# EXHIBIT A

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# Latest News

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FOR IMMEDIATE RELEASE: March 28, 2007

**New Schumer Analysis: Upstate New York At Tip Of Foreclosure Crisis - More Than 50,000 Families Could To Lose Their Homes As Subprime Mortgage Market Collapses**

***Schumer: The Subprime Market is the Wild West of Mortgage Loans and We Need a Sheriff in Town***

***Schumer Releases New County-by-County Foreclosure Estimates for Every Region in the State: 6,000 Foreclosures in the Capital Region over the Next Two Years, 6,000 Central New York, 9,000 Rochester-Finger Lakes, 14,000 Hudson Valley, 2,500 North Country, 4,000 Southern Tier, 10,000 Western New Y***

As the subprime mortgage market goes from boom to bust, U.S. Senator Charles E. Schumer revealed today that foreclosures will soar in Upstate New York over the next two years, with more than 50,000 families in upstate New York at risk of losing their homes by the end of 2008. Schumer today unveiled his plan to ensure that the subprime lending market, which has been able to operate with little oversight from federal regulators - is finally scrutinized on a federal level. Schumer outlined a plan today to regulate these rogue mortgage lenders, eliminate "liar" loans and establish a foreclosure prevention task force.

"The subprime market is the wild west of mortgage loans and its time we bring a sheriff into town," Schumer said. "The first step is making sure that borrowers are protected from these usurious lenders. It's long past time that we ensure that working people are protected from loans that promise them the world and instead give them a mountain of debt and leave them homeless."

The impending avalanche of mortgage foreclosures in upstate New York and across the nation can be directly tied to the exploding popularity of costly non-traditional mortgage products over the past decade. These non-traditional mortgage products, which include hybrid adjustable-rate mortgages with intricate interest rate terms and conditions, have been sold to middle and lower-income families in record numbers. While they offer attractive and easy lending terms, they also include excessively high interest rates that can sharply spike, leaving new homeowners struggling to meet rising mortgage payments.

Over the next two years, nationwide 1.8 million risky subprime borrowers who were "teased" into their loans may be forced to foreclose because they will be hit with steep rate increases that they can not possibly afford. This follows in the wake of more than 1.2 million foreclosures in 2006. According to a report by the Center for American Progress - the number of homeowners who entered into some stage of foreclosure in

December 2006 was up 35% from December 2005. These numbers are only expected to soar in the coming years as the interest rates reset.

The problem is only magnified in the subprime mortgage market, where borrowers with weaker credit histories and lower incomes have flocked to mortgages that have higher interest rates than prime mortgages. Despite subprime loans being universally more expensive than prime loans, they still remain a main source of capital for millions of low-income Americans, especially minorities, who wish to fulfill the American Dream and purchase a house.

Subprime loans leave borrowers in an extremely precarious financial state. In comparison to a prime loan, a subprime loan is more costly due its higher-than-normal interest rates and the borrower being saddled with a high number of points that must be initially paid to obtain the loan. (A point is one percent of the amount being borrowed.) The interest rate and points charged depend on various criteria, including credit history, income, assets, type of property, loan amount, loan duration and the amount of the down payment. To make matters worse, many of these bor¬rowers had to pay costly origination fees on their mortgages, which left them with little cash left to invest in their new homes or to service their mortgages when their adjustable interest rate rises.

The most popular "affordable" subprime loans are adjustable rate mortgages (ARMs) that offer an initial fixed rate that is set low - often called a "teaser" rate. The rate resets after an initial fixed rate period (commonly two to three years), to a more onerous rate that leads to a significantly higher mortgage payment that low-income borrowers generally have great difficulty affording. These ARMs, commonly known as "2/28s" or "3/27s" represented more than 60 percent of all subprime mortgages originated in 2006. The FDIC estimates that this year alone, one million of these loans will reset to higher rates. Next year, 800,000 more will reset to higher rates.

Across upstate New York, 51,076 upstate New York families could loose their house and foreclose on their subprime mortgages.

• In the **Capital Region**, 173,238 houses were mortgaged, and 6,194 families are now in danger of losing their homes.

• In **Central New York**, 164,497 houses were mortgaged, and 5,929 families are now in danger of losing their homes.

• In the **Rochester-Finger Lakes** region, 248,361 houses were mortgaged, and 8,859 families are now in danger of losing their homes.

• In the **Hudson Valley**, 387,573 houses were mortgaged, and 13,825 families are now in danger of losing their homes.

• In the **North Country**, 57,560 houses were mortgaged, and 2,680 families are now in danger of losing their homes.

• In the **Southern Tier**, 98,186 houses were mortgaged, and 3,877 families are now in danger of losing their homes.

• In **Western New York**, 272,277 houses were mortgaged, and 9,712 families are now in danger of losing their homes.

"The bottom line here is that the subprime bust is leading us right into a foreclosure boom, and thousands of people will be left in the lurch," Schumer said. "We are staring straight into the barrel of the biggest foreclosure crisis ever, and action must be taken now to avoid disaster."

In an effort to protect homebuyers from usurious lenders and potential foreclosure - today Schumer unveiled his plans for legislation to stem the tide of subprime mortgages. Schumer's three-point plan will:

• **Establish a National Regulatory System for Mortgage Brokers:** The subprime lending business has become an unregulated mess and a new authority is needed to regulate rogue mortgage lenders and brokers who operate below the radar of federal regulators. Schumer's plan will fill the gaping void in our federal regulatory structure and create a national system for ALL mortgage brokers and loan officers, including those at non-bank companies.

• **Eliminate "Liar" Loans:** It has become too obvious too late that for many of these defaulting loans, the borrowers could never have paid them. They were mathematically designed to fail the homeowner and give the lying mortgage broker fat fees. It is not right that families that got "teased" into their house with the promise that they could afford the loans, will all-to-predictably be kicked out when their loans reset to onerous rates. To prevent this tragedy from happening again, Schumer's bill will establish a suitability standard for borrowers so that they will never issue a loan that the borrower cannot afford. It will also prohibit pre-payment penalties, stated-income or low documentation loans, and "pick a payment" options that are used to deceive borrowers into signing their dream of homeownership down the drain.

• **Create a NYS Foreclosure Prevention Task Force:** Schumer plans to bring together private sector and non-profit groups in New York State to keep the nearly 100,000 residents who are standing on the edge of the foreclosure cliff from losing their homes. The focus would be on helping homeowners restructure their individual loans, offer forbearance periods, assist homeowners sell distressed properties for borrowers that choose to no long own, provide credit counseling and negotiate with credit reporting agencies to delete defaults or forecloses for borrowers that are considered to be in failing, predatory loans. The working group would include - elected officials, regulators, financial institutions, and groups (ACORN, Operation Hope, NeighborWorks, Neighborhood Economic Development Advocacy Project, and others).

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# EXHIBIT B

**FEDERAL RESERVE SYSTEM**

**Home Equity Lending Market; Notice of Hearings**

**[Docket No. OP-1288]**

**AGENCY:** Board of Governors of the Federal Reserve System

**ACTION:** Public Hearing; Request for Comment

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**SUMMARY**: Section 158 of the Home Ownership and Equity Protection Act of 1994 (HOEPA)[1] directs the Board to hold public hearings periodically on the home equity lending market and the adequacy of existing regulatory and legislative provisions (including HOEPA) in protecting the interests of consumers. Consequently, as previously announced, the Board will hold a hearing on the home equity lending market and invites the public to attend and to comment on the issues that will be the focus of the hearing. Additional information about the hearing will be posted to the Board's website at http://www.federalreserve.gov.

**DATES:** The date of the hearing is June 14, 2007.

Comments. Comments from persons unable to attend the hearing or otherwise wishing to submit written views on the issues raised in this notice must be received by August 15, 2007.

**ADDRESSES:** The location of the hearing is:

The Federal Reserve Board, 20th and C Streets, N.W., Washington, D.C., 20551, in the Martin Building, Terrace Level, Dining Room E.

You may submit comments, identified by Docket No. OP-1288, by any of the following methods:

- Agency Web Site: http://www.federalreserve.gov. Follow the instructions for submitting comments at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.

- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

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[1] Pub. L. 103-325, 108 Stat. 2160.

- E-mail: regs.comments@federalreserve.gov. Include the docket number in the subject line of the message.

- Fax: (202) 452-3819 or (202) 452-3102.

- Mail: Address to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551.

All public comments will be made available on the Board's web site at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20th and C Streets, N.W.) between 9:00 a.m. and 5:00 p.m. on weekdays.

**FOR FURTHER INFORMATION CONTACT:** Kathleen C. Ryan, Counsel, or Paul Mondor, Attorney, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, at (202) 452-2412 or (202) 452-3667. For users of Telecommunications Device for the Deaf (TDD) only, contact (202) 263-4869.

**SUPPLEMENTARY INFORMATION:**

## I. Background

### 1. HOEPA

In 1994, the Congress enacted the Home Ownership and Equity Protection Act (HOEPA) as an amendment to the Truth in Lending Act (TILA), in response to testimony about predatory home equity lending practices in underserved markets, where some lenders were making high-rate, high-fee home equity loans to cash-poor homeowners. HOEPA identifies a class of high-cost mortgage loans based on the loans' rates and fees. Loans above HOEPA's price triggers require additional disclosures and are subject to substantive restrictions on loan terms. HOEPA is implemented by the Board's Regulation Z (12 CFR 226.32 and 34).

Section 158 of HOEPA also directs the Board to hold public hearings periodically on the home equity lending market and the adequacy of existing regulatory and legislative provisions for protecting the interests of consumers, particularly low-income consumers. Hearings were held in 1997, 2000, and 2006. Following the 2000 hearings and the receipt of public comment, the Board amended the provisions of Regulation Z that implement HOEPA. These revisions included extending HOEPA's coverage to more loans, enhancing disclosures for HOEPA loans, and expanding its substantive restrictions. The revisions took effect in October 2002.

In addition to the Board's general grant of rulewriting authority under HOEPA, Section 129(l)(2) of HOEPA also confers regulatory authority on the Board to prohibit acts or practices:

- In connection with mortgage loans—if the Board finds the practice to be unfair, deceptive, or designed to evade HOEPA; and

- In connection with refinancings of mortgage loans—if the Board finds that the practice is associated with abusive lending practices or otherwise not in the interest of the borrower.

2. The Board's 2006 hearings

The Board's most recent hearings under HOEPA covered three broad topics: (1) the impact of the 2002 HOEPA rule changes and state and local predatory lending laws on predatory lending practices; (2) nontraditional mortgage products and reverse mortgages; and (3) informed consumer choice in the subprime market. Hearing panelists included mortgage lenders and brokers, credit ratings agencies, realtors, consumer advocates, community development groups, housing counselors, academicians, researchers, and state and federal government officials.

Consumer advocates and some state officials stated that HOEPA (and state predatory lending laws) are generally effective in preventing loans with abusive terms from being made for loans subject to the HOEPA price triggers. Some advocated that Congress should lower HOEPA's coverage triggers so that more loans are subject to HOEPA. Consumer advocates and state officials urged regulators and Congress to take action to curb abusive practices for loans that do not meet HOEPA's price triggers.

Consumer advocates urged the Board to prohibit or restrict certain loan features or terms, such as prepayment penalties, and underwriting practices such as "stated income" or "low documentation" ("low doc") loans where the borrower's income is not documented or verified. They also expressed concern about aggressive marketing practices that include steering borrowers to higher-cost loans by emphasizing initial low monthly payments based on an introductory rate without adequately explaining that the consumer will have considerably higher monthly payments after the introductory rate expires. Finally, some consumer advocates stated that brokers and lenders should be held to a fiduciary standard such as a duty of good faith and fair dealing or a requirement that they make only loans that are suitable for a particular borrower.

Industry panelists and commenters, on the other hand, expressed concern that HOEPA may reduce the availability of credit for some subprime borrowers. They stated that state predatory lending laws may also reduce credit availability. Most industry commenters opposed prohibitions on stated income loans, prepayment penalties, and other loan terms, asserting that these features could benefit some borrowers. They urged the Board and other regulators to focus instead on enforcing existing laws to remove "bad actors" from the market. Some lenders indicated, however, that carefully constructed reasonable restrictions on certain loan features or practices might be appropriate if the conditions were clear and would not unduly reduce credit availability. Fiduciary responsibilities would, in industry's view, create conflicts for lenders, who are responsible to their shareholders. Industry commenters also stated that subjective suitability standards would create uncertainties for brokers and lenders and subject them to litigation risk.

## II. Information About the Board's 2007 Hearing

The June 14th hearing is open to the public to attend. Seating will be limited, however. All visitors must register at least 24 hours in advance for security purposes and may access the Board's online registration service at https://www.federalreserve.gov/secure/forms/hoeparegistration.cfm. Further information about the hearing, as it becomes available, will be posted on the Board's web site at http://www.federalreserve.gov. The hearing will begin at 8:30 a.m. and conclude at 4:00 p.m. (EST).

The Board will invite persons to participate in panel discussions on the topics discussed below. In addition to the panel discussions, the Board intends to reserve about one hour after the conclusion of the panels, at 3:00 p.m., to permit interested parties other than those on the panels to make brief statements. To allow as many persons as possible to offer their views during this period, oral statements will be limited to three minutes or less; written statements of any length may be submitted for the record. Interested parties who wish to participate during this "open-mike" period may contact the Board in advance of the hearing date at the telephone numbers provided in this notice, to facilitate planning for this portion of the hearings.

## III. 2007 Hearing Discussion and Request for Comment

This hearing will examine how the Board might use its rulemaking authority under section 129(l)(2) of HOEPA to address concerns about abusive lending practices in the mortgage market, including the subprime mortgage market. The purpose of the hearing is to enable the Board to gather information to evaluate whether it can address issues about predatory lending in a way that preserves incentives for responsible lenders to provide credit to borrowers, particularly subprime borrowers.

The Board solicits comment on whether it should use its rulemaking authority to address concerns about the loan terms or practices listed below, and any others that commenters identify. Commenters are requested to discuss whether these terms or practices are associated with unfairness or deception, evasion of HOEPA, abusive lending, or are not otherwise in the interest of borrowers. In addition, commenters are requested to address whether the term or practice should be prohibited or restricted for all mortgage loans, only for loans offered to subprime borrowers, or other subsets of loans such as loans to first-time homebuyers, home purchase loans, or refinancings and home equity loans; only certain products, such as adjustable rate mortgages or nontraditional mortgages.[2]

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[2] Nontraditional mortgage products are mortgage loans that allow borrowers to defer repayment

Comment is also requested on the effectiveness of state laws that have prohibited or restricted the practices listed below (and others) and whether the Board should consider adopting similar regulations to curb abuses without restricting access to responsible mortgage lending.

A. Prepayment penalties. Consumer advocates state that prepayment penalties deter a consumer from refinancing the loan on more favorable terms and that consumers do not receive any benefit in return. Consumer advocates are also concerned about prepayment penalties that extend beyond the expiration of an introductory or teaser rate on an ARM, which deter consumers from refinancing to avoid payment shock when the rate resets. Consequently, some consumer advocates recommend that penalties be banned or restricted for such loans. According to industry representatives, however, prepayment penalties ensure a minimum return on the transaction if loans are paid off early. Industry representatives also state that consumers receive, in return, a benefit in the form of lower up-front costs or lower interest rates.

The Board requests comment on the following questions related to prepayment penalties:

- Should prepayment penalties be restricted? For example, should prepayment penalties that extend beyond the first adjustment period on an ARM be prohibited?
- Would enhanced disclosure of prepayment penalties help address concerns about abuses?
- How would a prohibition or restriction on prepayment penalties affect consumers and the type and terms of credit offered?
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B. Escrow for taxes and insurance on subprime loans. Loans to prime borrowers typically include an escrow for taxes and insurance, while loans to subprime borrowers typically do not include escrows. Consumer advocates are concerned that subprime borrowers are not aware of, and may not be able to budget for, these expenses. They are also concerned that lenders quote monthly payments to subprime borrowers that do not include taxes and insurance, and these borrowers do not realize that they will have to budget separately for these obligations.

The Board requests comment on the following questions related to escrows for taxes and insurance:

- Should escrows for taxes and insurance be required for subprime mortgage loans? If escrows were to be required, should consumers be permitted to "opt out" of escrows?

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of principal and, sometimes, interest. They include interest-only loans and ''payment option'' ARMs where a borrower has flexible payment options with the potential for negative amortization.

- Should lenders be required to disclose the absence of escrows to consumers and if so, at what point during a transaction? Should lenders be required to disclose an estimate of the consumer's tax and insurance obligations?

- How would escrow requirements affect consumers and the type and terms of credit offered?

C. "Stated income" or "low doc" loans. In some cases a lender will make a mortgage loan without documenting or verifying a borrower's income; lenders may charge higher rates for such loans. Lenders state that these loans are appropriate for many borrowers, including those who are self-employed and cannot easily document their income or who choose not to. Consumer advocates state that many borrowers who could document their income are not aware that they are getting a stated income loan with a higher rate. They state that some brokers and lenders use "stated income" or "low doc" loans to perpetrate fraud (e.g., the consumer's income is falsified or "marked up" by a broker or loan officer and is not verified by the lender). Concerns have also been raised about the use of stated income loans with other "risk layering features" such as second-lien loans for all or part of the consumer's downpayment.

The Board requests comment on the following questions related to stated income and low doc loans:

- Should stated income or low doc loans be prohibited for certain loans, such as loans to subprime borrowers?

- Should stated income or low doc loans be prohibited for higher-risk loans, for example, for loans with high loan-to-value ratios?

- How would a restriction on stated income or low doc loans affect consumers and the type and terms of credit offered?

- Should lenders be required to disclose to the consumer that a stated income loan is being offered and allow the consumer the option to document income?

