

NATIONAL CIVIL RIGHTS GROUPS CALL FOR IMMEDIATE MORATORIUM ON FORECLOSURES RESULTING FROM RISKY SUBPRIME LOANS

April 4, 2007

BACKGROUND INFORMATION

As the nation seeks to recover from the devastation caused by reckless subprime lending, we must squarely address the disproportionate impact on African-Americans and Latinos and other traditionally underserved communities. For years, subprime lenders have targeted communities of color and aggressively marketed dangerous and abusive loans. As a result, people in communities of color have lost billions of dollars in home equity, and today they are losing their homes on a massive scale.

National civil rights groups, including the Leadership Conference on Civil Rights, NAACP, the National Fair Housing Alliance, the National Council of La Raza, and the Center for Responsible Lending, call for mortgage lenders, loan servicers and the investors who hold unaffordable hybrid adjustable-rate mortgage (ARM) loans all over the country to institute an immediate six-month moratorium on subprime home foreclosures and to work actively with homeowners to help them keep their homes by putting these borrowers into affordable loan products. Lenders, servicers and investors have a variety of tools at their disposal to restructure or otherwise change the terms of mortgages to provide relief to homeowners who now struggle with unaffordable loans that were never designed to be sustainable. The six months will be time for the industry to work with these groups to establish benchmarks and set long-term goals for easing the foreclosure crisis and to assist borrowers.

Why This Moratorium Must Be Enacted Now

The need for a moratorium on foreclosures of unaffordable subprime loans with “payment shock” is urgent. If lenders, servicers, Wall Street and policymakers allow the flood of subprime foreclosures to continue rising unchecked, years of economic progress in communities of color will be wiped out, and the racial wealth and equity gap will widen even further. Borrowers must be put into affordable loan products now.

As shown in the charts below, African American and Latino borrowers receive a disproportionate share of subprime mortgages:¹

People of Color Receive Disproportionate Rate of All Subprime Loans

	# Higher Cost	% of Total Loans to Each Group
African-American	388,471	52%
Latino	375,889	40%
White	1,214,003	19%

The share is even higher for loans used to purchase homes, excluding refinances:

People of Color Receive Disproportionate Rate of Subprime Loans, Excluding Refinances

	# Higher Cost	% of Total Loans to Each Group
African-American	170,911	55%
Latino	214,196	46%
White	479,754	17%

Another study revealed even starker differences: African-Americans were six times more likely than Whites to receive higher-cost loans. The same study revealed that Latinos were 4.8 times more likely than Whites to receive higher-cost loans.²

These disparities are even more disturbing in light of the enormous losses in the subprime market. Recent lending data show that subprime mortgages—which make up 13% of the overall mortgage market—account for over 60% of new foreclosure filings.³ Thus, African-American and Latino families, which already lag far behind White families in wealth and ownership, are more likely to receive dangerous, high-cost subprime loans than White borrowers. In fact, studies show this is true even when families of color have similar income levels and credit scores.⁴

Lost Homeownership for African-Americans and Latinos

Subprime lenders frequently assert that subprime loans have been a boon for African-American and Latino families in particular; however, these populations are likely to experience a net loss of homeownership due to these loans. This constitutes a tragic erosion of wealth these communities worked so hard to achieve in the past decade.

Impact of 2005 Subprime Lending on Homeownership by Race/Ethnicity

	African-Americans	Latinos	Other Borrowers
2005 Subprime Originations	505,286	570,484	2,244,617
Number of Subprime Loans to First-Time Homebuyers (Homeownership Gain)	50,925	72,981	200,455
Projected Foreclosures on 2005 Subprime Loans (Homeownership Loss)	98,025	110,674	423,723
Net Homeownership Gain or (Loss) ⁵	(47,100)	(37,693)	(223,268)

Damage Caused by Non-Traditional Mortgages, Including Hybrid Adjustable-Rate Mortgages (“HARMS”)

Civil rights groups want to stop home losses for families that received unaffordable subprime mortgages with “payment shock.” The predominant loan type marketed by subprime lenders in recent years are hybrid subprime mortgages, which begin with a temporary fixed interest rate that changes to a much more costly adjustable-rate mortgage (ARM). These “exploding” ARMs, as well as other types of non-traditional mortgages, have been a driving force in massive foreclosures occurring today.

The typical “hybrid” adjustable-rate mortgage (HARM) has an initial teaser rate that is fixed for two or three years, followed by substantial serial rate increases in six-month increments.⁶ (The borrower is only qualified to make the initial payments, before the increase occurs.) These serial rate increases can increase the borrower’s interest rate by 1.5 to 3 percentage points, and the monthly payment can go up by as much as 30 to 40%.

Subprime lenders have abandoned traditional underwriting practices, and put borrowers into loans *without considering whether they would be able to afford the monthly payments* after the teaser rate expires.⁷ To make matters worse, lenders typically do not include the cost of real estate taxes and insurance in the monthly payment—costs that are routinely factored into prime payments. In addition, these loans typically carry prepayment penalties of thousands of dollars, which do not expire before the teaser rate resets. Because these loans are underwritten so that a substantial proportion of borrowers cannot afford the loan when the rate resets, borrowers must choose between paying the penalty or defaulting when the payment shock hits.

