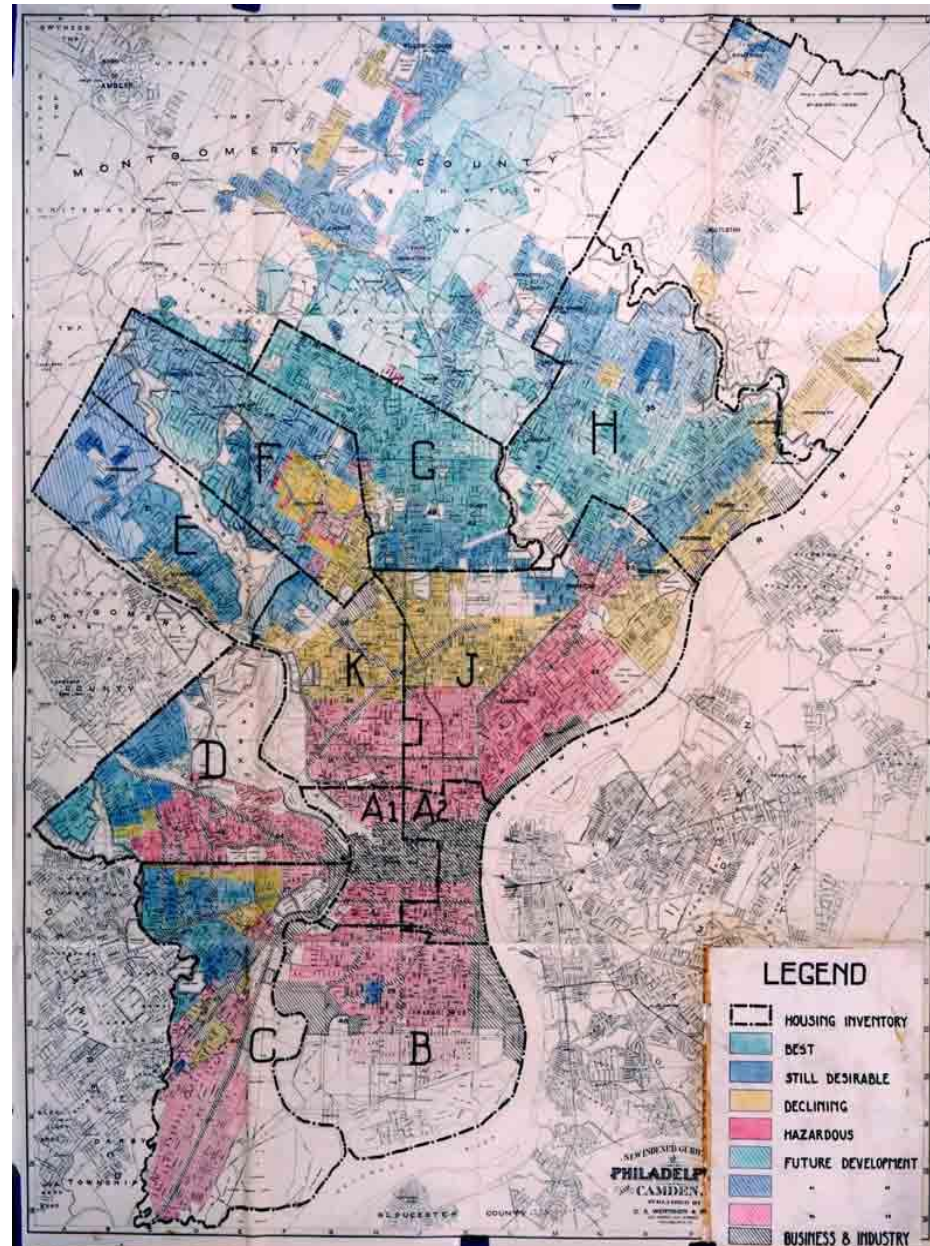
*McMichael's Appraising Manual*, 4th Edition 1951

Ranking of race and nationality by impact on real estate values (in order of preference):

1. English, Germans, Scotch
2. North Italians
3. Bohemians or Czechs
4. Poles
5. Lithuanians
6. Greeks
7. Russians, Jews (lower class)
8. South Italians
9. Negroes
10. Mexicans



# 1936 Residential Security Map – Philadelphia



# "Red-Lining"

A.....Red (Hazardous), north of main business section to North Philadelphia at Lehigh Avenue between Broad Street and Delaware River, also including Kensington. This area is very old, mainly obsolete and consisting almost entirely of two, three and four story brick row houses, averaging in age from fifty years or more. Demolition has been heavy particularly in Ward 20 and the number of structures unfit for habitation is large. In addition to the water front being all industry, there are a substantial number of small plants engaged in light manufacturing scattered throughout the section.

North of Fairmount to York between Broad and Front Streets is occupied by Polish, Italians, Jewish and Negro with the latter predominating from Broad to 8th Streets. East of Front Street is Kensington and while it is densely populated, it is essentially an industrial area, including a number of textile mills. Population is mixed laboring class, including a large Polish colony along the water front.