D. Unaffordable loans. Consumer advocates state that some lenders extend loans without adequately considering the borrower's ability to repay the loan. For example, lenders may qualify borrowers based on an ARM's introductory rate and not at the fully- indexed rate that will apply once the introductory rate expires. Lenders state that it is appropriate to make such loans in certain circumstances, for example, where the borrower is likely to be able to refinance the loan at a lower rate before the reset date. Other circumstances include those in which borrowers expect to sell their home within a few years, or expect a significant decrease in their monthly obligations or a significant increase in income, such as a borrower who is completing professional training. Because loans are frequently sold to purchasers who generally cannot be held liable for the loan originator's actions, and because the risk of default is spread out among investors in loan pools, some consumer advocates believe that there is insufficient accountability for making loans that consumers cannot repay.

Recently the Board and the other banking and thrift regulators issued guidance on underwriting nontraditional mortgage products. The guidance provides that:

> An institution's analysis of a borrower's repayment capacity should include an evaluation of their ability to repay the debt by final maturity at the fully indexed rate, assuming a fully amortizing repayment schedule. In addition, for products that permit negative amortization, the repayment analysis should be based upon the initial loan amount plus any balance increase that may accrue from the negative amortization provision.

71 FR 58609, 58614 (Oct. 4, 2006) (footnotes omitted).

Some have urged that lenders should be required to underwrite all mortgage loans based on a fully-indexed rate and a fully amortizing payment. Some have also advocated a rebuttable presumption that a borrower cannot afford to repay a loan if the borrower's debt-to-income ratio exceeds 50 percent and that such loans should be prohibited by regulation.

The Board requests comment on the following questions:

- Should lenders be required to underwrite all loans based on the fully-indexed rate and fully amortizing payments?
- Should there be a rebuttable presumption that a loan is unaffordable if the borrower's debt-to-income ratio exceeds 50 percent (at loan origination)?
- Are there specific consumer disclosures that would help address concerns about unaffordable loans?
- How would such provisions affect consumers and the type and terms of credit offered?

By order of the Board of Governors of the Federal Reserve System, May 24, 2007.

Jennifer J. Johnson (signed)
Jennifer J. Johnson
Secretary of the Board

# EXHIBIT C

# Fed looks to rein in 'liar loans'

**At a hearing in Washington, policy makers look for recommendations for curbing abusive lending practices.**

**By Les Christie, CNNMoney.com staff writer**
June 14 2007: 10:14 AM EDT



NEW YORK (CNNMoney.com) -- The Federal Reserve opened a hearing in Washington today to solicit suggestions on how to curb abusive mortgage lending practices.

Representatives from a wide range of interest groups were scheduled to appear at the hearing, which was chaired by Randall S. Kroszner, a member of the Fed's Board of Governors.

In opening remarks Kroszner said, "The hearing will focus specifically on how the Board might use its rulemaking authority under HOEPA (Home Ownership and Equity Protection Act) to address concerns about abusive mortgage lending practices."

HOEPA, which Congress enacted in 1994, gives the Federal Reserve wide authority in regulating against abusive lending, but Kroszner pointed out that the states can pass their own prohibitions against predatory lending.

Bad loans are contributing to a crisis in home ownership with delinquencies and foreclosures rising steeply this year.

Kroszner also recognized that the mortgage lending transaction is already overburdened with often arcane, legalistic or incomprehensible paperwork that cover disclosures of various kinds.

Therefore, a main goal of the hearing was to gather information in order to craft rules that would curb abusive lending efficiently and effectively.

They would be aimed at four of the most troublesome practices he cited:

- Prepayment penalties: When borrowers seek to pay off expensive loans early they may be hit with a fee of as much as six months of mortgage payments.
- Failure to require escrows for taxes and insurance: These expenses add to the monthly costs of home ownership but mortgage servicers do not always require borrowers to bank the payments in escrow accounts with them. As a result, the payments may be put off, resulting in tax delinquencies or insurance coverage lapses.
- Stated income and low-documentation lending: "So-called "liar loans" that encourage borrowers to exaggerate income to qualify for larger mortgages than they can handle.
- Failure to give adequate consideration to a borrower's ability to repay a loan: Many loan originators have no monetary interest in loans after they the deal is done. That encourages them to approve borrowers they know, or should know,

cannot afford to make the payments.

These practices are not, in themselves, abusive. Borrowers may, for example, rightly choose a loan with hefty prepayment penalties if that lowers the interest rates on their loans. The problems arise when loan originators apply these provisions indiscriminately or with predatory intent.

"Today, with your help," said Kroszner, "we intend to explore in detail when these types of practices can be beneficial and when they might be problematic." ■

Study: Housing grows less affordable

Find mortgage rates in your area.

# EXHIBIT D

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Office of the Secretary

September 14, 2006

Jennifer L. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th and C Streets, N.W.
Washington, D.C. 20551

Re: Docket No. OP-1253

Dear Ms. Johnson:

The Federal Trade Commission ("Commission") appreciates the opportunity to comment on the Federal Reserve Board's ("Board") notice regarding the "Home Equity Lending Market."[1]

The Commission has wide-ranging responsibilities regarding consumer financial issues for most nonbank segments of the economy, including mortgage lenders, brokers, and advertisers. The FTC enforces a number of federal laws governing home equity lending, including the Truth in Lending Act ("TILA") and the Home Ownership and Equity Protection Act ("HOEPA"), which amended TILA to address certain practices for high-cost home equity loans.[2] The Commission also enforces Section 5 of the Federal Trade Commission Act ("FTC Act"), which more generally prohibits unfair and deceptive acts and practices in the marketplace.[3] In addition, the Commission conducts research on home mortgage lending and related topics, develops consumer and business education materials,[4] responds to inquiries about these matters from consumers, industry, and the media, and works with other federal and state

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1 71 Fed. Reg. 26,513 (May 5, 2006).

2 The TILA is at 15 U.S.C. § 1601 *et seq.*

3 The FTC Act is at 15 U.S.C. § 41 *et seq.*

4 These materials on mortgage issues are available at the Commission's *For Consumers Credit* web page, at http://www.ftc.gov/bcp/conline/edcams/credit/coninfo.htm, under the category *Mortgages & Your Home*. The web page includes consumer education materials such as "Home Equity Loans: Borrowers Beware," "High-Rate, High-Fee Loans (HOEPA/Section 32 Mortgages)," and "Reverse Mortgages: Get the Facts Before Cashing In On Your Home's Equity," http://www.ftc.gov/bcp/conline/pubs/homes/eqscams.pdf, http://www.ftc.gov/bcp/conline/pubs/homes/32mortgs.pdf, and http://www.ftc.gov/bcp/conline/pubs/homes/rms.pdf.

law enforcement entities to protect consumers from unfair or deceptive mortgage lending and servicing practices.

The following comments are based on the Commission's consumer protection experience in the home equity market. First, we describe the unfair and deceptive practices uncovered in the Commission's law enforcement activities. Second, we discuss the key issues raised regarding alternative mortgage products in the Commission's recent public workshop on this subject, including both the advantages and risks these market innovations provide consumers. Finally, we discuss the importance of informed consumer choice at each stage of the mortgage lending process and the Commission's research into important, unanswered questions about how best to provide material information so that consumers can use it when making decisions.

## I. UNFAIR AND DECEPTIVE PRACTICES IN THE MORTGAGE LENDING MARKET: THE COMMISSION'S LAW ENFORCEMENT ACTIVITIES

The Commission's law enforcement actions have targeted deception and other illegal practices in the mortgage market, focusing in particular on the subprime market. In recent years, the agency has brought 21 actions against companies and principals in the mortgage lending industry, involving companies large and small in various regions of the country.[5] Several of these cases have resulted in large monetary judgments, with a total recovery of more than $320 million in redress for consumers. These enforcement actions have targeted deceptive or unfair practices in all stages of mortgage lending – from advertising and marketing through loan servicing – by mortgage brokers, lenders, and loan servicers.

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[5] *FTC v. Mortgages Para Hispanos.Com Corp.*, No. 4:06-CV-00019 (E.D. Tex. filed Jan. 18, 2006); *FTC v. Ranney*, No. 04-F-1065 (D. Colo. 2005) (judgment against ind. def.), (D. Colo. 2004) (judgment against corp. defs.); *FTC v. Capital City Mortgage Corp.*, No. 1:98-CV-00237 (D.D.C. 2005) (stipulated order with relief defs.), (D.D.C. 2004) (consent decree with ind. def.); *FTC v. Chase Fin. Funding*, No. SACV 04-549 (C.D. Cal. filed May 12, 2004); *United States v. Fairbanks Capital Corp.*, No. 03-12219 (D. Mass. 2003); *FTC v. Diamond*, No. 02-C-5078 (N.D. Ill. 2003); *United States v. Mercantile Mortgage Co.*, No. 02-C-5079 (N.D. Ill. 2002); *FTC v. Associates First Capital Corp.*, No. 1:01-CV-00606 (N.D. Ga. 2002); *FTC v. First Alliance Mortgage Co.*, No. SA CV 00-964 (C.D. Cal. 2002); *United States v. Action Loan Co.*, No. 3:00CV-511-H (W.D. Ky. 2000); *FTC v. NuWest, Inc.*, C00-1197 (W.D. Wash. 2000); *United States v. Delta Funding Corp.*, No. CV-00-1872 (E.D.N.Y. 2000); *FTC v. Barry Cooper Prop.*, No. 99-07782 (C.D. Cal. 1999); *FTC v. Capitol Mortgage Corp.*, No. 2:99CV580 (D. Utah 1999); *FTC v. CLS Fin. Serv., Inc.*, No. 99-CV-1215 (W.D. Wash. 1999); *FTC v. Granite Mortgage, LLC*, No. 99-CV-289 (E.D. Ky. 1999); *FTC v. Interstate Res. Corp.*, No. 1:99-CV-5988 (S.D.N.Y. 1999); *FTC v. LAP Fin. Serv., Inc.*, No. 3:99-CV-496 (W.D. Ky. 1999); *FTC v. Wasatch Credit Corp.*, No. 99-CV-579 (D. Utah 1999); *In re First Plus Fin. Group, Inc.*, FTC Docket No. C-3984 (2000); *In re Fleet Fin., Inc.*, 128 F.T.C. 479 (1999).

servicers – it did not originate any loans, but collected and processed payments on behalf of the holders of the mortgage notes. The Commission alleged that Fairbanks received consumers' payments on time, but failed to post them until after the payment deadline had expired, and then imposed late fees and other charges as a result. It also challenged Fairbanks' alleged practice of charging for homeowners' insurance even though the borrowers already had insurance in place. The Commission further alleged that Fairbanks charged to those borrowers whom it deemed were in default numerous fees that were not authorized by the mortgage contract or by state law, or that were based on services never performed. And, the complaint charged Fairbanks with violating federal laws in using dishonest or abusive tactics to collect debts, and in reporting to credit bureaus consumer payment information that it knew was inaccurate. As a result of the settlement, Fairbanks paid $40 million in consumer redress.[17] Fairbanks also agreed to halt the alleged illegal practices and implement significant changes to its business practices to prevent future violations.

Unfair and deceptive loan servicing practices also came to light in the Commission's lengthy litigation against Capital City Mortgage Corp. ("Capital City"), which both originated and serviced subprime mortgage loans.[18] The Commission alleged Capital City targeted consumers with fixed or low incomes with offers for loans based on the equity in their homes, rather than on the borrowers' creditworthiness. According to the Commission's complaint, Capital City included phony charges in monthly statements, added phony charges to loan balances, forced consumers to make monthly payments for the entire loan amount while withholding some loan proceeds, foreclosed on borrowers who were in compliance with the terms of their loans, and failed to release liens on borrowers' homes after the loans were paid off. A settlement, reached in February 2005, permanently enjoined the defendants from future deception, required them to pay consumer redress and other monetary relief, and required them to post a $350,000 performance bond to remain in the lending business.[19]

## II. ALTERNATIVE MORTGAGE PRODUCTS: THE COMMISSION'S PUBLIC WORKSHOP ON ALTERNATIVE MORTGAGES

The home mortgage marketplace has evolved rapidly in recent years in response to rising home prices and growing consumer demand for mortgage products other than the traditional, 30-year, fixed-rate, amortizing loans or adjustable rate mortgages ("ARMs"), where the borrower pays principal and interest each month for the life of the loan. The new demand has engendered a wave of new mortgage products, some of which offer consumers considerable financial benefits, but some that also pose substantial financial risk.

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17 The Commission charged Fairbanks' former CEO with similar law violations, and he agreed to a settlement with the FTC and HUD requiring $400,000 in consumer redress.

18 *FTC v. Capital City Mortgage Corp.*

19 *Id.*

In May 2006, to explore the financial benefits and risks of new mortgage products, the Commission sponsored a day-long public workshop, *Protecting Consumers in the New Mortgage Marketplace* (the "Workshop").[20] The Commission frequently sponsors public workshops such as this, in addition to its investigatory and law enforcement efforts, to learn more about new or changing areas in the marketplace and to obtain input on policy issues presented by those changes. The Commission generally then places the workshop transcripts on the public record. The transcript of this Workshop is available at the Office of the Secretary to the Commission or at *http://www.ftc.gov/bcp/workshops/mortgage/transcript.pdf*.[21]

The Workshop focused primarily on the two types of alternative mortgage products that have experienced the greatest growth in popularity and market share in the past two years: interest-only ("I/O") loans and payment option adjustable rate mortgages ("payment option ARMs" or "option ARMs").[22] Workshop participants also briefly discussed other non-traditional loan products, including fixed-rate I/O loans, 40-year fixed-rate mortgages, and 50-year hybrid ARMs.[23] Additionally, the Workshop addressed the pending Interagency Guidance on Nontraditional Mortgage Products.[24] Workshop panelists included industry representatives, consumer advocates, federal and state regulators, and academic and market authorities.

### A. Alternative Mortgage Products: I/O and Option ARM Loans

#### 1. Interest-Only Loans

According to the Workshop record, the most prevalent alternative mortgage product today is the I/O loan,[25] which commanded a more-than-25% share of the mortgage market in 2005, up sharply from less than 2% of the market in 2000.[26] I/O loans provide for an initial loan period

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20 *See* 71 Fed. Reg. 15,417 (Mar. 28, 2006) and *http://www.ftc.gov/bcp/workshops/mortgage/index.html.*

21 This Comment cites the Workshop transcript as "Tr." followed by the applicable transcript page numbers. This Comment also cites handouts that panelists distributed at the Workshop by the panelist's name, followed by the page or other appropriate reference. They are available by panelist name at *http://www.ftc.gov/bcp/workshops/mortgage/index.html*.

22 *See*, *e.g.*, Cutts Handout, slide 8.

23 *See*, *e.g.*, Tr. 23-24.

24 *See generally* Tr. 118-141. The proposed Interagency Guidance is found at 70 Fed. Reg. 77,249 (Dec. 29, 2005). *See also* 71 Fed. Reg. 9,339 (Feb. 23, 2006).

25 *See generally* Tr. 16-19, 36-40, 69-74, on I/O loans.

26 Tr. 16. In regions that have experienced especially elevated home price growth, the popularity of I/O loans has climbed even higher, constituting as much as 60% of new

during which borrowers pay only the interest that is accruing on the loan balance. When the initial period expires, the borrower's payments expand to pay both principal and interest. Because the payments during the introductory period are not amortizing, they are smaller than the payments in a traditional amortizing loan. Particularly popular are hybrid-rate I/O loans, which carry a fixed interest rate for an introductory period, generally one to ten years, and then become variable-rate loans for the remainder of the loan's term.[27]

### 2. Payment Option ARMs

Payment option ARM loans[28] also have experienced a rapid growth in popularity in recent years. Option ARMs are different than traditional ARMs in that they generally offer borrowers four choices about how much they will pay each month during the loan's introductory period. Borrowers may pay: (1) a minimum payment amount that is smaller than the amount of interest accruing on the principal; (2) the amount of interest accruing on the loan principal; (3) the amount of principal and interest due to fully amortize the loan on a 15-year payment schedule; or (4) the amount of principal and interest due to fully amortize the loan on a 30-year payment schedule.

Option ARMs vary in the length of the introductory periods they offer. Some, especially in the subprime market, have introductory periods of only one year, six months, or even one month.[29] When the loan's introductory term expires, the loan is recast,[30] amortizing to repay principal and the variable interest rate over the remaining term of the loan.

## B. Alternative Mortgage Products: Benefits and Risks

The new mortgage products offer significant benefits for many consumers but also may pose substantial risks. As discussed below, some of the benefits and risks of the new products are unique to those products. In addition, there are some risks that are common to traditional and alternative mortgage products, but may be greater for holders of alternative mortgage loans.

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mortgage originations. *See, e.g.,* Cutts Handout, slide 9; McBride Handout, slide 3; Tr. 33.

[27] Unless otherwise specified, all subsequent references to I/O loan products within this Comment refer to hybrid-rate I/O loans.

[28] *See generally* Tr. 19-22, 29-31, 36-40, 69-74, 78-85, on payment option ARM loans.

[29] *See*, *e.g.*, Tr. 30-31, 152, 218, 241.

[30] Sometimes loan recasting occurs early, as discussed on pages 8-9, *infra*. Option ARMs may be recast periodically, *e.g.*, every five years, for the remainder of the loan's term.

### 1. Unique Benefits and Risks of Alternative Mortgage Products

Workshop participants agreed that I/O and option ARM mortgages are similar in the benefits they offer and the risks they carry. The magnitude of these benefits and risks vary based on borrower characteristics and market conditions, but may be more extreme on both scales for consumers with alternative loans as compared to traditional mortgage products.[31]

According to Workshop participants, by offering consumers the option of making lower required payments in the early years of a loan, the alternative loans make it easier, initially, to purchase a home, or to purchase a more expensive home than a consumer might otherwise buy at that time. The alternative loans also may be very useful for certain groups of consumers. These include consumers who work on commission or for other reasons have variable incomes: they can pay more when they earn more, and pay less when they earn less. Other beneficiaries may be affluent or financially sophisticated consumers, such as investors who can earn a higher rate of return on the money they would otherwise use to make larger, fixed-rate mortgage payments.[32] Additionally, borrowers who are confident they will sell or refinance their homes for an equal or increased value before the introductory period of the loan expires may benefit from alternative loan options. Also, upwardly mobile borrowers who can reasonably expect to have higher incomes by the end of the initial loan repayment period likely benefit from alternative mortgage products.[33]

According to Workshop participants, other consumers, however, may not be good candidates for alternative loans.[34] According to Workshop panelists, consumers who hold alternative I/O or option ARM loans can see their minimum payment requirements as much as double when the introductory period ends.[35] Three factors contribute to this sudden upswing. First, borrowers who pay interest only during the introductory period must begin repaying both principal and interest when the introductory period ends, and must amortize the principal within a shorter time span than in a traditional 30-year loan, resulting in higher payments. Second, if the loan was offered with a special low "teaser" rate that has now expired, a higher, "fully-indexed"

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31 For benefits of nontraditional mortgages, *see generally* Tr. 16-17, 19-21, 64-66, 70, 81; McCoy Handout, slide 2.

