



The Subprime Mortgage Crisis: Context, Causes, Solutions

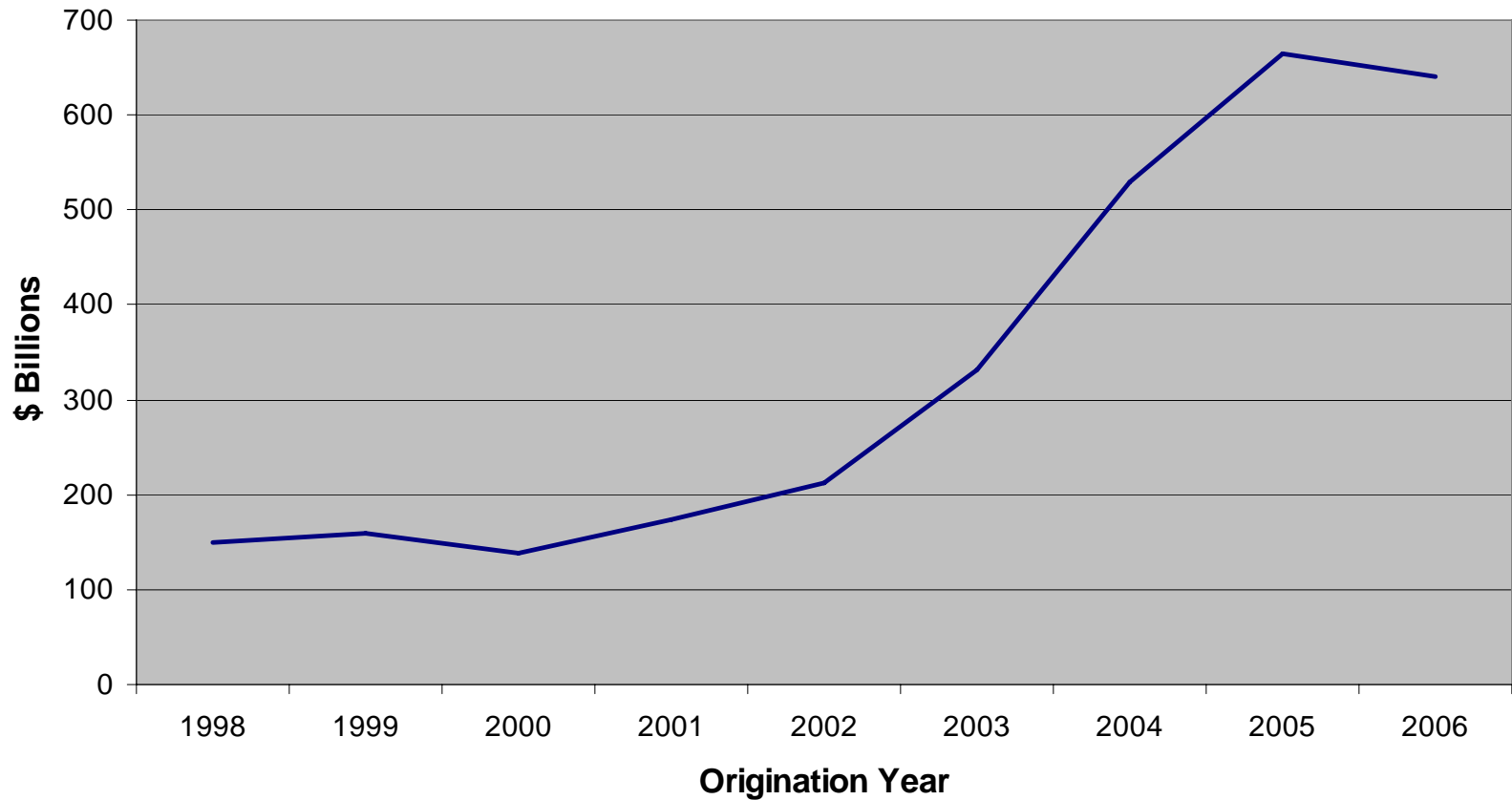
Center for Responsible Lending

About CRL



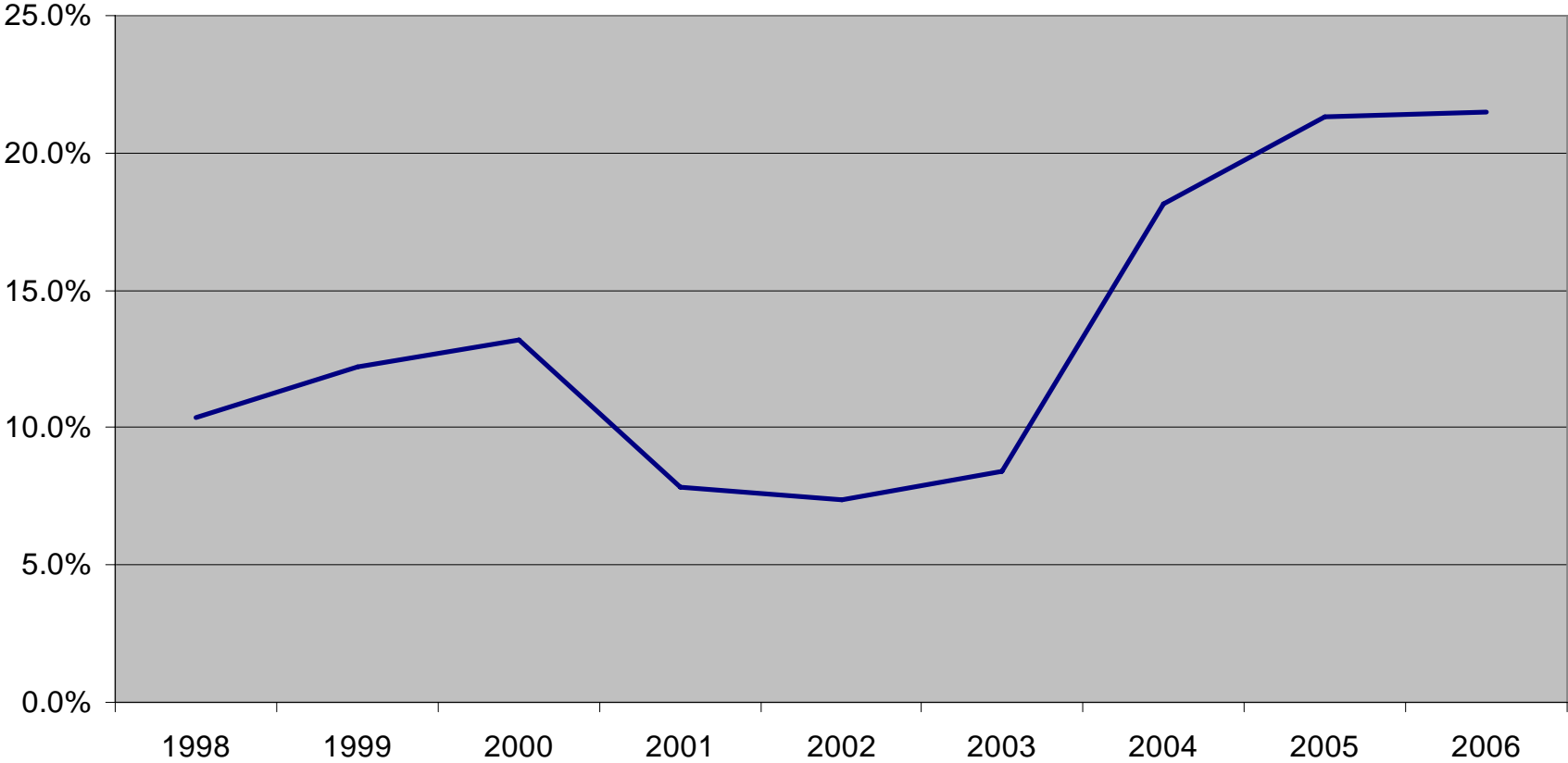
- Nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices;
- Offices in Durham, N.C., D.C., and Oakland;
- Affiliated with Self-Help, one of the nation's largest community development financial institutions

Subprime Market Growth



Source: IMF Publications

Subprime Share of All Mortgages (by origination year)



Source: IMF Publications

Origination Year

My Mother's Mortgage Market



- **Products:** Mostly 30-year fixed; Limited ARMs
- **Underwriting:** Manual, Labor-Intensive, Lengthy
- **Lenders:** Banks and S&Ls Make and Hold in Portfolio
- **Profits:** Interest Spread
- **Underserved:** Redlining, High Denial Rates and Lower Homeownership Rates for Minorities and Those with Imperfect Credit

