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Can the Mortgage Crisis Swallow a Town?

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Maple Heights, Ohio

TAMMI and Charles Eggleston never took out a risky mortgage, never borrowed more than they could afford and never missed a monthly payment on their neat, three-bedroom colonial in the Cleveland suburbs. But that hasn't prevented them from getting caught in the undertow of the subprime mortgage mess now submerging this town.

Over the last 18 months, the Egglestons have watched one house after another on their street, Gardenview Drive, end up foreclosed and vacant. Although lawns are still tidy and empty homes are not boarded up and stripped as they are in inner-city Cleveland, the Egglestons say Maple Heights no longer feels safe after dark. Nor do they have the confidence they had when they moved in a decade ago that this is the ideal place to raise their 6-year-old twin girls, Sydney and Shelby. So, in May 2006, they put their home on the market in order to move closer to Mrs. Eggleston's parents in another middle-class Cleveland suburb, Richmond Heights.

They have had no takers. Although they lowered the asking price to $99,000 from $109,000, no one has even come to look at it in more than six weeks. "My heart panics every time I drive down the street and I see another for-sale sign," says Mrs. Eggleston, pointing past the placards in front of her porch to others that dot surrounding yards like lawn furniture. "Some people on the street couldn't pay, so they just left. The competition to sell is just ridiculous."

It is a scene being repeated in cities and towns across America as loans that were made to borrowers with little or no credit history, many of whom could not even afford a down payment, fail in ever-growing numbers. It is also a story of how local economic trends are intersecting with national politics, with local foreclosures drawing the attention of Democratic presidential candidates, includingJohn Edwards and Representative Dennis J. Kucinich of Ohio.

On the Republican side, President Bush announced on Friday several steps aimed at alleviating the impact of the subprime crisis on homeowners. In a Rose Garden appearance, he ruled out a federal bailout, citing both "excesses in the lending industry" and unduly optimistic homeowners who took out "loans larger than they could afford," as reasons for the mortgage woes.

Indeed, what was once a problem confined mostly to economically struggling areas is quickly becoming a national phenomenon. Last year, there were 1.2 million foreclosure filings in the United States, up 42 percent from 2005, according to RealtyTrac, a firm that analyzes such data. At current rates so far this year, RealtyTrac expects foreclosure filings to hit two million in 2007, or roughly one per 62 American households — a rate approaching heights not seen since the Great Depression.

Analysts also say that the fallout from mortgages gone bad is spreading well beyond borrowers now in default. It has begun to engulf middle-class communities like Maple Heights, where nearly 10 percent of the houses — or 910 properties — have been seized by banks in the last two years. And it foreshadows what could lie in store if mortgage holders default on what the Federal Reserve conservatively estimates to be $100 billion in risky subprime loans. Many of these loans were made in 2005 and early 2006, when standards were at their most lax and cities like this were blanketed with aggressive pitches from mortgage providers.

"I don't think we've hit bottom," says Michael G. Ciaravino, the mayor of Maple Heights. "My fear is that foreclosure rates could go to double where they are today."

IN terms of the subprime mortgage meltdown, Ohio has been among the hardest-hit states, according to the Mortgage Bankers Association. In Cuyahoga County, which includes Cleveland and surrounding suburbs, roughly 30 percent of subprime mortgages are either delinquent or in foreclosure, says Jim Rokakis, the county treasurer.

But this leafy community of bungalows and small family homes built after World War II could be described as its epicenter. Already, Maple Heights, with a population of 27,000, ranks No. 1 in Cuyahoga County in foreclosures per capita, according to Policy Matters Ohio, a nonprofit research group. Ranked by ZIP code, the number of foreclosures here puts Maple Heights in the top one-half of 1 percent nationally, RealtyTrac says.

Mayor Ciaravino has already had to shut his town's two swimming pools, cut the ranks of police officers and firefighters and eliminate services like free plowing for senior citizens with snow-covered driveways.

With so many houses vacant, says Michael H. Slocum, the finance director of Maple Heights, "it puts a big question mark out there; historical collection patterns for taxes are becoming less reliable."

In fact, when the town made its annual assessment on homes for garbage collection last month, receipts came in 15 percent below projections, forcing a 50 percent rate increase.

"There is truly a cascading effect," says Mr. Ciaravino, 43, who grew up in Maple Heights and was a local prosecutor before being elected mayor four years ago. Sitting in his 1950s-style wood-paneled office in City Hall, he says that "the folks living next to these empty homes get discouraged, and middle-class people are leaving."