32 *See*, *e.g.*, Tr. 65-66, 81 (borrowers using the extra pocket cash from alternative rate mortgages to invest in employer-matched 401K programs, or make other investments with estimated higher yield than housing appreciation).

33 *See*, *e.g.*, Tr. 16-17, 19-20, 70; McCoy Handout, slide 2.

34 *See generally*, *e.g.*, Tr. 17-22, 70-74, and accompanying McCoy Handout, on risks of nontraditional loans.

35 *See* Tr. 18-22, 70-71.

interest rate based on the current market takes effect.[36] Third, even if there is no teaser rate, if interest rates have risen during the introductory period, the interest portion of the monthly payment will now increase. The result for consumers who see their monthly minimum payment requirements skyrocket at the end of the introductory period is often termed "payment shock." Thus, Workshop panelists concluded, consumers who may have trouble paying the minimum monthly payments during the introductory period and have few economic resources or no reason to expect a rise in income when the introductory period ends may risk financial hardship, refinancing costs, and/or loan default once payment shock sets in.

Finally, according to Workshop participants, there are some circumstances in which "payment shock" in an option ARM loan may occur prior to the expiration of the loan's introductory period. Generally, when a consumer has made only the minimum payment, the loan "negatively amortizes," so that the amount the person owes is increased by the difference between the interest accruing and the minimum amount paid. This can result in heftier monthly payments down the road.[37] However, if the consumer frequently pays the minimum payment option, the unpaid loan balance may grow so large that it triggers a "negative amortization cap" – often from 110% to 125% of the initial loan principal amount.[38] When the cap is reached before the end of the introductory period, the loan is recast and amortized to repay principal and interest within the remaining period of the loan, thereby substantially increasing the consumer's monthly payments.[39] Several panelists commented that for some consumers this may pose a grave risk,[40] because they may even owe more than the home is worth. In such situations, refinance and resale options may be unattractive or unavailable, and the consumer at some point could default and eventually lose the home.[41]

### 2. Common Mortgage Risks that are Heightened for Alternative Loans

With any mortgage, whether a traditional or alternative product, consumers can find themselves in financial straits for any number of reasons. Unexpected health-care costs or loss of a job are the top two reasons why consumers may suddenly find themselves unable to meet their

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36 The fully-indexed rate of an ARM is the then-current value of its index (*e.g.*, LIBOR, Treasury, COFI), plus any additional percentage points (known as the margin) that the lender adds to the index. *See generally*, *e.g.*, Tr. 78.

37 *See*, *e.g.*, Tr. 19-22.

38 *See*, *e.g.*, Tr. 31, 80, 114.

39 *See*, *e.g.*, Tr. 80-81.

40 *See*, *e.g.*, Tr. 21, 72-73, 89-90, 127-130, 218-219.

41 *See*, *e.g.*, Tr. 72-73.

monthly mortgage obligations.[42] Certain loan practices, borrower features, and market shifts, however, can have a greater adverse financial impact for some holders of alternative mortgage loans than traditional mortgage loans.

**Risk Layering.** "Risk layering" means relaxing more than one of the traditional underwriting standards, which potentially increases the risk of a loan default.[43] Panelists discussed how a lender could add additional risk onto a nontraditional loan product in a number of different ways.[44] For example, the lender could issue the nontraditional loan to a borrower with little or no initial down payment or equity, creating a high loan-to-value ratio. Depending on market conditions, some borrowers in these circumstances may have no cushions of equity in their homes when their required loan payments increase, potentially making it more difficult for them to refinance their mortgages or cover the costs of selling their homes.[45] Or, risks may increase when a lender does not require a nontraditional loan borrower to thoroughly document income or assets, a practice commonly referred to as making "low-doc" or "no-doc" loans.[46] Panelists also suggested risk layering occurs when lenders offering alternative mortgages issue simultaneous second-lien mortgages known as "piggyback" loans.[47] Additionally, some panelists argued, a lender may increase risk by lending to subprime borrowers, characterized as such because of their low credit scores.[48] Such risk layering can exacerbate the risks of alternative mortgage loans, including the risk of default. Accordingly, many Workshop panelists cautioned against risk layering unless countervailing positive loan features mitigate the risks.[49]

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[42] Tr. 55-56; Cutts Handout, slide 11.

[43] *See generally*, *e.g.*, Tr. 22-23, 128.

[44] *See* Tr. 128.

[45] Panelists opined that equity in one's home might serve as a cushion permitting home sale, refinance, or conversion of stored equity to cash. *See* Tr. 40, 48-50. In recent years, borrowers have tended to make lower down payments when purchasing homes. Workshop participants reported that last year, 42% of first-time home buyers did not make any down payment. Tr. 22, 40.

[46] *See*, *e.g.*, 130-131.

[47] A piggyback loan is an additional mortgage that a borrower obtains at the same time as the primary mortgage to buy or refinance the same home, increasing the home's overall loan-to-value ratio. Often the secondary loan is an I/O home equity loan or another kind of ARM. *See*, *e.g.*, Tr. 23, 128-129.

[48] *See generally*, *e.g.*, Tr. 22-23, 70-74, 128, 131.

[49] For example, low loan-to-value ratios may help mitigate layering risks. Tr. 130-131.

**Market Shifts.** Panelists also noted that holders of alternative mortgage loans may be especially subject to financial jeopardy caused by certain market shifts.[50] Risk-enhancing market shifts include rising interest rates, which affect holders of variable rate mortgages because their payment obligations rise with the interest rates. Similarly, a borrower with an alternative mortgage who planned to sell or refinance his or her home at the close of the introductory period to avoid the higher payments could be hit especially hard if regional home prices were flat or declining.[51]

**Consumer Features**. Panelists further noted that consumers who assume an alternative mortgage based on their current ability to afford its low introductory rates, without regard to their future ability to make the higher, post-introductory period payments, may be at considerable risk of future default.[52] This risk may be exacerbated for consumers who are on a fixed income.

### C. Alternative Mortgages' Consumer Protection Issues

Beyond discussing the products and their costs and benefits, the Workshop panelists focused primarily on two consumer protection questions: whether consumers receive information about the terms of nontraditional mortgage products that is sufficient and timely; and, whether lenders should consider as part of their underwriting process the appropriateness of an alternative mortgage product for the consumer applying for the loan.

#### 1. Loan Term Disclosure Issues

Workshop panelists agreed that to make informed decisions about mortgage loans, consumers need clear information explaining their mortgage options. Panelists differed, however, about whether consumers are getting such information, and whether the disclosure timetable that the TILA establishes provides for early enough disclosure of critical loan terms.[53]

Some panelists suggested that brokers and lenders should explain loan product terms at the marketing or shopping phase of a consumer's mortgage acquisition process, not just, as the TILA requires, at the application phase or before closing.[54] Moreover, some panelists argued that

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[50] *See generally* Tr. 17-18, 21-23, 34-39, 56-57, 70-74, 129, 204.

[51] Of course, a decline in property values may harm all property owners, and not just those with alternative products, but the Workshop focused only on alternative mortgage products.

[52] *See*, *e.g.*, Tr. 17-22, 70-74.

[53] *See*, *e.g.*, Tr. 62-63, 75-76, 88-89, 91, 94-95, 95, 111-117, 123-125, 170, 171, 180-181, 243-244, 248, 258-260, 279.

[54] For proponents of earlier risk disclosures, *see* Tr. 88-91, 95, 95-96, 138, 184, 264-265; *see also* Tr. 117; 266-267 (arguing self-interested lenders face a "dilemma" because early disclosure of product risks might "scare away some borrowers"). For TILA disclosure timing

## IV. CONCLUSION

The Commission appreciates your consideration of its views. If any other information would be useful regarding these matters, please contact Peggy Twohig, Associate Director for Financial Practices, at (202) 326-3224.

By direction of the Commission.

Donald S. Clark
Secretary

# EXHIBIT E



# Predatory and Subprime Mortgage Lending Issues

There are serious problems in our country's mortgage lending market. Foreclosure rates are rising, housing prices are stagnating and too many consumers are surprised to find out that their monthly payments are spiking. The difficulties have been concentrated in "subprime" loans, which generally go to borrowers with limited or damaged credit, although there is evidence that some borrowers are shifted into the subprime category because they are African-American or Hispanic. Real damage has been done to families and communities as many adjustable-rate mortgage loans "reset" to higher interest rates and monthly payments.

The Democratic-led House Financial Services Committee has been intently focused on these issues and is working toward a balanced solution that stops abuses, preserves access to credit, and aids stable homeownership. The Committee is examining this issue through hearings, is working with Federal and state banking regulators to improve guidelines and disclosures, and is in the process of drafting a legislative response to these problems that will be introduced later this session.

The House Financial Services Committee has begun a series of hearings on the topic designed to determine: (1) the scope of the problem and its implications for homeowners and the economy; (2) the causes of the problem, (3) what regulators, industry and community organizations are doing about it; and (4) what additional steps regulators and Congress can take to improve the situation and ensure that we do not end up here again. We will also be addressing the discrimination aspects of these activities.

Some responses do not require legislation and are already underway: working cooperatively with the Committee, Federal and state banking regulators have issued new guidelines to improve loan underwriting and consumer disclosures for risky loan products, and Members of the Committee have urged federal regulators to provide clear authority to financial institutions so that they can voluntarily avert foreclosures.

A number of states have passed strong anti-predatory lending legislation over the last few years, and this has helped reduce abuses that put homeowners at risk. However, a number of states do not have such laws, and some parts of the state laws have been preempted by Federal regulators. The Financial Services Committee now plans to act on this issue, including legislation later this session. Click here for several key principles that Democratic Committee leadership will incorporate in the drafting of this legislation.

Click here for the April 25, 2007 letter from Chairman Barney Frank and Ranking Republican Spencer Bachus asking the Government Accountability Office to investigate the high number of foreclosures and the subprime mortgage market.

Click here for documents of the April 17, 2007 Financial Services Committee Hearing: "Possible Responses to Rising Mortgage Foreclosures."

Click here for Chairman Barney Frank's March 29, 2007 Dear Colleague: "Financial Services Committee to Address Predatory Mortgage Lending Problems."

Click here for documents of the March 27, 2007 Financial Services Subcommittee on

Financial Institutions and Consumer Credit Hearing: "Subprime and Predatory Mortgage Lending: New Regulatory Guidance, Current Market Conditions and Effects on Regulated Financial Institutions."

Click here for Chairman Barney Frank's and Ranking Member Bachus' March 18, 2007 Dear Colleague bringing attention to HUD hotline assisting distressed homeowners.

**House Financial Services Committee**
Democratic Staff
2129 Rayburn House Office Building
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Subcommittee on Financial Institutions and Consumer Credit Hearing

# Subprime and Predatory Mortgage Lending: New Regulatory Guidance, Current Market Conditions and Effects on Regulated Financial Institutions

Tuesday, March 27, 2007, 10:00 a.m., 2128 Rayburn House Office Building

**Click Here to View Archived Webcast**

**Witness List & Prepared Testimony:**

**Panel One:**

- The Honorable Sheila Bair, Chairman, Federal Deposit Insurance Corporation
- The Honorable John Reich, Director, Office of Thrift Supervision
- The Honorable JoAnn Johnson, Chairman, National Credit Union Administration
- Mr. E. Wayne Rushton, Senior Deputy Comptroller, Office of the Comptroller of the Currency
- Ms. Sandra F. Braunstein, Director, Division of Consumer and Community Affairs, Federal Reserve Board
- Mr. Steve Antonakes, Commissioner of Banks, Massachusetts Division of Banks, on behalf of Conference of State Banking Supervisors

**Panel Two:**

- Mr. Michael Calhoun, President, Center for Responsible Lending
- Mr. John Taylor, President & CEO, National Community Reinvestment Coalition
- Mr. Allen Fishbein, Director of Housing and Credit Policy, Consumer Federation of America
- Mr. John Robbins, Chairman, Mortgage Bankers Association
- Mr. Harry H. Dinham, CMC, President, National Association of Mortgage Brokers
- Mr. Alex J. Pollock, Resident Fellow, American Enterprise Institute

**Available Member Statements:** Congresswoman Brown-Waite, Congressman Gilmor

**Printed Hearing:**
The printed version of this hearing will be posted as soon as it is available.

**Related Documents:**

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Full Committee Hearing

# Possible Responses to Rising Mortgage Foreclosures

Tuesday, April 17, 2007, 10:00 a.m., 2128 Rayburn House Office Building

**Click Here to View Archived Webcast**

**Witness List & Prepared Testimony:**

**Panel One**:

- The Honorable Marcy Kaptur; The Honorable Michael R. Turner

**Panel Two:**

- The Honorable Sheila Bair, Chairman, Federal Deposit Insurance Corporation
- The Honorable Brian Montgomery, Assistant Secretary for Housing, Department of Housing and Urban Development
- Daniel Mudd, President and CEO, Fannie Mae
- Richard F. Syron, Chairman & CEO, Freddie Mac

**Panel Three:**

- David Berenbaum, Executive Vice President, National Community Reinvestment Coalition
- Janis Bowdler, Senior Policy Analyst, National Council of La Raza
- The Honorable John H. Dalton, President, Housing Policy Council, The Financial Services Roundtable
- Mr. George Miller, Executive Director, American Securitization Forum, also representing the Securities Industry and Financial Markets Association
- Douglas A. Garver, Executive Director, Ohio Housing Finance Agency
- Kenneth D. Wade, CEO, NeighborWorks America

**Available Member Statements:** Congressman Sires, Congressman Gillmor

**Printed Hearing:**
The printed version of this hearing will be posted as soon as it is available.

**Related Documents:**

**House Financial Services Committee**
Democratic Staff
2129 Rayburn House Office Building
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EXHIBIT F

**JOINT ECONOMIC COMMITTEE**
**Senator Charles E. Schumer (D-NY) – Chairman**

# Sheltering Neighborhoods from the Subprime Foreclosure Storm

Recent increases in delinquencies and foreclosures in the subprime mortgage market have raised widespread concerns about the possibility of accelerating foreclosures throughout this year and next. While lenders, banks, and securities traders scramble to figure out how to insure themselves from the market consequences of rising subprime mortgage defaults, local communities are struggling to stem the tide of foreclosures that impose significant costs on families, neighborhoods and cities. This report analyzes the subprime foreclosure phenomenon at the local level, describes the high spillover costs of foreclosures, and argues that foreclosure prevention is cost-effective.

## Key Points

- **Subprime foreclosures are expected to increase in 2007 and 2008 as 1.8 million hybrid ARMS—many of which were sold to borrowers who can not afford them—reset in a weakening housing market environment.**

- **Varying local economies, housing markets and state regulatory regimes mean that some local areas are getting hit by the subprime foreclosure crisis much harder than others and deserve immediate attention.**

- **It pays to prevent foreclosures in these high-risk cities – every new home foreclosure can cost stakeholders up to $80,000, when you add up the costs to homeowners, loan servicers, lenders, neighbors, and local governments.**

- **Policy responses to the subprime crisis should be designed to address the local foreclosure phenomenon and include both foreclosure prevention strategies and improved mortgage lending regulations.**

## Subprime Foreclosures to Date: The "Tip of the Iceberg"?

Over the past several months, it has become increasingly clear that irresponsible subprime lending practices have been contributing to a wave of foreclosures that are hitting homeowners and rattling the housing markets. (For more information on subprime loans, see **Box A** on page 3.) The loan product that has both fueled the recent growth in the subprime market over the past two years and that is largely responsible for the foreclosure spikes is the so-called "exploding ARM." These are hybrid adjustable rate mortgages that offer a 30-year loan with an initial fixed rate that is set below market rates (often called a "teaser" rate). When the rate resets after an initial fixed rate period (commonly two to three years, hence the nicknames "2/28s" and "3/27s"), it often resets to a more onerous rate that leads to a significantly higher mortgage payment.[1] Exploding ARMS are almost exclusively underwritten to the subprime market, and the majority of subprime originations over the past several years were "2/28s" and "3/27s."[2]

In recent years, a significant portion of exploding ARMs have been underwritten without consideration of whether the borrower can afford the loans past the initial low teaser rate. Because mortgages are often immediately bundled together and sold as securities once a loan is placed, the primary financial incentive for mortgage brokers is to close the deal and collect the attendant fees and commission, rather than consider the long-term performance of the loan. When the loan resets after the initial teaser rate period, the overall increase in monthly payment can be quite disruptive – particularly for subprime borrowers. A 2006 analysis by Fitch Ratings reported that 2/28 subprime ARMs carried an average "payment shock" of 29 percent over the teaser-rate payment, even if short-term interest rates remained unchanged.[3] Since the short-term interest rate (LIBOR) that determines the rate at which the loan resets increased at the end of last year, the payment shock is even higher now – at approximately 50 percent by some estimates.[4]

This payment shock can be even more disastrous for borrowers who qualify for loans with an initial low rate based on stated income (qualifying the borrower based on the income they *state* on their loan applications, also called "liar loans" or "no-doc" loans) or reduced documentation ("low-doc" loans). Roughly half of all subprime borrowers in the past two years have been required to provide only limited documentation regarding their incomes.[5] And an estimated ninety percent of borrowers in stated income loans exaggerated their income.[6]

Today's housing market – with increasing rates and a softening of home prices—has placed increased stress on risky subprime loans. When ARMs reset to higher rates and borrowers can't make the higher mortgage payments, delinquencies result. Borrowers who attempt to refinance unsuitable loans before they reset find that falling home prices make it difficult for them to do so, especially if their loan is "upside down" because they owe more than their house is worth. Recent statistics issued by the Mortgage Bankers Association's nationwide survey show that 14.44 percent of subprime borrowers with ARM loans were at least 60 days delinquent in their payments in the fourth quarter of 2006.[7] This is up from third quarter delinquency rate of 13.22 percent for such mortgages, representing a four-year high.

