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Published by the Consumer and Community Affairs Division

November 2009

## Examining Successful Collaborations and Ongoing Barriers to Foreclosure Prevention *A Conference Review and Update*

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*Profitwise News and Views*  
Consumer and Community Affairs Division  
Federal Reserve Bank of Chicago  
230 South LaSalle Street  
Chicago, IL 60604-1413  
or CCA-PUBS@chi.frb.org

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# Examining Successful Collaborations and Ongoing Barriers to Foreclosure Prevention

## *A Conference Review*

by Steven Kuehl

In November 2008, the Federal Reserve Bank of Chicago's Consumer and Community Affairs division convened "Examining Successful Collaborations and Ongoing Barriers to Foreclosure Prevention." The foreclosure crisis has continued to impact the nation, including the Federal Reserve's Seventh District; this conference was one in a series that the Chicago Fed has organized since the foreclosure crisis emerged. The conference brought together experts who addressed the issues and concerns surrounding Wisconsin's increasing number of foreclosures. This article briefly summarizes key information shared at the conference and provides updates on issues of continuing concern.

### **Panel Discussion – The Financial Crisis and Its Implications for Foreclosure Prevention**

Steven Kuehl, of the Federal Reserve Bank of Chicago, described the latest efforts of the Federal Reserve System to develop solutions to rising foreclosures. These efforts included working with other agencies to put in place the standards and procedures for the Hope for Homeowners (H4H) program as well as calling upon lenders, investors, and servicers to redouble loss mitigation activities. For example, the Federal Reserve and the other banking agencies issued supervisory guidance to encourage mortgage lenders and servicers to pursue prudent loan workouts, and embarked on a joint effort with NeighborWorks® America on neighborhood stabilization to help

communities develop strategies to address sharp increases in foreclosures and vacant properties. Kuehl also highlighted the Housing and Economic Recovery Act of 2008 (HERA), which he characterized as the most significant housing bill passed in decades. The legislation included stronger regulations for Fannie Mae and Freddie Mac, tax credits for first-time home buyers, and higher limits on Federal Housing Administration (FHA) loans.

David Balcer, of the U.S. Department of Housing and Urban Development (HUD), outlined both new and long-standing FHA initiatives (FHA programs are administered by HUD). He began by pointing out that there is no one single loan program or initiative for all borrowers; people face a whole range of difficulties, and FHA provides options for a range of circumstances. Balcer stated that the H4H program contains many restrictions and consequently, hadn't gotten off to a quick start (through August 31, 2009, the H4H program originated only one loan).

Balcer commented that the Treasury Department was developing a new initiative to address foreclosures, and subsequently, on March 4, 2009, the Treasury issued uniform guidance for two distinct programs under President Obama's "Making Home Affordable" (MHA) plan. MHA is designed to offer assistance to as many as 7 to 9 million home owners, making their mortgages more affordable and helping to prevent the destructive impact of foreclosures on families, communities, and the national economy.

The plan includes a refinance program and a modification program. The Home Affordable Refinance program will be available to 4 to 5 million home owners who have a solid payment history on an existing mortgage owned by Fannie Mae or Freddie Mac. Normally, these borrowers would be unable to refinance under Fannie or Freddie guidelines because their homes have lost value, pushing their loan-to-value ratios above 80 percent. Under the Home Affordable Refinance program, many will nonetheless be eligible to refinance to lower rates or from an adjustable-rate mortgage into a fixed rate loan. Government sponsored enterprise lenders and servicers generally have thorough (and accurate) borrower information on file, so any new documentation requirements should not be burdensome. In some cases even a new appraisal will not be necessary, further speeding the process. The Home Affordable Refinance program ends in June 2010.