21st Century Subprime Mortgage Market



- **Products:** Many options, multiple features, risk layering.
- **Underwriting:** Automated, Instantaneous, Heavy Reliance on Credit Scores
- **Lenders:** Banks and Independent Non-depositories, Most Originated by Brokers
- **Profits:** Volume = Transaction fees and sales to secondary markets
- **Underserved:** “If you can fog a mirror ...,” Prepayment Penalties, Flipping

21st Century Subprime Mortgage Market: Structure



- Brokers
- Lenders
- Wall Street
- Ratings Agencies
- Investors

Regulators: Market Changes Far Outpaced Consumer Protections



- **Federal Regulators:** Non-traditional and subprime guidance is too little, too late.
- **CA Regulators:**
 - Inadequate Staffing.
 - Limited Mandate: Focus on licensing compliance, not consumer protection.

California Subprime Lending Facts



- **Subprime Loans:** 600,000 subprime loans made annually in 2005 and 2006
- **Percentage of Market:** 20-25% of total U.S. subprime lending
- **Refinance:** 50%, though % varies with geography
- **Broker-Originated:** 80%
- **State-/HUD-Regulated Lender:** 70%

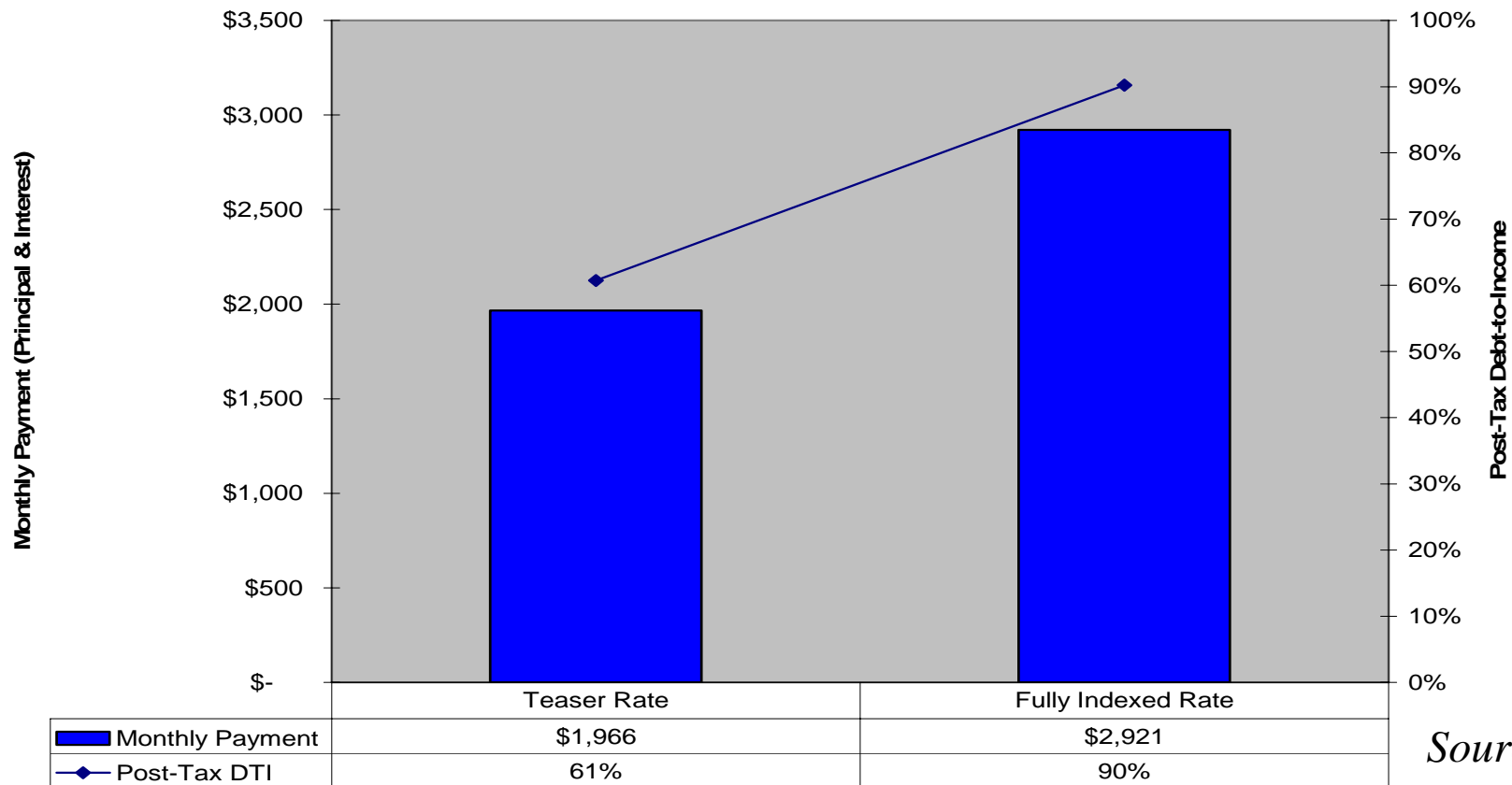
Layering Risky Features

- **Exploding ARMs: 70% - 80%**
- **Stated Incomes: 50%**
- **No Escrows: 75%**
- **No Down Payments/Piggy Backs: 80%**
- **Prepayment Penalties: 80%**

Exploding 2-28 ARM: A Typical \$300,000 Loan



Assumes No Change in Market Interest Rates



Source: CRL
Calculations

Racial Disparities In Subprime Lending



U.S.	# Higher cost	US % of total
■ <u>African-American</u>	388,471	52%
■ <u>Latino</u>	375,889	40%
■ <u>White</u>	1,214,003	19%
California	# Higher cost	CA % of total
■ <u>African-American</u>	31,000	37%
■ <u>Latino</u>	141,059	35%
■ <u>White</u>	233,320	17%

(Source: 2005 HMDA)

What's Driving SP Foreclosures?



- Housing Prices Moderating
- Early Wave: Early Payment Defaults
- Resets: The Coming Surge
 - 1 Million CA Exploding ARMs Facing Reset 07-08
 - Accelerating over the Next 18 Months

CRL *Losing Ground* Report

December 2006



DATA

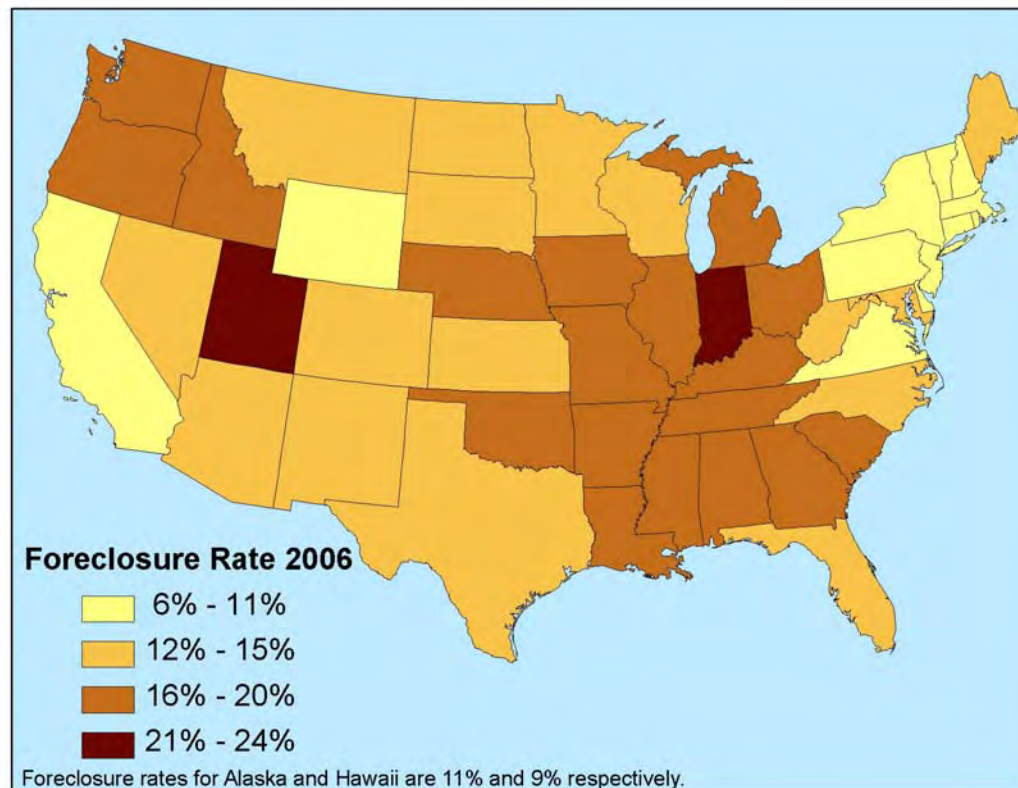
- 6 million securitized subprime mortgage loans totaling \$1.2 trillion;
- Originated between 1998 and December 2004;
- Originated in 50 states and D.C.