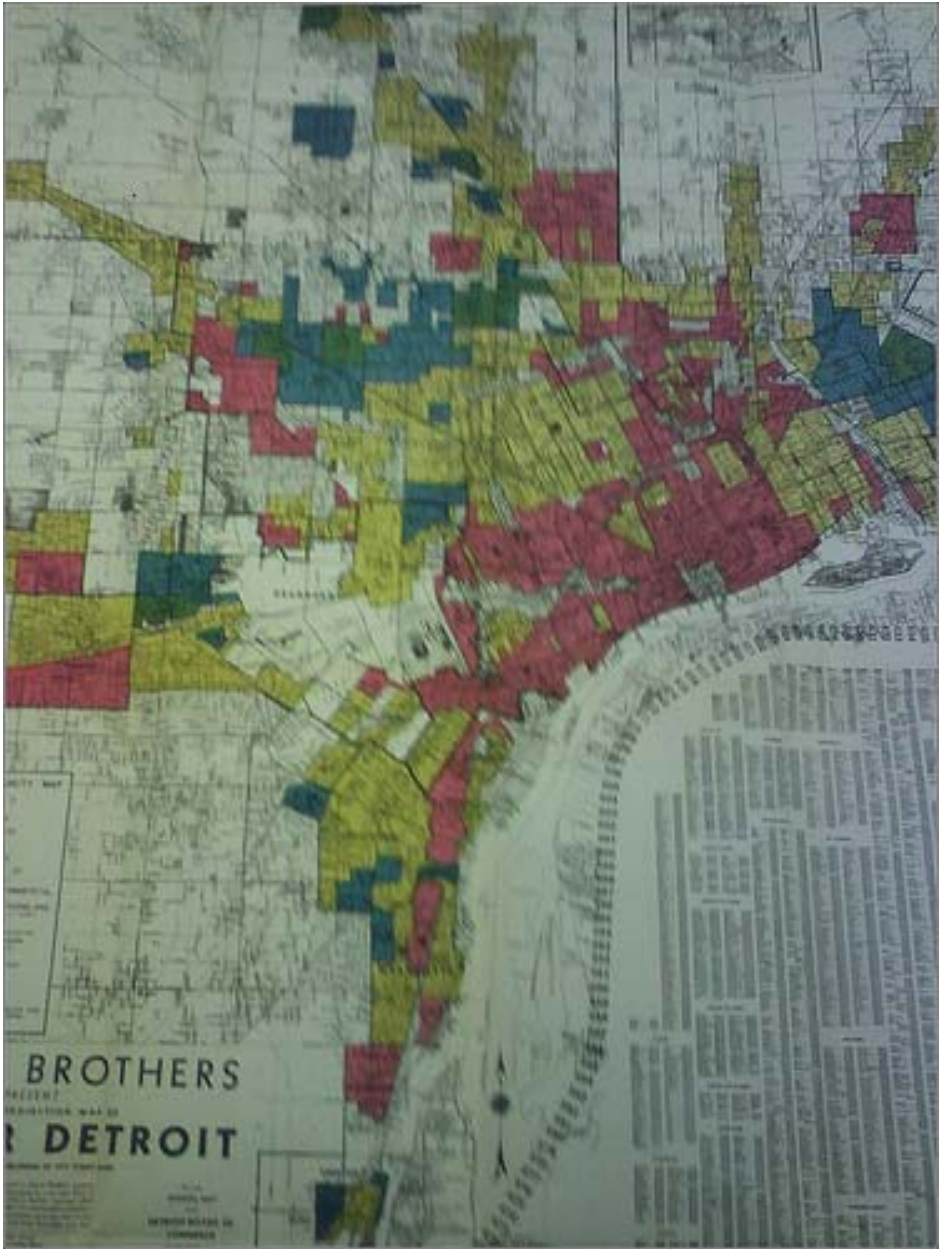
C.....Yellow area (Definitely Declining) - North of Lehigh and Kensington to Wingohocking and east of Broad Street. This area is heavily dotted with light industries. The tracks of both the Pennsylvania Railroad and the Reading Railroad are lined with miscellaneous plants. In addition, this section contains a large number of the city's textile and hosiery mills. Consequently, its residents are mainly workers in these industries, most of which require skilled workers - largely women - who are normally well paid.

Houses are practically all of substantial age and of very modest two story brick row type.

D.....Blue areas (Still Desirable) - Frankford and Bridesburg. Houses are chiefly modern and fairly modern five and six room, brick, row type. Inhabitants are mostly native whites of white collar and skilled mechanic class.

E.....Green area (Best) at extreme north eastern end of section - really a part of the Roosevelt Boulevard development. New since 1926 - 1928. Modern semi-detached and row, porch-front houses which are small but of good type. The inhabitants are of good class native whites with modest incomes.

# 1939 Residential Security Map – Detroit



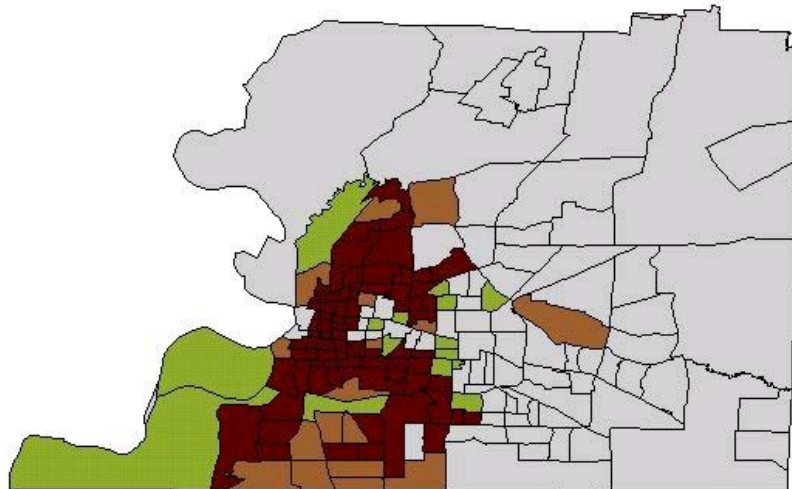
# Federal Housing Administration Policy (1940s - 1960s)

“If a neighborhood is to remain stable, it is necessary that properties shall continue to be occupied by the same racial and social classes. Changes in social or racial occupancy contribute to neighborhood instability and the decline of value levels.”

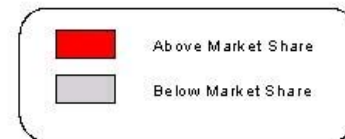
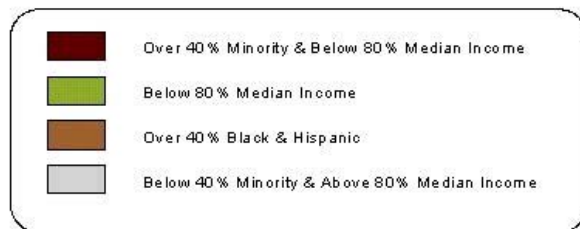
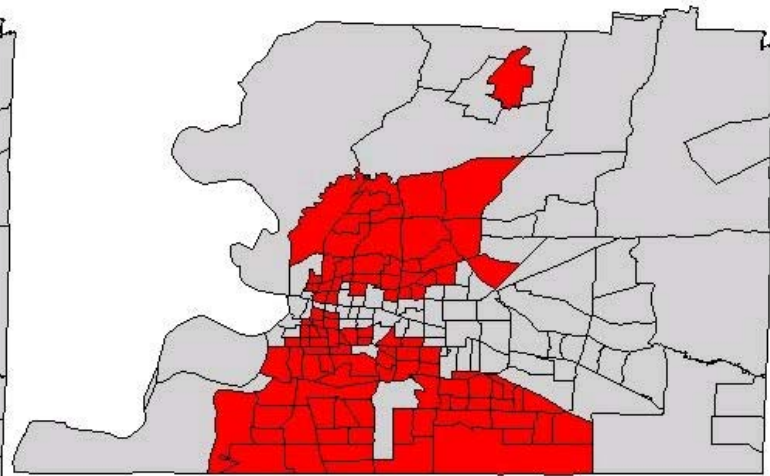
# Subprime Loans & Non-White Communities