MHA provides \$75 billion for sustainable mortgage modifications through the Home Affordable Modification Program (HAMP). The HAMP will help up to 3 to 4 million at-risk home owners avoid foreclosure by reducing monthly mortgage payments. Working with the banking industry and its regulators, the Treasury announced program guidelines that were designed to become standard industry practice in pursuing affordable and sustainable mortgage modifications. Under HAMP, servicers

began to immediately modify eligible mortgages using a “waterfall” approach to first, capitalize arrears (add accrued interest and eligible expenses to the principal balance) to determine the new loan amount; second, reduce the interest rate (at 12.5 basis point increments subject to a floor of 2 percent) until the debt service-to-income (DTI) ratio is 31 percent. The 31 percent ratio does not take into account debt other than the mortgage debt service, and is referred to as the “front-end ratio;” the “back-end ratio” is the debt service related to all contractual debt obligations (e.g., credit cards, installment loans) divided by monthly gross income. A back-end ratio exceeding 51 percent triggers a credit counseling requirement for the borrower. If the second step does not result in a DTI of 31 percent or less, the term of the loan is extended to 40 years. If the DTI threshold is still not reached, the final step is to create a balloon payment at the end of a specified term. The servicer estimates the probability of default with and without modifying the loan, and calculates the net present value (NPV) of the loan in both cases. If the NPV is higher with a modification, the loan must be modified; even if the modified NPV is lower, the lender can still modify if other conditions warrant the action. Larger servicers/lenders, those with more than \$40 billion in mortgages in portfolio, have some leeway as to estimating the probability of defaults among loans not modified, as well as re-defaults among loans they do modify.

On August 4, 2009, the Treasury released its first monthly Servicer Performance Report detailing the progress to date of the MHA loan modification program. The purpose of the report was to document the number of struggling home owners already helped under the program, provide information on servicer performance and expand transparency around the initiative. According to the Treasury, MHA has made rapid progress in a few short months. Servicers covering more than 85 percent of loans in the country

are already modifying loans under the program. More than 400,000 modification offers have been extended, and more than 230,000 trial modifications have begun. This pace of modifications puts the program on track to offer assistance to up to 3 to 4 million home owners over the next three years, which was the goal announced by Treasury on February 18, 2009.

**“On August 4, 2009, the Treasury released its first monthly Servicer Performance Report detailing the progress to date of the MHA loan modification program. The purpose of the report was to document the number of struggling home owners already helped under the program, provide information on servicer performance and expand transparency around the initiative.”**

The report also disclosed performance on a servicer-by-servicer basis in order to increase transparency for participating institutions. The data show that servicer performance has been uneven. The Administration has asked servicers to ramp up implementation to a cumulative 500,000 trial modifications started by November 1, 2009. This would more than double in three months the number of trial modifications started in the first five months of the program.

The administration is taking additional steps to improve performance. On July 9, 2009, Treasury Secretary Tim Geithner and HUD Secretary Shaun Donovan wrote the CEOs of

participating servicers calling upon them to redouble their efforts to increase staffing, improve borrower response times, and streamline the application process. Senior administration officials discussed the importance of these steps in a face-to-face meeting with servicer executives on July 28, 2009. The Administration will develop more exacting metrics to measure the quality of borrower experience, such as average borrower wait time for inbound inquiries, completeness and accuracy of information provided applicants, and response time for completed applications. As an additional protection for borrowers, the administration has asked the program compliance agent, Freddie Mac, to develop a “second look” process to audit MHA modification applications that have been declined.

Geoffrey Cooper, of the Wisconsin Housing and Economic Development Authority (WHEDA), opened by commenting on how conference participants had spent their respective careers working to *create* home ownership; but now, the focus was on how to *preserve* home ownership. He reminded participants that just a few years ago, the major channel for mortgage creation, involving approximately 75 percent of all loans, utilized a thinly capitalized mortgage broker who had no equity stake in the outcome, and who sold the packaged loans with no recourse and with no consequences for failure. Today that channel is under severe pressure, going through major changes, and may even become extinct. Unfortunately, those changes are coming far too late to save millions of home owners, including thousands in Wisconsin.

Cooper described the impact of the financial crisis on WHEDA and how, despite the crisis, it is moving forward with its quest to rekindle home ownership in Wisconsin. WHEDA is a state housing finance agency (HFA), and as such, is granted the authority to issue tax-exempt mortgage revenue

bonds (MRBs). The MRBs enable WHEDA to raise low-cost money that it can re-lend to low- and moderate-income consumers to purchase their first home.

