



Michael D. Calhoun

Legislative Remedies to Predatory Lending

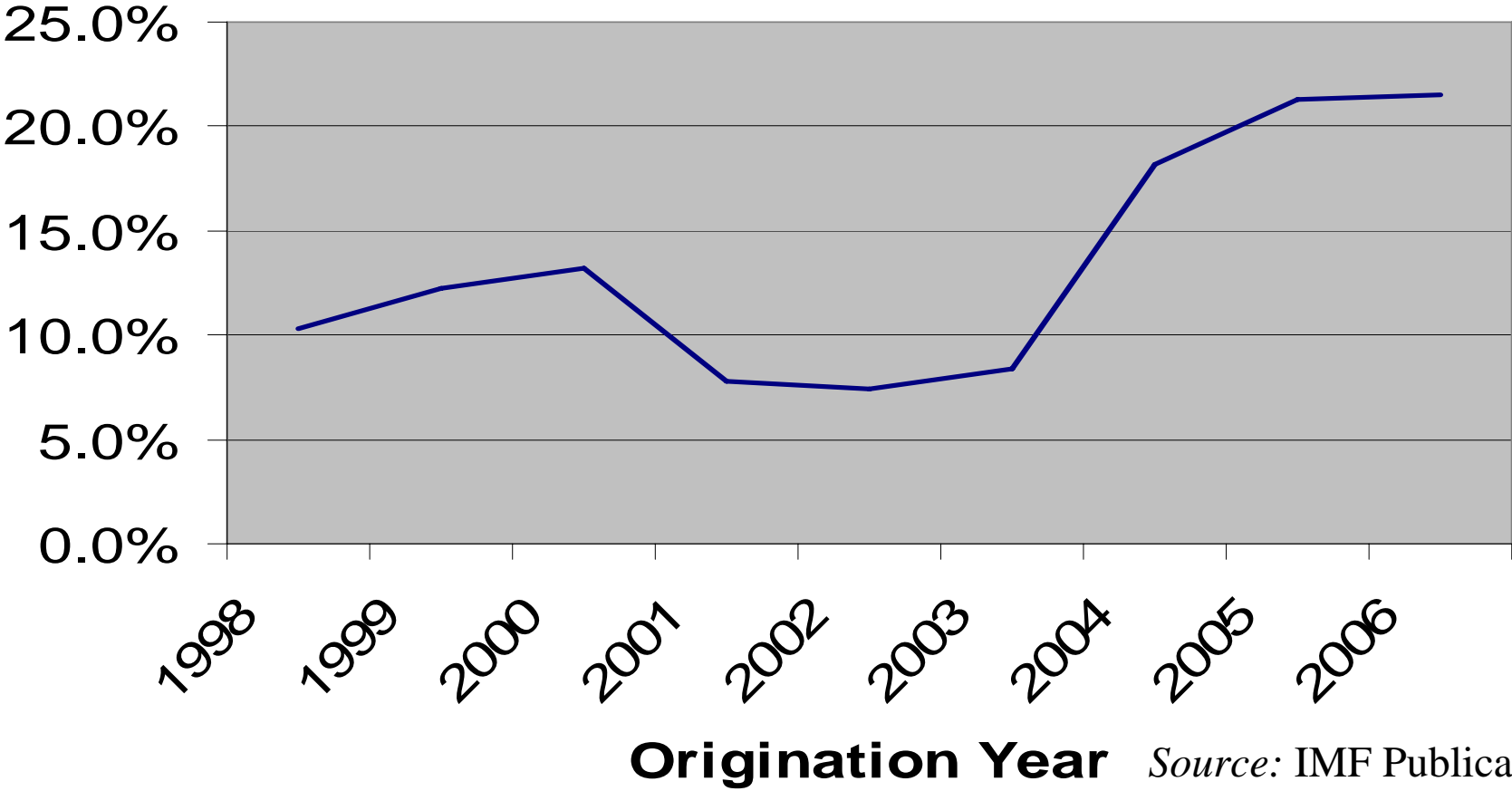
March 29, 2007
Washington, D.C.

Federal Reserve System Community Affairs Conference:
Financing Community Development