Lenders and mortgage insurers have been aware for decades that adjustable-rate mortgages (ARMs), payment shock and prepayment penalties individually increase the risk of default on loans. In fact, adjustable-rate mortgages of any kind carry a 72% greater risk of foreclosure than fixed-rate mortgages.⁸ Yet, when marketing loans, lenders routinely load loans with two or more high-risk features, showing reckless and blatant disregard for sustainability.

This pattern of lending has been directed disproportionately at people of color. Furthermore, despite warnings from civil rights and consumer advocacy groups, investors and rating companies have not adequately taken into consideration these added risk features and thus have not appropriately assessed and monitored the institutions originating these mortgages.

Fast Facts on Subprime Home Loans

- Subprime mortgages make up over 20 percent of all home loans originated and currently representing \$1.2 trillion of mortgages currently outstanding.⁹
- One out of five subprime mortgages originated during the past two years will end in foreclosure.
- The majority of subprime home loans are refinances, not for buying a home.
- Through the second quarter of 2006, HARMs made up 81 percent of the subprime loans that were packaged as investment securities. That figure is up from 64 percent in 2002.¹⁰

- \$600 billion in subprime loans will have a rate reset in the next two years, making these loans immediately unaffordable for hundreds of thousands of families.
- Subprime loans with prepayment penalties carry a 52% greater risk of foreclosure, and subprime ARMs had 72 percent greater risk of foreclosure than fixed-rate mortgages.¹¹
- African-American and Latino borrowers are disproportionately represented in the subprime market as 52% and 40% of African-Americans and Latinos respectively receive subprime loans.

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¹ Calculations from data reported in Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, Higher-Priced Home Lending and the 2005 HMDA Data, Federal Reserve Bulletin A123, A160-161 (September 8, 2006).

² Campen, Nafici, Rust, Smith, Stein and Kerkhove, "Paying More for the American Dream: A Multi-State Analysis of Higher Cost Home Purchase Lending", March, 2007. A Joint Report By: California Reinvestment Coalition, Community Reinvestment Association of North Carolina, Empire Justice Center, Massachusetts Affordable Housing Alliance, Neighborhood Economic Development Advocacy Project, and Woodstock Institute. Report available at: www.calreinvest.org. This report looks at the cost of home purchase lending in six urban areas – New York City, Los Angeles, Chicago, Boston, Charlotte and Rochester.

³ MBA National Delinquency Survey through the third quarter of 2006, cited in testimony Michael D. Calhoun before the U.S. House Committee on financial Services/Subcommittee on Financial Institutions and Consumer Credit, "The New Regulatory Guidance on Subprime Hybrid Mortgages," (March 27, 2007).

⁴ Debbie Gruenstein, Bocian, Keith S. Ernst and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, Center for Responsible Lending (May 31, 2006).

⁵ Assumes a 19.4% foreclosure rate as calculated for all 2005 subprime originations—see Table 2. This is a conservative estimate, as communities of color receive a disproportionate share of subprime loans, and the clustering of foreclosures in these markets is likely to cause a "feedback loop" that further depresses home values in the market and spurs additional foreclosures.

⁶ See, e.g. *Structured Finance: U.S. Subprime RMBS in Structured Finance CDOs*, p. 2 [Fitch Ratings Credit Policy](#) (August 21, 2006).

⁷ For example, Fremont considered ability to repay based on initial payments due during the first year. Fremont Investment and Loan Prospectus, Fremont Home Loan Trust 2006-1 424B5 (April 4, 2006) available at: http://www.sec.gov/Archives/edgar/data/1357374/000088237706001254/d486451_all.htm. Option One qualified borrowers at the initial teaser rate. See Option One Prospectus, Option One Mortgage Loan Trust 2006-3 424B5 (October 19, 2006), http://www.sec.gov/Archives/edgar/data/1378102/000088237706003670/d581063_424b5.htm; Fremont Investment and Loan Prospectus, Fremont Home Loan Trust 2006-1 424B5 (April 4, 2006), http://www.sec.gov/Archives/edgar/data/1357374/000088237706001254/d486451_all.htm, Morgan Stanley Prospectus, Morgan Stanley ABS Capital I Inc. Trust 2007-NC1 Free Writing Prospectus (January 19, 2007), http://www.sec.gov/Archives/edgar/data/1385136/000088237707000094/d609032_fwp.htm. Likewise, New Century's strongest underwriting practice, which is applied only to borrowers with a credit score under 580 and a loan-to-value ratio over 80 percent, is to evaluate the borrower's ability to repay the mortgage at an interest rate equal to the fully indexed rate minus one percentage point. Best Practices Won't Kill Production at New Century, p. 3 Inside B&C Lending (November 24, 2006).

⁸ Losing Ground. This applies to subprime loans originated in 2000, after controlling for credit score.

⁹ Inside B&C Lending (Sept. 1, 2006); see also Inside Mortgage Finance MBS Database, 2006.

¹⁰ See *Structured Finance*.

¹¹ See Ellen Schloemer, Keith Ernst, Wei Li and Kathleen Keest, "Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners," December 2006 available at www.responsiblelending.org,