Subprime Foreclosure Rates on Loans Originated in 2000 (as of May 2005)

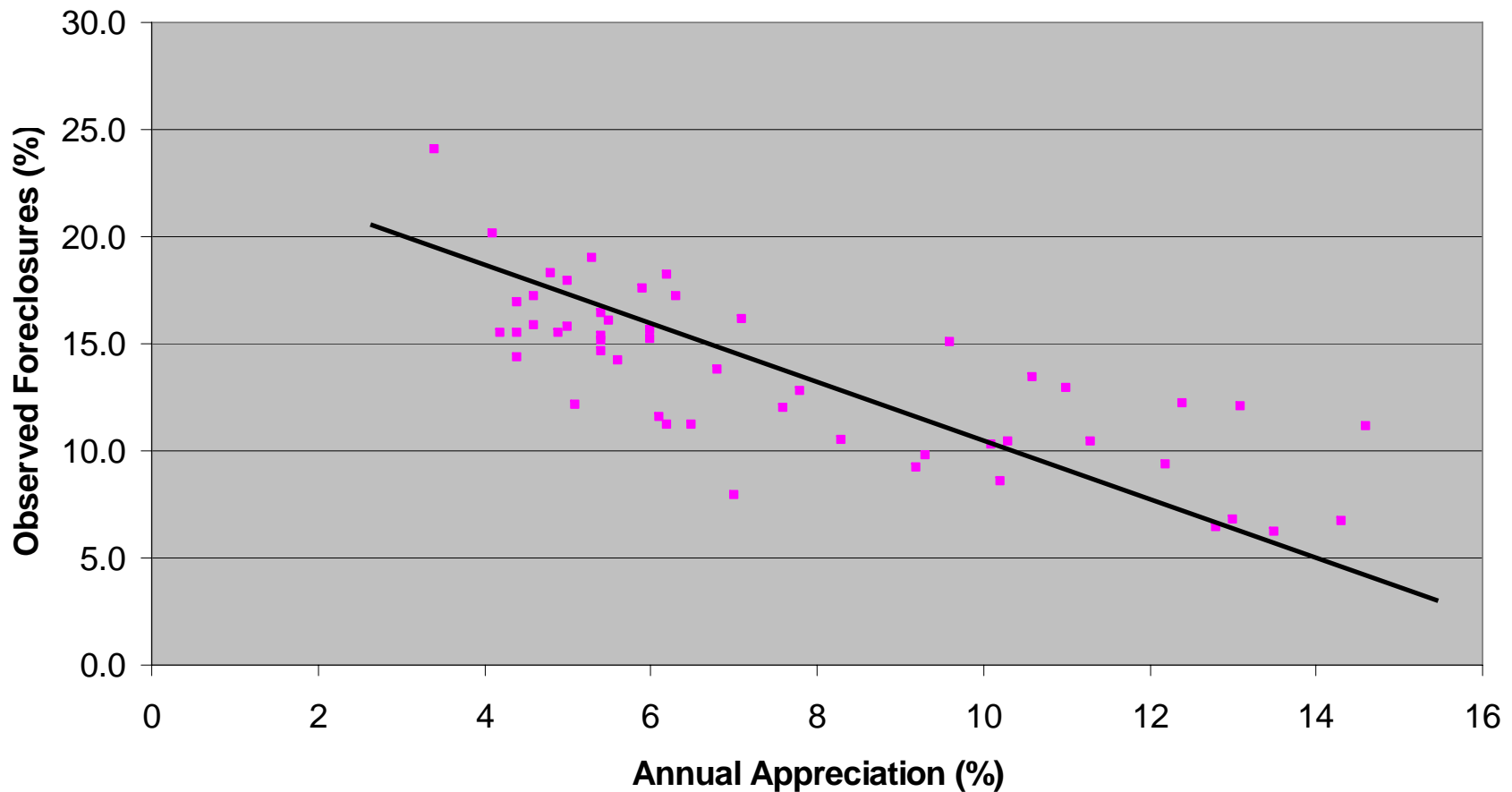


- One in eight (12.5%) subprime loans made in 2000 had foreclosed by May 2005.
- An additional 11% prepaid while they were delinquent for at least 30 days.