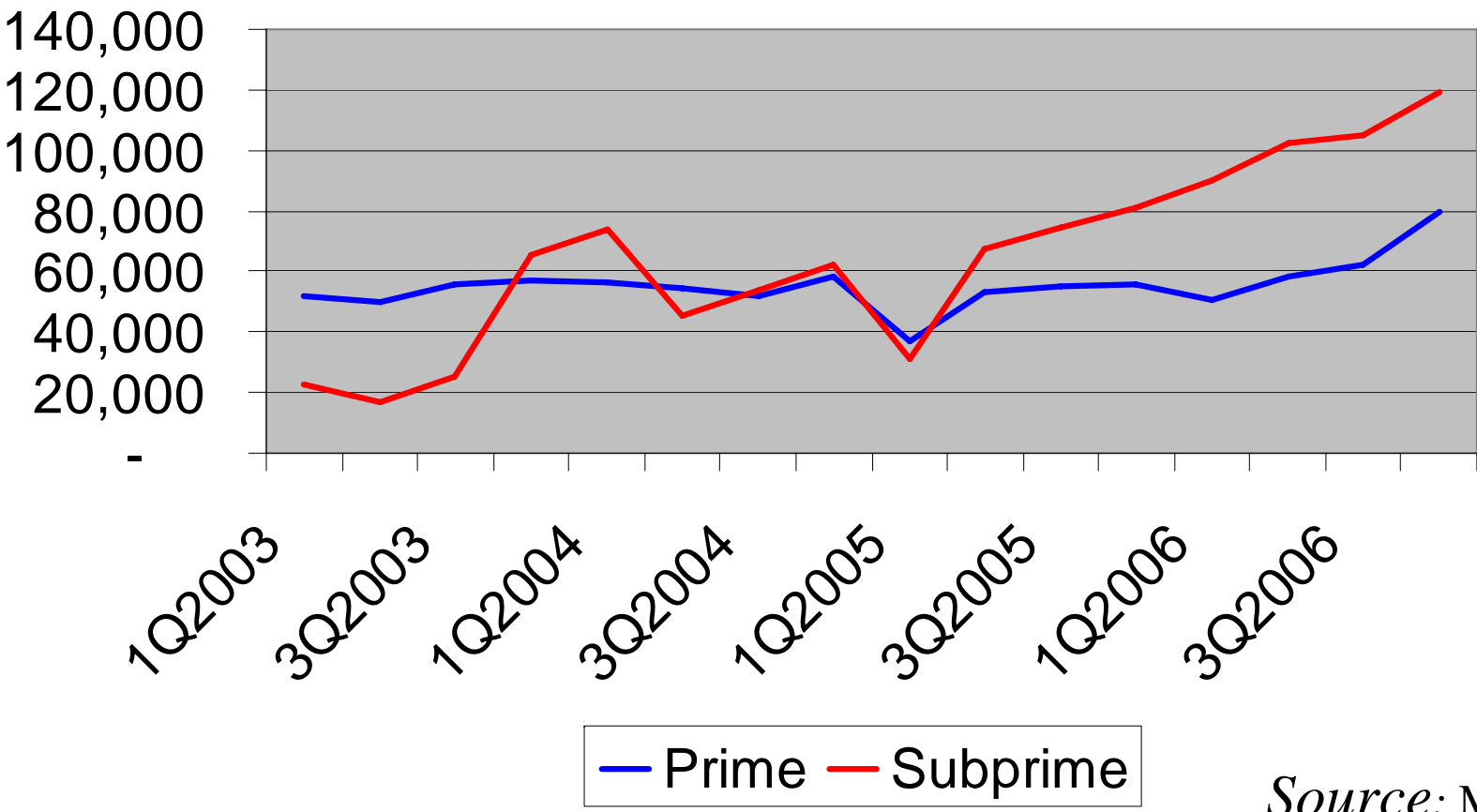
Papers Discussed

- Elliehausen, Gregory, Michael E. Staten, and Jevgenijs Steinbuks. “The Effect of Prepayment Penalties on the Pricing of Subprime Mortgages.” March 2007.
- Bostic, Raphael W., Kathleen C. Engel, Patricia A. McCoy, Anthony Pennington-Cross, and Susan M. Wachter. “State and Local Anti-Predatory Lending Laws: The Effect of Legal Enforcement Mechanisms.” January 2007.

Subprime Share of All Mortgages (by origination year)



Subprime Foreclosure Starts Now Drive MBA Overall Foreclosure Starts



Source: MBA

Subprime Home Loan Traits



- Typically hybrid ARM with large built-in payment shock.
- Majority carry prepayment penalties matched to date of first adjustment in interest rate.
- Up-front fees are many times higher than in the prime market.
- Predominance of low levels of income documentation.
- Typically refinance loans originated through a mortgage broker.
- Debt-to-income ratios can rise as high as 55 percent.
- Regularly packaged in securities and sold to investors.

