Subprime Lending, Foreclosures, and Possible Solutions

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Woodstock Institute

Government Housing Policy and Local Communities
North Park University
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Informing communities about the financial services policy issues that impact them most.

Documenting patterns in the financial services industry and helping local organizations and media understand problems.

Giving communities the tools to make better, safer financial decisions.

Woodstock Institute
Our mission and how we accomplish it.
About Woodstock Institute
Determining individual and community impacts

Individual Impacts

Community Impacts
Changes in Mortgage Market Make-Up: RMBS Issuance by Mortgage Type, 1995 to 2007-2Q

Concerns about Subprime Lending
Decreasing Equity

Percent of ARM Loans with LTVs Below 80% by Type of Mortgage, 2002 to 2006

Source: LoanPerformance, UBS from "The Deflating Mortgage and Housing Bubble, Part II" by Thomas Zimmerman. October 2007
Concerns about Subprime Lending
Increasing Popularity of Low Docs

Percent of ARM Loans with Low Income Documentation by Type of Mortgage, 2002 to 2006

Source: LoanPerformance, UBS from “The Deflating Mortgage and Housing Bubble, Part II” by Thomas Zimmerman. October 2007
Concerns about Subprime Lending
Growing Popularity of Hybrid ARMs

Subprime Loans By Mortgage Adjustment Period, 1999 to 2006

Source: LoanPerformance, UBS from "The U.S. Subprime Industry in Turmoil" by Thomas Zimmerman. March 2007
Concerns about Subprime Lending
Product features and characteristics

- Brokers more common in subprime market
  - Subprime: 71%
  - All Loans: 50%

- Loans through mortgage companies, not depositories
  - Not covered by CRA
  - Less rigorous safety and soundness regulations

- Increasing popularity of risky products and loan terms in subprime market
  - Interest Only
  - Option ARM
  - Hybrid ARM
  - Piggyback 80/20

- Poor underwriting
- Fraud
Concerns about Subprime Lending
Implications of inappropriate pricing

Pricing implications of interest rate changes on $100,000 30-year fixed rate mortgage

<table>
<thead>
<tr>
<th>Rate</th>
<th>Monthly Payment</th>
<th>Interest paid over life of the loan</th>
</tr>
</thead>
<tbody>
<tr>
<td>5%</td>
<td>$537</td>
<td>$93,256</td>
</tr>
<tr>
<td>7%</td>
<td>$665</td>
<td>$139,509</td>
</tr>
<tr>
<td>10%</td>
<td>$878</td>
<td>$215,926</td>
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</tbody>
</table>

Source: Woodstock Institute calculations
What type of mortgage do you currently have?

- Fixed-Rate (57%)
- Interest Only (3%)
- Adjustable Rate Mortgage (6%)
- Don’t Know (34%)

What do you plan to do when your ARM loan readjusts?

- Refinance to a fixed-rate loan (36%)
- Won’t have the loan anymore (24%)
- Don’t Know (34%)
- Get Another ARM (2%)
- Move (4%)

Source: Elizabeth Razzi, "Mortgage Ignorance Rampant." Bankrate.com [March 26, 2007]
### Alternative Products Produce Borrower Payment Shock

Increase in Minimum Monthly Payments and Outstanding Loan Balance with an April 2004 $400,000 Payment-Option ARM, Assuming Rising Interest Rates

<table>
<thead>
<tr>
<th>Year</th>
<th>Minimum Monthly Payment</th>
<th>Total increase in outstanding balance</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>$1,287</td>
<td>N/A</td>
</tr>
<tr>
<td>2</td>
<td>$1,383</td>
<td>$3,299</td>
</tr>
<tr>
<td>3</td>
<td>$1,487</td>
<td>$10,714</td>
</tr>
<tr>
<td>4</td>
<td>$1,598</td>
<td>$19,735</td>
</tr>
<tr>
<td>5</td>
<td>$1,718</td>
<td>$27,278</td>
</tr>
<tr>
<td>6 and beyond</td>
<td></td>
<td>$33,446</td>
</tr>
</tbody>
</table>