Subprime Foreclosures by State (as of 5/2005; loans originated in 2000)



Foreclosures Fall As Housing Price Appreciation Rises

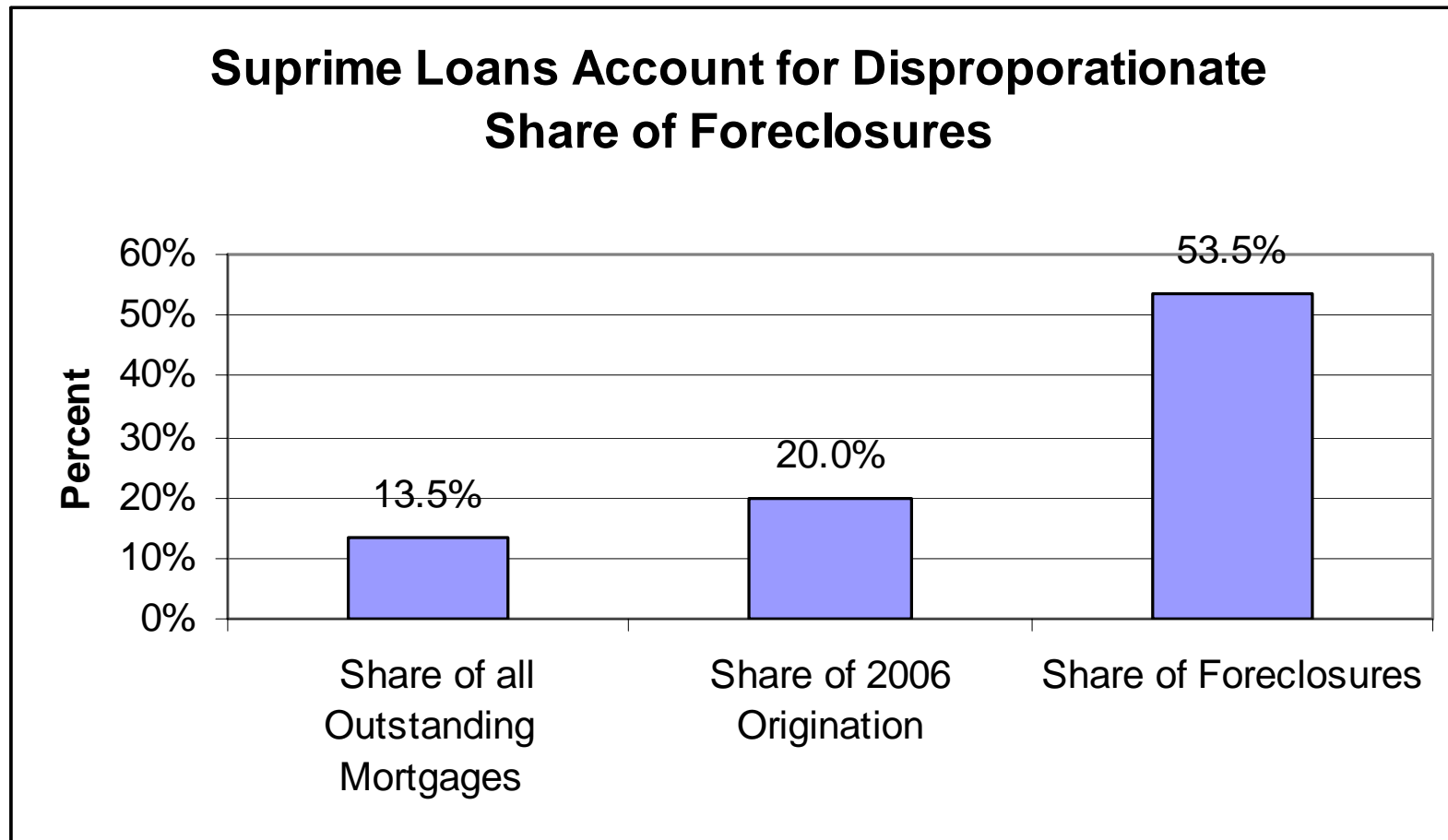


Predicted U.S. Foreclosures 1998–2006: Lost Homes, Lost Equity



- Approximately 1 in 5 mortgages (20%) will end in completed foreclosure (i.e., loss of home)
- 2.2 million homeowners losing their homes
- \$164 billion in lost equity

