Section 1
Why People are Losing Their Homes

Today, home foreclosures are at epidemic proportions. In a year or so the epidemic will subside, but thousands of shattered families will be left in the wake of the economic turmoil.

In just a few years you may find yourself sitting in front of a young credit manager, just out of college and still wet behind the ears, and he will have had no concept of today's economic mayhem. He'll look you in the eye and say, "Jeez, you've had a foreclosure. We can't give you the loan you want." In the back of his mind he'll be thinking, "This person is a loser."

The reality is, you are not a loser. You are the victim of failed American capitalism. People like you who are facing foreclosure were just trying to share in the Great American Dream of home ownership, a dream planted by parents and grandparents and nourished by unrelenting advertising that constantly told you that you were not a complete person unless you had the right home, carpet and appliances.

In this section, we will go into depth about the forces which led to so many foreclosures and bankruptcies at the end of the first decade of the 21st century. You will discover that the events that led to your foreclosure were already out of your control by the time you signed your loan documents.

Chapter 1

Home Ownership: The American Dream

"Commitment means that it is possible for a man to yield the nerve centre of his consent to a purpose or cause, a movement or an ideal, which may be more important to him than whether he lives or dies."
Dr. Howard Thurman

The dream we all have of having our own home is a simple and pleasant one. We all have idyllic thoughts of children playing in the yard, dad working in the garage, mom nurturing her garden, and the entire the family gathered around the dinner table for meals and celebrations. Most of us think of our homes as warm, safe, comfortable, pleasant places where we can manufacture memories that will bind our families together forever.

The dream of *owning* our homes is something different. After all, people can have all the comforts of home and hearth without owning the building. Historically, individuals did not own their own dwelling. At the dawn of history people made do living in caves, and tents were the domiciles of nomadic groups. Later, huts were a part of communal villages, and as society evolved, houses were chattels of a King. In modern times apartment complexes and houses were owned by investors who rented to families. Today, most of the people in the world rent the place where they live.

Foreclosure: Fight ot Flight?

In America, people began to see home ownership as an important expression of their individualism. Status was accorded to the privacy a family had by owning their own free-standing dwelling. People wanted to be free to decorate interiors if they wanted, to add rooms as the children grew, and most importantly to be free from sudden rent increases or demands that they vacate the premises on short notice. Leases for houses or apartments, which guaranteed a longer term residency at a fixed price, became popular at a later stage of economic evolution in the U.S.

Home ownership had another facet that was important in the American experience. That is, people could build equity over time in homes they owned. A rent payment was money lost; the landlord reaped all the benefits of an ever-decreasing mortgage and the ever-increasing value of the property. Average Americans soon decided that they wanted a bite of that particular piece of the American Pie. The difference between the amount of money people owed on their home, and its market value, was equity that enterprising people could use to start new businesses, expand existing businesses, educate children, or fund trips around the country or the world. Home ownership gave rise to the great American Middle Class.

There was always a problem with acquiring a house, and that was the fact that a house always cost more to build or buy than the average person earned over several years. If your rich uncle died and left you an inheritance you could buy a house outright, otherwise you were forced to save for many years. The only other alternative was to find someone to lend you the money, which was secured by the building itself, and paid back over an agreed term. The financial instrument which formalized this transaction was known as a mortgage.

Prior to 1929, getting a mortgage was a very personal thing. First and foremost, you needed to have a good relationship with a local banker. Terms were tough; buyers usually needed to make a down payment of 40 per cent, and, depending on the lender, had between 3 and 15 years to repay the loan. Generally, the loans were interest only, with a giant balloon payment at the end of the term. Perhaps the most onerous aspect of these loans was that the interest rate needed to be renegotiated every 3-12 months. Nevertheless, these terms met the needs of many Americans in those days; home ownership rates remained at about 50 per cent until the Great Depression changed everything.

President Herbert Hoover made a major economic error after the Stock Market crash of 1929. He thought inflation was the biggest threat to the economy, not stagnation, and he allowed the Federal Reserve Bank to raise interest rates. This had unintended consequences for the fledging home mortgage industry. Since most homeowners were required to renegotiate their interest rate every 3-12 months, it meant that people were quickly priced out of their homes. By 1932 near 10 per cent of all the homes in the U.S. were in foreclosure. High interest rates and high unemployment left 2.4 million families homeless, 10 per cent of the population back then.

When Franklin Roosevelt took office, he acted quickly to change things. He backed legislation that created the Federal Deposit Insurance Corporation (FDIC) so that people would have faith in banks again, and later created the Federal Housing Administration (FHA). Both of these organizations were government-backed insurance companies. The FDIC insured deposits in banks so that even if a bank failed the depositor would get his or her money back. The FHA guaranteed bank loans for home purchases. Since the government was backing the loans, the banks were willing to make home loans for longer terms at lower rates.