The newly enacted HERA legislation provided state HFAs, such as WHEDA, with several new resources and authorities relating to single-family home ownership. Under HERA, WHEDA's bonding authority temporarily doubled. It was given the ability to issue non-AMT bonds, meaning that income derived from WHEDA bonds is not subject to the alternative minimum tax (calculation). The IRS Tax Code was changed to allow WHEDA to temporarily use its bond proceeds to make refinance loans for the sole purpose of getting people out of subprime ARMs and into affordable fixed-rate mortgages. HERA also enabled WHEDA to temporarily waive the first-time home buyer requirement in 31 of Wisconsin's 72 counties, and to temporarily increase income and purchase price limits, so that more people could qualify for WHEDA financing. WHEDA estimated that more than 1 million Wisconsin households would have access to WHEDA loans on the basis of higher income purchase price limits and the waiving of first-time home buyers' requirements in those 31 counties. So HERA gave WHEDA a short window of time in order to use its new authorities to stimulate home buying. Cooper stated that the new changes could provide a huge boom to the housing financing industry going forward because, by not subjecting MRB income to the alternative minimum tax, the industry's cost of funds are projected to drop dramatically, possibly by as much as half to three-quarters of a percent (50 to 75 basis points). A lower cost of funds means lower interest rate for borrowers, which increases affordability.

Despite being excited about WHEDA's new found authorities and tax advantaged investment opportunities for investors, WHEDA is unable to sell

single-family bonds and raise money to keep lending. WHEDA is not alone. Virtually all of the other state HFAs nationwide have also ceased lending or have effectively choked off lending by raising lending rates to 7.5 or 8 percent. The big problem is the frozen credit market, with institutional investors fleeing to cash or risk-free U.S. government securities. Without the access to investors willing to purchase MRBs, WHEDA can't lend, or as some of its peers are doing, they have to ration the small pool of low-cost money that they have left.

Cooper declined to speculate as to when WHEDA will once again be able to access normally functioning credit markets, as no one really knows. In the interim, WHEDA is focusing on utilizing its limited resources to continue to fulfill its core mission to help Wisconsin consumers become or remain home owners. For example, WHEDA is still offering its Property Tax Deferral Loan Program that helps senior citizens on low, fixed incomes cover their property taxes. Also, in May 2009, WHEDA introduced a niche loan product to help eligible home buyers purchase foreclosed homes in seven targeted Wisconsin counties. The home buyer must meet the program's income limits, occupy the property as a primary residence after purchase, complete all repairs within 90 days after closing, and meet other property eligibility requirements. Despite the frozen credit market, WHEDA leveraged \$6.2 million from federal Neighborhood Stabilization Program (NSP) funds, which secured the Neighborhood Housing Services of America as an investor in the loans. The NSP funds were allocated by the Wisconsin Department of Commerce (flowing from the federal government through the recently enacted HERA of 2008).

### **Perspective from University of Wisconsin-Extension**

In addressing the conference,

Richard Klemme, interim dean and director of Cooperative Extension, University of Wisconsin-Extension (Extension), stated that the mission of the Extension is to extend the knowledge and resources of the University of Wisconsin to the people – where they live and work in the state. Klemme stated that collaboration is a niche that is very important to the Extension, and it views itself as the University closest to the people. Through its county educator, community development, family living, agriculture, and 4-H youth development agents located throughout the state, it serves those needs. And because the Extension derives part of its funding from Wisconsin's counties, it remains highly accountable to the people. Klemme pointed out that the key to the Extension is its local presence within every county and access to the resources in the University system. For example, both foreclosure education and more broadly, family financial management education, are basic programs in the Extension's family living program area. Although the Extension does not develop public policy, Klemme identified it as playing a crucial role in tapping into research and helping to provide data that informs both the public and Wisconsin's policymakers.

### **Hot Spots: A Zip Code Analysis of the Evolution of Foreclosures in the State of Wisconsin**

There has been much confusion in the mainstream media regarding the number of foreclosures and what the data sources are actually reporting, stated Russell Kashian, University of Wisconsin-Whitewater, but the number of filings is not a reliable data source to indicate the number of properties actually facing foreclosure. Kashian explained that when foreclosure filings are reported, those numbers include many "repeats," as often times there are multiple filings for the same property as well as numerous lenders

