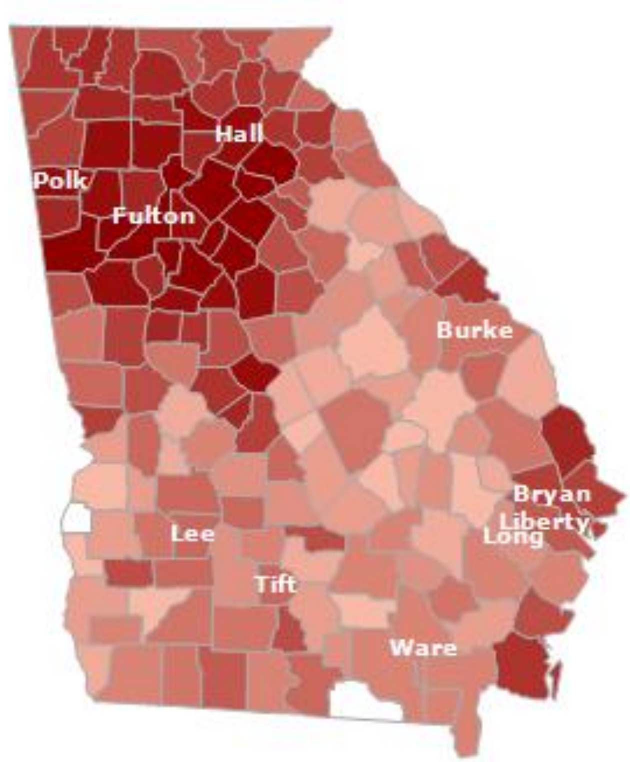
Georgia Foreclosure Crisis Part One:
The Rippling Effects of Reckless Lending



A product of Georgia Watch, the state's leading consumer advocacy group. We impact statewide policy and provide pro-consumer education in the areas of health care, foreclosure, energy efficiency, predatory lending and identity theft.

Georgia Watch
55 Marietta St.
Suite 903
Atlanta, GA 30303
[P] (404) 525.1085
[F] (404) 526.8553
www.georgiawatch.org

EXECUTIVE SUMMARY

The United States is currently entangled in its worst housing crisis since record-keeping began in the 19th century. The catastrophic number of foreclosures nationwide can be largely attributed to inappropriate lending supported by many parties, including lenders and Wall Street investors; but the unsustainable lending typically began with mortgage brokers and lenders who originated high-interest, subprime mortgages.

Mortgage brokers and lenders often steered borrowers into costlier loans with attractive introductory rates, while taking advantage of specific mechanisms to facilitate overcharging such as yield spread premiums (YSP), or kickbacks. As interest rates adjusted, borrowers began defaulting on their increased monthly mortgage payments and foreclosure**s** started spreading like wild fire across the country.

Projections that foreclosures will hit 13 million by 2014[i] are now surfacing as the job market continues to falter and adjustable-rate mortgages reset, creating even higher monthly payments for many borrowers.

Georgia is currently seventh in the nation for foreclosures[ii] and is expected to see approximately 350,000 more foreclosures by 2012.[iii] Additional factors that all but guarantee more foreclosures in Georgia are the state's rising unemployment rate and the increase of "underwater" mortgages, or homeowners who owe more on their mortgage than their home is worth.

The 13-county Metro Atlanta area is in decay as many of the communities that thrived during the housing boom are now struggling with record-breaking foreclosures and bank failures. Further perpetuating the problem is the "spillover" effect; the phenomenon which causes properties located near foreclosures to depreciate in value, meaning families lose equity wealth while local governments lose much needed tax revenues.

This report examine**s** the causes and effects of the foreclosure crisis on the state's economy and residents, and how it will likely get worse before improvements are seen. Among the key findings:

- By the end of 2009, 13 percent, or one in eight, of the state's mortgage-holders was at least 30 days behind on their loan[iv];
- Fulton, Gwinnett and DeKalb Counties deliver the highest number of foreclosure notices in the state with a combined average of 21,865 per month[v];
- The FDIC claims that Georgia saw 25 bank failures in 2009, the most in the nation;
- Approximately one in four or 377,000 of Georgia's 1,573,628 mortgages are "underwater"; and,
- Georgia families will lose $13 billion in home equity as the result of nearby foreclosures between 2009 and 2012.

