

# AMERICAN BANKER

On Focus and In Depth

## Viewpoint: Toxic Drywall Poses Foreclosure Risk to Banks

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Chinese drywall, which is causing untold damage to an estimated 60,000 U.S. homes built after 2001, is proving equally toxic for mortgage lenders.

In a troubled national economy already weakened by historically high loan default and foreclosure rates, many frustrated homeowners are walking away from their mortgages, leaving lenders stuck with portfolios of unlivable, worthless homes.

"Chinese" drywall is the term for drywall with an abnormal composition that causes it in humid climates to emit gases that damage home components such as ground wires for electrical outlets and air conditioning units, as well as personal property like microwaves and computers.

Just as important, the defective drywall also afflicts health with problems including burning eyes, sore throats, bloody noses, insomnia and respiratory problems. Many homes built with this drywall have a "rotten egg" smell due to the sulfur gases emitted by the defective product.

Florida legislation that requires property appraisers to adjust assessed values of single-family residences with drywall problems confirms that homes with defective drywall are considered worthless; properties deemed unlivable unless rehabilitated to current building standards must be assessed at \$0.

Remediation, which usually requires gutting the home and essentially rebuilding from the ground up, is usually not financially feasible for homeowners.

Based on the volume of drywall imports from China since 2001, about 60,000 houses, condominiums and townhomes are estimated to contain this toxic product.

To date, the Consumer Product Safety Commission has reported receiving 3,418 reports from residents in 37 states, the District of Columbia, American Samoa and Puerto Rico who believe their symptoms of ill health or the corrosion of certain metal components in their homes is related to problem drywall.

State and local authorities have received similar reports, and these complaints are burgeoning as more owners realize their homes were built with this defective drywall.

Many homeowners, when they realize their homes are considered worthless because of defective drywall — and could be damaging their health — feel little incentive to continue paying their mortgages. In addition, many who abandon their toxic homes simply cannot afford to pay both their mortgages and the expense of an alternative living space such as rent.

As a result, either because the borrower considers it a good financial decision and/or can simply can no longer afford to pay the mortgage, many drywall-damaged homes are ending in foreclosure.

The federal government has already begun to act. Sen. Bill Nelson, D-Fla., along with other senators, wrote to President Obama, Treasury Secretary Geithner and others in the executive branch in July 2009, demanding that they "reach out" to mortgage lenders — especially those who had been given Troubled Asset Relief Program funding — to help home-owners.

In September 2009, Congress passed a resolution encouraging banks to "work with families affected by contaminated drywall to allow temporary forbearance without penalty on payments on their home mortgages." In June, Fannie Mae announced a policy to offer immediate relief by directing its services to give qualifying borrowers up to six months of forbearance on mortgage loan payments and to minimize adverse credit effects. Finally, as part of the Dodd-Frank Act, Congress authorized funds to study the effect of defective drywall on loan foreclosures.

Simply put, lenders should act now.

Banks must develop thoughtful, fair programs to help borrowers in good standing and work with them so they can temporarily move from their homes and afford additional living expenses. Lenders must work with qualified attorneys to fight for recovery from the entities that may be liable to pay for the home repairs.

The continuing legal battle against builders, developers, installers, distributors and manufacturers will take time, and borrowers must be afforded this time to fight and obtain a recovery. When they obtain recovery and their homes are fixed, borrowers can move back into their homes and, eventually, resume mortgage payments. This is a scenario that, if performed properly, could be a win/win — letting people keep their homes and enabling lenders to avoid foreclosing on literally toxic assets.

Lenders also may protect themselves by inspecting properties they own after foreclosures.

Many lenders probably are unaware how many properties in their portfolios have defective drywall.

In these cases, banks own truly toxic assets; the homes would have to be repaired before a sale or be put on the market as worthless assets.

Banks also may join the litigation that has been filed in state or federal courts, in order to protect their interests and recover the damages they have suffered.

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