

**Testimony of Minnesota Attorney General Lori Swanson**

**Regarding Predatory Mortgage Lending  
and the Effect of Foreclosures on Minnesota**

**Before the United States House of Representatives  
Financial Services Committee**

**August 9, 2007**

**Minneapolis Central Library  
300 Nicollet Mall  
Minneapolis, MN 55401**

GOOD EVENING. MY NAME IS LORI SWANSON, THE ATTORNEY GENERAL OF MINNESOTA. CHAIRMAN FRANK, CONGRESSMAN ELLISON, THANK YOU FOR THIS OPPORTUNITY TO ADDRESS THE TOPIC OF PREDATORY MORTGAGE LENDING AND THE IMPACT OF FORECLOSURES ON OUR COMMUNITIES.

**I. THE STACKED DECK AND LACK OF MARKET DISCIPLINE.**

FORECLOSURES OCCUR FOR MANY REASONS, INCLUDING JOB LOSS, DIVORCE, ILL HEALTH, AND A MYRIAD OF OTHER FACTORS. IT IS NOW BEYOND DISPUTE THAT FORECLOSURES ALSO OCCUR WHEN HOMEOWNERS ARE PLACED IN PREDATORY MORTGAGE LOANS THAT THEY CAN'T BACK.

OVER THE YEARS, THE "AMERICAN DREAM" OF HOMEOWNERSHIP HAS BEEN THE WAY THAT MOST MIDDLE AND LOWER INCOME AMERICANS HAVE SAVED FOR THE FUTURE. TODAY, INSTEAD OF BEING A SAVINGS VEHICLE, THE HOME HAS BEEN TURNED INTO A FINANCIAL LIABILITY FOR FAR TOO MANY OF OUR NEIGHBORS WHO HAVE BEEN SOLD IMPROPER MORTGAGE PRODUCTS. MANY OF OUR NEIGHBORS LIVE PAYCHECK-TO-PAYCHECK. COLLEGE TUITION IS RISING, HEALTH CARE COSTS ARE SOARING, AND GASOLINE AND UTILITIES COST MORE, TOO. HERE IN MINNESOTA THE UNEMPLOYMENT RATE IS UP, AND GOOD PAYING JOBS ARE MORE SCARCE. AS A RESULT, MANY OF OUR NEIGHBORS ARE BORROWING, NOT TO GET HEAD BUT TO GET BY. IN 2006, OVER 85 PERCENT OF PEOPLE WHO REFINANCED THEIR MORTGAGE TOOK CASH OUT TO PAY OTHER BILLS, SUCH AS CREDIT CARD AND HEALTH CARE BILLS.

BECAUSE MIDDLE AND LOWER INCOME AMERICANS ARE FINANCIALLY SQUEEZED, THEY ARE VULNERABLE TO DEFAULT WHEN THEY FACE SURPRISES

IN THEIR MORTGAGE DUE TO UNDISCLOSED INTEREST RATES OR FEES. AND THE COMPLEXITY OF THE MORTGAGE TRANSACTION CREATES AN ATMOSPHERE RIPE FOR FRAUD AND THE SALE OF UNSUITABLE PRODUCTS.

## **II. THE MINNESOTA EXPERIENCE.**

IMPROPER SALES PRACTICES HAVE RESULTED IN GROWING FORECLOSURES. HERE IN MINNESOTA, WE HAVE SEEN MORTGAGE LOANS SOLD WITH LITTLE OR NO REGARD FOR THE BORROWER'S ABILITY TO REPAY THE LOAN AND THAT ARE UNSUITABLE FOR THE BORROWER'S FINANCIAL SITUATION.

THE MINNESOTA ATTORNEY GENERAL'S OFFICE WAS A LEAD STATE IN THREE OF THE COUNTRY'S LARGEST MORTGAGE LENDING ENFORCEMENT ACTIONS. THESE CASES INVOLVED ABUSES SUCH AS:

- MISLEADING BORROWERS INTO PURCHASING "TEASER" ADJUSTABLE RATE MORTGAGES WITH EXPLODING INTEREST RATES THAT WERE NOT ADEQUATELY DISCLOSED;
- PLACING BORROWERS IN "NO DOCUMENTATION" LOANS IN WHICH THE BROKER FABRICATED BORROWERS' INCOME OR ASSETS. IN MANY CASES, LENDERS DID NOT EVEN LOOK AT A PRIOR YEAR'S TAX RETURN TO CONFIRM THAT THE INCOME "STATED" ON THE APPLICATION WAS IN THE BALLPARK TO REALITY. IN MY OFFICE, WE HAVE SEEN BROKERS FALSIFY APPLICATIONS TO CLAIM THAT OCTOGENARIANS HAULED IN CASH BY MAKING BIRDHOUSES THEY DIDN'T MAKE, THAT A

GARDENER IN HIS EARLY 20'S MADE \$6,000 PER MONTH AS A "LANDSCAPE ENGINEER," OR THAT A SUBURBAN COUPLE EARNED MONEY RENTING OUT A NONEXISTING APARTMENT IN THEIR HOME BASEMENT. IT IS NO SURPRISE THAT THESE BORROWERS DEFAULT WHEN THEY CANNOT AFFORD THE MONTHLY PAYMENTS.

SO WHAT HAS THIS MEANT FOR MINNESOTA? WHILE OUR STATE HAS HISTORICALLY HAD RELATIVELY HIGH LEVELS OF HOMEOWNERSHIP, WE NOW FACE HIGH LEVELS OF MORTGAGE DEFAULTS AND FORECLOSURES. THESE FORECLOSURES ARE OCCURRING NOT JUST IN OUR CITIES, BUT IN OUR SUBURBS AND IN RURAL AREAS.