Although there is much debate among industry analysts, economists, policymakers and the media about the risk of accelerating defaults in the subprime market going forward, a federal regulator recently agreed at a Senate Banking Committee hearing that we are only at the "tip of the

[1] A typical 2/27 subprime borrower in 2005 may have been issued a loan at a teaser rate of 7 percent. Two years later, as that teaser rate resets, the borrower may see his rate reset to 10 percent. But the next time the loan resets – typically in six months or a year – the rate will go up yet again, based on a certain margin or spread over short-term interest rates (typically LIBOR).
[2] Testimony of Sandra Thompson, Director of the Division of Supervision and Consumer Protection at the FDIC, Before the Committee on Banking, Housing, and Urban Affairs of the United States Senate, March 22, 2007.
[3] Al Heavens, "On the House; Subprime Loans Start Inflicting Pain," The Philadelphia Inquirer, March 25, 2007.
[4] *Ibid*.
[5] Credit Suisse, "Mortgage Liquidity du Jour: Underestimated No More," March 12, 2007.
[6] Mortgage Asset Research Institute, Inc., *Eighth Periodic Mortgage Fraud Case Report to Mortgage Bankers Association*, April 2006.
[7] National Delinquency Survey, Mortgage Bankers Association, March 2007.

iceberg" in terms of subprime foreclosures.[8] The FDIC estimates that this year alone, one million of these loans will reset to higher rates. Next year, approximately 800,000 are anticipated to reset to more onerous payments.[9] If housing prices continue to fall in 2007 and into next year, then last year's foreclosure spike is probably only the beginning and we could be, as the Center for Responsible Lending (CRL) has predicted, entering "the worst foreclosure experience in the modern mortgage market."[10] In fact, CRL estimates that approximately one in five of the subprime loans issued in 2005 and 2006 will go into default, *costing 2.2 million homeowners their homes over the next several years*.[11] According to foreclosure tracker, RealtyTrac, 1.2 million foreclosures were reported nationwide in 2006 alone, an increase of 42 percent since 2005. That translates into one foreclosure event for every 92 households.[12] And, according to RealtyTrac, the pace of foreclosures has continued into 2007, with foreclosures on track to match or surpass 2006 levels.[13]

**BOX A: Subprime Loans: The Good, the Bad, and the Ugly**

Subprime mortgages are a relatively new and rapidly growing segment of the mortgage market. While subprime loans have expanded home ownership opportunities for borrowers with low or limited credit histories, this expanded opportunity has come at a cost as subprime mortgages carry higher interest rates than prime mortgages to compensate for the increased credit risk.[14]

Since their inception, subprime loans have been controversial. On the one hand, the subprime market has opened up credit opportunities to people who might not otherwise be able to finance home purchases and has thus contributed to expanding homeownership. On the other hand, the subprime market has created opportunities for "predatory" lending to the extent that unscrupulous lenders have hidden the true cost of subprime loans from unsophisticated borrowers. According to the chief national bank examiner for the Office of Comptroller of the Currency, only 11 percent of subprime loans went to first-time buyers last year. The vast majority were refinancings that caused borrowers to owe more on their homes under the guise that they were saving money.[15]

During the recent housing boom, the subprime mortgage market changed dramatically. From 2001 until last year, historically low mortgage rates, rising home prices, and increased liquidity in the secondary mortgage market enticed more non-bank lenders (who are not subject to federal regulation) to relax their loan underwriting standards and attracted new mortgage brokers with little business experience into the market. Commercial banks and Wall Street firms provided these lenders with capital by buying up subprime mortgages, repackaging them into mortgage-backed securities, and selling them to hedge funds and private equity investors looking for higher returns than less

[8] Gene Sperling, "Subprime Market—Isolated or a Tipping Point," Bloomberg News, March 14, 2007; Testimony of Sandra Thompson, Director of the Federal Deposit Insurance Corporation's Division of Supervision and Consumer Protection, Before the Committee on Banking, Housing, and Urban Affairs of the United States Senate, March 22, 2007.
[9] Testimony of Sandra Thompson, Director of the Federal Deposit Insurance Corporation's Division of Supervision and Consumer Protection, Before the Committee on Banking, Housing, and Urban Affairs of the United States Senate, March 22, 2007.
[10] Ellen Schloemer, Wei Li, Keith Ernst, and Kathleen Keest, *Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners*, Center for Responsible Lending, December 2006.
[11] *Ibid.*
[12] RealtyTrac 2006 US Foreclosure Market Report, January 25, 2007.
[13] RealtyTrac Foreclosure Database, January and February 2007 foreclosure numbers.
[14] Generally, the increased interest rate charged to subprime borrowers ranges from one to three percent higher than prime rates. For a more in depth discussion of the evolution of the subprime mortgage market, see Souphala Chomsisengphet and Anthon Pennnington-Cross, "The Evolution of the Subprime Mortgage Market," *Federal Reserve Bank of St. Louis Review*, January/February 2006, 88(1), pp. 31-56.
[15] Les Christie, "Subprime Losses Lead to Drop in Home Ownership," CNNMoney.com, March 27, 2007.

risky Treasury and corporate bonds. As a result, loans to subprime borrowers jumped from just 8 percent of total mortgage originations in 2003, to 20 percent in both 2005 and 2006.[16] There are now $1.3 trillion in subprime loans outstanding, up from $65 billion in 1995 and $332 billion in 2003.[17]

The subprime loan market often operates below the federal regulatory radar screen. Although bank lenders are subject to bank regulatory standards, mortgage brokers and loan officers in non-bank companies are not subject to federal enforcement of lending laws. Rather, states have the primary enforcement responsibility for regulating these mortgage brokers. State-chartered mortgage brokers and nonbank affiliates underwrote approximately 77 percent of subprime loans in 2005.[18] While some states have taken measures to improve the licensing, education and experience requirements for non-bank brokers and lenders, many states lack the resources and/or mandates to police predatory lending practices.

Subprime mortgage loans are most prevalent in lower-income neighborhoods with high concentrations of minorities.[19] In 2005, 53 percent of African American and 37.8 percent of Hispanic borrowers took out subprime loans due in large part to limited access to sound financial counseling, availability of alternative loan products, and limited assets and income.[20] A study by the Department of Housing and Urban Development and the United States Treasury found that subprime loans were issued five times more frequently to households in predominantly black neighborhoods as they were to households in predominantly white neighborhoods, even after controlling for income. Moreover, many of these minority borrowers were steered into subprime loans when they may have qualified for less expensive, prime loans.[21] Because minorities and low-income households have less financial resources to draw upon to help restructure or refinance mortgage loans with steeply escalating payments, adverse housing market conditions can put these homeowners at greater risk of defaults.

## The Foreclosure Story at the Local Level

While national foreclosure and delinquency rates are telling, an examination of local-level foreclosure data reveals that the subprime lending woes are affecting some states and cities much more than others. A number of states and cities have much higher delinquency and foreclosure rates than the national average, and these localities deserve particular attention from state and federal policymakers as they craft their responses to the subprime market crisis. Local economies, housing market conditions, and regulatory environments can help explain why particular regions are getting hit the hardest by subprime troubles. Using state- and city-level foreclosure and delinquency data provided to the Joint Economic Committee by RealtyTrac and First American LoanPerformance, the following analysis highlights areas where subprime delinquencies are getting worse, and where foreclosures are on the rise.

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[16] Testimony of Emory W. Rushton, Senior Deputy Comptroller and Chief National Bank Examiner, Office of the Comptroller of the Currency, Before the Committee on Banking, Housing, and Urban Affairs of the United States Senate, March 22, 2007.
[17] Statement of Scott M. Polakoff, Deputy Director Office of Thrift Supervision, "Nontraditional Mortgages and Supbrime Hybrid Adjustable Rate Mortgages," before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, March 22, 2007; Souphala Chomsisengphet and Anthon Pennnington-Cross, "The Evolution of the Subprime Mortgage Market," *Federal Reserve Bank of St. Louis Review,* January/February 2006.
[18] Greg Ip and Damian Paletta, "Regulators Scrutinized in Mortgage Meltdown," The Wall Street Journal, March 22, 2007.
[19] Paul Calem, Kevin Gillen and Susan Wachter, "The Neighborhood Distribution of Subprime Mortgage Lending," *Journal of Real Estate Finance and Economics,* 2004, vol. 29 (4).
[20] Allen J. Fishbein and Patrick Woodall, "Subprime Locations: Patterns of Geographic Disparity in Subprime Lending," Consumer Federation of America, September 5, 2006, pg. 4.
[21] *Ibid.*; US Department of Housing and Urban Development and US Department of the Treasury, "Curbing Predatory Home Mortgage Lending," 2000.

According to RealtyTrac's data for 2006, states in the Midwest (Ohio, Michigan, Illinois, and Indiana), the South and West "Sun Belt" (Florida, Georgia, Texas, California, Arizona and Nevada), and Colorado experienced the highest rates of foreclosures in 2006.[22] RealtyTrac estimates that nearly 60 percent of these foreclosures are subprime loans, even though subprime loans comprise only 14 percent of the total mortgage debt outstanding.[23] (See table below.)

[22] The RealtyTrac U.S. Foreclosure Market Report provides the total number of homes entering some stage of foreclosure nationwide each quarter of 2006. The total for each quarter and for the year includes foreclosure filings for all three phases of foreclosure: defaults, auctions, and real estate owned (properties that have been foreclosed on and repurchased by a bank.) One of the difficulties in measuring subprime data more accurately on a local level is that loan documents are not labeled as "prime" or "subprime," so RealtyTrac uses a prevailing rate methodology instead. That is, they compare the loan rate to the Freddie Mac index of prime rates on the date of issuance, and assign any loan with a rate more than 2 percentage points above the prime rate as subprime.
[23] Interviews with RealtyTrac; Mortgage Bankers Association 2006 Survey.

**State Foreclosures Rankings (2006)**

| | | Foreclosure Rates (2006) | | | Home Price Appreciation (Percent Change) | | |
|---|---|---|---|---|---|---|---|
| State | Foreclosure Rank[1] | Ratio of Foreclosures to Number of Households | Foreclosures as % of Households | Unemployment Rate % (2006) | 2005 | 2006 | Change in Home Price Appreciation (2005 to 2006) |
| **United States** | **-** | **1:92** | **1.1** | **4.6** | **13.2** | **5.9** | **-7.3** |
| Colorado | 1 | 1:33 | 3.0 | 4.3 | 6.0 | 3.3 | -2.7 |
| Georgia | 2 | 1:41 | 2.5 | 4.7 | 6.3 | 5.6 | -0.8 |
| Nevada | 3 | 1:41 | 2.4 | 4.2 | 18.7 | 4.0 | -14.7 |
| Texas | 4 | 1:51 | 1.9 | 4.9 | 5.7 | 6.9 | 1.3 |
| Michigan | 5 | 1:52 | 1.9 | 6.9 | 3.4 | -0.4 | -3.8 |
| Indiana | 6 | 1:53 | 1.9 | 5.0 | 4.5 | 2.3 | -2.2 |
| Florida | 7 | 1:59 | 1.7 | 3.3 | 28.1 | 9.4 | -18.6 |
| Ohio | 8 | 1:59 | 1.7 | 5.5 | 3.6 | 1.0 | -2.6 |
| Utah | 9 | 1:59 | 1.7 | 2.9 | 13.4 | 17.5 | 4.2 |
| Tennessee | 10 | 1:67 | 1.5 | 5.2 | 8.0 | 7.9 | -0.1 |
| Illinois | 11 | 1:67 | 1.5 | 4.5 | 9.6 | 5.7 | -3.9 |
| Arizona | 12 | 1:79 | 1.3 | 4.1 | 35.7 | 9.6 | -26.1 |
| New Jersey | 13 | 1:83 | 1.2 | 4.6 | 16.0 | 5.8 | -10.2 |
| California | 14 | 1:86 | 1.2 | 4.9 | 21.6 | 4.6 | -17.0 |
| Oklahoma | 15 | 1:96 | 1.0 | 4.0 | 6.3 | 4.6 | -1.7 |
| Arkansas | 16 | 1:104 | 1.0 | 5.3 | 7.8 | 6.6 | -1.2 |
| Connecticut | 17 | 1:118 | 0.8 | 4.3 | 12.1 | 3.9 | -8.2 |
| Washington | 18 | 1:129 | 0.8 | 5.0 | 18.8 | 13.7 | -5.1 |
| Pennsylvania | 19 | 1:137 | 0.7 | 4.7 | 12.7 | 7.0 | -5.7 |
| Missouri | 20 | 1:138 | 0.7 | 4.8 | 7.2 | 4.7 | -2.5 |
| New York | 21 | 1:148 | 0.7 | 4.5 | 13.3 | 4.9 | -8.4 |
| New Mexico | 22 | 1:148 | 0.7 | 4.2 | 15.1 | 13.1 | -2.0 |
| Oregon | 23 | 1:152 | 0.7 | 5.4 | 20.2 | 13.5 | -6.7 |
| North Carolina | 24 | 1:157 | 0.6 | 4.8 | 8.4 | 8.2 | -0.2 |
| Massachusetts | 25 | 1:165 | 0.6 | 5.0 | 8.0 | 0.5 | -7.5 |
| Alaska | 26 | 1:192 | 0.5 | 6.7 | 14.2 | 7.6 | -6.6 |
| Idaho | 27 | 1:210 | 0.5 | 3.4 | 19.3 | 14.0 | -5.3 |
| Nebraska | 28 | 1:237 | 0.4 | 3.0 | 4.1 | 2.6 | -1.5 |
| Kentucky | 29 | 1:246 | 0.4 | 5.7 | 5.2 | 4.1 | -1.0 |
| South Carolina | 30 | 1:252 | 0.4 | 6.5 | 9.1 | 8.1 | -1.0 |
| Kansas | 31 | 1:274 | 0.4 | 4.5 | 5.1 | 4.5 | -0.6 |
| Wisconsin | 32 | 1:304 | 0.3 | 4.7 | 8.1 | 4.1 | -4.0 |
| Rhode Island | 33 | 1:344 | 0.3 | 5.2 | 10.7 | 3.4 | -7.3 |
| Minnesota | 34 | 1:345 | 0.3 | 4.0 | 8.0 | 2.5 | -5.5 |
| Iowa | 35 | 1:358 | 0.3 | 3.7 | 6.1 | 3.1 | -3.1 |
| Montana | 36 | 1:387 | 0.3 | 3.2 | 14.6 | 10.7 | -3.9 |
| Alabama | 37 | 1:452 | 0.2 | 3.6 | 9.0 | 8.1 | -0.9 |
| Maryland | 38 | 1:474 | 0.2 | 3.9 | 22.1 | 9.0 | -13.1 |
| Wyoming | 39 | 1:547 | 0.2 | 3.2 | 12.8 | 14.3 | 1.5 |
| Louisiana | 40 | 1:646 | 0.2 | 4.0 | 9.5 | 10.9 | 1.4 |
| Virginia | 41 | 1:664 | 0.2 | 3.0 | 19.9 | 7.5 | -12.4 |
| Hawaii | 42 | 1:684 | 0.1 | 2.4 | 24.5 | 7.3 | -17.1 |
| Delaware | 43 | 1:780 | 0.1 | 3.6 | 15.7 | 7.3 | -8.4 |
| West Virginia | 44 | 1:970 | 0.1 | 5.0 | 11.3 | 5.2 | -6.1 |
| South Dakota | 45 | 1:1115 | 0.1 | 3.2 | 7.8 | 5.9 | -2.0 |
| Mississippi | 46 | 1:1218 | 0.1 | 6.8 | 8.0 | 9.6 | 1.6 |
| North Dakota | 47 | 1:1637 | 0.1 | 3.2 | 8.5 | 5.4 | -3.1 |
| Maine | 48 | 1:3309 | 0.0 | 4.6 | 10.8 | 4.8 | -6.0 |
| New Hampshire | 49 | 1:3721 | 0.0 | 3.4 | 9.7 | 2.7 | -7.0 |
| Vermont | 50 | 1:6542 | 0.0 | 3.6 | 13.9 | 6.4 | -7.5 |
| District of Columbia | - | 1:2432 | 0.0 | 6.0 | 23.6 | 7.5 | -16.1 |

Sources: RealtyTrac, U.S. Department of Labor, Office of Federal Housing Enterprise Oversight.
[1]Foreclosures are ranked from 1 (highest rate of foreclosures) to 50 (lowest rate of foreclosures).

Delinquent mortgage payments by borrowers are an indicator of future foreclosures. Once a mortgage is 90 days delinquent, the lender will generally begin the foreclosure process, which varies by states. According to February 2007 data from First American LoanPerformance, the areas with the highest increase in delinquencies over 60 days from February 2005 to February 2007 largely mirror the areas that experienced the most foreclosures in 2006—indicating that these areas are at higher risk of experiencing even more foreclosures in 2007.[24] Notably, there is also a significant spike in subprime delinquencies in the Northeastern corridor states of New York, Massachusetts, New Hampshire, New Jersey, and Rhode Island, suggesting possible increases in foreclosures for those states in months to come. The following discussion looks at each of these high risk regions individually.

### *The Midwest*

Last year, Detroit, Michigan had the highest percentage of households in foreclosure in the 150 largest metropolitan areas, with an average of more than 10,000 foreclosures in each quarter. Foreclosures in Detroit in 2006 directly affected 4.4 percent of the city's households—one foreclosure event for every 21 households, nearly five times the national average of one foreclosure event for every 92 households. Detroit's depressed automotive industry has no doubt contributed to increased high foreclosure rates. From 2001 to 2006, the Detroit metropolitan area lost 132,800 jobs, 65 percent of which were in the manufacturing sector.[25] In 2006, Detroit had an unemployment rate of 9.7 percent – nearly double the U.S. average.[26] (See table below. For a detailed listing of the top 50 metropolitan areas by foreclosures, see **Appendix A**.)