Subprime Foreclosures



National Delinquency Survey, 2006 4Q Mortgage Bankers Association

CA Foreclosure Projection Data



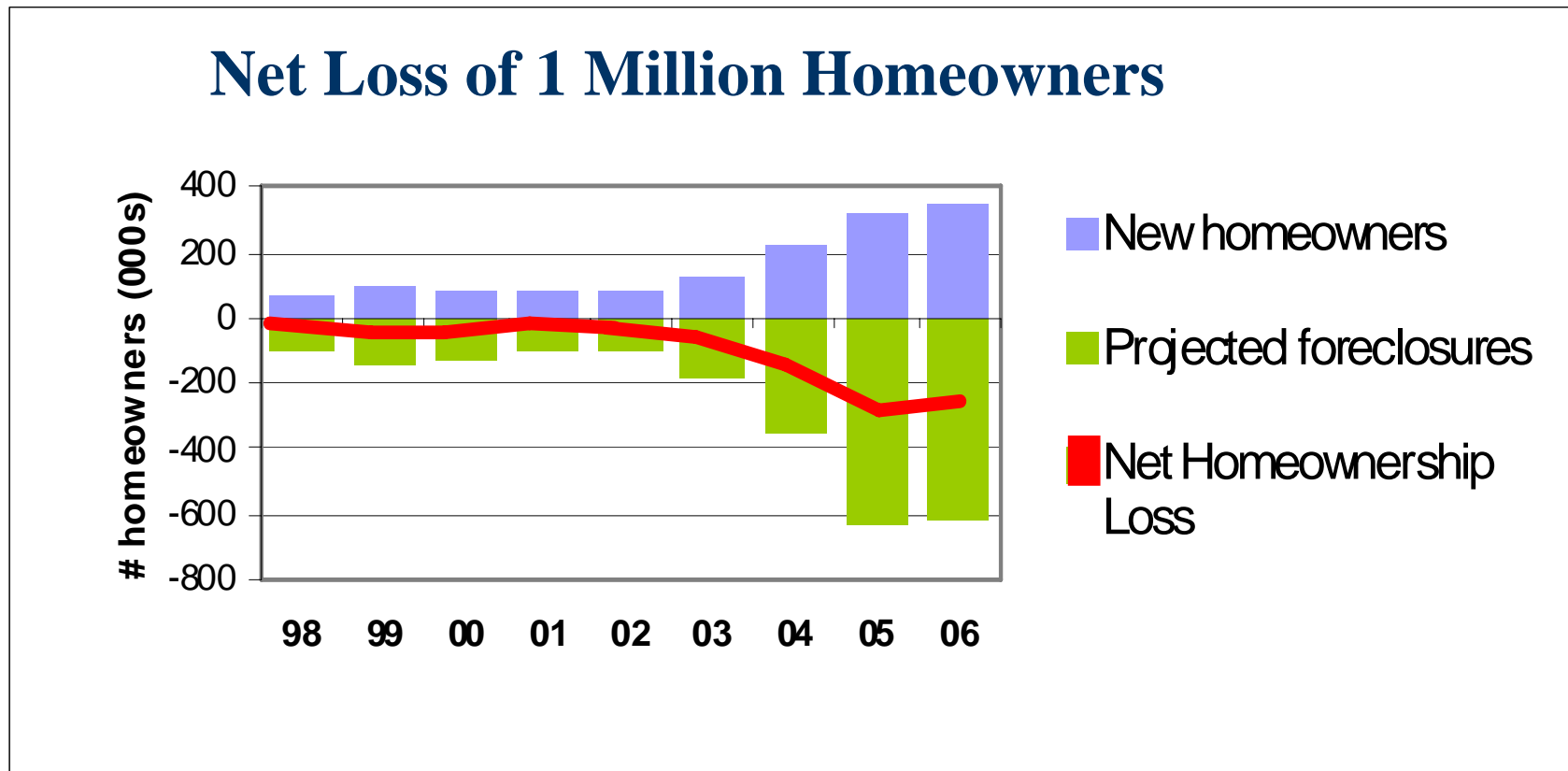
- 21.4% projected foreclosure rate for loans originated in 2006
- Approximately 465,000 total foreclosures from 1998 – 2006 loans