As foreclosures continue to escalate, lawmakers in Georgia will have the chance to pass sensible mortgage reform that would protect communities from a similar crisis in the future. In the second part of this report, Georgia Watch will examine common sense legislation that would improve underwriting standards and home loan origination which are necessary to stabilize the current housing market and to stop crises of this magnitude from reoccurring in the future.

WHAT IS FORECLOSURE?

Home purchases by prospective owner-occupants are most often funded by a mortgage loan. The basic loan transaction consists of the borrower receiving funding in exchange for an obligation to repay the lender. The lender receives security interest in the property being purchased. In the event that mortgage payments are not made, or defaulted on, the security interest gives a lender the right to foreclose, auction off the property and keep all proceeds in order to recover the initial investment.

If property cannot be sold for what is owed, a deficiency judgment could be pursued against the former homeowner/borrower. A deficiency judgment means that the borrower has to repay any debt leftover after sale of the home. Both a foreclosure and a deficiency judgment could seriously affect an individual's ability to qualify for credit in the future.[vi]

FORECLOSURE CRISIS

Since 2007, the United States has seen nearly six million homes fall into foreclosure. According to the Center for Responsible Lending, there are 6,600 foreclosure filings across the nation every day. And though the end of 2009 saw a slight decrease in foreclosures, the year is predicted to end with 2.4 million[vii], the highest recorded number in U.S. history. As indicated by these numbers, it is fair to say that the nation's housing market is in crisis, and as a corresponding result, our economy as a whole.

How it Happened

Predatory lending

In 2005, subprime lending was touted as an innovative tool by then Federal Reserve Chairman Alan Greenspan that would help the housing market thrive while allowing borrowers with poor credit histories the opportunity to purchase property[viii], borrowers that would otherwise not qualify for a home loan.

Subprime borrowers are often turned away by traditional lenders who offer prime loans due to a low credit score or other factors that suggest high probability for default on loan repayments. Subprime loans tend to have higher interest rates than the prime rate offered on traditional loans. The additional percentage points of interest may translate to tens of thousands of dollars in additional interest payments over the life of a loan. Borrowers in the prime market pay considerably less in interest over the long term.[ix]

During the housing boom, many subprime loans were issued as adjustable-rate mortgages (ARMs), which are more complex than the fixed-rate loans that have long dominated the prime market. The interest rates on these types of loans often start out relatively low and then reset, generally after two years, to a much higher rate. In addition to an initial teaser rate of an ARM, Option ARMs allow a borrower to pay as much or as little as they preferred initially, which can lead to loan balances that ratchet up month after month rather than decline.

The chart below compares accrued interest over a 30 year period between the three common types of loans: subprime, near prime and prime.

Loan Type	1 Year	4 Years	30 Years
Subprime	**$1,174**	**$5,222**	**$35,874**
Near Prime	**$154**	**$1,316**	**$7,094**
Prime	**($179)**	**($42)**	**($1,767)**

Source: Center for Responsible Lending

Many subprime loans were pushed by mortgage brokers. A consumer can acquire the services of a mortgage broker to help sift through the complexities of home loan origination and to secure financing from a menu of available lenders. The mortgage broker acts as the intermediary between consumers and lenders during mortgage transactions. A typical broker has a working relationship with numerous banks and other lenders and has the ability to provide the consumer with access to hundreds of options when it comes to financing a home.[x] However, it is at the broker's discretion as to which option he/she presents to a potential borrower.

According to the Center for Responsible Lending 61 percent of subprime borrowers prior to the housing crash could have qualified for a home loan with a better rate, but brokers steered them into costlier loans in order to make a higher profit through fees. Mortgage brokers take advantage of specific mechanisms to facilitate overcharging such as yield spread premiums (YSP) and prepayment penalties.

A YSP is kickback paid to the broker by the ultimate lender for delivering a mortgage with a higher interest rate than what the borrower may actually qualify for. In the subprime market the maximum YSP is only paid if a loan agreement contains a prepayment penalty. This penalty ensures that a borrower will not pay a loan back too quickly before the broker receives a YSP via accrued interest over time or prepayment penalty. Prepayment penalties discourage early repayment of a loan, making it more difficult for borrowers to later refinance into a less expensive loan.