filing for the same property. For example, there may be default notices, auction sale notices and bank repossessions, as well as a first, second, and third mortgage – all for the same property. The data that Kashian analyzes, and which was reported at the conference, is gleaned from the Wisconsin Circuit Court database and has been cleaned up to remove multiple cases involving the same property and therefore simply reveals only the true number of properties facing foreclosure. The data indicate that the number of properties facing foreclosure in Wisconsin increased 26 percent between 2006 and 2007. Recently, the pace seems to have moderated slightly as Kashian estimated that foreclosures were up approximately 21 percent between 2007 and 2008. Hot spots – dense clusters of foreclosures have occurred in just a few counties located in southeast, northwest, and central Wisconsin. Further, the causes of the high numbers of foreclosure in these hot spots are not always the same from region to region within the state. For example, the closing of auto industry-related manufacturing has severely impacted Rock County, as has the closing of paper mills in central Wisconsin. Northwest Wisconsin has been adversely impacted by rising unemployment and underemployment in the twin cities through foreclosures on people with long commutes as well as vacation properties. However, higher unemployment means higher foreclosures.

## **Panel Discussion – Local Strategies to Address Foreclosures**

The housing market peaked, based upon the pace of sales, in late 2005 to early 2006. There was much speculation in some markets, according to David Clark, Marquette University. Television shows like *“Flip This House,”* became very popular and these speculative buyers couldn’t afford to hold onto their house once the market started to significantly

decline. That, in turn, contributed to further decline in prices. As home prices decline, it is more difficult to sell or refinance, and thereby get out from under an unaffordable mortgage (payment). There was a perfect storm of

**Communities of color have been destabilized in the past by disinvestment and improvident mortgage lending; the current wave of foreclosures is destroying years of work to stabilize and rebuild these communities.**

decreasing housing prices, tightening credit standards, and at least in some areas, significant job losses, Clark summarized.

The trends in housing prices ultimately derive from the basics of supply and demand. On the demand side, different components change at varying speeds. For example, slowly changing components are elements such as household formation and population growth. In the intermediate run, components such as economic conditions are changing a little more rapidly. In the short run, components such as mortgage rates and credit availability change very quickly. According to Clark, the long-run trends are favorable to increasing housing prices because there has been solid household growth and solid population growth over the last decade, and that will continue.

Geoff Smith of the Woodstock Institute discussed the effects of the foreclosure crisis in Chicago. He asserted that because there are many similarities between Chicago and Milwaukee, the Chicago experience could inform the mostly Wisconsin-based audience. He found similarities between the two cities in segregated

residential patterns and could plainly discern geographic foreclosure concentrations based on the racial composition of a community. Primarily Black communities have been much more heavily impacted than White communities. He also noted similarities in the types of housing stock found in both cities, among both single-family and multi-family buildings.

Although the rate of foreclosures in Chicago increased dramatically between 2005 and 2008, Smith stated that the share of foreclosed properties in the Chicago region was disproportionately greater in communities of color than in predominately White communities. In 2007, foreclosed properties entering real estate owned (REO) status in communities that are greater than 80 percent Black accounted for 35 percent of the Chicago region’s total REO properties, even though predominantly Black communities account for less than 9 percent of the region’s total mortgageable properties. He explained that this means Black communities’ proportion of Chicago regional REO properties is roughly four times their proportion of regional mortgageable properties. He also noted that these disparate patterns are also seen to a lesser degree in census tracts that are 50 percent or greater Latino and census tracts that are 50 percent or greater diverse minority. Conversely, in census tracts that are below 10 percent minority, the Chicago regional percentage of properties becoming REO is just 6.6 percent, despite the fact that these areas contain over 23 percent of the region’s mortgageable properties. Smith concluded that the concentration of REO properties in Chicago metro area minority neighborhoods and the similarities between the cities on several levels, likely signals the problem will be significant for both cities. Communities of color have been destabilized in the past by disinvestment and improvident mortgage lending; the current wave of foreclosures is destroying years of work to stabilize and rebuild these communities.

Maria Prioletta, of Milwaukee's Department of City Planning, concurred with Geoff Smith's comments when she stated that foreclosures are largely the consequence of subprime and predatory lending in Milwaukee. She also agreed that predominantly Black neighborhoods were disproportionately affected, citing that over two-thirds of all loans made to Blacks were high interest or subprime, compared to only one-third for Whites. Further, over half were refinance loans. Essentially, these were not borrowers with a typical profile of getting in over their heads; many were long-time home owners in the neighborhood who were refinanced into a subprime or predatory lending product. Prioletta described it as a "double whammy," because not only did Milwaukee suffer a foreclosed property, but the city lost a long-time home owner who has been a stabilizing influence in the neighborhood. Further, she added that over 95 percent of all the foreclosed properties are one- and two-family properties. The crisis has greatly affected Milwaukee's residential neighborhoods.