Over the first quarter of 2007, the foreclosure trend in the Detroit area has gotten worse rather than better. According to RealtyTrac data, Detroit is on pace to record 11,000 foreclosures in the first quarter of 2007, about 1,000 more than the 2006 quarterly average.[27]

In Ohio and Indiana sagging job markets may also be responsible for recent foreclosure spikes. But states have been hit hard by manufacturing job losses in recent years. Cities such as Indianapolis, Cleveland, Dayton and Akron are ranked in the top 20 metropolitan areas nationally with the highest number of foreclosures in 2006. In Indianapolis (ranked 3rd), there was one foreclosure event for every 23 households last year. In Cleveland, the ratio of foreclosures to households was one in 40, while in Dayton and Akron, one in 43 households entered into foreclosure last year. (See table below.)

In addition, the states of Michigan, Ohio and Indiana lack strict requirements for licensing brokers and lenders, and testing requirements for loan originators.[28] The state of Michigan does not regulate or license individual mortgage brokers and lenders (as opposed to companies), nor provides testing requirements for loan originators. Like Michigan, the Indiana institution that regulates lenders—the Department of Financial Institutions—neither regulates nor licenses individual brokers or lenders and has no testing requirement for loan originators. While Ohio does have licensing requirements for individual brokers, there are also no testing requirements for loan originators. (See **Appendix D** for more information.)

[24] First American LoanPerformance subprime delinquency estimates are based on the value of mortgages outstanding and a coverage of 49 percent of subprime-mortgage originators.
[25] Bureau of Labor Statistics, 2006.
[26] Bureau of Labor Statistics, 2006.
[27] RealtyTrac Foreclosure Database, as of April 10, 2007.
[28] Survey of the Conference of State Bank Supervisors (CSBS) and American Association of Residential Mortgage Regulators (AARMR) Agency Licensing Survey," January 2006.

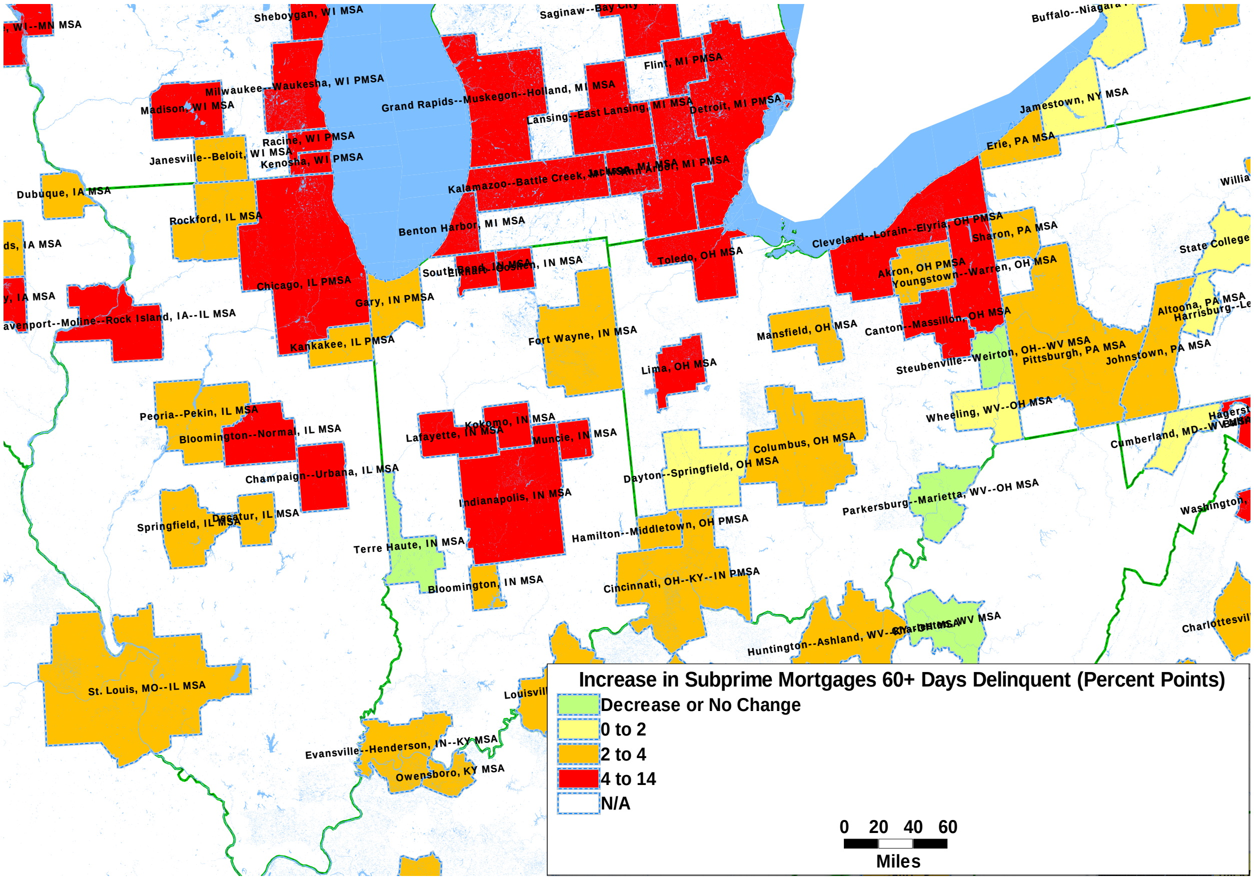
**Midwest Metro Areas With Highest Foreclosures in 2006**

| MSA | National Foreclosure Rank[1] | Foreclosure Rates (2006): Ratio of Foreclosures to Number of Households | Foreclosure Rates (2006): Foreclosures as Percent of Households | Unemployment Rate (2006) |
|---|---|---|---|---|
| Detroit-Livonia-Dearborn, MI | 1 | 1:21 | 4.9 | 8.3 |
| Indianapolis, IN | 3 | 1:23 | 4.3 | 4.5 |
| Cleveland-Elyria-Mentor, OH | 14 | 1:40 | 2.5 | 5.4 |
| Dayton, OH | 15 | 1:43 | 2.3 | 5.8 |
| Akron, OH | 16 | 1:43 | 2.3 | 5.2 |
| Columbus, OH | 19 | 1:45 | 2.2 | 4.7 |
| Lake County-Kenosha County, IL-WI | 21 | 1:48 | 2.1 | 4.5 |
| Chicago-Naperville-Joliet, IL | 22 | 1:50 | 2.0 | 4.4 |
| Warren-Farmington Hills-Troy, MI | 28 | 1:58 | 1.7 | 6.2 |
| Toledo, OH | 30 | 1:60 | 1.7 | 6.1 |
| Gary, IN | 44 | 1:81 | 1.2 | 5.4 |
| Cincinnati-Middletown-Wilmington, OH-KY-IN | 49 | 1:87 | 1.1 | 5.1 |
| Pittsburgh, PA | 50 | 1:88 | 1.1 | 4.8 |
| **United States** | **-** | **1:92** | **1.1** | **4.6** |

Sources: RealtyTrac and Bureau of Labor Statistics, U.S. Department of Labor.

[1]Foreclosures are ranked from 1 (highest rate of foreclosures) to 150 (lowest rate of foreclosures).

The Midwest communities are at high risk of experiencing rising foreclosures over the coming months. The high level of subprime delinquencies in these communities as of February of this year suggests a likely increase in the number of foreclosures going forward. According to data provided by First American LoanPerformance, 24 percent of all subprime loans in Detroit were delinquent 60 days or more as of February 2007, an increase of nearly 10 percentage points since February 2005. In Flint and Jackson, Michigan, subprime delinquencies climbed to over 20 and 22 percent, respectively in February 2007, an increase of 8 and 10 percentage points since February 2005. In the Ohio cities of Cleveland, Akron, Canton and Dayton, at least 19 percent of subprime loans were in delinquency in February 2007, with Cleveland leading with 24 percent of subprimes loans delinquent. Across the state, subprime delinquencies are up 4 percentage points on average versus February 2005. And in the Indiana cities of Indianapolis, South Bend and Muncie at least 18 percent of subprime loans were 60 or more days delinquent in February 2007, an average increase of 5 percentage points since February 2005. (See map below. For a detailed table of historical subprime delinquency rates in cities and states across the U.S., see **Appendix B.**)




Source: First American LoanPerformance data comparing the percentage of subprime mortgages 60 days or more delinquent, in February 2005 and February 2007.

### *The Sun Belt*

In the Sun Belt states like California and Florida, where job markets are generally healthier, unemployment is typically lower, and incomes are higher than the national average, a different story unfolds. Steep home price appreciation and population influxes, followed by flat or falling home prices, have created a difficult housing market for all recent mortgage borrowers—but particularly for subprime borrowers. For example, borrowers who took out adjustable rate loans in 2003 and 2004 when home prices were rising are finding that falling home prices are making it very difficult for them to refinance their exploding ARMs before the teaser rate period expires, especially if they are "upside-down" on their loan.

Seven metropolitan areas in the top 50 foreclosure areas are in California, where home prices appreciated rapidly from 2001 until last year. Although home prices have continued to rise, the rate of increase declined by 17 percentage points across the state in 2006. Six of Florida's metropolitan areas are among the top 50 in foreclosures. Florida experienced rapid growth in housing prices from 2001 up until last year, when home price appreciation decelerated by nearly 19 percentage points in 2006. Similarly, Nevada and Arizona experienced a deep slowdown in home price appreciation in 2006, by 15 and 26 percentage points respectively, after rapid acceleration during the housing boom. (See table below.)

Notably, the California Department of Corporations, which regulates mortgage brokers and lenders, does not require regulation or licensing for individual brokers and lenders (as opposed to companies). The state of Nevada does not have testing requirements for loan originators. Florida has reasonable state regulations and requirements for mortgage lenders and brokers, and Arizona's state legislature is currently working on adopting measures to better regulate individual brokers and lenders. (See **Appendix D** for more information.)

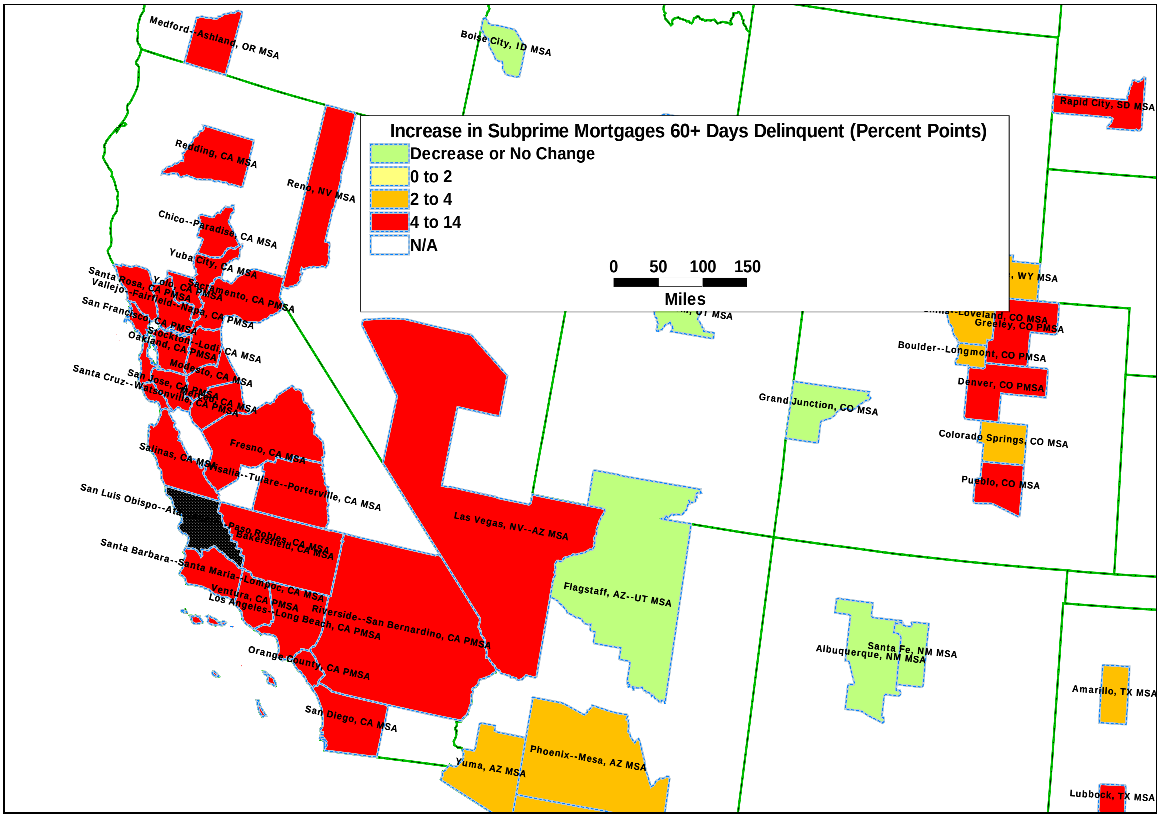
**Sun Belt Metro Areas With Highest Foreclosures In 2006**

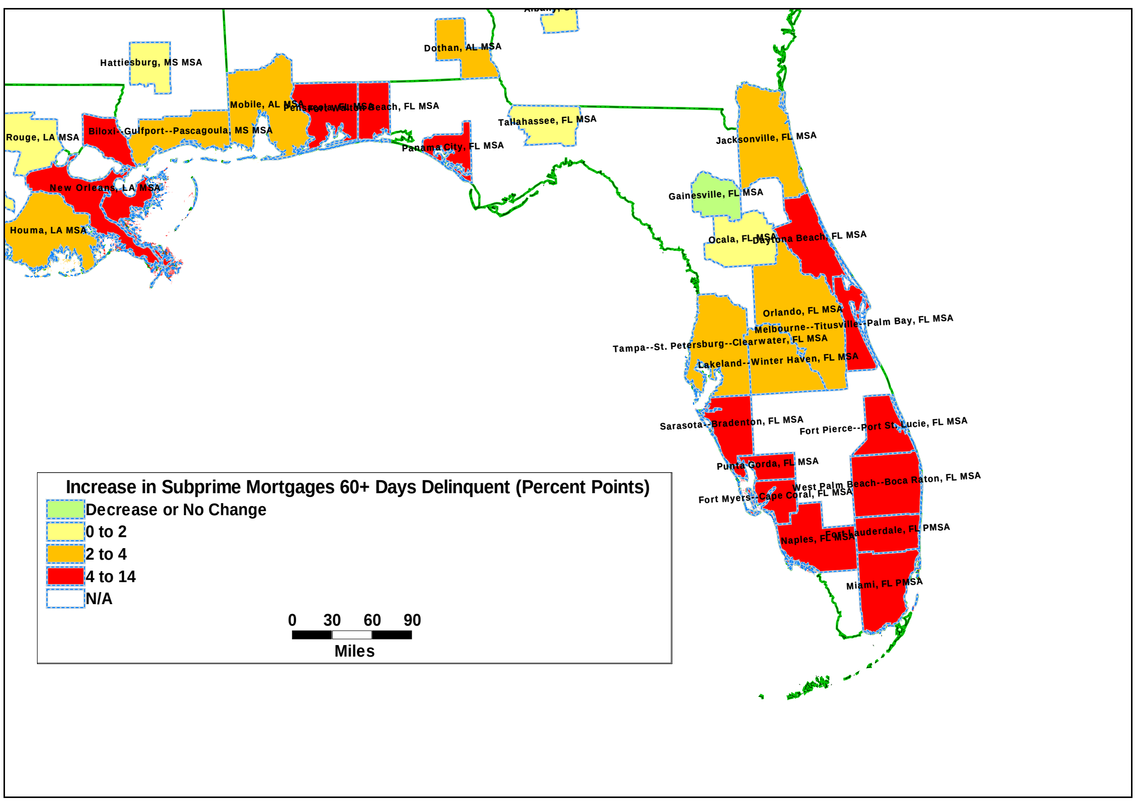
| | Foreclosure Rates (2006) | | | Home Price Appreciation (Percent change) | | |
|---|---|---|---|---|---|---|
| MSA | Foreclosure Rank[1] | Ratio of Foreclosures to Number of Households | Foreclosures as Percent of Households | 2005 | 2006 | Change in Home Price Appreciation (2005 to 2006) |
| Atlanta-Sandy Springs-Marietta, GA | 2 | 1:23 | 4.4 | 5.2 | 4.3 | -0.9 |
| Dallas-Plano-Irving, TX | 5 | 1:26 | 3.9 | 3.7 | 4.1 | 0.4 |
| Fort Worth-Arlington, TX | 6 | 1:27 | 3.7 | 3.3 | 4.9 | 1.6 |
| Las Vegas-Paradise, NV | 7 | 1:31 | 3.3 | 16.2 | 5.4 | -10.8 |
| Memphis, TN-MS-AR | 8 | 1:31 | 3.2 | 5.1 | 5.7 | 0.6 |
| Fort Lauderdale-Pompano Beach-Deerfield Beach, FL | 9 | 1:35 | 2.8 | 30.6 | 7.4 | -23.2 |
| Miami-Miami Beach-Kendall, FL | 10 | 1:35 | 2.8 | 29.0 | 15.3 | -13.7 |
| Stockton, CA | 11 | 1:37 | 2.7 | 26.8 | 0.8 | -26.0 |
| San Antonio, TX | 12 | 1:37 | 2.7 | 10.5 | 7.7 | -2.8 |
| Riverside-San Bernardino-Ontario, CA | 13 | 1:39 | 2.6 | 22.3 | 8.5 | -13.8 |
| Austin-Round Rock, TX | 16 | 1:43 | 2.3 | 6.6 | 9.1 | 2.5 |
| Houston-Sugar Land-Baytown, TX | 18 | 1:43 | 2.3 | 5.4 | 6.7 | 1.3 |
| Jacksonville, FL | 20 | 1:48 | 2.1 | 19.8 | 12.7 | -7.1 |
| West Palm Beach-Boca Raton-Boynton Beach, FL | 23 | 1:51 | 2.0 | 28.2 | 6.4 | -21.8 |
| Orlando-Kissimmee, FL | 26 | 1:54 | 1.8 | 33.4 | 11.7 | -21.7 |
| Little Rock-North Little Rock-Conway, AR | 27 | 1:55 | 1.8 | 7.0 | 5.4 | -1.6 |
| Oklahoma City, OK | 29 | 1:58 | 1.7 | 7.3 | 4.2 | -3.1 |
| Tampa-St. Petersburg-Clearwater, FL | 31 | 1:61 | 1.6 | 26.3 | 11.4 | -14.9 |
| Sacramento-Arden-Arcade-Roseville, CA | 32 | 1:61 | 1.6 | 18.7 | -2.4 | -21.1 |
| Tulsa, OK | 33 | 1:62 | 1.6 | 4.3 | 3.6 | -0.7 |
| Phoenix-Mesa-Scottdale, AZ | 34 | 1:66 | 1.5 | 40.9 | 9.0 | -31.9 |
| Charlotte-Gastonia-Concord, NC-SC | 35 | 1:67 | 1.5 | 5.6 | 9.1 | 3.5 |
| Albuquerque, NM | 36 | 1:67 | 1.5 | 16.4 | 14.5 | -1.9 |
| Oakland-Fremont-Hayward, CA | 38 | 1:73 | 1.4 | 22.6 | 1.7 | -20.9 |
| Fresno, CA | 39 | 1:74 | 1.4 | 24.9 | 5.2 | -19.7 |
| Bakersfield, CA | 42 | 1:78 | 1.3 | 29.5 | 8.5 | -21.0 |
| San Diego-Carlsbad-San Marcos, CA | 43 | 1:79 | 1.3 | 11.3 | -0.2 | -11.5 |
| El Paso, TX | 45 | 1:81 | 1.2 | 12.2 | 16.5 | 4.3 |
| Tucson, AZ | 46 | 1:82 | 1.2 | 29.8 | 8.6 | -21.2 |
| **United States** | **-** | **1:92** | **1.1** | **13.2** | **5.9** | **-7.3** |

Sources: RealtyTrac and Office of Federal Housing Enforcment Oversight.
[1]Foreclosures are ranked from 1 (highest rate of foreclosures) to 150 (lowest rate of foreclosures).