Secondary mortgage market

At the settlement of a loan, or shortly thereafter, a lender is not required to hold onto that debt. Rather than add it to his/her portfolio of loans, a lender may choose to sell the loan on the secondary mortgage market. This often involves the pooling of a large number of loans, securitization of that pool and finally the sale of the securities to an investor. Securitization and sale will not change the terms agreed upon by the borrower and the original lender.

When a mortgage is owned by multiple investors within the secondary mortgage market, an entity must exist that can service the loan. This role is filled by a mortgage servicer. The servicer collects monthly payments, monitors loan principle and enforces the provisions of the loan agreement, including protocols for default and foreclosure.

Servicers work with investors in the secondary mortgage market, such as Freddie Mac and Fannie Mae, which buy mortgages from primary lenders including mortgage bankers, banks and savings and loan associations. Many primary lenders make mortgage loans and sell them to secondary market investors to maintain a steady stream of funds for future loans.

Because of the long-term nature of mortgages, the secondary market is an essential factor in maintaining lender liquidity. The secondary market also provides and redistributes funds nationwide, moving them from areas where there are surpluses to areas where additional funds are needed.[xi]

However, the practice of lenders selling loans to other parties on the secondary market has drawn some blame for the current foreclosure crisis. Lenders who underwrite loans with no intention of holding the debt have little incentive to ensure that the borrower is capable of repayment. Therefore, the lender does not bear the risk of failure or default, because once the loan is sold; the risk rests with the new holder of the debt[xii]. This displacement of responsibility led to a loosening of common sense lending guidelines, leading to high foreclosure rates that have been widely recognized as a key factor in the current economic downturn.

Fallout

Over the past decade, investors in the US housing market and mortgage industry gained considerable wealth as lending and construction boomed and home prices skyrocketed. However, economists warned the bubble would burst as they saw more and more borrowers with poor credit histories become first-time homeowners due to lenient, reckless lending practices.

In 2006, hordes of borrowers began to default on their monthly payments as the low introductory rates they received upon signing began to reset. Mortgage-holders were no longer able to afford their loans and many were delivered foreclosure notices. In 2007, foreclosure rates in the United States increased 75 percent[xiii] and families were left dumbfounded, filling the nation's homeless shelters with ferocious speed.

At the end of 2009, the Treasury Department predicted another 6 million families may lose their homes in the coming years as foreclosures become commonplace among prime loan borrowers due to the rise in unemployment.[xiv] Chief economists from the Mortgage Bankers Association (MBA) and Moody's Investors Service forecast that home prices will continue to decline through 2010 and take at least another 10 years to reach their pre-recession peaks.[xv]

GEORGIA FORECLOSURES

In 2009 alone, Georgia saw almost 90,000[xvi] homes foreclosed upon. The state currently ranks seventh in the nation for foreclosures.[xvii] By the end of 2009, one in eight, or 13 percent, of the state's mortgage-holders was at least 30 days behind on their loan, giving the state the sixth highest delinquency rate in the country according to the Mortgage Bankers Association.[xviii] Not all mortgage delinquencies result in foreclosure, which is why these nationwide rankings differ. Occasionally, homeowners will be able to make loan payments after becoming delinquent, therefore avoiding foreclosure.

Process of Foreclosure in Georgia

In Georgia, as in over half of the states, foreclosure is a 'non-judicial" process. That means there is no court to oversee the process. A lender alerts the property owner that the mortgage is in default and then advertises with the intent to sell the property at auction. A notice of sale is sent to the borrower/homeowner a minimum of 30 days before the sale date. The notice is published once a week for four weeks before the property is allowed to be sold. Once this process starts in Georgia, a house can be sold in as few as 37 days.

Foreclosure sales take place at the local county courthouse on the first Tuesday of the month. If the winning bidder is anyone other than the lender, that person is required to pay the full bid amount to the auctioneer immediately following the sale. Often times, there are no buyers and the lender is forced to take ownership of the property – this often leads to homes falling into disrepair, pulling down neighboring property values (*see* Spillover on page 9).

There is no right of redemption for the borrower following a foreclosure sale in Georgia.[xix] The right of redemption gives a borrower the right to reclaim their home at some point after the foreclosure process has begun if they are able to get current on their loan payments and any fees due to default.