The conference speakers included other experienced practitioners who have demonstrated and implemented successful foreclosure prevention measures. One such individual is Matt Lasko, of the Detroit Shoreway Community Development Organization (DSCDO). Detroit Shoreway is a neighborhood located within the City of Cleveland – a city hit hard by foreclosures. Lasko discussed the key elements of DSCDO's strategy in the Detroit Shoreway neighborhood.

DSCDO utilized a Model Blocks Program, which leverages a large-scale project, such as a hospital, new school, or even a housing development to create the critical mass needed to bring about further investment and improvements in a relatively small area, rather than spread (and thereby marginalize the effect of) scarce resources over too broad an area. In the Detroit Shoreway neighborhood, DSCDO's anchor is Battery Park, a 328-unit housing development

## Keynote Address

The keynote address was provided by Tara Twomey, Of Counsel to the National Consumer Law Center and Lecturer at Stanford Law School. Following is a summary of her remarks.

The subprime mortgage crisis began with brokers and lenders portraying subprime loans as a stepping stone to a prime loan; but the reality is that most borrowers in subprime loans were refinancing to another subprime loan, and each time, they lost equity as funds were taken out to cover the costs of each new loan. The expansion of the subprime lending market was heralded as an "open-up-the-door to home ownership" opportunity for families who might have been excluded from the markets otherwise. Many families were encouraged to believe that home ownership achieved through these kinds of products was appropriate and sustainable.

But the reality is that the majority of subprime loans were not purchase money loans, but refinances. In 1998, nearly two-thirds of subprime loans were refinances. In 2006, the ratio was still more than 56 percent. First-time home owners with a subprime loan accounted for only 11 percent of mortgagors in 2006.

More than half of the subprime loans have adjustable rates and nearly three-quarters have prepayment penalties. In 2006, alternative mortgage products such as interest-only loans and payment option ARMs made up more than half of the subprime originations. We also know that immigrant and minority communities received a disproportionate share of those subprime loans. Further, we are aware that almost 20 percent of subprime qualified for primes – and they still ended up with subprime pricing and terms. Unfortunately, the promise of the American dream for many home owners has become a nightmare.

Home owners aren't the only ones feeling the loss. Renters have been hurt, even those who pay their rent on time, as landlords have defaulted on building mortgages anyway. We have had more and more Americans being driven into bankruptcy for the first time since the 2005 Amendments to the Bankruptcy Act.

Times of crises are also a rich opportunity for change and several key issues and reforms could be enacted to help address the current problems. First, there is a need for fundamental bankruptcy reform. The goal of Chapter 13 has always been to provide an opportunity for consumers to save their homes and to repay their obligations (under modified terms). Unfortunately, that has become exceedingly difficult in recent years because our bankruptcy laws have not kept pace with the mortgage industry. Generally, bankruptcy allows debtors to modify the rights of both secured and unsecured creditors. However, there is an exception to this rule and that exception is for claims secured only by an interest in real property that is the debtor's principal residence. In other words, a debtor can modify a loan on their boat, car, or vacation home, but they cannot modify a loan on their principal residence. Twomey questioned whether or not it is good public policy to provide less protection to a family's residence in bankruptcy than their car, boat, or vacation home.

Second, Twomey noted that the consumer credit market place is governed by disclosure rules, like Truth in Lending. However, it is clear that disclosure rules weren't sufficient to curb abuses in the marketplace.

New ideas are needed regarding how to regulate credit going forward. The Annual Percentage Rate (APR), which is part of the Truth in Lending Act (TILA), was intended to promote informed consumer shopping and level the playing field for lenders by requiring standard disclosures. But in reality, there are exceptions to the finance charge definition that can undermine the purpose of the TILA.

Finally, Twomey stated, "we made home ownership a high policy priority in the last decade and it is time to revisit whether traditional home ownership should remain a priority." There are different types of home ownership opportunities, and some are often more affordable than the traditional model of home ownership, for example, through a community land trust. Although these alternative models may not come with all of the benefits of traditional home ownership, they do provide some of the most important aspects.

exterior home improvements, counseling requirements of the home owner, including foreclosure intervention, or ascertaining whether a building is beyond repair (and should be demolished).