In many areas of the Sun Belt states—where housing prices have surged—the delinquency rates have increased quickly, indicating more foreclosure trouble to come. For example, in Sacramento, California, 60-day delinquencies for subprime loans increased 12 percentage points from 3 percent of all subprime loans in February 2005 to 15 percent of all subprime loans in February 2007.[29] And in Fort Meyers, Florida, delinquencies spiked 8 percentage points to 13 percent from February 2005 to February 2007. (See maps below, and **Appendix B** for more cities.)

[29] FirstAmerica LoanPerformance data, as of April 6, 2007.




Source: First American LoanPerformance data comparing the percentage of subprime mortgages 60 days or more delinquent, in February 2005 and February 2007.

### *Northeast*

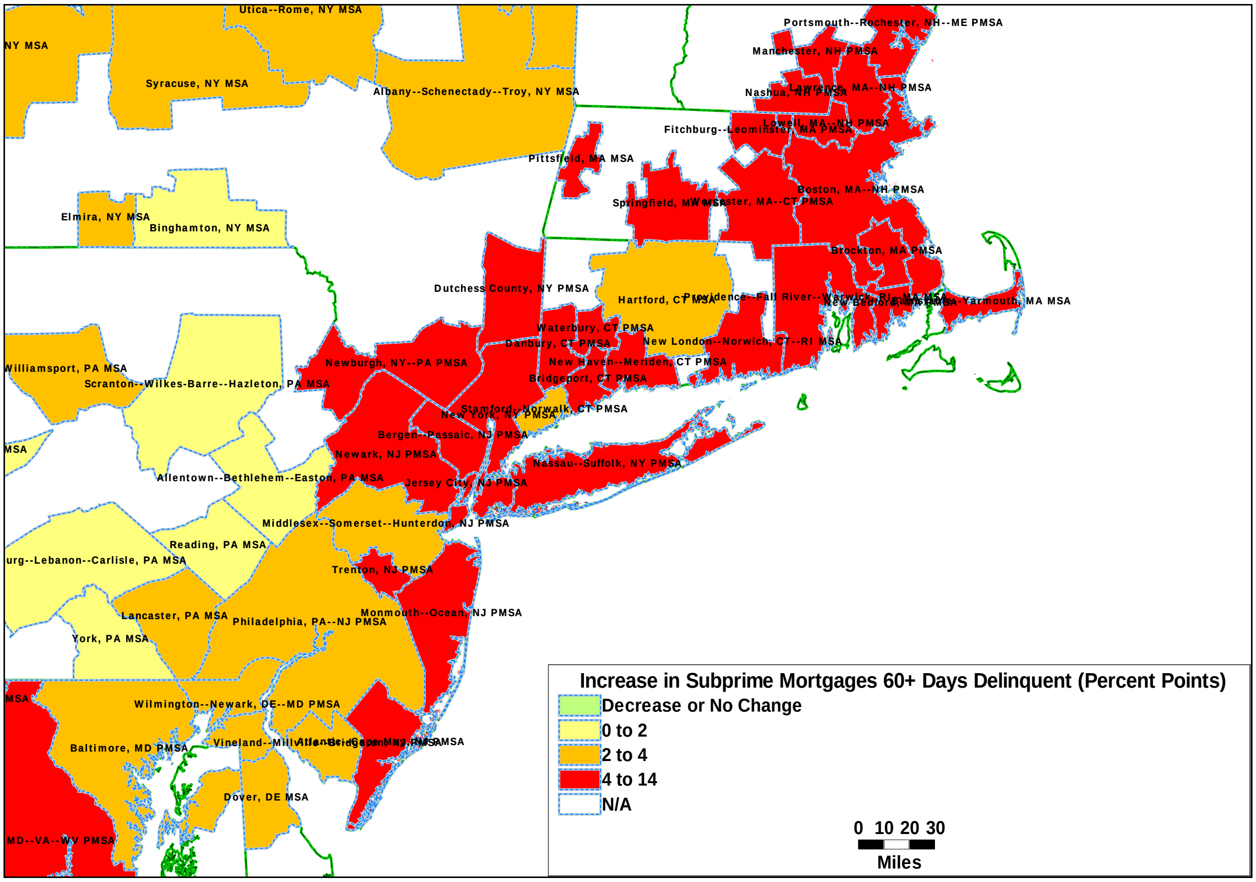
Although the Northeastern states did not rank as high as the Sun Belt and Midwest states in foreclosures in 2006, a closer look at the localities along the Northeast coast also suggest more foreclosures to come. Five Northeastern metro areas were in the top 50 metropolitan areas with the most foreclosures in 2006: Camden, Newark, and Edison, New Jersey; Long Island, New York; and Philadelphia, Pennsylvania. All five metro areas fared worse than the national average of foreclosures in 2006. While these areas have unemployment rates close to the national average, these five metro areas have in common cooling housing markets, with an average of a 10 percentage point slowdown in home price appreciation from 2005 to 2006. (See chart below).

**Northeast Metro Areas With Highest Foreclosures In 2006**

| | | Foreclosure Rates (2006) | | | Home Price Appreciation (Percent Change) | | |
|---|---|---|---|---|---|---|---|
| **MSA** | **National Foreclosure Rank[1]** | **Ratio of Foreclosures to Number of Households** | **Foreclosures as Percent of Households** | **Unemployment Rate** | **2005** | **2006** | **Change in Home Price Appreciation (2005 to 2006)** |
| Camden, NJ | 25 | 1:54 | 1.8 | 4.7 | 16.4 | 7.7 | -8.7 |
| Nassau-Suffolk, NY | 37 | 1:69 | 1.5 | 3.9 | 14.5 | 4.3 | -10.2 |
| Newark-Union, NJ-PA | 41 | 1:77 | 1.3 | 4.9 | 14.7 | 5.0 | -9.7 |
| Philadelphia, PA | 47 | 1:84 | 1.2 | 4.6 | 14.4 | 6.7 | -7.7 |
| Edison, NJ | 48 | 1:87 | 1.2 | 4.4 | 15.8 | 4.3 | -11.5 |
| **United States** | **-** | **1:92** | **1.1** | **4.6** | **13.2** | **5.9** | **-7.3** |

Sources: RealtyTrac, Department of Labor, Office of Federal Housing Enforcment Oversight.
[1]Foreclosures are ranked from 1 (highest rate of foreclosures) to 150 (lowest rate of foreclosures).

The most recent subprime delinquency data suggest that the Northeastern cities will likely see more foreclosures in the coming months. Delinquencies are on the rise in all five metro areas entering into 2007. Across New York, 13 percent of subprime loans were 60 or more days delinquent as of February 2007, up 7 percentage points since February 2005, with the highest increases in Long Island, Dutchess County, and New York City. New Jersey also had 13 percent of subprime loans delinquent in February, an increase of 6 percentage points in two years, with the sharpest increases in Newark and Monmouth-Ocean. In Pennsylvania, a state where 13 percent of subprime loans were also delinquent in February 2007, Philadelphia had the highest increase in delinquencies over the last two years, with a 5 percentage point increase. (See map below.)




Source: First American LoanPerformance data comparing the percentage of subprime mortgages 60 days or more delinquent, in February 2005 and February 2007.

### *Colorado*

Colorado experienced the highest level of foreclosures per household of any state in 2006, with one foreclosure for every 33 households, a substantial jump over previous years.[30] The city of Denver has been hardest hit, with one foreclosure for every 24 households.[31] Yet unlike the Midwest states, Colorado has a lower unemployment rate than the national average and a healthy job market. And unlike the Sun Belt and Northeastern regions, Colorado has not had a dramatic change in home price appreciation in recent years. For example, from 2005 to 2006, home prices appreciation Denver decelerated by 3.2 percentage points, compared to a 7.3 percentage point deceleration nationwide.

Rather, insufficient lending protections may have been the main contributor to the increased foreclosures in Colorado as many homeowners signing loans they were unable to afford during the housing boom. Notably, limited state regulation, licensing and education requirements for brokers and lenders as well as weak anti-predatory lending laws have contributed make Colorado one of the highest-ranking states for mortgage fraud in the country.[32] Colorado legislators

[30] RealtyTrac, "More than 1.2 Million Foreclosures Reported in 2006 According to RealtyTrac U.S. Foreclosure Market Report," January 25, 2007
[31] *Ibid.*
[32] Associated Press, "Colorado Legislators Introduce Measures Targeting Foreclosures," February 27, 2007.

themselves argue that lax enforcement combined with the proliferation of non-traditional loans substantially contributed to the state's rapid increase in foreclosures.[33] The Colorado state legislature is currently considering a licensing bill that includes enhanced education and testing requirements for mortgage lenders and brokers.[34]

## Foreclosures Are Costly to Local Communities

Foreclosures entail substantial costs for individual borrowers and lenders. Additionally, foreclosures can also impact cities and neighborhoods, particularly if concentrated, by putting downward pressure on neighboring housing prices and raising costs for local governments.

### *Costs of Foreclosures to Families*

A home is the primary asset for the majority of America's families. This is particularly true for low-and moderate-income families, minority families, and young couples, as most have a large portion of their assets tied up in their homes. As noted, these are the same population groups that are most at risk of foreclosure due to unsuitable subprime loans. For a homeowner, a foreclosure results not only in the loss of a stable living place and significant portion of wealth, but also reduces the homeowner's credit rating, creating barriers to future home purchases and even rentals. For the homeowner, foreclosures also create a possible tax liability, since any principal balance and accrued interest forgiven is treated as taxable income for the owner.

Foreclosures are also costly from a legal and administrative standpoint. According to one estimate, the average foreclosure results in $7,200 in administrative charges to the borrower.[35]

### *Cost of Foreclosures to Businesses*

Lenders also bears substantial foreclosure related costs, which helps explain why the spike in foreclosures has put significant financial pressure on the residential mortgage industry. Lenders do not typically benefit from taking over a delinquent owner's property, so they have an incentive to prevent foreclosure. A study from the Federal Reserve Bank of Chicago reported that lenders alone can lose as much as $50,000 per foreclosure. In 2003, this translated into approximately $25 billion in foreclosure-related costs for lenders alone—well before the 2006 foreclosure spike.[36] Indeed, substantial losses have led many of these lenders to tighten their lending standards, which will make it even more difficult for families facing foreclosure to refinance their homes, or purchase another if they have already foreclosed.

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[33] David Ollinger, "Two Bills Target Home Loans," Denver Post, February 26, 2007.
[34] Svaldi, Aldo, "Bill for Mortgage Broker License Passes Senate Committee," Denver Post, March 19, 2007.
[35] Anne Moreno, *The Cost-Effectiveness of Mortgage Foreclosure Prevention*, Minneapolis: Family Housing Fund, 1995.
[36] Desiree Hatcher, "Foreclosure Alternatives: A Case for Preserving Homeownership," *Profitwise News and Views,* Chicago Federal Reserve Bank, February 2006.

### *Costs of Foreclosures to City and Local Governments*

Foreclosures can also be very costly for local governments, particularly when they result in property vacancies. A foreclosed property that remains on the commercial market too long and becomes vacant can become an economic and administrative drain for cities. Moreover, cities, counties and local school districts lose tax revenue from abandoned homes. A Chicago case study by the Homeownership Preservation Foundation estimates that a city can lose up to nearly $20,000 per house abandoned in foreclosure in lost property taxes, unpaid utility bills, property upkeep, sewage and maintenance.[37] Many of these costs of foreclosure fall on taxpayers who ultimately pay the bill for foreclosure-related services provided by their local governments.

For example, several suburbs of Cleveland are already spending millions of dollars in an effort to maintain vacant houses as they try to contain the fallout of mortgage foreclosures.[38] It was recently reported that there are more than 200 vacant houses in Euclid (a suburb of Cleveland). Many of Euclid's 600 foreclosures over the past two years were homes of elderly people who refinanced with 2/28s (low two-year teaser rates), then saw their payments grow by 50 percent or more after the rates reset.[39] The suburb is currently losing $750,000 in property taxes a year from the vacant houses.[40]

### *Costs of Foreclosure on Neighboring Homeowners*

Finally, foreclosures can have a significant impact in the community in which the foreclosed homes are located. Studies have found that there is a contagion effect whereby concentrated foreclosures cause additional foreclosures in the community.[41] For lower-income communities attempting to revitalize, the consequence could be a substantial setback in neighborhood security and sustainability.

Areas of concentrated foreclosures can affect the price that other sellers can get for their houses. As higher foreclosure rates ripple through local markets, each house tossed back into the market adds to the supply of for-sale homes and could bring down home prices. A recent study calculated that a single-family home foreclosure lowers the value of homes located within one-eighth of a mile (or one city block) by an average of 0.9 percent, and more so in a low to moderate-income community (1.4 percent).[42] For a foreclosure in Atlanta, for example, where the median home price is $218,500, this would result in a decline in home prices of approximately $3,100 per single-family home within an eighth-mile. (For a table of neighboring home price impact of subprime foreclosures in the largest 50 foreclosure metropolitan areas, see **Appendix C.)**

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[37] William C. Apgar and Mark Duda, "Collateral Damage: The Municipal Impact of Today's Mortgage Foreclosure Boom," National Multi-Housing Council, May 11, 2005.
[38] Erik Eckholm, "Foreclosures Force Suburbs to Fight Blight, New York Times, March 23, 2007.
[39] *Ibid.*
[40] *Ibid.*
[41] NeighborWorks America, *Effective Community-Based Strategies for Preventing Foreclosures*, September 2005.
[42] Dan Immergluck and Geoff Smith, "The External Costs of Foreclosure: The Impact of Single-family Mortgage Foreclosures on Property Values," *Housing Policy Debate*, Vol. 17, Issue 1, 2006.

In a more recent estimate of subprime foreclosures on home prices, the chief economist for Moody's Economy.com projected that subprime defaults (which he expects to reach 800,000 this year alone) could result in *mid-single digit declines in housing prices*, and as much as double-digit declines in areas such as Arizona, Nevada, parts of California and Florida.[43] Assuming that this projection is correct—a 15 percent decline in home prices in Nevada would cost the average home owner $42,450 in lost home equity, based on the median home price in Nevada of $283,000.[44]

The impact of increased foreclosures on local housing prices can be more severe in areas where credit tightening adversely affects the availability of loans, and consequently the demand for housing. In response to the subprime crisis, commercial banks are tightening their underwriting standards for residential mortgages in general, as evidenced by the most recent Federal Reserve survey of bank lending terms. According to the survey, a net 15 percent of banks reported they had tightened their lending standards for residential mortgages - the largest percentage since the second quarter 1991.[45] According to one estimate, about 890,000 fewer Americans this year will be able to obtain financing to purchase a home because of tighter lending standards.[46] Moreover, it typically takes a victim of foreclosure 10 years to recover and buy another house, which means that more and more potential homeowners will be taken out of the home buyer base.[47]

Finally, the predominance of subprime loans in low-income and/or minority neighborhoods means that the bulk of the spillover costs of foreclosure are concentrated among the nation's most vulnerable households. These neighborhoods already have higher incidences of crime, and increased foreclosures have been found to contribute to higher levels of violent crime.[48]

**The High Costs of Foreclosures**

| **Stakeholders** | | **Estimated Costs Per Foreclosure** | |
|---|---|---|---|
| Homeowner | $ | 7,200 | 1 |
| Lender | $ | 50,000 | 2 |
| Local Government | $ | 19,227 | 3 |
| Neighbor's Home Value | $ | 1,508 | 4 |
| **Estimated Total Costs of Foreclosure** | **$** | **77,935** | |

Sources:

[1]Anne Moreno, *The Cost-Effectiveness of Mortgage Foreclosure Prevention,* Minneapolis: Family Housing Fund, 1995.