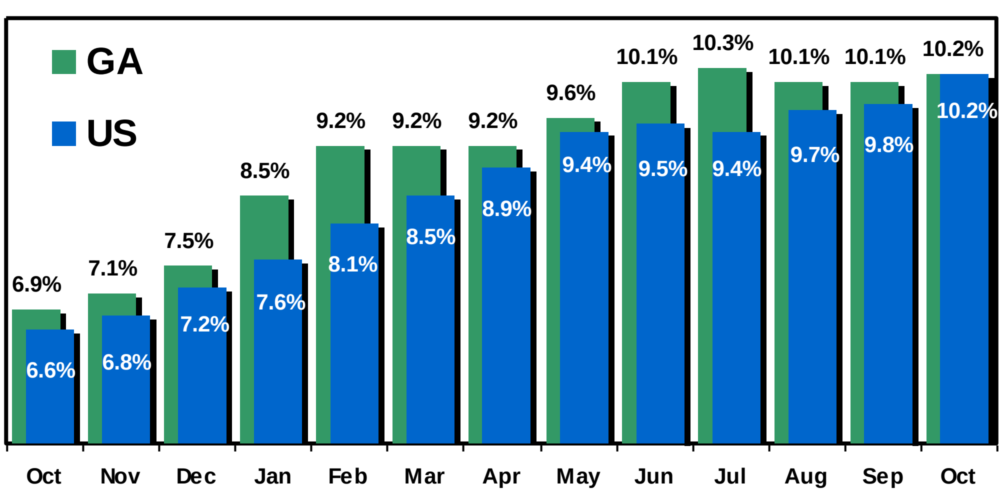
Georgia Foreclosures to Climb

Georgia is expected to see around 350,000 more foreclosures by 2012,[xx] as adjustable-rate loans continue to reset with higher interest rates, meaning higher monthly payments for borrowers. Georgia's 13-county metro area delivered a total of 117,170 foreclosures notices by the end of 2009, compared to 79,484 in 2008. Additional factors that all but guarantee increased foreclosures are the influx of underwater mortgages and the state's rising unemployment rate.

Unemployment

Georgia's current unemployment rate is 10.2 percent – the highest it's been in a century. As the number of unemployed Georgians raises, so too will the number of mortgage delinquencies on traditional loans. No longer are subprime borrowers the sole recipients of foreclosure notices. Those with good credit ratings who qualified for prime rates are beginning to default due to job loss and other unforeseen consequences of the economic recession.

Georgia Unemployment Oct 2008 – Oct 2009[xxi]



And though unemployment will likely drag more Georgia families through the foreclosure process, negative equity is another major reason to believe this crisis is far from over.

Negative equity or "underwater" mortgages

Having negative equity, often referred to as being "underwater", means a borrower owes more on their mortgage than their home is worth. At the end of 2006, 3.5 million homeowners were underwater; however, by September 2009, 10.7 million, or 23 percent, of all residential properties with mortgages in the U.S. were in negative equity. Negative equity can occur because of a decline in value, an increase in mortgage debt or a combination of both.[xxii] The real estate crash has led to more and more underwater mortgages.

By now it is understood that subprime lending played a major role in causing foreclosures by placing people in inherently problematic mortgages. But these loans also created a class of homeowners who were particularly sensitive to declining house price appreciation. Unfortunately, as previously addressed, as mortgage-holders of prime rate loans become victims of the spillover effect, they too will lose equity in their homes.

Examining the surmounting number of underwater mortgages is important because homeowners with little or no equity are more vulnerable to negative events, as they would likely have difficulty selling their home and would not be able to borrow against their property to meet emergency needs.[xxiii] Therefore, it can be assumed that many will fall victim to foreclosure.

The following chart depicts the number of mortgages in Georgia that were underwater, or within 5 percent of being so, at the end of 2009.

Total Mortgages	Negative equity	Near negative equity	Outstanding mortgage debt	Net homeowner equity
1,573,628	**376,954**	**130,616**	**$253,577,714,203**	**$72,688,049,523**

Source: MBA First American CoreLogic 3Q 2009 Findings

In mid-2008, three Georgia counties were among the country's highest for negative equity and foreclosures: Fulton, Dekalb and Clayton. Unfortunately, Fulton and Dekalb Counties also boast the state's highest unemployment rates, and will likely experience continued record-breaking foreclosures as a result.