Loan Features Carry Foreclosure Risk



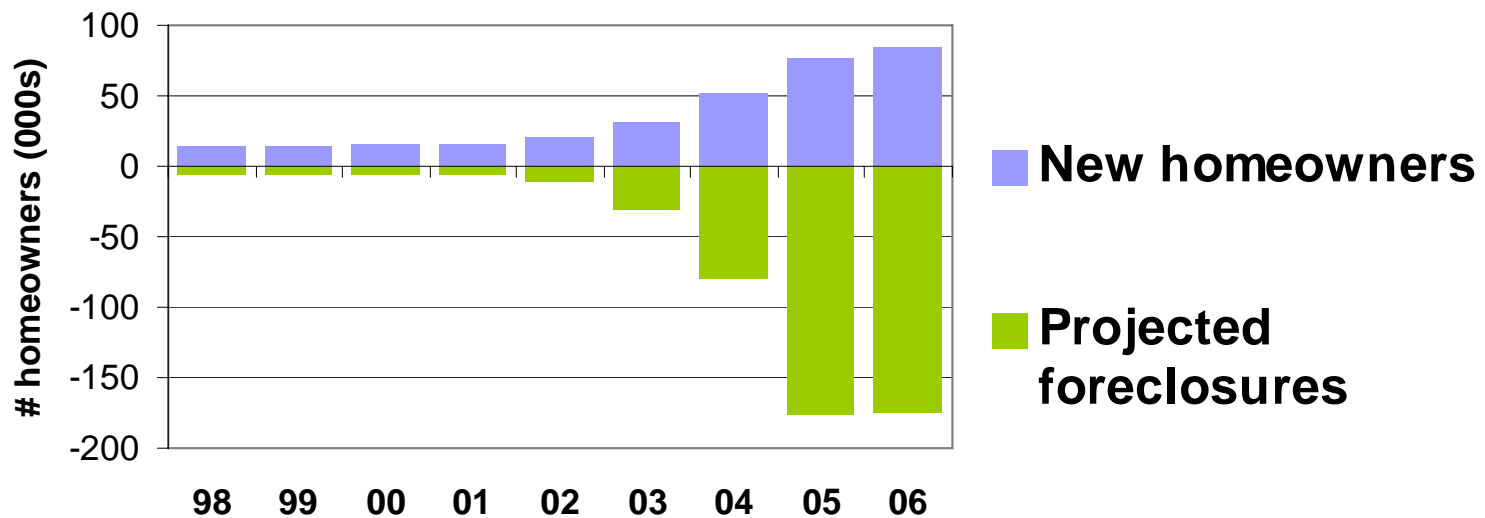
- Among subprime loans originated in 2000, after controlling for credit score:
 - ARMs had **72% greater risk** of foreclosure than FRM
 - Prepayment penalties associated with **52% greater risk**
 - Low/no doc loans with **29% greater risk**.
 - Purchase money with **29% greater risk** than refinance.

Impact of Subprime Lending U.S. 1998-2006



CA Subprime Lending, 1998 - 2006

Projected Net Loss of CA 175,000 Homes



Policy Recommendations:

1. Help Existing Borrowers at Risk

- Encourage Lender/Servicers to Make Loan Modifications for Long-Term Affordability
- Bankruptcy: Amend Federal Law to End Favored Status of Home Mortgage Loans
- Federal Tax Relief for Debt Forgiveness

Policy Recommendations

2. Avert Future Foreclosures



- Require sound lending practices
 - Establish borrower ability to repay at fully indexed rate
 - Verification of income
 - Escrow for taxes and insurance
 - Limits on prepayment penalties
- Align broker incentives with borrower needs
- Assignee Liability: Require secondary market loan purchasers to take reasonable steps to avoid purchasing predatory loans

Inadequate Policy Response in CA

- State Regulators: Slow to Enact Federal Guidance
- Limited Legislative Action to Date
 - SB 385: Only Requires Guidance that Other States Have Enacted More Quickly w/o Legislation
 - AB 1538: Unshaped Potential Refinancing Tool for CalHFA
 - AB 512: Translation of Mortgage Documents
- Other States Have Responded Far More Aggressively

Policy Recommendations for CA



- Hold Industry Accountable for Minimizing Foreclosures
- Increase funding for counseling/legal services
- Stronger Anti-Predatory Lending Laws

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