## Subprime Lending Patterns Memphis (Shelby Co.), TN

Minority & Low-Income Tracts

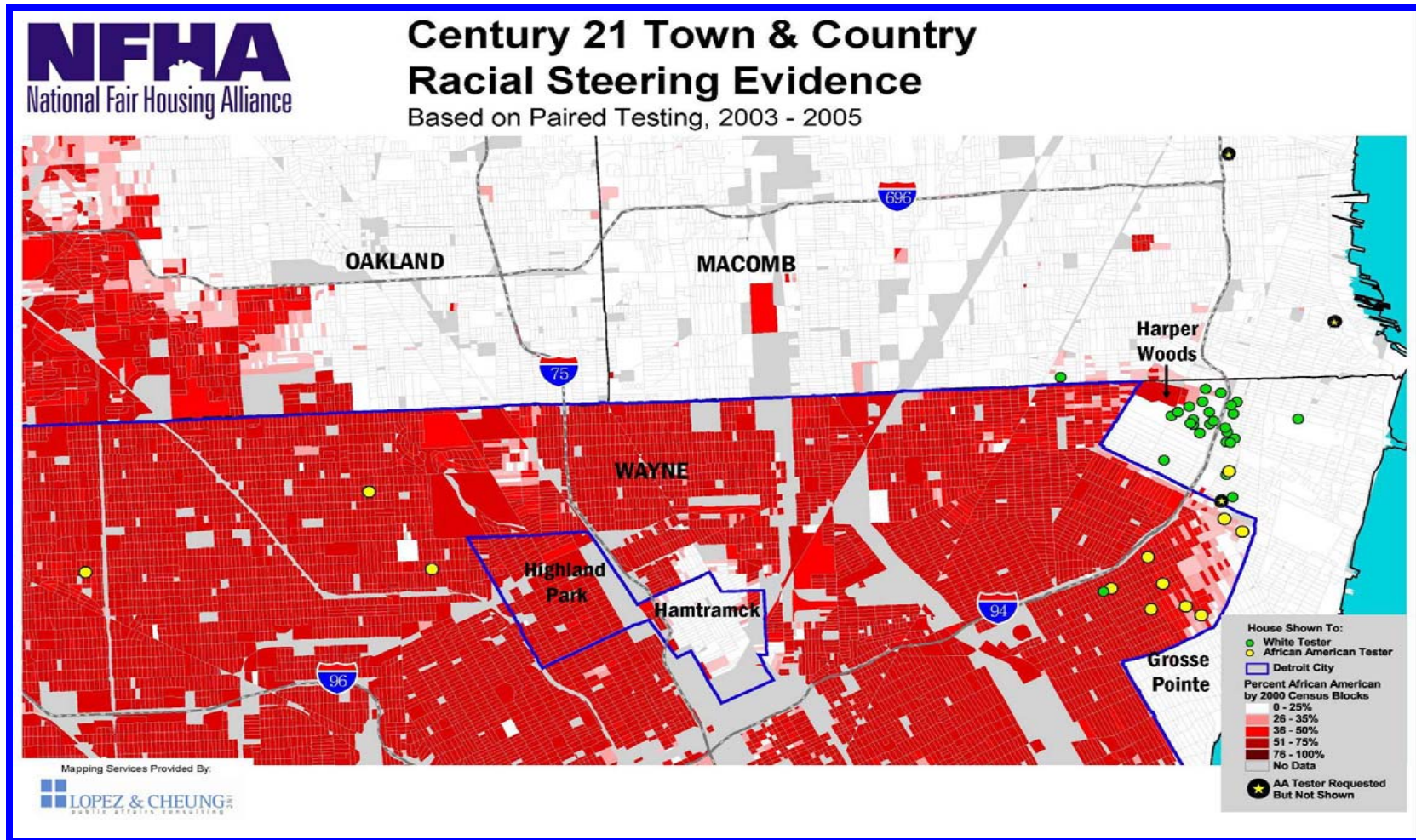


Subprime Lending Concentration

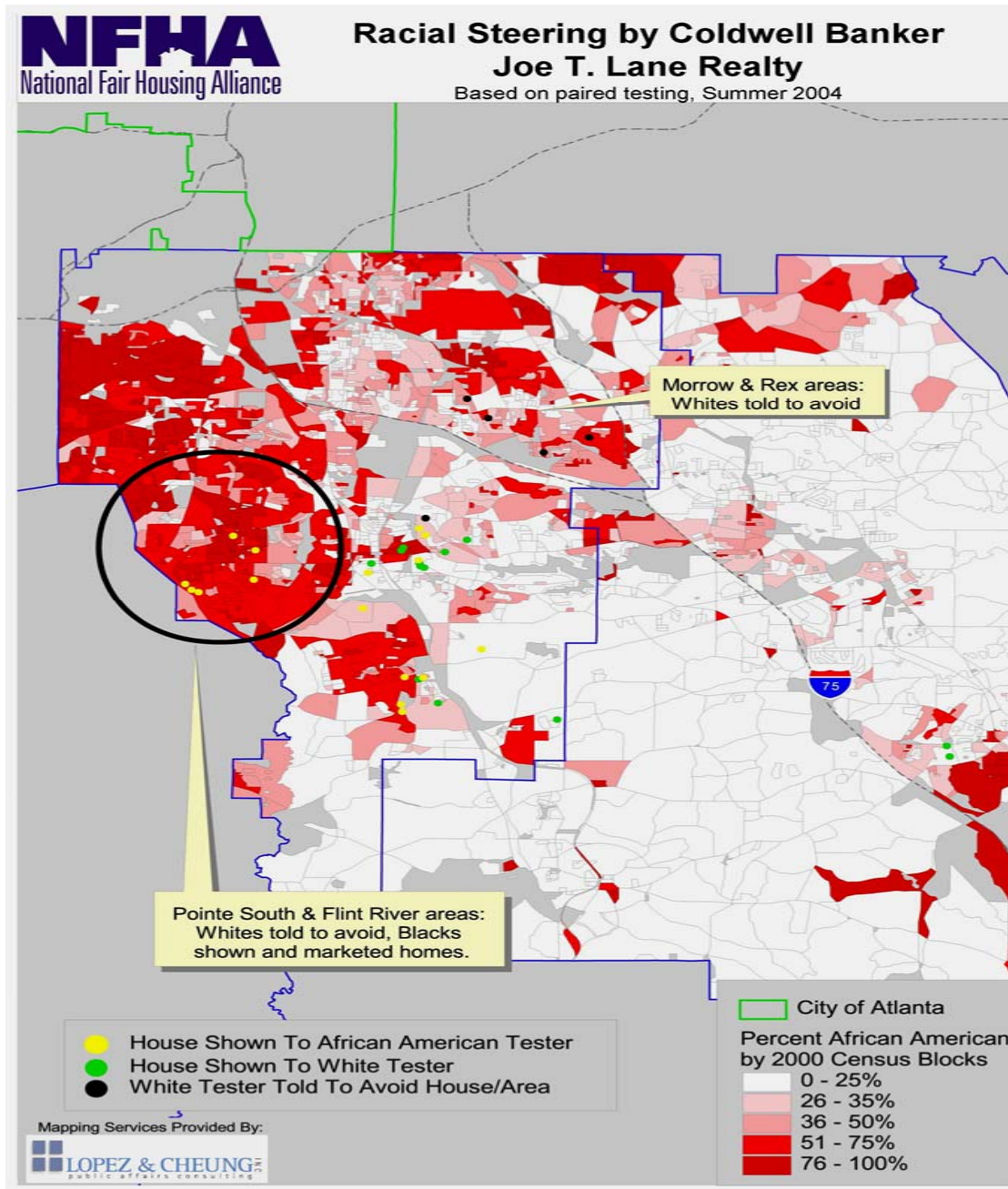


Sources: 2000 U.S. Census; 2002 Home Mortgage Disclosure Act data

# Steering and Segregation: Detroit

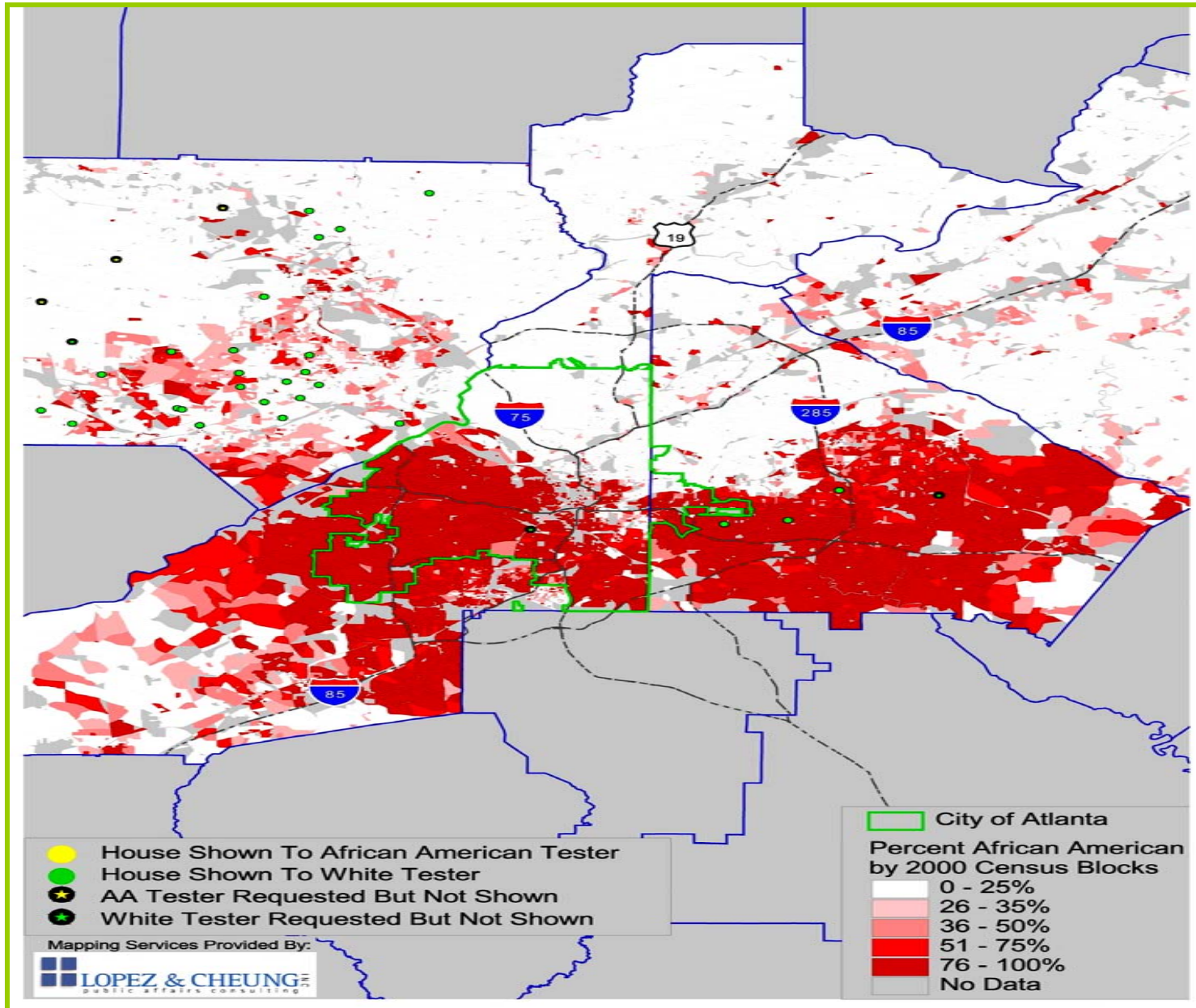


# Steering and Segregation: Atlanta





# Marietta, GA 23 to 0



# Wealth Gap Widens

**In 2005** – household net worth

African American households: \$12,124

White households: \$134,992 (**11 times larger**)

**By 2010** – household net worth

African-American households: \$4,995 (**down 59%**)

White households: \$110,729 (**22 times larger**)  
(**down 18%**)

# Recent Lending Trends

- Lenders funded a smaller percentage of mortgage applications from African Americans and Latinos than the national average.
- 2011 Home Mortgage Disclosure Act data show that **59.27%** of all mortgage applications were funded.
  - **50%** of African-American applicants
  - **57%** of Latino applicants
  - **64%** of Whites applicants

# NFHA REO Investigations

**April 2012 Report:** *The Banks Are Back –  
Our Homes Are Not: Discrimination in the  
Maintenance and Marketing of REO  
Properties*

**April 2012:** *Wells Fargo and US Bank Complaints*

**September and October 2012:** *Bank of America  
Complaint*

# Bank of America REO Complaint – So Far



# Methodology for Investigation

- Neighborhoods selected for investigations were made up of predominantly African-American residents, Latino residents, Non-White residents, and/or White residents.
- Neighborhoods selected had recent high foreclosure rates of Bank of America REOs located in the zip codes evaluated.
- **100%** of REOs of Bank of America were evaluated within the zip codes.

