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15 Minutes

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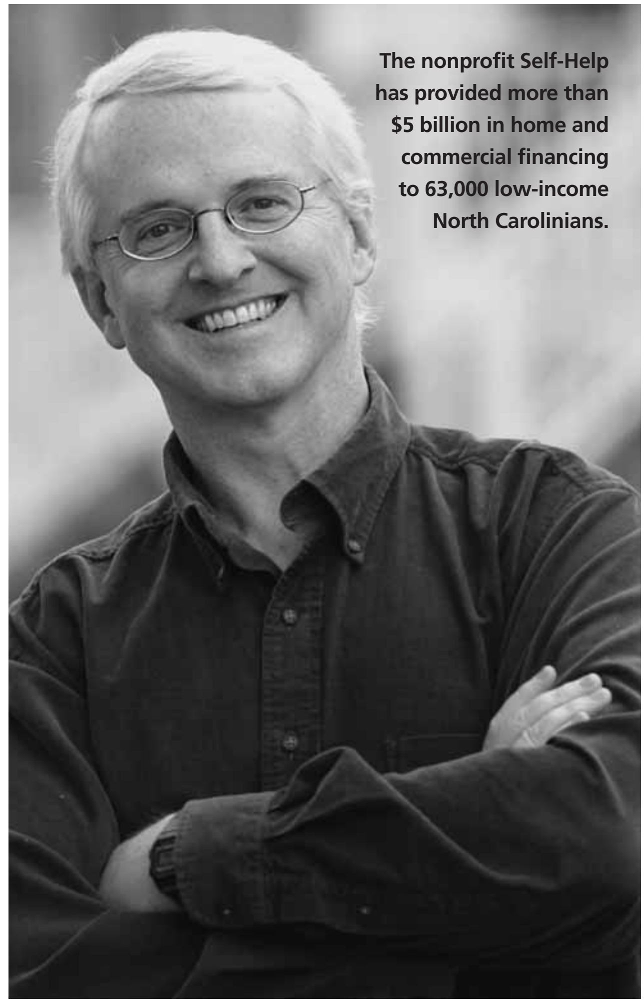


The nonprofit Self-Help has provided more than $5 billion in home and commercial financing to 63,000 low-income North Carolinians.

PHOTOGRAPH BY COREY LOWENSTEIN/*THE NEWS & OBSERVER*

When Martin Eakes was a teenager growing up in a poor, rural community outside of Greensboro, N.C., his best friend, who was an African American, was shot and killed in a playground near Eakes' home. On that day, Eakes vowed to live his life for the two of them. Eakes went on to graduate from Yale Law School, but instead of taking a lucrative position at a high-powered New York law firm, he returned to North Carolina to devote his energy and talents to improving the lives of the poor.

In 1980, Eakes started Self-Help as a way to help the poor help themselves. His first loan was for $1,700, to help seven laid-off textile workers start a community bakery. From those modest beginnings, Self-Help has grown into a financial powerhouse. At its core is a credit union that takes in deposits and lends out money to low-income people who want to buy homes or start businesses, and to nonprofit organizations. Self-Help also repurchases home loans made by large banks to low-income buyers. The 501(c)(3) community development financial institution now has more than $1 billion in assets.

Self-Help isn't the only organization lending to low-income home buyers. In the last decade a host of lenders went after these borrowers, some offering loans with reasonable conditions and others offering predatory loans with onerous terms, now dubbed subprime loans. To combat these predatory lending practices Eakes helped launch the Center for Responsible Lending (CRL), a research and policymaking organization that operates at the state and national level. Eakes and other staffers at CRL have testified before Congress on numerous occasions. Unfortunately, Congress didn't listen to CRL's earlier warnings about the problems that predatory lending creates. The danger now is that lenders will become so conservative that they will stop all home lending to lower-income families.

ERIC NEE: How big a problem are predatory home loans?

MARTIN EAKES: At the beginning of 2007 there were 7.5 million subprime mortgage loans outstanding. We estimate that over the next two to three years between 2 million and 3 million of those families will lose their homes. Subprime loans accounted for 60 percent of all foreclosures, which is astronomical because only 10 to 13 percent of the outstanding mortgage loans in the country were subprime. When you've got 10 to 13 percent of the loans creating 60 percent of the total foreclosures, it means that the foreclosure rate on subprime loans was 10 to 12 times the rate on prime mortgages.