Concerns about Subprime Lending
Reset patterns suggest problems will persist

Source: IMF and Credit Suisse
Concerns about Subprime Lending
Concentrated in minority areas

Percent of 1998 refinance application by type of lender – heavily concentrated in minority communities

Source: Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development. 1999 Woodstock Institute
Concerns about Subprime Lending
Concentrated subprime lending drives foreclosures

Expected Foreclosures per 100 loans by loan type

- **Home Purchase**
  - Prime Loan: 0.31
  - Subprime or “High Cost” Loan: 8.91

- **Home Improvement**
  - Prime Loan: 1.76
  - Subprime or “High Cost” Loan: 9.55

- **Refinance**
  - Prime Loan: -0.54
  - Subprime or “High Cost” Loan: 7.82

Source: Risky Business: An Economic Analysis of the Relationship Between Subprime Lending and Neighborhood Foreclosures. 2004 Woodstock Institute
Quarterly Changes in Chicago Area Foreclosure Starts, January 2003 to June 2007

Source: Woodstock Institute analysis of data from Foreclosure Report of Chicago
• Regionally there was a 36% increase in foreclosures 2005 to 2006
  – North Cook – 52.1%
  – NW Cook – 48.7%
  – DuPage – 46.4%
  – Will – 44.8%
  – Kane – 37.5%
  – Chicago – 36.9%
  – Lake – 36.1%
  – Southwest Cook – 29.3%
  – West Cook – 29%
  – South Cook – 26.9%
  – McHenry – 25.3%

Source: Woodstock Institute analysis of data from Foreclosure Report of Chicago
2006 Foreclosures in the Chicago Region

Foreclosures per 1,000 Properties

Source: Woodstock Institute analysis of data from Foreclosure Report of Chicago
• Many of the Largest Subprime Lenders Are Out of Business
  – New Century
  – Fremont
  – Ameriquest
  – Option One
  – Aegis
  – Accredited
  – BNC

• Implications
  – Lenders clearly making problem loans
  – More aggressive pursuing foreclosure
  – Difficult to work out troubled loans

• Investment Properties
  – Made up growing share of mortgage market
  – More vulnerable to foreclosure
Possible Trouble Spots for Foreclosures:
Problem Lenders and Investment Properties

Concentrated subprime lending increases risk of foreclosure and reduces neighborhood property values

3,750 foreclosures in 1997 and 1998 are estimated to reduce nearby property values by more than $598 million

average cumulative single-family property value effect of $159,000 per foreclosure

1.44 percent decline in property values for each foreclosure within one-eighth of a mile of a house in a low- or moderate-income census tract.

Given the $111,002 for properties in low- and moderate-income tracts, this amounts to a loss of nearly $1,600 per foreclosure for the average property

Source: There Goes the Neighborhood: The Effect of Single-Family Mortgage Foreclosures on Property Values. 2005 Woodstock Institute
Implications of Subprime Lending
Individual and community impacts

• Individuals
  – Credit Card Issues
  – Credit History

• Housing Market
  – Difficult to obtain favorable mortgage terms
  – Increased inventory

• Local Property Values
  – Foreclosures affect values of surrounding properties

• Crime
  – Foreclosures lead to increased crime
  – Neighborhood instability and vacant properties

• Municipal Costs
  – Lost property tax revenue
  – Increased burden on city services (police, fire, public health) to secure and monitor vacant properties
Why is this Happening?
And what can be done?

- Government subsidies focused on driving demand for home ownership
- Poor regulatory oversight
- Strong demand for mortgage backed securities
- Perception that home prices would continue to rise
- Government, homeowner, investor, lender and servicer must all absorb portion of loss
- Freeze interest rates for adjustable rate mortgages at starter rate
- Change bankruptcy law to allow for modification of primary mortgage
- Develop government-backed acquisition mechanism to purchase loan pools at a discount and modify loans to ensure all parties share in loss
- Ensure counseling and loan review for loans with potentially predatory features