# Evaluation Measures



- Curb Appeal
  - Accumulated mail, trash, overgrown or dead grass/shrubbery, invasive plants



- Structure
  - Unsecured/broken doors, locks, windows, damaged roof, fence, deck, holes, wood rot



- Signage
  - Trespass/warning signs, “bank owned,” “For Sale signs,” broken/discarded signs, unauthorized occupancy

# Evaluation Measures

- Paint/Siding
  - Graffiti, severe peeling/chipped paint, damaged siding, missing/broken shutters
- Gutters
  - Missing, out of place, broken, hanging, obstructed
- Water Damage
  - Mold, water damage, erosion
- Utilities
  - Tampered with or exposed





# Dallas – 65 REOs Evaluated

- 31 in predominantly African-African communities
- 17 in predominantly Latino communities
- 6 in predominantly non-White communities
- 11 in predominantly White communities

# Dallas – 65 REOs Evaluated

- 13% of REO properties in communities of color were **marketed as distressed**, while **none** of REO properties in White communities had the same problem).
- 14.8% of REO properties in communities of color had a **broken mailbox**, while **none** of REO properties in White communities had the same problem.
- 20.4% of REO properties in communities of color had **accumulated mail**, while **none** of REO properties in White communities had the same problem.

# Dallas – 65 REOs Evaluated

- REO properties in communities of color were **almost 2 times as likely** as REOs in White communities to have **substantial amounts of trash**.
- REO properties in communities of color were **3 times as likely** as REOs in White communities to have **overgrown grass or leaves**.

**8629 Eden Valley Lane, Dallas, TX 75217**

**Neighborhood: Predominantly Latino**





8629 Eden Valley Lane, Dallas, TX 75217  
Neighborhood: Predominantly Latino



**1007 Ann Arbor Ave Dallas, TX**  
**Neighborhood: Predominantly African  
American**



1007 Ann Arbor Ave Dallas, TX  
Neighborhood: Predominantly African  
American





# 1007 Ann Arbor Ave, Dallas, TX

## Next Door Neighbor



**5935 Prospect Ave, Dallas, TX**  
**Neighborhood: Predominantly White**



## **Metro-Washington DC– 41 REOs Evaluated**

- 40 located in predominantly African-American communities
- 1 located in a predominantly White community

# Metro-Washington DC– 40 REOs Evaluated in Communities of Color

- 70% of REO properties in communities of color had **substantial amounts of trash**.
- 52.2% of REO properties in communities of color had **overgrown or dead shrubbery**.
- 30% of REO properties in communities of color had **broken doors or locks**.
- 37.5% of REO properties in communities of color had **broken or boarded windows**.
- 25% of REO properties in communities of color were **marketed as distressed**.
- 80% of REO properties in communities of color **did not have a “for sale” sign**.

