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Legislative Remedies to Predatory Lending

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Federal Reserve System Community Affairs Conference:
*Financing Community Development*
Papers Discussed


Subprime Share of All Mortgages (by origination year)


Source: IMF Publications

http://www.responsiblelending.org
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**

<table>
<thead>
<tr>
<th>YSP (first mortgages only): Change in Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.50 point YSP: +0.250</td>
</tr>
<tr>
<td>1.00 point YSP: +0.500</td>
</tr>
<tr>
<td>1.50 point YSP: +0.875</td>
</tr>
<tr>
<td>2.00 point YSP: +1.250</td>
</tr>
<tr>
<td>1.00 point Buydown: -0.500</td>
</tr>
</tbody>
</table>

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

Waive prepayment penalty: +1.00
Net Cost of Prepayment Penalties

<table>
<thead>
<tr>
<th>Item</th>
<th>Estimated Borrower Benefit (Cost)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reported Interest Rate Benefit (0.18% * 30-month average life)</td>
<td>0.45%</td>
</tr>
<tr>
<td>Expected Cost (2.8% fee * 33% experience rate)</td>
<td>(0.95%)</td>
</tr>
<tr>
<td>Expected Value to Borrower</td>
<td>(0.50%)</td>
</tr>
</tbody>
</table>
Example of 2-28, $200,000
Hybrid ARM, No Change in Rates

Monthly Payment (Principal & Interest)

$2,500
$2,000
$1,500
$1,000
$500
$-

$1,948
$1,311

Teaser Fully-Indexed

61%
90%

90%
61%

Post-Tax Debt-to-Income

http://www.responsiblelending.org
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.