The dominant subprime loan was called a 228, where the mortgage loan had a fixed payment for the first two years. Starting in the 25th month it would become an adjustable rate loan, often jumping by 30 percent.

During the last three to four years, the dominant home loan offered to African-American and Latino families was an unsustainable product, and in many cases was known by the lender to be unaffordable at the time the loan was made. It's really disgusting.

Most of these loans also had a high prepayment penalty for anyone who wanted to get out of the loan. Most of the problems to date were a result of these subprime loans.

There is what I call the Willy Hortonization of the foreclosure victims—the portrayal by some that every person who's being foreclosed on was a bad actor, that they were speculators or fraudsters. It's true that up to 10 percent of the subprime loans were made to investors, but the vast majority, 80 to 90 percent of all of the borrowers who got subprime loans, were ordinary people trying to own a modest home, not a fancy house. Remember, the subprime loan product started with an 8.5 percent interest rate when regular mortgages were 6 percent. It's not like the subprime enabled people to buy a house larger than their income. It was an expensive mortgage from the beginning, and then after two years it went up.

What impact are these foreclosures having on people?

When Hurricane Katrina hit, 133,000 families lost their homes and dispersed. When the subprime crisis is finished, about 3 million families will be displaced and lose their homes. This tsunami is almost 30 times larger than Katrina, but it is invisible because it happens one house at a time in neighborhoods across the country. It's a silent and invisible storm, but the magnitude is utterly catastrophic. And for African-American and Latino families, the impact is dramatic.

In 2005, 52 percent of all mortgage loans made to African Americans were subprime. In 2006 it was much the same, and I would project it will be similar when 2007 data come out. Among Latinos, subprime loans accounted for 40 percent of all home loans. In reality these numbers are about 10 percentage points higher because the way that they are being calculated is too conservative. During the last three to four years, the dominant home loan offered to African-American and Latino families was an unsustainable product, and in many cases was known by the lender to be unaffordable at the time the loan was made. It's really disgusting.

What impact will this have on those communities?

In 2000 the median African-American and Latino family wealth was approximately $7,500. The median family wealth for white households was about $78,000, or 10 times the amount. Part of the reason for that is homeownership patterns. For most lower-income families, the only path into the middle class is to own your own home. It is the best forced savings vehicle that you can have. It is also leveraged—you can purchase a house with a $3,000 down payment and borrow $97,000. If your house goes up $3,000 in value each year, you are getting a 100 percent return on your initial cash investment. So for most families of modest means, purchasing and owning a home is the only leverage strategy that they can use for building wealth, and it has been until now the most dramatic single strategy for a family to enter the middle class. The jump in home foreclosures has eroded and flooded the very foundation that made neighborhoods a safe and viable financial economic opportunity strategy for communities and families of color.

What happens to people who lose their homes?

I don't know that anyone knows right now. A number end up literally homeless. A larger number go to live with friends and family. And I would guess that a larger percentage end up in much more modest rental housing—which is OK—because obviously in some cases the families who got into these stretch loans had more house and more loan than they could afford. But with subprime loans, it wasn't a matter of the house being too big, it was that the product being offered in the marketplace was reckless and dangerous. It was a product doomed to create exactly what we see.

Because of foreclosures, homeownership rates for African-American and Latino families will fall by at least 4 or 5 percentage points and probably more, from a high of 49 percent to as low as 40 to 41 percent, which is utterly devastating. That means that close to 20 percent of all African-American homeowners will lose their homes, which is not too surprising if you remember that 50 to 60 percent of all mortgages by African Americans in the last three years have been subprime loans.

Regardless of whether you're interested in early childhood education or neighborhood health, you have to be concerned about the problem of rampant foreclosures—because it acts as a California wildfire and burns everything in its path. You can't have a stable school if 20 percent of the households that had children attending those schools are kicked out on the street. You can't have a functioning neighborhood health clinic if houses on each side of it have become crack houses because they're boarded up and vacated.