**1213 Dunbar Oaks, Capitol Heights, MD**  
Neighborhood: Predominantly African  
American

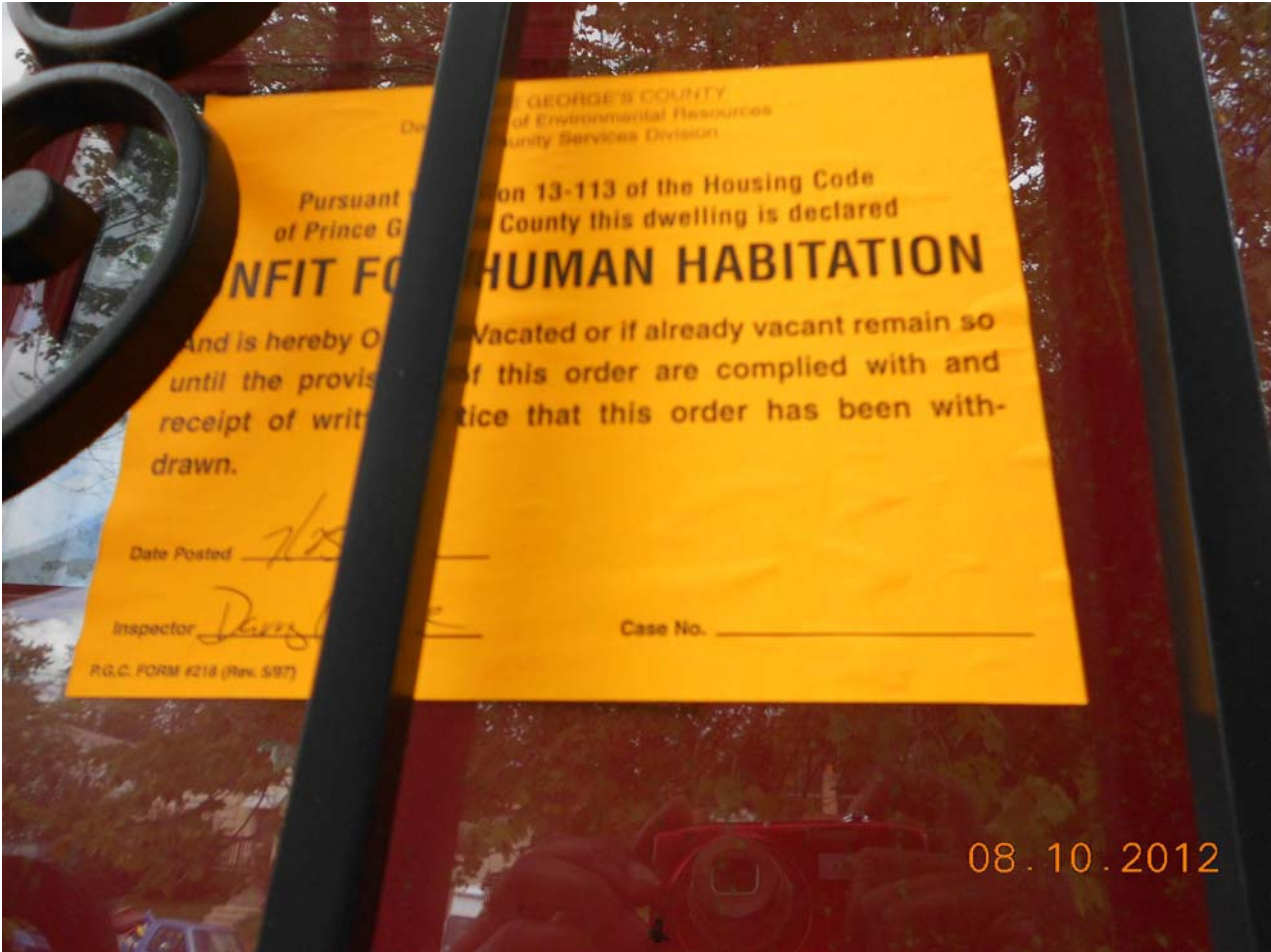


# 1213 Dunbar Oaks, Capitol Heights, MD

Neighborhood: Predominantly African American



# 1213 Dunbar Oaks, Capitol Heights, MD Neighborhood: Predominantly African American



# 1213 Dunbar Oaks, Capitol Heights, MD

## Next Door Neighbor

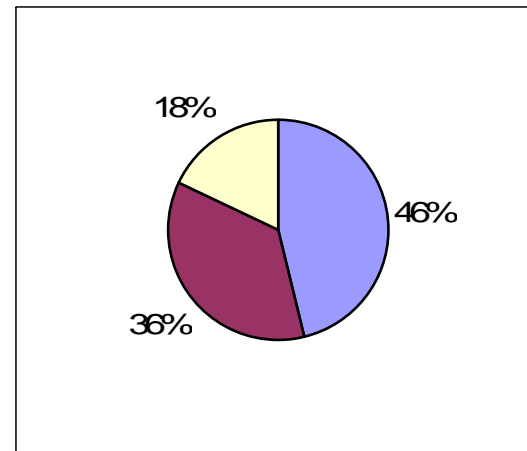




# Homeowner vs. Investor

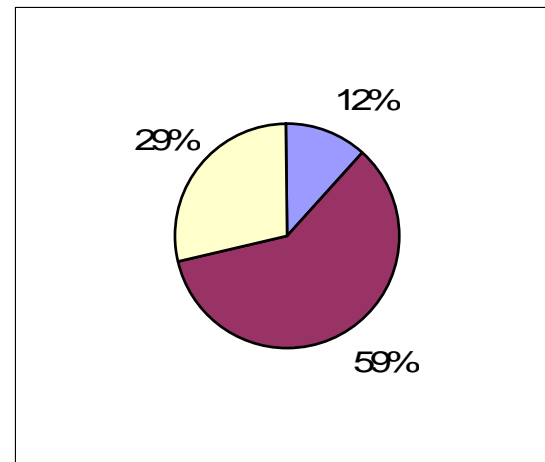
## Maintenance Score A or B

- 46% Owner-Occupant
- 36% Investor
- 18% REO



## Maintenance Score D or F

- 12% Owner-Occupant
- 59% Investor
- 29% REO





# NFHA

National Fair Housing Alliance

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**NCLC**<sup>®</sup>  
NATIONAL  
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LAW  
CENTER<sup>®</sup>

October 22, 2012  
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# DOJ Civil Rights Division Cases

(1) United States v. Wells Fargo 12-cv-01150 U.S. D.Ct. D.C. (July, 2012)

(2) United States v. Countrywide Financial Corp. 11-cv-10540 U.S. D.Ct. C.D. CA (December, 2011)



# MA AGO Cases

(3) Commonwealth v. H.R. Block/Option One  
(August, 2011)

<http://www.mass.gov/ago/news-and-updates/press-releases/2011/option-one-settlement.html>

(4) Commonwealth v. Morgan Stanley (June, 2010)

<http://www.mass.gov/ago/news-and-updates/press-releases/2010/attorney-general-martha-coakley-reaches-102.html>

(5) Commonwealth v. Fremont (June 2009)

<http://www.mass.gov/ago/news-and-updates/press-releases/2009/ag-coakley-reaches-10m-settlement-with.html#materials>



# Municipal Actions

(1) City of Memphis and Shelby County v. Wells Fargo, 09-cv-02857, U.S.D.Ct.W.D.TN.

(2) Mayor and City Council of Baltimore v. Wells Fargo, 08cv00062, U.S. D.Ct. D.MD.



# Private Actions

(1) Miller v. Countrywide Financial Corp, Case No. 12-5250, 6th Cir.; In re Countrywide Financial Corporation Mortgage Lending Practices Litigation , 08md1974, U.S. D. Ct. W.D. KY.

(2) Ramiriez v. Greenpoint Mortgage Funding, Inc., 08-cv-00369, U.S..D.Ct.N.D.CA.



# Fair Housing Act

Under the Fair Housing Act, it is unlawful “for any person or other entity whose business includes engaging in residential real estate-related transactions to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction, because of race . . . .” 42 U.S.C. § 3605(a). A residential real estate transaction is defined to include, inter alia, the “purchasing of loans . . . secured by residential real estate.” Id. at § 3605(b)(1).





# Fair Housing Act Regulations

Federal regulations promulgated under the Fair Housing Act confirm that discriminatory policies and practices in connection with the purchase and securitization of mortgage loans are unlawful under 42 U.S.C. § 3605. See 24 C.F.R. § 100.125 (2010).



# Equal Credit Opportunity Act

Under the Equal Credit Opportunity Act (“ECOA”), it is unlawful for “any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction . . . on the basis of race.” 15 U.S.C. § 1691(a).



# ECOA Creditor Definition

The ECOA's prohibition against discrimination applies to securitizers of residential mortgage loans. The ECOA defines the term "creditor" to mean, *inter alia*, "any assignee of an original creditor who participates in the decision to extend, renew, or continue credit." *Id.* at § 1691a(e).



# ECOA Regulation B

Federal regulations promulgated under the ECOA confirm that the ECOA's definition of "creditor" includes participants in the secondary mortgage market such as Morgan Stanley. See 12 CFR § 202.2(l) ("Creditor means a person who, in the ordinary course of business, regularly participates in a credit decision, including setting the terms of the credit.



# ECOA Regulation B (cont'd)

The term creditor includes a creditor's assignee, transferee, or subrogee who so participates."); *see also* Official Staff Commentary, 12 C.F.R. pt. 202, Supp. L § 202.2(l) (stating that a creditor may include "a potential purchaser of the obligation who influences the credit decision by indicating whether or not it will purchase the obligation if that transaction is consummated").