[2] Desiree Hatcher, "Foreclosure Alternatives: A Case for Preserving Homeownership," *Profitwise News and Views,* February 2006.

[3] Estimate assumes property is abandoned before foreclosure is completed. William C. Apgar and Mark Duda, *Collateral Damage: The Municipal Impact of Today's Mortgage Foreclosure Boom,* Homeownership Preservation Foundation, May 11, 2005.

[4]Assumes a .9 percent home price depreciation based on the national median home price of $167,500 as of 2005. Census Bureau, 2005 American Community Survey. Dan Immergluck and Geoff Smith, "The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values," *Housing Policy Debate,* Vol. 17, Issue 1.

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43 Les Christie, "Scary Math: More Homes, Fewer Buyers," CNNMoney.com, March 13, 2007.
44 U.S. Census Bureau, American Community Survey, 2005.
45 Federal Reserve, The January 2007 Senior Loan Officer Opinion Survey on Bank Lending Practices, January 2007.
46 Credit Suisse, "Mortgage Liquidity du Jour: Underestimated No More," March 12, 2007.
47 Schlomer *et al*, December 2006.
48 According to a study by Dan Immergluck and Geoff Smith, a standard deviation increase in the foreclosure rate (about 2.8 foreclosures for every 100 owner-occupied properties in one year) corresponds to an increase in neighborhood violent crime of approximately 6.7 percent). Dan Immergluck and Geoff Smith, "The Impact of Single-Family Mortgage Foreclosures on Neighborhood Crime," *Housing Studies*, Vol. 21, No. 6, November 2006.

## Conclusion: It Pays to Prevent Foreclosures

Foreclosures are costly – not only to homeowners, but also to a wide variety of stakeholders, including mortgage servicers, local governments and neighboring homeowners. The high costs of foreclosures – up to $80,000 for all stakeholders combined – present a strong incentive to prevent them. In their efforts to respond to the subprime foreclosure crisis, policymakers may want to consider enacting some combination of the following measures to prevent future foreclosures that may come as a result of a high concentration of unsuitable loans in areas of economic downturns, areas of steep housing market slumps and areas of lax regulatory enforcement.

**Increase Federal Support for Local Foreclosure Prevention Programs.** In the short term, local community-based non-profits may be best positioned to implement foreclosure prevention programs. State and national organizations exist throughout the country to both enhance homeownership and prevent foreclosures. Many of these programs have been successful in coordinating a wide range of services for borrowers in order to help restructure unsuitable loans, aid borrowers with foreclosures prevention counseling or initiate legal action against the most egregious predatory lenders.[49] Some of these programs also provide financial assistance, such as low-interest bridge loans to help borrowers recover from delinquency. To assist existing community-based nonprofits with increasing caseloads, the federal government should work with nonprofits with proven track records and consider providing them with enhanced funding. ***Estimates suggest that foreclosure prevention costs approximately $3,300 per household -- substantially less than the nearly $80,000 in costs of foreclosure described above.***[50]

**Strengthen and Reform FHA.** The Federal Housing Administration (FHA) currently issues more than $100 billion in mortgage insurance annually for loans made by private lenders to low-income, minority and first-time buyers. However, the FHA has not provided insurance for borrowers in the subprime market and its market share has steadily dropped in the last several years. William Apgar, at Harvard's Kennedy School of Government, has proposed that the FHA should be funded and revamped to oversee a "rescue fund" to purchase the portfolios of failed mortgages and try to restore the credit on these loans.[51] While this policy option would also include upfront costs, companies holding such portfolios may be likely to sell at reduce costs given the prospect of mass delinquency and foreclosure.

To prevent the origination of risky subprime mortgages designed to fail their borrowers going forward, the following measures may be helpful:

**Strengthen Regulation of Mortgage Origination at Federal Level.** Although bank lenders are subject to bank regulatory standards, mortgage brokers and loan officers in non-bank companies are not subject to federal enforcement of lending laws. Rather, states have the primary responsibility for regulating these mortgage brokers. While some states have taken measures to

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[49] NeighborWorks, *Effective Community-Based Strategies for Preventing Foreclosures,* September 2005; Almas Sayeed, "From Boom to Bust: Helping Families Prepare for the Rise in Subprime Mortgage Foreclosures," Center for American Progress, March 13, 2007.
[50] Ana Moreno, *Cost-Effectiveness of Mortgage Foreclosure Prevention,* Family Housing Fund, November 1995.
[51] Bill Swindell, "FHA Overhaul Might Be Part of a Subprime Loan Solution," *National Journal,* March 20, 2007.

improve the licensing, education and experience requirements for non-bank brokers and lenders, many states still lack sufficient oversight requirements. Thirty-nine states, including the District of Columbia, do not have testing requirements for loan originators and/or broker and lending executives, and 17 states, including the District of Columbia, do not have licensing requirements for individual brokers and lenders. (See **Appendix D**.) Improved federal oversight and enforcement could enhance industry practices, including loan underwriting, while further protecting borrowers. Federal standards could include licensing for individual brokers and lenders (not just companies) and minimum education and experience standards. Efforts are currently underway in Congress to investigate ways to strengthen the existing federal mortgage regulatory structure to improve compliance among non-bank mortgage brokers.

**Create a Federal Anti-Predatory Lending Law that Bans Unfair and Deceptive Practices.** Currently, no anti-predatory lending law exists at the federal level, but such a law is being considered in Congress. In the process, policymakers should investigate whether they should prohibit certain types of harmful loan provisions and practices all together, like pre-payment penalties, stated income or low documentation loans. In addition, lawmakers should consider requiring all subprime loan borrowers to escrow property taxes and hazard insurance.

**Establish Borrowers' Ability to Pay Standard**. In the financial services sector, investors are required to meet a "suitability standard" prior to being allowed to invest in certain products, based on their ability to afford the risk. Policymakers should consider how to apply similar tests to mortgage borrowers and lenders. Many exploding ARMs were approved based on the borrower's ability to pay the mortgage only in the first two or three years of the loan at the teaser rate, when the interest rate was lower, but not over the life of the loan once it resets with higher interest rates. A stricter standard to determine borrowers' ability to afford the loan over the life of the loan could prevent borrowers from being trapped in mortgage products that will lead them down the path to ultimate foreclosure.

**Disclosures Relating to Alternative Mortgage Products Must Be Enhanced**. The full impact of new complicated features such as teaser rates, interest-only payments and option-payments must be clearly and effectively communicated to potential borrowers. Existing disclosures designed for traditional mortgage products that tell borrowers that their payment "may increase or decrease" based on interest rate changes are not adequate for explanation of a teaser-rate mortgage in which payments increase dramatically after two or three years. Additionally, these disclosures must be written in plain language and must be prominently displayed in a manner that is visually clear and effectively communicates the intended information to the potential borrower. Lenders must be given a new format and new requirements for alternative mortgage product disclosure. This new disclosure should include a table clearly displaying a full payment schedule over the life of the loan, all fees associated with the loan, an explanation of the "alternative" features of the loan (i.e. negative amortization), and a full explanation of the risks associated with taking advantage of those features, including the timeframe in which borrowers were likely to feel the negative effects of those risks.

# EXHIBIT G

# Press Releases

**Joint Release**

**Board of Governors of the Federal Reserve System**
**Federal Deposit Insurance Corporation**
**National Credit Union Administration**
**Office of the Comptroller of the Currency**
**Office of Thrift Supervision**

For Immediate Release March 2, 2007

## Agencies Seek Comment on Subprime Mortgage Lending Statement

The federal financial regulatory agencies today issued for comment a proposed Statement on Subprime Mortgage Lending to address certain risks and emerging issues relating to subprime[1] mortgage lending practices, specifically, particular adjustable-rate mortgage (ARM) lending products.

The proposal addresses concerns that subprime borrowers may not fully understand the risks and consequences of obtaining these products, and that the products may pose an elevated credit risk to financial institutions. In particular, the proposed guidance focuses on loans that involve repayment terms that exceed the borrower's ability to service the debt without refinancing or selling the property.

The statement specifies that an institution's analysis of a borrower's repayment capacity should include an evaluation of the borrower's ability to repay the debt by its final maturity at the fully indexed rate, assuming a fully amortizing repayment schedule. The statement also underscores that communications with consumers should provide clear and balanced information about the relative benefits and risks of the products. If adopted, this statement would complement the 2006 Interagency Guidance on Nontraditional Mortgage Product Risks, which did not specifically address the risks of these ARM products.

The agencies request comment on all aspects of the proposed statement and are particularly interested in public comment about whether: 1) these arrangements always present inappropriate risks to institutions and consumers, or the extent to which they can be appropriate under some circumstances; 2) the proposed statement would unduly restrict existing subprime borrowers' ability to refinance their loans; 3) other forms of credit are available that would not present the risk of payment shock; 4) the principles of the proposed statement should be applied beyond the subprime ARM market; and 5) an institution's limiting of prepayment penalties to the initial fixed-rate period would assist consumers by providing them sufficient time to assess and act on their mortgage needs.

Comments are due sixty days after publication in the Federal Register, which is expected shortly. The guidance is attached.

Attachment: http://www.fdic.gov/news/news/press/2007/pr07018a.html

[1]The term "subprime" is defined in the *Expanded Guidance for Subprime Lending Programs*, issued by the agencies on January 31, 2001.

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FDIC-PR-18-2007

Media Contacts:

| | |
|---|---|
| Federal Reserve | Susan Stawick (202) 452-2955 |
| FDIC | David Barr (202) 898-6992 |
| NCUA | Cherie Umbel (703) 518-6330 |
| OCC | Kevin Mukri (202) 874-5770 |
| OTS | Kevin Petrasic (202) 906-6677 |

# EXHIBIT H

# Mortgage Liquidity du Jour: Underestimated No More

**Research Analysts**

**Ivy L. Zelman**
212 325 2443
ivy.zelman@credit-suisse.com

**Dennis McGill, CFA**
212 325 4466
dennis.mcgill@credit-suisse.com

**Justin Speer**
212 325 2448
justin.speer@credit-suisse.com

**Alan Ratner**
212 538 0331
alan.ratner@credit-suisse.com

**SECTOR REVIEW**

## Tightening the Housing Food Chain

In response to the recent turmoil in the mortgage market, we surveyed our private homebuilders and their mortgage lenders to asses the new home market's exposure to mortgage products that are at greatest risk for tightening and increased regulation in the coming months --- it's not just a subprime issue.

We believe that 40% of the market (share of subprime and Alt-A) is at risk of significant fallout from tightening credit and increased regulatory scrutiny. In particular, we believe the most pressing areas of concern should be stated income (49% of originations), high CLTV/piggyback (39%), and interest only/negative amortizing loans (23%). The proliferation of these exotic mortgage products has been disproportionately weighted to former hotbeds such as California, Nevada, Arizona and Florida, which have accounted for the lion share of builder profits.

Major lenders such as Countrywide, Option One and Wells Fargo have already announced plans to discontinue certain high CLTV and stated income loan programs, and over thirty subprime lenders have closed shop since late 2006. In addition, Freddie Mac recently indicated it will cease buying subprime ARMs that qualify buyers at the teaser rate. We take these recent events and conversations with our industry contacts to estimate a total impact to incremental originations of 21%, or an approximate decline of 236,000 new home sales from December's annual pace to 887,000 units. Combining the reduction in demand from credit tightening with the excessive level of investor speculation in recent years and the risks of a softening economy/declining consumer confidence yields our total estimated peak-to-trough drop in housing starts of 35-45%. This compares to our previous forecast of a 25% decline as discussed in our September 2006 report titled *"Data Masks Grim Reality,"* and the current 16% decline thus far on a trailing twelve month basis.

We remind investors that the headwinds from deteriorating credit will impact supply and pricing conditions, as well as incremental demand. With delinquency and foreclosure rates continuing to rise, we believe this will result in more supply hitting the market throughout the year. In addition, we estimate that current inventory figures released by the NAR could ultimately be 20% higher when homes currently in the foreclosure pipeline hit the resale market.

Finally, we believe that tightening liquidity and more stringent appraisals puts current builder backlogs at considerable risk for fallout, which should lead to another surge in cancellations and additional spec inventory on the market. As such, we believe the impact of these headwinds will be felt throughout the entire market (regardless of builder price point), and will likely contribute to the next tranche down in pricing, which in turn could lead to impairment risk surpassing our initial estimate of 20% of book as detailed in our *"Wonder-Land"* report.

# Table of contents

# Executive Summary

## Overview

We have long been of the opinion that the current housing downturn is as much a function of deteriorating affordability as an issue of over supply from fleeing investors and aggressive homebuilders building inventory. In order to mitigate the record price increases seen throughout the majority of the country, homebuyers became increasingly dependant on exotic mortgage products intended to reduce down payments and monthly mortgage payments. We initially highlighted the proliferation of these mortgage products and easing lending standards nearly four years ago in our report titled *"Mortgage Liquidity: Don't Underestimate the Underwriting."* Since our initial discussion on the topic, the evolution of the mortgage market has only accelerated further in the form of sustained easing of lending standards and the more innovation of exotic mortgage products.

In this report, we begin by slicing the mortgage market into five major segments and estimate the overall share of prime conforming, jumbo, Alt-A, subprime, and government (FHA and VA) loans in the purchase mortgage market. Although there is plenty of grey area in terms of defining and reporting lending data (with particular ambiguity surrounding the Alt-A, jumbo and subprime universes), we believe our estimates provide a reasonable depiction of the purchase mortgage market and how it has evolved in the past few years.

We provide investors with a factual understanding of how the loan characteristics of each segment of the market differ, and how easing underwriting standards in recent years have led to a change in mortgage product mix used by homebuyers. We use data from Loan Performance, SMR Research, the Credit Suisse ABS and MBS research teams, and our proprietary network of private homebuilders and mortgage contacts (covering roughly 10% of the total new home market) to determine which states have seen the most dramatic shift into subprime, Alt-A and other exotic mortgages. We then delve into the specific alternative mortgage products that have grown to represent a significant portion of the market, such as interest only loans, negative amortization loans (option ARMs), piggybacks/second mortgages, and low/no documentation mortgages. We highlight the prevalence of these products, the inherent risks involved, and discuss how recent scrutiny from regulators and legislators will likely impact these loan programs and the entire housing market going forward. Although regulatory actions taken thus far have primarily been on the state level, the Credit Suisse Group of External Affairs and Public Policy believes that this legislation could potentially be brought to the federal level within the next 18 months, implying that we will likely see the share of exotics decline drastically throughout the country in the coming months.

We extrapolate our analysis down to the new home market and builder fundamentals. While much of the focus in recent weeks has been on the fallout in the subprime market, we believe the question that investors should be focusing on deals with the builders' reliance on exotic mortgage products throughout the entire credit spectrum and the potential fallout from credit tightening.

That said, responses from public builders regarding subprime exposure have varied greatly, ranging anywhere from 1% of total sales to nearly 20%. We caution investors using the builders' statistics that the data only accounts for the percentage of loans captured through the builders' internal mortgage subsidiary or preferred lender. With capture rates averaging in the 60-80% range, this leaves roughly a quarter or more of the builders' business un-accounted for. Therefore, we would expect the builders' overall exposure to the subprime mortgage market to be greater than disclosed.

Finally, we address topics such as rising foreclosures, early payment default provisions on loans sold by the builders, tightening appraisal standards, and impending ARM resets --- all of which will likely provide additional supply and pricing pressures that ripple through the entire housing food chain and negatively impact all housing related segments.

# Key Takeaways

**Sizing Up The Market**

In comparing the mortgage market in 2006 to the lending environment four years ago, we highlight the following key takeaways:

- The overall share of prime conventional loans has declined from an estimated 66% of total purchase dollar originations in 2002 to 45% last year. The GSEs' share loss has been largely attributed to the proliferation of "exotic" mortgage products such as high CLTV loans, low/no documentation mortgages and interest-only/negative amortization loans, which the GSEs have typically chosen to limit their exposure to given the high risk profiles of these products.

- The Alt-A mortgage market has become a haven for homebuyers and investors looking for exotic mortgage products intended to mitigate the lack of affordability caused by surging home prices. While the rapid expansion of the subprime market has been highly publicized and scrutinized of late, the Alt-A market has expanded from just 5% of total originations in 2002 to approximately 20% in 2006. Although the credit profile of Alt-A borrowers is stronger than that of the subprime market (717 average FICO score for Alt-A borrowers versus 646 for subprime), we believe that there is considerable risk associated with the lax underwriting standards and exotic mortgage products utilized in this segment of the market in recent years, both in the form of continued credit deterioration and reduced incremental demand resulting from tightening lending standards.
    - The combined loan to value on Alt-A purchase originations was 88% in 2006, with 55% of homebuyers taking out simultaneous seconds (piggybacks) at the time of purchase.
    - Low/no documentation loans (stated income loans) represented a staggering 81% of total Alt-A purchase originations in 2006, up significantly from 64% just two years earlier (not likely a phenomena just out of convenience).
    - Interest only and option ARM loans represented approximately 62% of Alt-A purchase originations in 2006.
    - Adding to the risk is the fact that 1-year hybrid ARMs represented approximately 28% of Alt-A purchase originations in 2006, setting the stage for considerable reset risk.
    - Investors and second home buyers represented 22% of Alt-A purchase originations last year, which is the largest non-owner occupied share among the various segments of the mortgage market.

- In the past five years, subprime purchase originations have more than doubled in share to approximately 20% of the total in 2006. Over this time period, subprime lenders eased underwriting standards in an effort to gain market share. As one private builder indicated to us, in the past nine months anybody with a pulse that was interested in buying a home was able to get financing, which certainly helps explain the poor performance thus far of 2006 loan vintages. In the third quarter of 2006, the Mortgage Bankers' Association reported that 12.6% of subprime loans were delinquent.
    - 2006 subprime purchase originations posted an alarming 94% combined loan-to-value, on an average loan price of nearly $200,000.
    - Roughly 50% of all subprime borrowers in the past two years have provided limited documentation regarding their incomes.

- In 2006, 2/28 ARMs represented roughly 78% of all subprime purchase originations according to data from Loan Performance. According to our contacts, homebuyers were primarily qualified at the introductory teaser rate rather than the fully amortizing rate, which for many buyers was the main reason they were even qualified in the first place.