For a mayor presiding over a town in crisis, Mr. Ciaravino doesn't seem angry, but beneath an affable exterior is barely concealed frustration that the danger of subprime debt became a national issue only after Wall Street began to wake up to the threat this summer. "We've been warning of problems for years," he says. "I'm just a small-town mayor. Where was the foresight?"

That same question is echoing among politicians with constituencies far larger than Mr. Ciaravino's. In July, Mr. Edwards came to Cleveland to tour a neighborhood hammered by foreclosures. Two months earlier, Mr. Kucinich took reporters on a walking tour of the neighborhood where he spent part of his childhood, Slavic Village, pointing out boarded homes and criticizing what he called "predatory lenders."

What's more, Cleveland is key in a crucial battleground state in the next presidential election, so it is a good bet that more candidates from both parties will be here touring neighborhoods dotted with foreclosed homes, much the way Ronald Reagan went to the South Bronx in 1980 to highlight what he called the failure of Jimmy Carter's economic policies.

"There's plenty of blame to go around," warns Mr. Ciaravino.

TWICE a week, the East Side Organizing Project, an advocacy group in an industrial neighborhood midway between downtown Cleveland and Maple Heights, is host to what its executive director, Mark Seifert, calls "the cattle call." The group helps mortgage holders keep their homes, and these afternoon sessions are when new clients first go over their cases.

Until this year, he says, about 80 percent of the people who came for help lived in the city, with the balance from close-in suburbs like Maple Heights. Today, the mix is split evenly between city and suburb.

So, in a windowless conference room in late August, as ceiling fans buzz overhead, James Jones, an intake specialist, tells newcomers: "We're in the business of trying to save your home. The information we get from you is what we use to negotiate."

The group uses other resources, too — like a bit of street theater to coax recalcitrant banks into renegotiating loans going sour. Mr. Seifert and his colleagues have scattered plastic sharks on the lawns of regional Countrywide Financial Corporation managers, and organized protests outside their offices. "We have cellphone numbers of the folks in the ivory tower making decisions, and we can call them at 1 a.m.," Mr. Jones promises the group.

It usually doesn't come to that. The project holds conference calls with Countrywide, CitiFinancial and others, mediating between the lender and individual mortgage holders. In successful renegotiations — which happen in about 85 percent of the cases the project handles — Mr. Seifert and his team persuade lenders to accept lower interest rates, or even a reduction in the total value of the loan, instead of foreclosing.

Lenders have incentives to negotiate. In addition to the plastic sharks and bad publicity, Mr. Seifert says, they can avoid the loss that comes with the seizure of a property. "Let's say the loan is for $100,000," he explains. "The banks know that if the house ends up getting foreclosed, they'll only walk away with $50,000 or $60,000."

If foreclosures ultimately harm underlying property values and cause losses to both lender and borrower, why are they still so prevalent?

"Some lenders understand; others don't," Mr. Seifert says. "Countrywide doesn't." Out of 120 recent mortgages cases with Countrywide, Mr. Seifert says, 15 have resulted in work-out deals, only two of which he said were "very good."

One of those loans belonged to Audrey Sweet, a Maple Heights resident and a first-time home buyer who borrowed $118,000 from Countrywide in late 2004 without putting any money down. Because of Mrs. Sweet's poor credit history and lack of assets, the adjustable loan's rate was 10.25 percent, but she says she was told that if the couple "just proved themselves," they could quickly refinance at a lower rate.

Mrs. Sweet says Countrywide advised her that the monthly property tax bill would be $100, but it turned out to be $230 and the Sweets quickly fell behind. Countrywide stepped in and paid $3,493 in back taxes in March 2007, and the next month raised the Sweets' monthly mortgage bill to $1,713 from $1,055.

That was far beyond the budget of the couple, so Mrs. Sweet turned to the East Side group in April. She says Countrywide finally budged in late July, the day before she testified before Congress at a Joint Economic Committee hearing about her experiences with Countrywide. Working with a local lender, Third Federal Savings and Loan, the Sweets managed to refinance the loan at a fixed rate of 7.2 percent, and the original $1,055 monthly payment now covers the property taxes the Sweets couldn't afford before.

Countrywide says it has tried to work with East Side but "has been met with nothing but derision and grandstanding," adding that it does not believe "these efforts help to save anyone's home from foreclosure." Nationally, Countrywide has completed 35,000 successful renegotiations so far this year, including 50 in Cleveland in a two-day period last week, according to Rick Simon, a Countrywide spokesman.

"We have made a tremendous effort to avoid foreclosures and work with customers," he says.