THE NUMBER OF FORECLOSURES IN MINNESOTA HAS NEARLY DOUBLED IN THE LAST YEAR, AND NEARLY QUADRUPLED IN THE LAST TWO YEARS. IN 2006, THERE WERE OVER 11,200 FORECLOSURES IN MINNESOTA, UP FROM UNDER 6,000 IN 2005. IN RURAL MINNESOTA, THE NUMBER OF FORECLOSURES ROSE FROM 2,707 IN 2005 TO 4,168 IN 2006. IT IS EXPECTED TO REACH 8,700 THIS YEAR. THE SITUATION WILL WORSEN, NOT IMPROVE, AS MORE ADJUSTABLE RATE MORTGAGES HAVE THEIR INTEREST RATES RESET UPWARD, RESULTING IN HIGHER MONTHLY PAYMENTS. IN SOME RURAL MINNESOTA COUNTIES, NEARLY ONE HALF OF ALL LOANS MADE IN 2005 WERE SUBPRIME MORTGAGE LOANS. MANY OF THESE BORROWERS WILL FACE ECONOMIC DISTRESS WHEN THE TEASER PERIOD ENDS ON THEIR ADJUSTABLE RATE MORTGAGES.

THE IMPACT OF FORECLOSURES RESULTING FROM PREDATORY SALES PRACTICES IS DESTRUCTIVE.

IT IS DESTRUCTIVE FOR THE FAMILIES AND HOMEOWNERS INVOLVED, WHO END UP LOSING THEIR HOMES OR ARE TRAPPED IN EXPENSIVE AND UNSUSTAINABLE LOANS. FAMILIES FORCED FROM THEIR HOMES FACE A LACK OF STABILITY THAT AFFECTS OTHER PORTIONS OF THEIR LIVES, RANGING FROM THEIR KIDS' EDUCATION TO THEIR OWN JOBS. THEY FACE DAMAGED CREDIT, WHICH MAKES IT HARDER FOR THEM TO BUY OTHER PRODUCTS OR EVEN GET JOBS, RESULTING IN A DOWNWARD FINANCIAL SPIRAL. I RECENTLY MET WITH AN OLDER WOMAN ON A FIXED INCOME WHO IS NOW IN DEFAULT ON HER OWN MORTGAGE BECAUSE SHE LENT HER CHILD MONEY AFTER BEING VICTIMIZED BY A PREDATORY LENDER.

IT IS DESTRUCTIVE TO THE COMMUNITIES AND NEIGHBORHOODS INVOLVED, BECAUSE IT RESULTS IN THE DEVALUATION OF SURROUNDING PROPERTY AND LESS STABLE NEIGHBORHOODS.

AND AS WE NOW SEE FROM THE DAILY STORIES IN THE PRESS, IT IS DESTRUCTIVE TO OUR ECONOMY, FINANCIAL INSTITUTIONS, AND INVESTORS.

### **III. STATES NEED THE FEDERAL GOVERNMENT'S HELP.**

CONGRESS CAN HELP.

FIRST, IT CAN PASS LAWS AGAINST PREDATORY MORTGAGE LENDING. AFTER I WAS ELECTED ATTORNEY GENERAL, I PUT TOGETHER A PREDATORY MORTGAGE LENDING STUDY GROUP TO RECOMMEND LEGISLATION, WHICH BECAME LAW AUGUST 1. THE LEGISLATION REQUIRES BROKERS AND LENDERS

TO VERIFY A BORROWER'S ABILITY TO REPAY THE LOAN AND OTHER EXPENSES, NOT JUST AT THE TEASER RATE BUT AT THE FULL RATE, BY RELIABLE DOCUMENTATION, AND IT PLACES A DUTY ON MORTGAGE BROKERS TO ACT IN THE BEST INTERESTS OF THE BORROWER.

WHILE STATES HAVE SHOWN LEADERSHIP IN ADDRESSING THIS CRISIS, THE SUPREME COURT HAS TIED OUR HANDS AS IT RELATES TO NATIONAL BANKS AND THEIR OPERATING SUBSIDIARIES. WE NEED THE FEDERAL GOVERNMENT'S HELP TO CLOSE THIS LOOPHOLE. CONGRESSMAN ELLISON AND CHAIRMAN FRANK, YOU BOTH HAVE BEEN ACTIVE IN THIS AREA, AND I COMMEND YOU FOR IT.

SECOND, CONGRESS CAN CONTINUE TO PUT PRESSURE ON FEDERAL REGULATORS TO RESPONSIBLY ADDRESS THIS CRISIS. ON JUNE 14, I TESTIFIED BEFORE THE FEDERAL RESERVE BOARD OF GOVERNORS TO ENCOURAGE THE BOARD TO USE ITS AUTHORITY UNDER THE HOME OWNERSHIP EQUITY PROTECTION ACT, OR HOEPA, TO REGULATE THESE PRACTICES. CONGRESS SHOULD CONTINUE TO PRESS THE BOARD TO DO SO AS WELL. CONGRESS SHOULD ALSO PRESS FEDERAL REGULATORS TO USE THEIR LEVERAGE OVER ENTITIES THEY REGULATE TO WORK WITH BORROWERS IN DISTRESS TO REACH EFFECTIVE LOAN RESTRUCTURINGS. THE LENDERS THAT HELPED CREATE THIS CRISIS BY DIRECTLY OR INDIRECTLY FINANCING THE SALE OF UNSUITABLE PRODUCTS MUST HELP TO RESPONSIBLY ADDRESS IT.

THANK YOU FOR YOUR TIME.