Subprime Rate Sheet Example



<u>YSP (first mortgages only): Change in Rate</u>

0.50 point YSP: +0.250

1.00 point YSP: +0.500

1.50 point YSP: +0.875

2.00 point YSP: +1.250

1.00 point Buydown: -0.500

Max YSP = 1 point if no prepay or loan amount > \$500,000

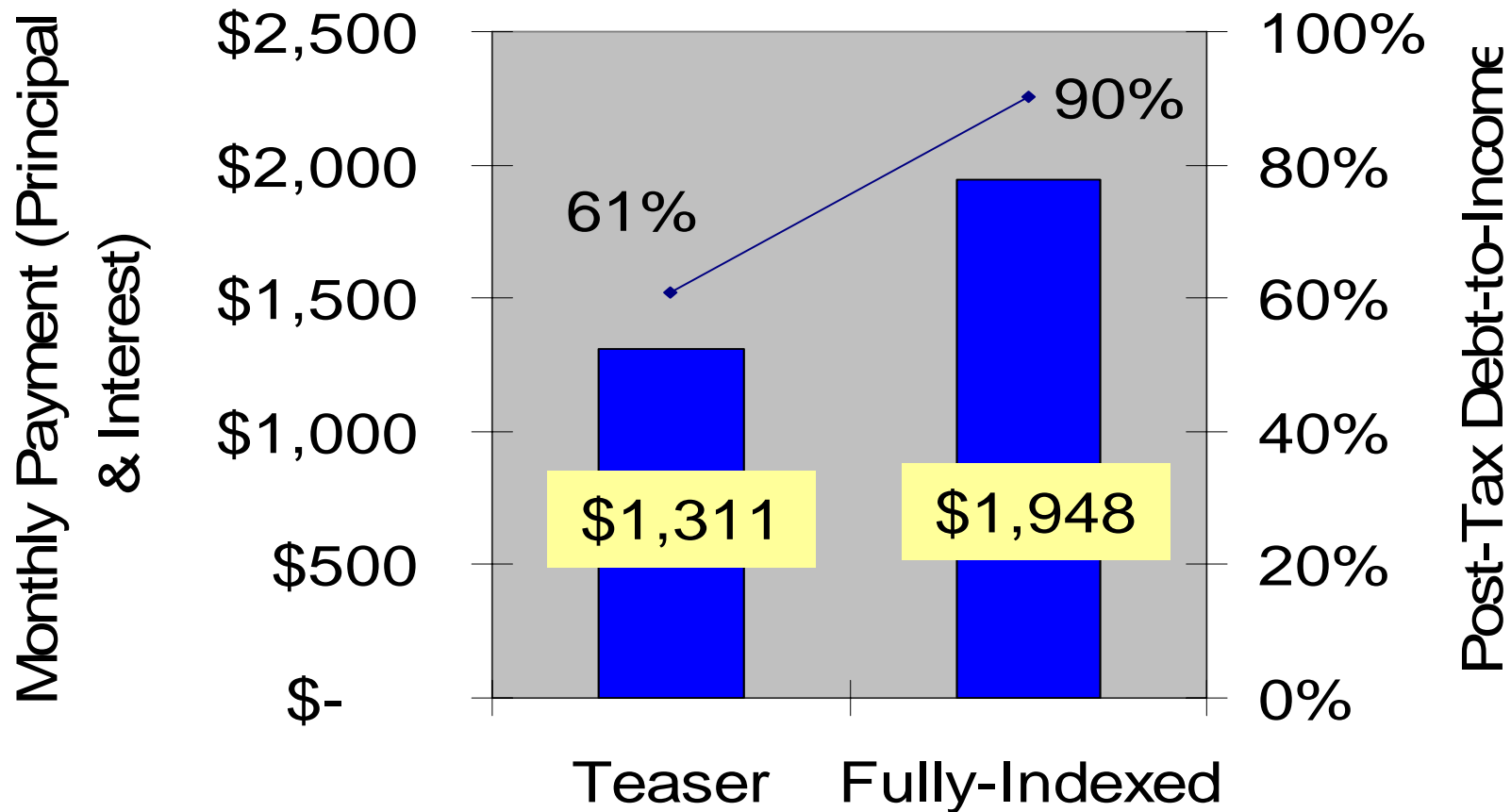
Waive prepayment penalty: +1.00

Net Cost of Prepayment Penalties



Item	Estimated Borrower Benefit (Cost)
Reported Interest Rate Benefit (0.18% * 30-month average life)	0.45%
Expected Cost (2.8% fee * 33% experience rate)	(0.95%)
Expected Value to Borrower	(0.50%)

Example of 2-28, \$200,000 Hybrid ARM, No Change in Rates



Goals of Anti-Predatory Lending Laws



- Eliminate or otherwise reform predatory lending, primarily as it relates to equity stripping through exorbitant fees or abusive subprime prepayment penalties.
- Preserve access to responsible and fairly priced subprime home loans.
- Additional points of suitability and ability to repay coming rapidly into focus.

Conclusion

- Subprime prepayment penalties:
 - Only 18 percent of the value of prepayment penalties indicated on lender rate sheets appears to inure to borrowers.
 - Each \$1 in interest rate benefits reported to accrue to borrowers appears to be offset by \$2 in penalty fees.
- State and local anti-predatory lending laws:
 - Result in no decreased access to credit.
 - Consistent with expectations, stronger provisions do appear to matter.