Fulton County - 11.2% unemployment rate (as of Oct 2009)

- Homes with negative equity $1-$9,999: 520
- Homes with negative equity $10,000-$49,999: 652
- Homes with negative equity $50,000-$99,999: 134
- Homes with negative equity beyond $100,000: 80
- Percent entering foreclosure with negative equity: 16.7%

Dekalb County - 9.7% unemployment rate (as of Oct 2009)[xxiv]

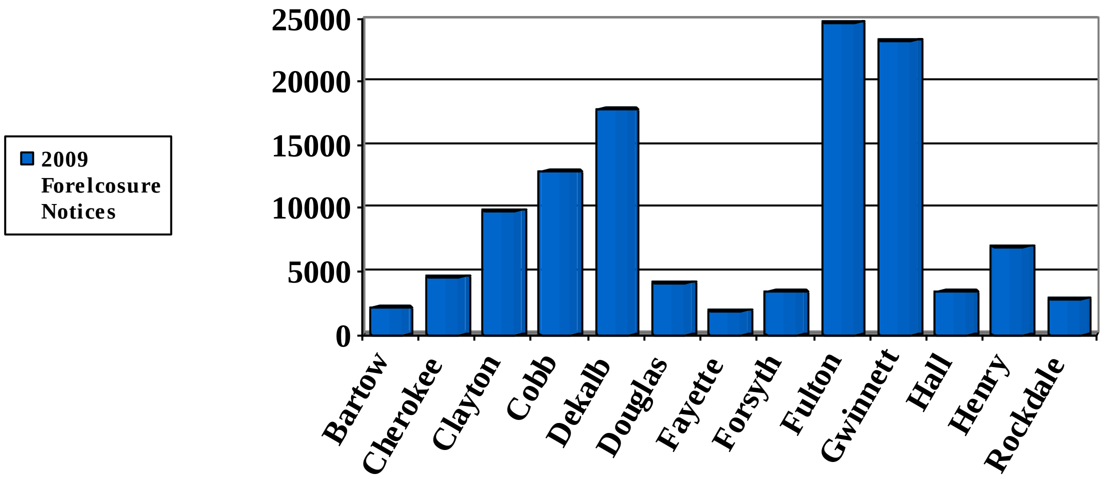
- Homes with negative equity $1-$9,999: 577
- Homes with negative equity $10,000-$49,999: 414
- Homes with negative equity $50,000-$99,999: 55
- Homes with negative equity beyond $100,000: 41
- Percent entering foreclosure with negative equity: 14% [xxv]

The aforementioned counties are all part of the 13-county Metro-area. During the housing boom, development moved rapidly in Georgia, unhindered. However, once the market crashed, homes in these counties started to sink underwater and receive foreclosure notices in record-breaking numbers.

Metro Atlanta in decay

In 2009, Gwinnett surpassed Dekalb and Clayton as the county that filed the second highest number of foreclosure notices in Georgia. (Fulton County typically has the highest number of foreclosures.) According to Equity Depot, 30-40 percent of all notices become completed foreclosures. Gwinnett, with one of the largest and wealthiest populations in the state, had 23,205[xxvi] notices delivered to its residents as of late 2009 as compared to 13,332 in all of 2008. Fulton County, which boasts the states highest number of foreclosures, posted 24,621 by the end of 2009.[xxvii]

The following graph shows the number of foreclosure notices in each of the Metro-area counties at the end of 2009. Fayette County marshals delivered the fewest notices by the end of 2009 with 1,853.[xxviii]



Source: EquityDepot.NET 2009 Foreclosure Notices

Rippling Effects of Foreclosure in Georgia

As foreclosures sped through the once booming Metro-Atlanta area, an area home to approximately 6 million people, the effects could be felt far and wide. In a matter of two years, Georgians working in the housing industry – whether construction, real estate or lending – started losing money and business rapidly. By 2009, many of the contractors, bankers and developers who contributed to Atlanta's rapid development were forced to file for bankruptcy protection.

As industry professionals struggle, searching for more opportunity to keep their businesses and families afloat, the story of those who lost their homes in the wave of foreclosures is similar. Though many were able to find temporary housing with loved ones or in a rental property, many remain in community shelters, searching for their next break.

