Regulatory Update on Nontraditional Mortgage Products and the Challenges Facing Subprime Mortgage Borrowers

An Informed Discussion of Nontraditional Mortgage Products and Escalating Foreclosures

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Today’s Program

• Background on the Subprime Mortgage Market
• Sources of the Recent Problem
• Prospects for Subprime Borrowers
Today’s Program

• Helping Borrowers and Mitigating Losses
• Actions Taken by Banking Supervisory Agencies
• Questions?
Background on the Subprime Mortgage Market

• What are subprime loans?
• Expansion of subprime lending
• Technological advances and financial innovations
• Ongoing growth in the secondary market
Background on the Subprime Mortgage Market

- Subprime loans mean increased risks
- Subprime loans are more likely to default
- For borrowers – this can mean the loss of a home and reduced access to future credit
- For lenders – the originate-to-distribute model can leave lenders with weaker incentives to maintain strong underwriting standards.
Sources of the Recent Problem

- Two-thirds of subprime borrowers have variable-rate mortgages
- More than 17% of these mortgages are in serious delinquency
- Near-prime loans are showing a rise in serious delinquencies as well
**Serious Delinquencies**

- Serious delinquencies – single family mortgage that is 90 days or more past due, or a multi-family mortgage that is two months past due
- Foreclosure proceeding averaged 320,000 mortgage loans per quarter during the first half of 2007
- Foreclosures averaged 240,000 mortgage loans per quarter during 2006 and 2005.
Factors Contributing to Delinquencies and Foreclosures

- Unemployment rate
- Slowing of house prices
  - Dampening the growth of home equity
  - “Under water” mortgages
  - Property purchased for investment purposes
Factors Contributing to Delinquencies and Foreclosures

Loosening of underwriting standards
- Investors did not demand information
- Many subprime originators engaged in risk-layering
  - Piggyback loans
  - Lack of full documentation
  - Failure to escrow taxes and insurance
Factors Contributing to Delinquencies and Foreclosures

Substantial payment increase at the first interest rate reset.

– Most common type of subprime variable-rate loan is the “2/28 loan”
– Typical first reset had the rate increase from 7% to 9 ½ %
– $350 per month increase for the average subprime variable-rate mortgage
Factors Contributing to Delinquencies and Foreclosures

What about refinancing as the answer to interest rate resets?

– In 2003 and 2004, about two thirds of subprime 2/28s were terminated by refinancing or home sale before reset.

– Prepayments on subprime variable-rate loans originated in late 2005 and 2006 have slowed.
Prospects for Subprime Borrowers

Conditions for subprime borrowers have the potential to get worse

– Housing activity continues to weaken
– Bulk of resets is pending

• Quarterly until the end of 2008, monthly payments for more than 400,000 subprime mortgages will reset
• This is up from 200,000 per quarter during the first half of 2007
Prospects for Subprime Borrowers

• Borrowers with solid payment records and enough home equity should be able to refinance

• Others will face challenges from tighter credit conditions:
  – Recent surveys of senior loan officers show significant tightening of standards on subprime loans.
  – Many lenders have gone out of business
  – Issuance of new securitized pools has dwindled
  – The supply of funds for subprime loans is likely to remain low
Helping Borrowers and Mitigating Losses

• We need to pay close attention to communities that may face more challenges than others, such as African-American families
  – According to HMDA data, African-American families account for a disproportionate share of higher-price (and more likely, subprime) loans
Actions Taken by Banking Supervisory Agencies

• Statements issued urging lenders and servicers to work with borrowers
Lenders and Services Generally Want to Work with Borrowers

- Foreclosures can lead to a loss of 40% to 50% of the unpaid mortgage balance.
- Loss mitigation techniques are typically less costly, especially before default.
- Borrowers who have been current should work with their creditor to make the loan payments manageable.
Loan Workouts and Modifications have been Limited

- Borrowers are not seeking help or advice from their lenders
- Borrowers believe lenders cannot or will not help
- Greatest barrier is making contact
- Lenders can make contact through trusted community advocates and partnerships between community groups and lenders
More Needs to Be Done to Deal with Significant Challenges Ahead

• The industry needs to join together to develop prudent loan modifications systemically.

• Regulation Z, which implements the Truth in Lending Act, will be amended.
  – Ban several deceptive advertising practices
  – Require important consumer disclosures earlier in the mortgage process
More Needs to Be Done to Deal with Significant Challenges Ahead

• The Board will issue proposed regulations under the Home Ownership and Equity Protection Act to address unfair and deceptive mortgage lending practices.
  – Prepayment penalties
  – Failure to offer escrow accounts for taxes and insurance
  – Stated-income and low-doc lending
  – Failure to give adequate consideration to a borrower’s ability to repay
That’s our finish!

Questions?
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