The nonprofit **National Consumer Law Center® (NCLC®)** helps build family wealth for low-income and other disadvantaged people in the U.S. by offering advocacy expertise through publications, policy analysis, research, litigation services, and training. **[www.nclc.org](http://www.nclc.org)**

# Key Factual Allegations in *Adkins* *v. Morgan Stanley*

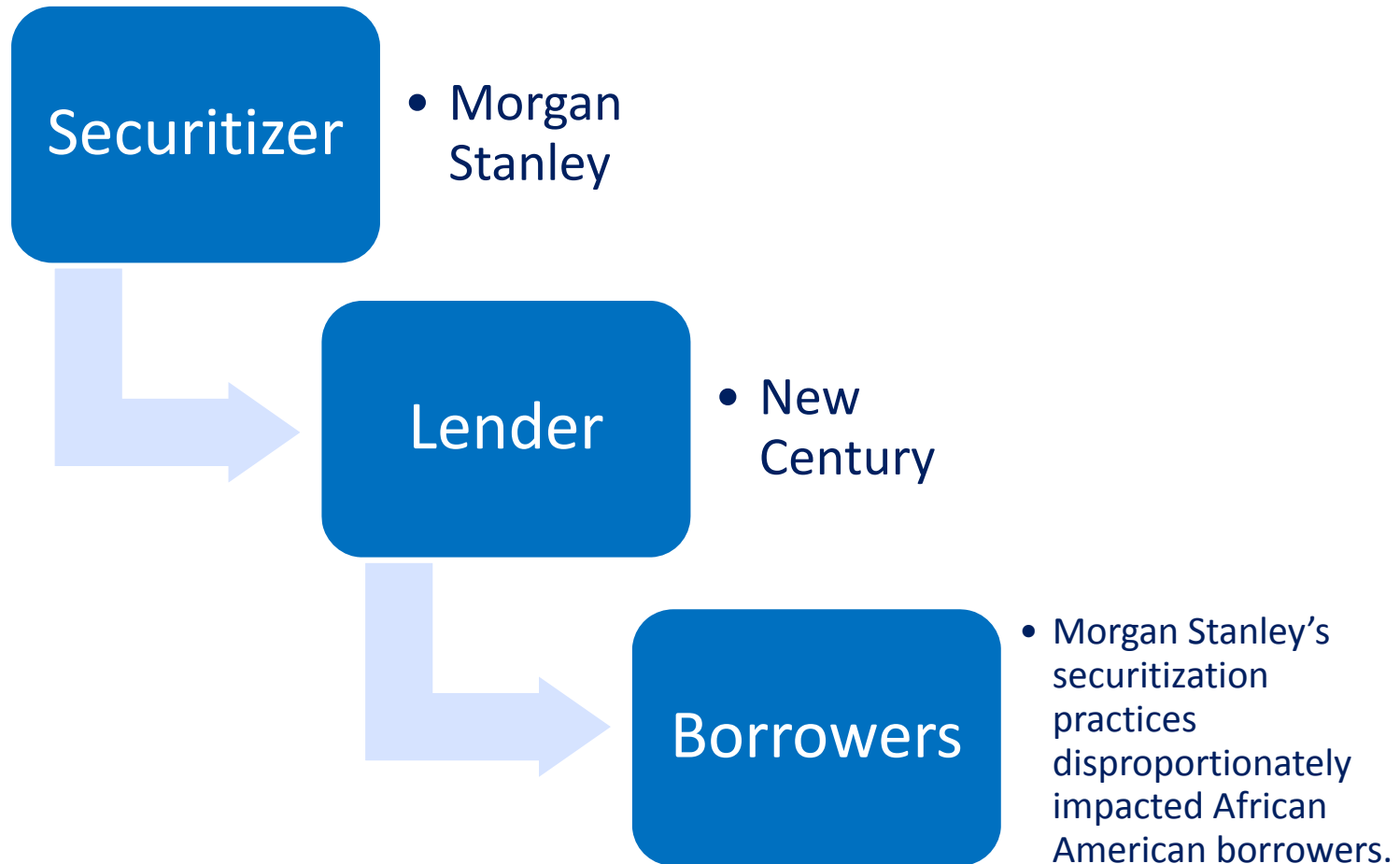
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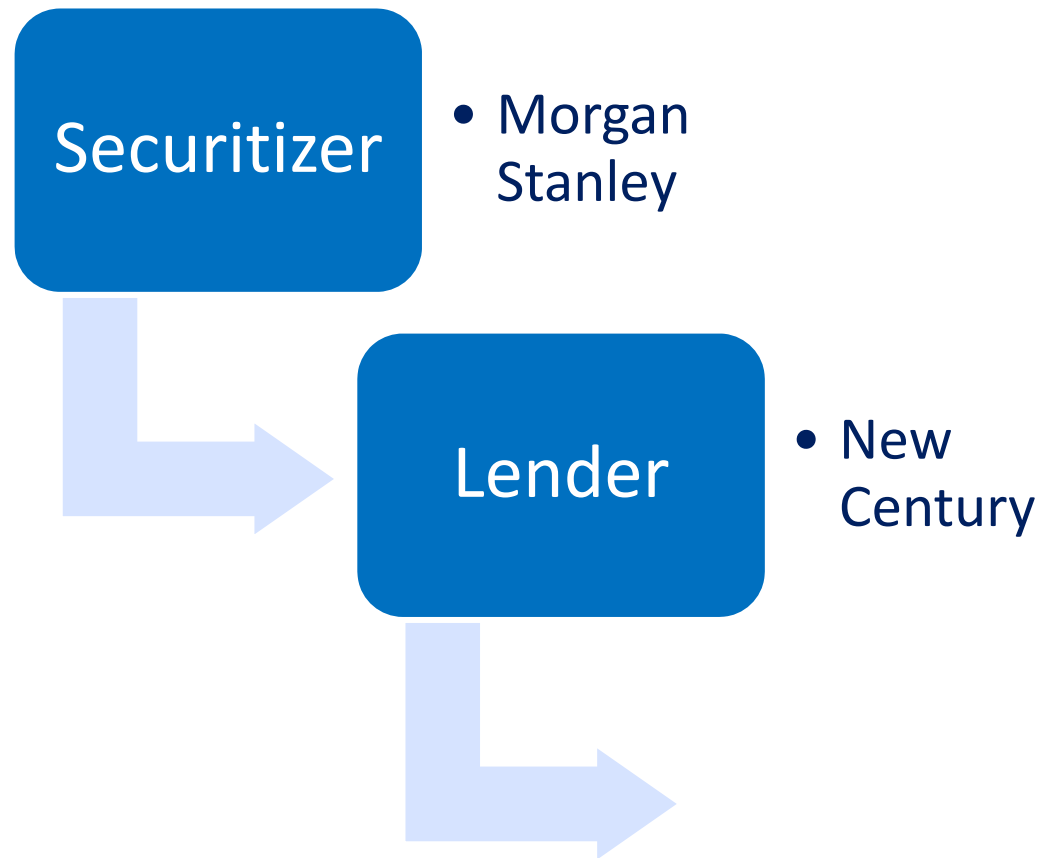
October 22, 2012

# Morgan Stanley's Mortgage Securitization Policies Directly Harmed Homeowners





# Morgan Stanley's Relationship with New Century



## **New Century was One of the Most Aggressive & Dangerous Predatory Lenders**

- 2004: 44% of New Century's loans were high-cost
- 2005: 86% of New Century's loans were high-cost
- 2006: 88% of New Century's loans were high-cost
- 2008: New Century topped the OCC's "Worst Ten in the Worst Ten" list

## **Morgan Stanley was the Principal Financer of New Century Loans**

- 2005: Morgan Stanley purchased 48% of loans sold by New Century
- 2006: Morgan Stanley purchased 36% of loans sold by New Century
- 2007: Morgan Stanley purchased 41% of loans sold by New Century
- Morgan Stanley purchased a greater proportion of New Century's loans than any other institution

“In response to Morgan Stanley’s policies and practices [], New Century needed to maximize the volume of Combined-Risk Loans it originated to meet Morgan Stanley’s requirements and demand and to maximize the overall volume of loans it originated, regardless of the levels of risk imposed on borrowers.”