Anatomy of a Georgia foreclosure

What does foreclosure look like from the inside? Far removed from the bureaucracy, paper work and legalities that accompany a foreclosure, the following account is based on the actual events of an eviction proceeding.

> Furniture is splayed across a front lawn – a queen-sized mattress, a vanity mirror, a kitchen table, a car seat.
>
> A crew of six men is working to empty a house that has been foreclosed upon, leaving all of its contents on the curb, the closest "right of way", vulnerable to scavengers. After receiving notice a day prior to their eviction, the family that had lived in the home is gone. Most of their belongings left behind, having no place to store them.
>
> The county marshal delivered an eviction summons to the home and was followed by county sheriffs who secured the property by entering the home with guns drawn. One officer reminds the others of the time they walked into a room to find a former homeowner sitting with a gun to his head. [xxix]
>
> It is the policemen's job to ensure the civilian crew working to clear out the home is safe and able to do their job. During the eviction process, it often takes a single day to completely gut a family's former home.

Former homeowners typically stay with friends and family until they can find affordable housing, though the amount of time they have to secure lodging and store their belongings is very limited. Meanwhile the stigma of being a victim of foreclosure is difficult to escape from, as the financial effects spread throughout communities.

Spillover

Foreclosures do not just affect borrowers who are delinquent on their mortgage; local economies and neighboring residents suffer as well. In Georgia and across the nation, homes under foreclosure have a "spillover" effect that depresses the value of neighboring properties. Nationwide, spillover devalues properties by an average $1,920 per home. In 2009, approximately 1,850,580 homes were devalued. By 2014, that number is projected to reach 2,823,000.[xxx]

In Georgia, the projected total home equity wealth lost due to nearby foreclosures between 2009 and 2012 is $13 billion.[xxxi] The following chart details the statistical data of the spillover effect in Georgia as of May 2009. In reality, these numbers can be considered low estimates as foreclosures continued rising across the state well into September 2009, dipping only slightly in subsequent months.

2009	**2009**	**2009**		**2009-2012**	**2009-2012**	**2009-2012**
# of neighboring homes experiencing devaluing	Decrease in house values as result of spillover (millions)	Average decline in home value		# of neighboring homes experiencing devaluing	Decrease in house values as result of spillover (millions)	Average decline in home value
1,850,583	**$3553.5**	**$1,920**		**2,823,007**	**$13,145.5**	**$4,657**

Source: "Soaring Spillover," Center for Responsible Lending, May 2009.[xxxii]

Despite purchasing her home without a mortgage, Pat Saunders[*], of Barrow County, Georgia, has seen her home's value depreciate 30 percent in the last two years. Six homes in her neighborhood were lost to foreclosure and now many of them have been turned into rental properties, owned by out-of-state lenders, and have fallen into disrepair without sufficient supervision. Some homeowners in the neighborhood have tried to sell, but find they would be receiving far less for their properties than what they initially paid for them.

Spillover not only affects the individual homeowner, it has consequences on local governments as well as depreciated property values make it difficult to raise revenues and enforce property codes.

Bank Failures

In addition to shrinking tax revenues and lower property values, some local governments in Georgia are being forced to contend with bank failures. And many rural communities in the state only have one bank, if it closes down every resident and small business is affected.

In 2009, 25 local Georgia banks were shuttered by regulators, more than any other state in the nation.[xxxiii] Comparatively, Illinois, the state with the second highest number of bank failures, 21 closed, and at third, California, with 15 closings. Georgia's total bank failures are almost twice that of most states that boast higher foreclosure rates and much larger populations, but why?

At the end of 2008, Georgia had 335 banks.[xxxiv] The small banks often gave consumers better, more competitive rates on loans and broader sources of credit, but when the market fell, they became a liability with less capital to protect their interests and weather the crisis.

Essentially, a perfect storm of factors caused the collapse of so many banks in Georgia. The Federal Deposit Insurance Corporation (FDIC) cites a number of reasons: a combination of substantial growth in metro Atlanta that stimulated real estate development; an archaic, now-repealed state law prohibiting state-chartered banks from operating in more than one county; and a plethora of newly formed banks in the wake of Atlanta's boom shortly before the nation's economy crashed.[xxxv]

Faltering loans were the impetus for many bank failures. For example, First City in Glascock County just southwest of Augusta, had $24.6 million in nonperforming loans in 2008, which means no payments had been made for 90 days resulting in an $8.3 million loss.[xxxvi] These small banks were investing too much into the real estate market, such that when it collapsed they were unable to sustain themselves.

