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Ally Financial Will Halt Mortgage Purchases in Massachusetts

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(Updates with BofA comment, cost of foreclosure review starting in the 13th paragraph.)

Dec. 2 (Bloomberg) -- Ally Financial Inc.’s GMAC Mortgage unit will stop buying home loans in Massachusetts after the state accused the five biggest mortgage lenders of conducting illegal foreclosures.

The halt, which affects loans originated by correspondent lenders and wholesale brokers, is “because recent developments have led mortgage lending in Massachusetts to no longer be viable,” the Detroit-based company said in a statement. Ally, owned mostly by the U.S. government after being bailed out during the 2008 financial crisis, is ranked fifth this year among the nation’s mortgage providers.

Massachusetts Attorney General Martha Coakley sued Ally and four other mortgage lenders yesterday for allegedly trying to seize homes when they didn’t hold the mortgage on the properties. Failure to obtain valid mortgage assignments before foreclosure has affected titles to “hundreds, if not thousands, of properties” in the state, she said.

“The company is disappointed that it can no longer participate in offering certain financing options in Massachusetts,” Ally said in its statement. “However, it has an obligation to manage risks and deploy capital in an appropriate manner and in a way that protects the investment of the U.S. taxpayer.”

Ally will continue making direct loans in the state, according to Gina Proia, a spokeswoman. The lender will honor any commitments through Dec. 5 and continue servicing existing customers, the statement said. Mortgage servicers send out and collect bills, and handle foreclosures if borrowers don’t pay.

Subprime Loans

Ally was once one of the largest subprime lenders through its ownership of Residential Capital, which gave loans to borrowers most prone to default. The firm has since backed away to cut risk and last month said it’s reducing purchases of mortgages made by other lenders. Those “correspondent loans” had comprised 84 percent of originations.

“The costs related to the mortgage business overall have increased and when additional litigation costs are added to the equation, the business case in certain channels is no longer viable," Proia said today. GMAC Mortgage will fight the state's claims and has worked "in good faith" with Coakley's office during the past year to discuss mortgage servicing and ways to assist borrowers, she said yesterday.

Matt Anderson, a spokesman at the U.S. Treasury Department, which owns 74 percent of Ally, declined to comment.

State Suit

Coakley's lawsuit also named Bank of America Corp., JPMorgan Chase & Co., Citigroup Inc. and Wells Fargo & Co. Her filing broke with state attorneys general across the country who have been negotiating a settlement with the five banks that would resolve a probe into foreclosure practices. With an accord still out of reach after more than a year, Coakley said, she decided to file her lawsuit.

"To do business in Massachusetts, GMAC has to follow the law before foreclosing on homeowners," Coakley said in an e-mailed statement. "With today's action, it appears GMAC has acknowledged it has a problem following those laws and being held accountable for doing so."

Mark Calabria, director of financial-regulation studies at the libertarian Cato Institute in Washington, said other lenders may follow Ally if they feel their ability to collect on collateral is jeopardized by the states.

"A mortgage is supposed to be a collateralized loan," Calabria said. "If banks feel like they can't foreclose or price for what the risk is going to be, or if these things are seen as being arbitrary or politically driven, there is the risk" that lending will slow, he said.

No Mass Exodus

Some banks may follow Ally's example only if their presence in Massachusetts or other states is small enough, Calabria said. And for most lenders, the California mortgage market is simply too big to ignore, he said. Bank of America has already exited the wholesale lending business and announced plans earlier this year to close its correspondent unit, spokesman Terry Francisco said in a phone interview.

"This could happen in places like Massachusetts that are arguably small enough," said Calabria, a former aide to Alabama Senator Richard Shelby, the senior Republican on the Banking Committee. "It'd be hard regardless of what the California AG says for a lender to say we won't do business in the state."

Ally said in a separate filing today that a review of its foreclosure practices ordered by regulators could cost $200 million. The bill could be "significantly higher" if the scope of the review is expanded, the company said.