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January 7, 2009

Stop mortgage-lending fraud but don't eliminate all risky loans

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There is a danger that in its zeal to eliminate predatory lending and protect consumers, the government may end up stifling freedom, competition and entrepreneurship in the housing market.

History is replete with frauds like Isaac Toussie, the New York real estate swindler who recently saw his pardon from President George W. Bush withdrawn after one day, in the wake of a storm of protest. But we must not pass laws that would eliminate the possibility of legitimate risky loans going to people who want them.

As a housing advocate and executive director of a Westchester nonprofit that has put 400 New York-region families into homes they can afford, without fear of foreclosure, I believe the answer is not "nanny state" rules that dictate to educated adults the loan terms that "are good for them"; or even rules that restrict the ability of banks to do high-risk lending.

Put the frauds like Toussie, who orchestrated an elaborate conspiracy in which lawyers, appraisers and bankers inflated home values, in jail. But rather than restrict freedom for the overwhelming majority of bankers and borrowers, enforce tough standards so everyone can make an informed decision.

For example, if the banks that bought the collateralized debt obligations - these are the mortgage loans bundled up and sold as securities - had know the true risks associated with these investments, they probably would not have purchased them in the first place. But the problem was the government refused to regulate the CDOs, and the rating agencies were paid by the issuers, creating a conflict of interest. On Dec. 3, the Securities and Exchange Commission took a step in the right direction with a ban that prevents agencies from accepting money for rating securities for which they have provided advice.

The same is true for the consumer. It is incumbent on any homebuyer to accept personal responsibility to avoid getting swept away with the romance and quest of "The American Dream." Homebuyers must look upon buying a home the same way in which they would make any large investment - with careful inspection and by asking a lot of questions. And the homebuyer should not assume that just because a government entity, a bank, or service professionals like lawyers or appraisers are involved in their transaction, that everything is, therefore, honest and fair. These people are not "friends" but rather service providers in a business transaction seeking to earn a fee.

While protecting banks, the SEC or some other government entity needs to pass similar protection for borrowers as banks. This would entail requiring first time homebuyers to complete counseling from a nonprofit agency on all of the major aspects of purchasing and owning a home - from budgeting and determining affordability to the role of insurance and maintenance. Statistics indicate that borrowers who receive counseling default at much lower rates than borrowers who do not, so it makes business sense as well. The New York State Coalition for Excellence in Homeownership Education has settled on a national curriculum for first time homebuyers, which should be adopted by all lenders, either voluntarily, or by law.

But once the market achieves the transparency and accountability to restore it to health, government must again get out of the way - while maintaining a watchful eye.

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