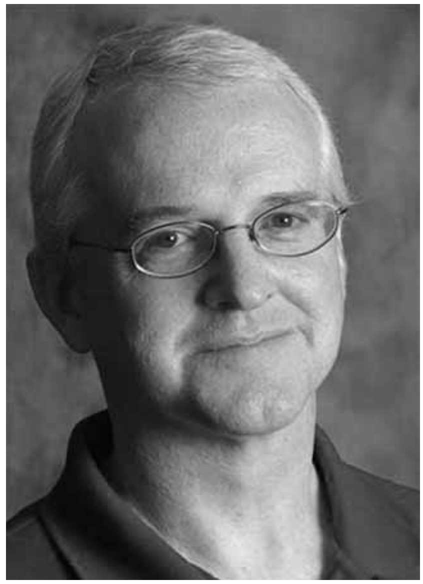
Self-Help also lends to people of modest means and poor credit, those who might be called subprime borrowers. What's the differ-

ence between what you do and what predatory lenders do?

We make home loans directly to families who are generally purchasing their first house. A large majority of those families would be considered subprime because their credit scores are very low and their credit reports have had difficulties. During the early years my banker friends told me: "Martin, you are going to lose your shirt. There's no way you can make home loans to single African-American mothers that no bank would lend to." My response to those well-wishers was that I know that you're wrong. I grew up in a neighborhood playing basketball with young African-American kids. I ate dinner with the mothers of my friends and I know that they will pay these loans back if they just have the opportunity to own a home. And I was proven right. During Self-Help's first 11 years, we made 1,000 home loans to poor people to buy their homes and we didn't lose a single penny.

Does that mean that no one defaulted or that when they did default you recovered the outstanding balance of the loan?

We had a very small number of foreclosures, but we didn't lose any money. Let me not be Pollyannaish here. I tell borrowers when we make a loan to them: "Don't let our name fool you. Self-Help does not mean we're going to be a pushover. If you don't pay your loan back, we will foreclose on you at least as fast as any bank would." I also tell them: "This is not a government program. We demand that you succeed. My half of the job is to get you the credit and the money to buy the home. Your half of the job is to pay us back. If you don't pay us back, that means there's another family that I



PHOTOGRAPH COURTESY OF SELF-HELP

can't help." You can call that tough love, or you can call it clear expectations. But we're very clear that this is a lending organization and that any person who does not pay us back prevents us from being able to help the next family who deserves help. It's been 23 years that we've been making direct home loans and the level of lawsuits that we have had is pathetically low. I would guess that the number of loans we foreclose on is well under a half of 1 percent per year.

What distinguishes your loans from predatory loans?

Our loans have fixed interest rates for 30 years. We have never charged a prepayment penalty, so if someone needs to refinance or get a different loan, they can. And we don't have any hidden fees. We require a down payment of between $500, which is the minimum, to as much as 10 percent or 20 percent of the house value. But most of our direct loans have a down payment between $500 and 3 percent of the value of the house.

That is less than the 10 percent to 20 percent down that lenders used to require.

It is. There are two constraints to buying a home. The first constraint is whether or not someone has enough money to make a down payment on a house. The second constraint is whether someone has enough income to pay the loan that they get to purchase the house. One thing you have to understand is that 60 percent of African-American families have zero or negative net cash resources in their households. What we discovered is that even though these families did not have enough cash to make a down payment, many of them did have enough income to pay the loan on a modest house. So what we did 23 years ago was cut against current wisdom and say: "We'll support families with a very high loan to value, or a very low down payment, because the constraint is not their ability to pay for a loan—the main constraint is that there is a disparity in savings that prevents people from being able to make the down payment."

Should some types of home loans simply be outlawed?

Yes. There's no question in my mind. In 2000, I testified before a House Committee that the Federal Reserve Board had the legal authority to prevent these abusive loans and that we were going to have a catastrophe if they didn't exert that authority. Had the Federal Reserve done its job over the last eight years we would not have this crisis. For simply ideological reasons, they chose not to do it. I've been fighting against predatory lending since 1999, and the right-wing ideological rhetoric is pathetic. You can put so much regulation in place that you choke off a market, but you can also have so little regulation that you haven't even defined the rules of the game. There is a middle ground. □