It is also clear that the Sweets bear some responsibility for their predicament. "I do blame myself a little bit," Mrs. Sweet acknowledges. "I feel dumb." She explains that she was focused on the monthly payment when she borrowed from Countrywide, not the interest rate or taxes due. "Once we got the loan documents at the closing, I just came home and stuck them in a drawer."

Although the Sweets' story has a happy ending, some neighbors have not been nearly as lucky. Three houses on their street have gone through foreclosure, including one home three doors down, where their neighbor's possessions were dumped onto the lawn. "And I live on the better end of town," Mrs. Sweet says.

AS he drives through the Slavic Village neighborhood, passing homes stripped of aluminum siding, copper pipes and other remnants, Marc A. Stefanski says, "There are still S.& L.'s and banks that lend with a conscience, but, man, you got to find them."

Mr. Stefanski should know: as the chief executive of Third Federal Savings and Loan, a Cleveland thrift that his parents founded in 1938, he has an unusual perspective on the mortgage mess. Unlike most of his competitors, Mr. Stefanski resisted the urge to cash in on the subprime lending boom.

His bank never offered no-money-down loans, piggyback mortgages, exploding adjustable-rate mortgages or the other financial exotica that ultimately tripped up the Sweets and millions like them. Third Federal pays its loan officers salaries, rather than commissions, so there is no incentive to go for volume. Even more remarkable is that Third Federal holds onto a sizable portion of its mortgages and keeps them on the books, rather than selling them to Wall Street to be sliced and diced into asset-backed securities owned by investors on the other side of the globe.

The result is that unlike many other mortgage lenders, Third Federal has a vested interest in making sure its loans do not go bad, so foreclosure is a last resort.

“The model has shifted,” says Mr. Stefanski. “It became very lucrative. But it was totally irresponsible for the sake of greed.” Not that Mr. Stefanski didn’t notice the profits to be had. “Absolutely, we were tempted,” he acknowledges. “We arm-wrestled and talked, but we decided not to change the model. We felt it wasn’t the right thing to do.”

Mr. Stefanski is no social worker. He lives in an affluent suburb of Cleveland and earned nearly $2 million last year. But he does not hide his feelings about just what went wrong in places like Maple Heights. “The whole system was based on raping the public,” he says, matter-of-factly. “Not everyone should own a home — just those who can afford it.”

Third Federal has a branch in Maple Heights, Mr. Stefanski says, and in the past, “we owned Maple Heights.” But in recent years, he says, “The predators just jumped on it.”

Third Federal’s share of the mortgage market in northeastern Ohio fell to a low of about 11 percent by 2001 from more than 30 percent in the early 1990s.

Tammi Eggleston also watched the more aggressive lenders move in, albeit from a different vantage point. “They were canvassing the neighborhood,” she recalls. “Letters in the mail, knocking on the door, calling on the phone. They were everywhere.”

Now, with other lenders pulling back and some fighting to stay in business, Third Federal has increased its share of the mortgage market to 24 percent, picking up mortgages like that of the Sweets and earning praise from community activists like Mr. Seifert. Perhaps even more significantly, Third Federal has created a program for more risky borrowers like the Sweets, with required classes so that mortgage holders understand exactly how their loans work and what they will owe.

WHY has the impact of the subprime meltdown been so much more severe in communities like Maple Heights than in other parts of the country? Mr. Rokakis suggests that it is a combination of Cleveland's underlying economic problems and a lack of the steadily appreciating housing prices that other areas enjoyed. That shut off a crucial safety valve — in other regions, overwhelmed borrowers could often turn around and sell their homes for at least a slight profit.

In Maple Heights, the situation is now reversed: with so many properties on the market, home values are dropping, and some delinquent mortgage holders owe more than their homes could now fetch in a sale. "The tax base is eroding," says Mr. Ciaravino, the mayor. He warns that property values may soon have to be reassessed downward, further crimping tax revenue and raising the heat on Maple Heights' remaining property owners. "This has affected virtually every aspect of community life, like increasing the rate of transient students in the schools," he says.

All of these factors are reasons the Egglestons want to move, but they are not sure they will be able to do so anytime soon. "We're torn," says Mrs. Eggleston, who works as an executive assistant at a Cleveland nonprofit organization. "You can see and feel the change in the neighborhood. We're really not sure what to do."

Mr. Ciaravino is torn, too. He understands the Egglestons' fears but needs middle-class families like them to stay if Maple Heights is to have a decent future. "We're not giving up the fight here," he says, with a trace of weariness in his voice. "It's frustrating because this could have been avoided. We as a nation are capable of much better than this."