The Roosevelt administration was also responsible for creating another important organization, the Federal National Mortgage Association, which today goes by the name of Fannie Mae. It was joined by a “brother” organization in 1970 called Freddie Mac. The role of both these government backed companies is to gather money from investors and make the money available for home loans. Investors have loved Fannie Mae and Freddie Mac because they provided an excellent return, and their solvency was backed by the full faith and credit of the U.S. government.

Since the Great Depression of the 1930's, the government has had a special interest in promoting home ownership. There are many reasons, including the legacy of the period from 1890 to 1930 when American values about marriage, family and home began to solidify in ways not previously experienced in the country. That led to a more wholesome, stable way of life that did not begin to disintegrate until the mid-1960's.

Family stability was not the only reason the government was so interested in bolstering the housing market; it was also a matter of economics. The availability of mortgage funding fueled a massive economic engine that created jobs for millions—from the cutting down of trees for lumber, to the construction of the homes, to the manufacturing of the furniture and appliances that went inside. Demand for homes was high. There were plenty of jobs and people could afford to buy them.

After World War 2, the frenzy of building activity increased. It was fueled by war weary soldiers who wanted to return home, reunite with their sweethearts, get married, get a good job, buy a house and car, and live the good life. That generation had enough of economic depression and war, and they wanted to contribute to a prosperous new America.

The government was happy to make the dreams if GI's come true; starting in 1944 the Veteran's Administration granted home loans to anyone who had served their country in uniform. That commitment to provide a mortgage with a low down payment and low interest to veterans was renewed by the government in 1952, 1966, 1972, 1976 and 1985. Millions were able to buy a home and have a level of financial security that was unique in human history.

The years between 1945 and 1980 were generally stable in the home mortgage market. There were peaks and valleys in the availability of money and the interest rate level, but families were generally able to purchase affordable homes. In 1980, however, the American economy hit the wall. The economic policies of President Jimmy Carter were unwise, and they led to a plethora of problems, including mortgage interest rates that soared to nearly 20 per cent. Home building came to a halt and that rippled throughout the entire economy. The collapse of the American economy was so bad that the *Wall Street Journal* said times had not been worst since the Great Depression. Now, nearly 30 years later, Americans are experiencing a deep recession that is probably worse than the one created by Carter policies, and families are taking a real beating. Foreclosures are at historic highs.

There is another important reason why Americans were interested in owning their own home. They discovered they were investments. People soon learned they could get ahead financially, either slowly though paying off their loans and gaining equity, or by gaining equity through rapid appreciation (or a combination of the two), and could gain a far greater income than a paycheck could ever provide.

For a long period of history, from at least the 1880's though the 1960's, many homeowners looked forward to the day when they could "burn the mortgage." When a mortgage was paid off, and the house was free and clear, people held a ceremony, usually with family and friends present, and burned the document to signify their freedom from debt and to celebrate the new security they felt by truly owning their own home.

Starting in the 1960's, things began to change in many places around the country, notably in California. The ever-increasing immigration to that state from other states and from around the world meant that there was a classic supply and demand situation that has persisted for the past 60 years. There were always more houses needed than were available, and that sparked an on-going building boom, and the willingness of people to pay more to get the homes that were available. Ever-increasing home prices have only retreated a few times over the decades, and when they did retreat it was only for 12-18 months, then the cycle of appreciation repeated itself. While California home prices have declined by 17.5 per cent in the last several years, they actually grew by 131.6 per cent since 1990.

What did this mean to the average home-owner? It meant that they lost sight of the amenity value of their home, and saw it only in terms of it being a cash cow. The ideal of burning the mortgage was lost. For example, Greg Geisen parlayed a $400,000 home in San Diego's South Bay in 2006, near the peak of the boom, into a new $1 million home purchase. He told a *San Diego Union* reporter that he wasn't worried about the financial leap he was making. "It's not real money," he said. "It's transferring equity from one home to another."

Many people lost sight of the idea that a home was a place to raise a family or find comfort in a busy world. The family home became an Automatic Teller Machine where they could get immediate cash for the increase in equity that market forces (supply and demand) had created. It was easy money dispensed by a banking industry eager to charge borrowers high interest rates. But even astronomical interest rates did not bother many home-owners. They thought that home appreciation would never end and that they could forever wash away the sins of their over-spending by new waves of redeeming easy money loans.

Today we are in the midst of a major decline in the housing market. People have been unable to pay higher mortgage payments and have abandoned their homes. This triggered problems with banks and other financial institutions since they were holding so many bad loans. The credit crisis quickly spread to the manufacturing industry and retail sales, and unemployment soared. Rising unemployment led to even more foreclosures.

Despite the current bad times, things will turn around. You need tenacity to hang on to your home, and barring that, to minimize the financial damage so you are prepared to purchase another home in the better times to come. Homeownership is an enduring part of the American spirit, and families will find ways to own their own homes regardless of the obstacles.