Lasko has found that one of the biggest factors contributing to foreclosures and neighborhood decline is that owners tend to abandon their homes when the property value falls below the mortgage principal balance. With the goal of retaining home owners, DSCDO provides owners with \$500 grants to spruce up their property with basic landscaping or other minor aesthetic improvements. The cost is low, and in many cases owners are less inclined to walk away. In this case, DSCDO paid a local landscape architect to visit each house and make design recommendations.

## **Panel Discussion – National Foreclosure Initiatives: Successes, Challenges, and Barriers**

The Homeownership Preservation Foundation (HPF) is a nonprofit organization that manages and operates a toll-free hotline devoted to foreclosure prevention and counseling, stated Josh Fuhrman, of Homeownership Preservation Foundation. It is available both in Spanish and English, 24 hours a day, seven days a week, year-round. The hotline is designed to provide on-demand counseling to distressed home owners in order to determine what options they have and facilitate communication with their lenders. Fuhrman described three major challenges facing the HPF and how those barriers were successfully overcome. The first challenge was getting people to reach out to HPF. HPF formed a partnership with NeighborWorks® America and the National Ad Council to develop a series of public service address announcements geared to distressed home owners. The media campaign has been very successful and the HPF is now reaching those hard-to-reach home owners. The

second challenge was bridging the historically adverse relationship between distressed home owners and servicers. Here, HPF partnered with HOPE NOW and servicers to develop strong communication lines. The third and final challenge was funding; HPF accessed federal dollars flowing through NeighborWorks® America, and secured partnerships and contracts with servicers to provide funding for HPF's efforts.

John Santner of NeighborWorks® America described the National Foreclosure Mitigation Counseling (NFMC) Program as an effort by congress to provide additional counseling and supportive counseling to address the subprime foreclosure crisis. Congress designed NeighborWorks® to serve as administrator for the program and appropriated \$180 million targeted to go directly to grants to agencies providing counseling to consumers, as well as funding for home buyer education. On June 15, 2009, NeighborWorks® America released a report showing that, through May 31, 2009, more than 405,000 home owners have received foreclosure prevention counseling as a result of NFMC funding, providing families much needed information, assistance, and guidance. The report found that more than 90 percent of home owners receiving counseling were still in their homes as of February 2009, although 18 percent of those families had a foreclosure process started. Approximately 53 percent of households who received counseling through the NFMC program were minority, and 67 percent of the families helped had household incomes at or below 80 percent of the median income in their area. The data are based on reports from more than 1,700 agencies that receive funding through NFMC. The NFMC program appears to be reaching home owners hardest hit by this housing crisis and are better informed about their options to avoid home foreclosure.

## **Conclusion**

When examining successful collaborations and ongoing barriers to foreclosure prevention, conference participants realized that there are a multitude of causes for the crisis and concurrent diverse impacts on consumers and throughout communities, the housing market, and to the broader economy, and the financial system as well. Development of solutions to address the underlying causes of the crisis requires a nuanced response, often tailored to address specific problems, and ideally administered by those closest to the problem. In working to formulate and apply solutions, many difficulties and setbacks have occurred. Not all foreclosures are preventable, and limited resources are best targeted to those situations where mortgages can be modified in order to reestablish sustainable homeownership. The massive response of the federal government has evolved since the crisis began, and the Obama Administration's Home Affordable Modification Program is beginning to make headway toward its numeric goals. The Chicago Fed's Consumer and Community Affairs division will continue its active engagement with the foreclosure crisis to promote a better understanding of the topic and to inform the policy process to address it.



## **Biography**

Steven W. Kuehl is the consumer regulations director for the Consumer and Community Affairs division of the Federal Reserve Bank of Chicago. Mr. Kuehl conducts seminars and workshops, and prepares articles and other written materials dealing with consumer compliance banking regulations. Since joining the Reserve Bank in 1995, Mr. Kuehl has been a commissioned senior examiner on consumer compliance and CRA examinations, as well as manager for Consumer Complaints, HMDA Processing, and the Advisory Service Program. Mr. Kuehl holds a B.S. in finance and economics from Carroll University and a Juris Doctor from Chicago-Kent College of Law, and is admitted to practice in Illinois and the United States District Court for the Northern District of Illinois.





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Federal Reserve Bank of Chicago  
230 S. LaSalle Street  
Chicago, IL 60604-1413

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