When the only bank closes in a small town, the community feels the effect instantly. Many residents who previously used local banks are forced to travel outside their county or city to open accounts elsewhere, an obstacle if transportation, health or time is an issue.

Renter's rights

In Georgia there is very little recourse for renters – even responsible renters who pay their rent on time each month are not safe if the home they live in is foreclosed upon. Once the property is acquired through foreclosure the tenant has no right to possess the property and can be evicted

[*] *Name changed for privacy.*

through Georgia's quick dispossessory process. If the new owner of the property moves forward with a dispossessory proceeding the tenant might have to leave the premises within as little as a week.[xxxvii]

Nationwide, more than 20 percent of properties in foreclosure are rentals, according to a December 2008 study by the National Low Income Housing Coalition. The study also says rentals are typically multi-family dwellings and that renters are about 40 percent of all families facing eviction.[xxxviii]

As a result, it can be assumed that of the 51,000 tenant eviction cases tried in Fulton County in 2008, a significant portion were foreclosure-related.[xxxix]

Frequently, banks will remain the owner of a foreclosed property because they can be difficult to sell, therefore acting as temporary landlord and doing very little in terms of upkeep on a property. Many renters see their homes fall into disrepair as the result of such neglect.

CONCLUSION

By any calculation, the epidemic of irresponsible lending and home loss has been catastrophic. At this point, we know that foreclosure not only hurts the family that loses their home but also nearby homeowners who see lower property values and local communities that lose tax revenues and the benefits of those funds.

A combination of elements: bank failures, unemployment, subprime lending and negative equity – has created a devastating situation in Georgia that is unique to the state. These factors have cost Georgia economies, businesses and local governments billions of dollars in taxes, job loss and depreciated property values.

At this point, as foreclosures are predicted to peak in 2010 and continue into 2014, it is imperative for Georgia legislators to pass common sense reform that will regulate standard underwriting procedures and home loan origination. Without aggressive action, more families will end up homeless and the state's economy will continue to suffer.

FORTHCOMING REPORT

In late January 2010, Georgia Watch will release a second part to this report, looking into foreclosure relief and mortgage reform. We will examine efforts made by the federal programs that have attempted to help American families stay in their homes. Additionally, part two of our in depth look at the foreclosure crisis in Georgia will evaluate reforms put into place in New York, Ohio and North Carolina that have regulated underwriting in home loan origination.

Finally, we will examine mortgage reform legislation that is coming before the Georgia legislature in 2010. The report will detail the benefits of common sense provisions to underwriting standards that will nominally affect the mortgage industry as a whole, but will greatly reduce predatory lending and its costly effects on our state.

FORECLOSURES AT A GLANCE

Georgia

• Total Foreclosure sales 2008-2Q 2009	**48,131**
• Total past due mortgages 2008-2Q 2009	**243,084**
• Change in foreclosure starts from 2006-2009	**141.7%**
• GA lost home equity as result of nearby foreclosures 2009 – 2012	**$13 billion**
• Number of homes experiencing foreclosure related decline	**2,823,007**
• Georgia average loss per home affected	**4,657**
• Number of Georgia's 1,573,628 mortgages "underwater" or homeowner owes more on mortgage than home is worth	**376,954**
• Number of mortgages 5% away from being "underwater"	**130,616**

National [xl]

• Number of foreclosures since 2007	**nearly 6 million**
• Projected foreclosures on all types of loans during the next 5 years	**13 million**
• Portion of all homeowners late on their mortgage	**1 in 7**
• Portion of homes where owners owe more than property value ("underwater")	**nearly 1 in 4**
• Between 2006 and 2008, % decline in new construction	**58%**
• Number of neighboring homes that will lose property value because of nearby foreclosures (2009)	**69+ million**
• Average price decline per home (2009)	**$7,200**
• Total property value lost because of nearby foreclosures (2009)	**$502 billion**
• Percentage of 2006 subprime loans that went to people who could have qualified for prime loans with better terms	**61%**

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