- *Adkins v. Morgan Stanley* Complaint

## **Morgan Stanley Ensured that New Century Originated Combined-Risk Loans**

- Adjustable Rate Mortgages (ARM)
  - Prepayment Penalties
  - Balloon Payments
  - Debt-to-Income ratio (DTI)
  - Stated Income
  - Loan-to-Value ratio (LTV)
- In 2005, Morgan Stanley required that 79.54% of the loans it purchased from New Century have adjustable rates
  - In 2005, Morgan Stanley required that no less than 73.11% of the loans it purchased from New Century contain prepayment penalties.
  - Morgan Stanley and New Century both acknowledged the abusive nature of balloon payments
  - Loans with balloon payments regularly made up over 34% of the loans in Morgan Stanley securities comprised of New Century loans.

## **Morgan Stanley Ensured that New Century Originated Combined-Risk Loans**

- Adjustable Rate Mortgages (ARM)
  - Prepayment Penalties
  - Balloon Payments
  - Debt-to-Income ratio (DTI)
  - Stated Income
  - Loan-to-Value ratio (LTV)
- According to Morgan Stanley's own DTI analysis, 45% of the loans it purchased from New Century were issued to borrowers who could not afford them
  - The level of risk associated with high DTI's was exacerbated by Morgan Stanley's preference for stated income ('no doc') and ARM loans
  - Between 2004 and 2007, stated income loans comprised between 30.56% and 47.70% of the New Century loans purchased by Morgan Stanley
  - Former executive director on Morgan Stanley RMBS trading desk: "We are telling you to lie to us. . ."

## **Morgan Stanley Ensured that New Century Originated Combined-Risk Loans**

- Adjustable Rate Mortgages (ARM)
  - Prepayment Penalties
  - Balloon Payments
  - Debt-to-Income ratio (DTI)
  - Stated Income
  - Loan-to-Value ratio (LTV)
- 31% of the New Century loans securitized by Morgan Stanley in 2006 and 2007 had LTV ratios that were greater than 100%.
  - New Century inflated its appraisal values in order to allow Morgan Stanley to understate borrowers' LTVs

“The Combined-Risk Loan products that New Century emphasized during this period, pursuant to Morgan Stanley’s requirements and encouragement, predictably exposed borrowers to elevated and spiraling risk that put many on a path to foreclosure.”

- *Adkins v. Morgan Stanley* Complaint

# Baseline Foreclosure Rates

- Between 1950 and 1997, foreclosure rates on conventional loans typically remained below 1%
- During the same time period, foreclosure rates on FHA insured loans generally remained below 2%
- Even during the unprecedented foreclosure crisis, white borrowers have faced a foreclosure rate of about 4.5%, while African-American and Latino borrowers have experienced foreclosure rates above 8%



# Exceedingly High Foreclosure Rates for Loans New Century Sold to Morgan Stanley

- For Morgan Stanley-New Century loans in the sample we analyzed, the foreclosure rate as of December 31, 2008 was **20.2%**
- Detroit borrowers represented in these Morgan Stanley-New Century securities had a foreclosure rate of **35.7%**
- These foreclosure rates *understates* the actual foreclosure rates on these loans.

# Loan Characteristics: DETROIT

- Detroit borrowers represented in these Morgan Stanley-New Century securities had an average LTV ratio of 98.1%
- 80% of the loans originated in Detroit included adjustable rates
- Almost 40% of the loans originated in Detroit were stated income loans

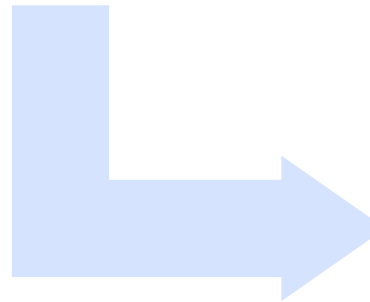
# Racial Disparities Within Morgan Stanley-New Century Securities

Among all borrowers represented in the sample, the rate of foreclosure among African Americans was 28.57% greater than the rate of foreclosure among white borrowers.

# The Impact of Morgan Stanley's Relationship with New Century on African Americans in Detroit

Lender

- New Century



Borrowers

- Morgan Stanley's securitization practices disproportionately impacted African American borrowers.

# Racial Segregation & Lending Discrimination in Detroit

- History of redlining in Detroit
- During the 1980s, even as segregation rates began to slowly decline nationally, the rate of segregation in the Detroit region increased by 2.6 percentage points.
- By 1990, Detroit was the most racially-segregated major metropolitan area in the United States.
- In 2000, African Americans composed 82% of the population in the city of Detroit.
- In order to properly measure reverse redlining, we studied nine county Detroit-metro region: Genesee, Lapeer, Livingston, Macomb, Monroe, Oakland, St. Clair, Washtenaw, and Wayne Counties

# New Century Took Advantage of the Lack of Credit Opportunities for African American Borrowers in Detroit

- While white borrowers received 3.7 times as many high-cost loans from New Century as non-high-cost loans, black borrowers received nearly ***ten times*** more high-cost loans than non-high-cost loans
- Controlling for income, loan amount, and other loan features reported pursuant to HMDA, an African-American borrower in Detroit was 70% more likely than a white borrower to obtain a high-cost loan from New Century.

# Plaintiffs: African-American Detroit Homeowners

The Named Plaintiffs received Combined-Risk Loans from New Century pursuant to Morgan Stanley's discriminatory policies and practices, subjecting them to excessive risk of default and foreclosure.

# Organizational Plaintiff: Michigan Legal Services (MLS)

MLS is a nonprofit legal services corporation dedicated to eliminating systemic causes of poverty.

The majority of its clients are African-American residents of Detroit.

In the wake of the foreclosure crisis, MLS has had to reallocate a significant amount of its scarce resources to foreclosure-related work.

As of 2011, through its joint Mortgage Foreclosure and Tax Foreclosure Prevention Projects, MLS and its partner organization are handling nearly half of the foreclosure litigation on behalf of homeowners in the state.