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States take a whack at foreclosures

Attorneys general across the nation take up the cause of housing rescue.

By Les Christie, CNNMoney.com staff writer
Last Updated: June 21, 2008: 8:11 PM EDT

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NEW YORK (CNNMoney.com) -- While Congress has talked for a year about a federal response to the foreclosure crisis, attorneys general have been busy helping troubled homeowners at the state level.

AGs are filing lawsuits, lobbying legislatures for tougher mortgage lender laws, and partnering with mortgage servicers and community development groups to help rescue homeowners from foreclosures.

Their efforts have paid off. While the Mortgage Bankers Association says a million homes were in [foreclosure](#) in the first three months of 2008, one community advocate says that number would have been larger if the AGs weren't involved.

"When the highest law enforcement officer in the state starts demanding action, mortgage servicers are going to pay attention" said John Taylor, CEO of the National Community Reinvestment Corp., a non-profit redevelopment group.

In Illinois, Attorney General Lisa Madigan is going after mortgage brokers and lenders she claims used abusive lending practices.

She filed suit in November against Chicago-based mortgage broker One Source Mortgage, alleging the outfit drew in hundreds of clients by advertising low rates on option adjustable rate mortgages (ARMs) but failed to inform borrowers that those rates would adjust upward, often very quickly.

One Source allegedly told one borrower his interest rate of 0.95% would last the entire first year of the loan. But it jumped to 7.5% after one month.

"The vast majority of people with these loans didn't understand them and were lied to by brokers," said Madigan.

The suit is still working its way through the courts. One Source's phone service has been disconnected and the attorney who represented it said One Source is no longer a

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client.

Madigan helped initiate a bill, now before the state legislature, requiring foreclosure notices to include an explanation of options that borrowers have to help them retain their houses. And she has used her influence with lenders and servicers to step up their foreclosure relief efforts and work closer with community groups offering counseling to at-risk borrowers.

Representing the client

Lori Swanson, attorney general for Minnesota, was a force behind a new state law requiring mortgage brokers to act in the best financial interests of their clients, much as attorneys do for clients or CEOs do for their companies.

"Instead of selling a mortgage like a car, the law requires that mortgage brokers take on the duty of agency, to act in the borrower's behalf," Swanson said.

That means brokers can't stick a borrower with a subprime loan just because it pays them more in fees and commissions. And it also means brokers are obliged to make sure borrowers understand exactly what kinds of costs and obligations they're signing up for.

"All loan originators should have fiduciary responsibility to clients," said Austin King, the director of the Financial Justice Center for Acorn, the non-profit advocate for low- and moderate income households.

Swanson is also going after companies that are bilking desperate homeowners by charging fees upwards of \$2,000 and promising to save their homes from foreclosure.

"They say, 'I can save your home,' then they take the money and don't deliver any service at all," said Swanson, who brought lawsuits in April against National Foreclosure Relief, American Foreclosure Specialists and four other companies.

Massachusetts' Attorney General Martha Coakley went after a particularly invidious form of this crime called "equity stripping" in which scamsters persuade borrowers to temporarily assign them title to their homes so the foreclosure can't proceed. The crooks promise to make payments while homeowners repair their finances and get back in a position to pay their mortgages again.

But instead, the home rescuer works with a crooked appraiser to inflate the value of the home. They resell the house at a big price to a straw buyer who obtains a mortgage based on the inflated appraisal. The crew disappears with the cash from the sale and the one-time owner loses the house.

Coakley got state regulations changed to ban for-profit foreclosure rescue companies.

In March, New York Attorney General Andrew Cuomo reached agreement with [Freddie Mac](#) and [Fannie Mae](#), the government sponsored enterprises (GSEs) created to keep funds flowing in home mortgage markets. They agreed to buy mortgage loans only from lenders who used independent appraisers to value real estate.

Appraisers often inflate home values to ensure that sales go through. If an appraisal comes in low, underwriters won't approve the deal because it means the loan is not fully secured by the value of the asset. Inflated appraisals contributed to the overheated prices of the bubble years.

The vast majority of loans now trade through the GSEs, so the pact has the effect of preventing all loan originators from using anything but independent appraisers, not only in New York but all over

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the nation.

But there has been some [pushback from federal bank regulators](#). The Office of the Comptroller of the Currency has charged that states have no authority over the nationally chartered banks that may be making these loans.

The Office of Federal Housing Enterprise Oversight, which helps regulate Fannie and Freddie, is still talking with the GSEs about how they will respond.

The act of persuasion

State AGs have banded together in the State Foreclosure Prevention Working Group, under the leadership of Tom Miller of Iowa, to encourage lenders to offer more workouts to borrowers.

The group has pushed for better reporting of mortgage workouts from lenders and servicers so everyone can understand the kind of progress being made in avoiding foreclosures.

The working group released a report in April that found fully half the people asking servicers for help were not getting it.

That is a tragic number, according to Acorn's King. "So many foreclosures are fundamentally avoidable and unnecessary," he said. ■

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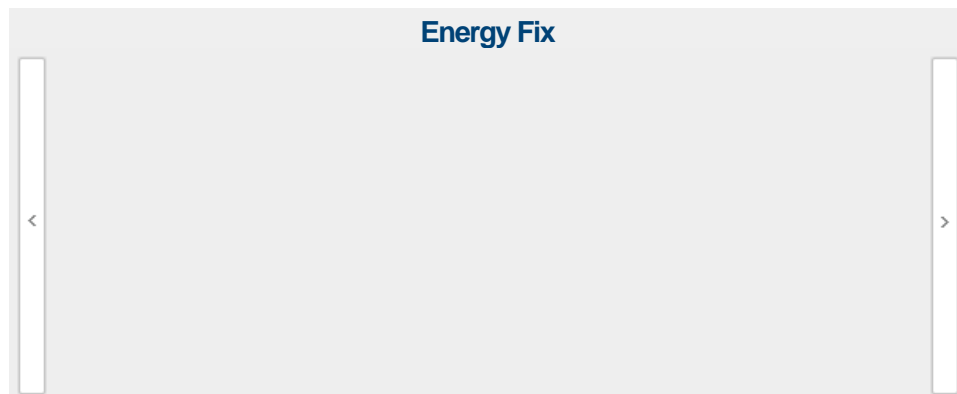
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