**Lenders and Borrowers Get Exotic**

The rapid shift into subprime and Alt-A mortgages does not come close to telling the whole story of the recent evolution of the industry. In order to mitigate record home price increases in recent years, exotic mortgage products have grown to represent a significant portion of the overall market.

- Based on data from SMR Research, approximately 40% of home purchase mortgages in 2006 involved piggyback loans (through the third quarter), compared to 20% in 2001. When speaking with our private builder contacts, even we were surprised by just how little money recent homebuyers have put down when taking piggybacks into account. Based on a survey of our builder contacts, their average *combined* loan-to-value ratio on home sales in 2006 was 91%, with 49% of homebuyers taking out a simultaneous second mortgage at the time of purchase. With home prices falling anywhere from 10-30% in previously frothy markets, high CLTV borrowers are finding themselves in with significant levels of negative equity in their homes.

- A misconception that we commonly hear is that the growth in piggybacks has generally been isolated to the subprime arena. While more than half of all subprime mortgages had a simultaneous second mortgage associated with them, Alt-A and jumbo loans have seen similar growth in piggyback prevalence in recent years. In fact, 55% of securitized Alt-A mortgages in 2006 had simultaneous seconds attached to them.

- In recent weeks, the lending environment for piggyback loans has tightened significantly. Just three weeks ago, Fremont General Corporation, a top 10 subprime lender, announced that it would no longer be providing these second mortgages to borrowers (the company has since exited the subprime market completely). On March 7, Option One, the 9th ranked subprime lender based on 2006 origination volume, announced that it would no longer originate any mortgages (not confined to subprime) with CLTV's above 95% due to the secondary market's lack of appetite for these loans. Two days later, Countrywide announced that it would no longer be offering any 100% LTV products, effective immediately. We believe it is extremely likely that other major lenders will follow suit, as investors' interest in these high-risk loans continues to wane making it unprofitable for issuers to originate them.

- An estimated 23% of total purchase originations in 2006 were interest only or negative amortization mortgages. Similarly, according to our private builder survey, interest only and option ARMs represented 24% of new home sales in 2006.

- Low/no documentation loans increased from just 18% of total purchase originations in 2001 to 49% in 2006 according to Loan Performance. Based on a survey of our private homebuilders, the percentage of buyers providing limited-to-no documentation was similar on the new construction side of the business to the overall market, at 46% in 2006. While many believe that buyers choose to provide limited or no documentation for convenience rather than necessity, a study by the Mortgage Asset Research Institute sampling 100 stated income (low/no documentation) loans found that 60% of borrowers had "exaggerated" their income by more than 50%.

- The crackdown on these mortgage products has already begun. Last week, Wells Fargo announced that it has completely discontinued its stated income/limited documentation wholesale loan programs in the state of Ohio. The announcement was made in response to the recently enacted Ohio Senate Bill 185, which suggests that certain mortgage products originated in Ohio by non-bank entities may not be included in securitization pools. While this announcement has not received much media attention, we believe it could be a major event if other states pass similar legislation.

- The Credit Suisse Group of External Affairs and Public Policy believes that this legislation could potentially be brought to the federal level within the next 18 months, implying that we will likely see the share of low and no documentation loans decline drastically throughout the country in the coming months.
- As a response to defaults rising and with new leadership in Congress, in December 2006, the Senate Banking Committee Chairman, Senator Chris Dodd and five other committee members increased pressure on federal banking regulators to take action and tighten underwriting of certain subprime products (notably 2/28 ARMs).
- Likely not coincidentally, in late February, Freddie Mac made it known that it will cease buying certain subprime mortgages, limiting its purchase to loans that qualify borrowers at the fully indexed, fully amortized rate and will limit the use of low-doc subprime loans (most importantly, this will impact 2/28 loans, which represented nearly 80% of subprime originations in 2006).

**Where's the Greatest Risk?**

While we ultimately believe that the impact of tightening lending standards will be felt in all markets across the country, there were several states and MSAs that were particularly reliant on risky and exotic mortgages in the past few years in order to fuel incremental housing demand.

- Given that we estimate that Nevada, California, Arizona, Florida and Virginia had the greatest share of Alt-A originations in 2005, we believe the fallout on incremental demand will be considerable in these markets. These five states are also the top five EBIT generators for our homebuilding universe, representing roughly 75% of total operating profit in 2005.
- In a survey of our private homebuilders, our contacts confirmed that the Alt-A market is a significant portion of their overall business, representing 18% of new home sales, on average, in 2006. In addition, our builder contacts specifically operating in Nevada (30% Alt-A share), California (28%), Florida (27%), and Arizona (20%) confirm that those states have an above average concentration of Alt-A loans of the overall mortgage pie.
- We estimate that Rhode Island (28% subprime share), California (25%), Mississippi (25%), Illinois (24%), and Texas (23%) had the greatest percentage of subprime homebuyers in 2005.
- More than 60% of homes purchased in 2006 had piggyback loans attached to them in hotbeds such as Los Angeles, the Inland Empire, Las Vegas, and Sacramento. More than half of all home purchases last year had CLTVs of 95% or higher in markets such as the Inland Empire, Las Vegas, Fresno, Detroit and Fort Myers (just to name a few!).
- Similar to piggybacks, the prevalence of IOs and option ARMs has been disproportionately weighted to high priced MSAs such as San Diego (42% of total), the Bay Area (40%), Los Angeles (39%) and Las Vegas (38%).
- While the share of low/no documentation loans appears to be the highest in former investor hotbeds such as California, Las Vegas and Florida, there is not much of a drop-off in other parts of the country. Based on a survey of our private homebuilders, the percentage of buyers providing limited-to-no documentation was greatest in Arizona (71% of total), California (69%), Nevada (52%) and Florida (47%), while the average for all markets in 2006 was 46%.

- We believe that tightening liquidity puts current builder backlogs at considerable risk for fallout, which should lead to another surge in cancellations and additional spec inventory on the market. We are already hearing anecdotes from builders in California, Florida, Nevada and Texas of buyers in backlog being unable to obtain financing because their loan program is no longer being offered by the lender (or the lending requirements have changed), which could lead to the next tranche down in pricing.

**Watch Out For Pent-Up Supply and Further Pricing Pressure**

While much of the focus in the next few months for the builders will likely be on credit tightening and how that will impact homebuyers' ability to get financing, we do not want to underestimate the impact that rising foreclosures and delinquencies will have on the supply and pricing dynamics of the housing market. Given the recent credit deterioration in the subprime and Alt-A markets, and the likely fallout throughout the entire housing chain, we are of the opinion that there is a real threat of "pent-up supply" that will hit the market in the next six-to-twelve months as a result of the lax underwriting standards of recent years.

- In January, RealtyTrac reported that roughly 130,500 homes entered the foreclosure process across the country, which represented the highest level since the company began disclosing the data two years ago.

- There are three basic stages of the foreclosure process. While the timing of each stage can vary depending on state laws, based on conversations with industry experts we believe it may take anywhere from six-to-twelve months for a home to move through the entire foreclosure process and finally end up as a unit of inventory. On a trailing six month basis (we take the low-end of our potential duration of the foreclosure process), roughly 700,000 homes have entered foreclosure based on RealtyTrac's data. Over the last twelve months, 1.0% of total households in the U.S. have entered foreclosure (1.29 million homes), up from 0.7% in 2005.

- We estimate that there are approximately 565,000 homes in the foreclosure process around the country that have the *potential* to be added to inventory within the next two-to-six months in the form of an REO, and another 135,000 that are already listed or on the verge of being listed as "must-sells."

- To put this into perspective, the National Association of Realtors reported existing inventory of 3.55 million units in January, implying that total inventory may be 20% understated when taking foreclosures into account.

- The builders may also be on the hook for defaults due to early payment default provisions. An early payment default (EPD) for a homebuilder occurs when a loan originated by the builder's mortgage subsidiary defaults within a pre-determined timeframe, and the builder is forced to repurchase the loan from the secondary market investor that it originally sold it to. Based on our survey of private builders, 43% of builders responded that they have EPD provisions attached to their mortgages, with the timeframe that they would be forced to repurchase a defaulted loan ranging anywhere from one month to more than six months. Only 19% of respondents have had to repurchase any loans thus far, although we believe this could become a larger issue if credit conditions continue to deteriorate and builders are forced to take REOs on to the balance sheet.

- The states with the highest level of foreclosures in 2006 were Colorado (2.7% of households), Nevada (2.1%), Georgia (2.0%) and Michigan (1.4%). Not surprisingly, all of these states have seen significant pricing pressure in the past year or more.

- Rising subprime and Alt-A delinquency rates will likely keep foreclosure levels elevated for the foreseeable future. Subprime 60+ day delinquencies and foreclosure rates for 2006 vintages are running more than 3 times the levels form 2004 vintages given the sharp downturn in home prices and underwriting standards that continued to ease through much of the year. Delinquencies of 90 days or more, foreclosure and REO rates on 2006 vintage Alt-A ARMs are running 3 to 4 times above the levels from 2003 and 2004 vintages.

- Roughly $300 billion of securitized subprime mortgages (36% of outstanding subprime MBS) are set to reset in 2007 alone, with $500 billion in total mortgage debt (6% of outstanding) scheduled to reset during the year. While we are not attempting to make a call on the consumer, part of our concerns surrounding our building products and furniture spaces, as well as the concerns expressed by the Credit Suisse Broadline and Hardline retail teams are centered on the potential consumer implications of payment shock associated with these rate resets.

- Another major issue that our contacts are extremely concerned with is the tightening of appraisals. Several of our builder contacts have reported increasing instances of appraisals coming in below the price that the home was sold for a few months earlier, which is causing builders to lower the price to the appraised value at closing. Appraisals are now coming back several times, and up to three days before closing given the tighter standards. On the existing side, many builders have reported buyers in backlog that have had to cancel because the appraisal value of their home came in below their sales price and outstanding loan value. While most of the focus on lending tightening has been on the actual mortgage products and lending criteria, we believe that this headwind may prove to have a significant impact on the overall housing market by forcing the next drop in home prices, as reluctant home sellers finally face the reality that their home is not worth what it was two years ago.

## Tying It All Together

- The obvious corollary to our analysis of the risk underlying the mortgage market is its pending impact on new home sales and homebuilder fundamentals. In recent days, several public homebuilders have commented on their exposure to the subprime mortgage market. While the focus has predominantly been isolated to the subprime market, we believe the question that investors should be focusing on deals with the builders' reliance on exotic mortgage products throughout the entire credit spectrum and the potential fallout from credit tightening.

- That said, responses regarding subprime exposure have varied greatly, ranging anywhere from 1% of total sales to nearly 20%. While we would be extremely surprised to see such a wide range in exposure among the various builders (especially those selling to similar price points), we are not terribly shocked to see the differing responses given the blurred boundaries between mortgage segments.

- We caution investors using the builders' statistics that the data only accounts for the percentage of loans captured through the builders' internal mortgage subsidiary or preferred lender. With capture rates averaging in the 60-80% range, this leaves roughly a quarter or more of the builders' business un-accounted for. Many of our contacts indicated that a disproportionate share of their non-captured home sales are subprime borrowers. If the same holds true for the publics, we would expect the builders' overall exposure to the subprime mortgage market to be greater than disclosed.

- The fact that builders do not have, or have not historically tracked more in-depth credit statistics for their buyers leaves risk that any tightening could take the group by surprise, reminiscent of our concerns regarding investors nearly two years ago.

**New Home Market Impact**

- With financing pulling back at the entry-level, we believe it is only a matter of time until the impact is felt in other price points. If 15-25% of entry-level buyers that would have used subprime financing can no longer obtain funding, does this mean that 15-25% of potential move-up buyers can no longer obtain a buyer for their home, and so on?

- Analyzed another way, we take each piece of the general mortgage market and use conversations with industry contacts, recent tightening announced by lenders and expected legislative and regulatory actions, to estimate the proportion of each segment that could be eliminated by tighter lending standards. In our base case, we assume that 50% of the subprime market is at risk, taking originations back to 2003 levels, which would impact total purchase volume by 10%. Similarly, we estimate that 25% of Alt-A and 10% of prime loans would not be approved under tighter restrictions for various combinations of investor purchases, piggybacks, low down payments and low documentation, and the impending ripple effect down the entire housing market food chain. In aggregate, the total fallout of incremental originations would be 21% over the next one-to-two years.

- Related to speculation, investors' share of the market climbed to roughly 18% in 2005 and 2006 from an average of 7% from 1998-2001, implying that a return to the mean would remove 11% of housing demand.

- Combining the two yields a 25-35% reduction in peak housing production. This would likely be exacerbated by declining consumer confidence, investor demand falling below historical norms, the risk of a softening economy and supply pressures weighing on demand (all of which seem present today), suggesting at least a further 10% drop. Aggregating the various impacts would result in a 35-45% drop-off in new starts from the peak of 2.1 million homes to roughly 1.2-1.4 million, as compared to the 16% decrease thus far on a trailing twelve month basis. For comparison, starts during the last three downturns ending in 1991 (down 34%), 1982 (down 32%) and 1980 (down 37%) fell by an average of 34%.

- Expressed differently, if we assume that the full impact of mortgage lending tightening will be felt in 2007, all else equal, we would expect new home sales to fall roughly 20% from December's seasonally adjusted rate of 1.123 million to an annual rate of 887,000 homes (236,000 reduction from tightening lending standards).

- Our new forecast of a 35-45% peak-to-trough decline in housing starts compares to our initial "back-of-the-envelope" estimate of 25% as discussed in our September 2006 report titled *"Data Masks Grim Reality."* Given our forecast reduction, we are lowering our 2007 earnings estimates across our space. Please see our note also published today called *"A Different Kind of Spring Selling Season: Reducing 2007 Estimates"* for more details.

- Thus far, the group has recognized $3.9 billion of our estimated $10.5 billion of impairments expected via writedowns and option forfeitures with new order home prices falling 12% in 4Q06 from a 4Q05 peak. Our estimated writedown analysis was predicated on new home values falling back to 2003 levels, which would be a further 5.5% reduction from current levels. Given the incremental headwinds of reduced demand from liquidity tightening, and additional supply coming to the market in the form of REOs, buyers falling out of backlog and appraisal tightening, we remain confident in our initial estimates and would not be surprised to see prices come under even greater pressure than originally anticipated, therefore implying additional impairment risk beyond our estimates.

**Market and Builder Risk**

- To summarize our views down to the public builders, we compared the exposure to subprime, Alt-A and prime mortgages by state to that of the builders' revenue breakdown. In addition to having geographic risk to frothy mortgage markets, builders that derive a higher percentage of units from the entry-level are likely to feel the tightening more immediately. We segment out the builders most exposed to the entry-level via industry statistics from Professional Builder of price point, in addition to the average selling price given our view that certain builders have different classifications of an “entry-level” home.

- Combining the two metrics highlights those builders that we believe would have the most risk to tightening credit. For example, in 2005, SPF and KBH generated roughly 50% and 47% of revenues from high or medium risk markets while also having above average exposure to the entry-level. On the other hand, NVR, PHM, TOL and WCI either have below average exposure to the first-time buyer, or are less prevalent in high risk markets. However, we caution that while this framework provides an easy method to measure relative risk, we reiterate our comment that a divergence in price points is only a temporary phenomenon, and therefore we believe that all builders will ultimately be negatively impacted by the headwinds discussed in this report.

*We would like to extend a special thanks to our Asset-Backed Securities Team led by Rod Dubitsky and our Mortgage Backed Securities Team led by Satish Mansukhani and Chandrajit Bhattacharya for their instrumental contributions in preparing this report.*

# The U.S. Mortgage Market

The mortgage market can be broadly broken down into five segments: prime conforming, jumbos, Alt-A, subprime, and government (FHA and VA). There are numerous factors that contribute to which financing option a prospective homebuyer ultimately uses. In general, a more established credit history, supportive assets and/or a consistent employment record translates to the most desirable of mortgage with the best rates and terms, i.e. prime conforming. However, poor credit quality, undocumented income or the purchase of a high priced home could push the borrower into a nonconforming mortgage.

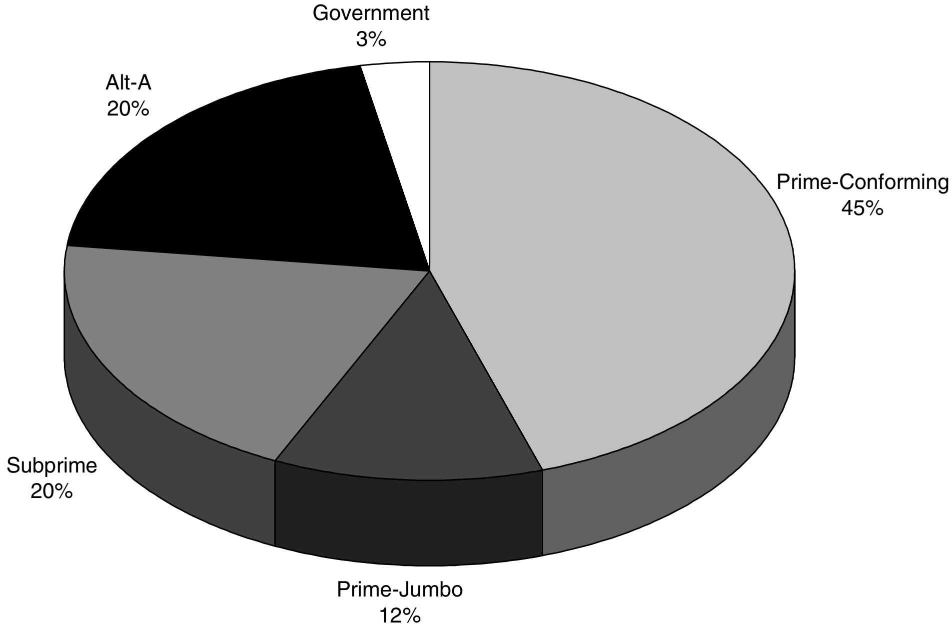
In this section, we briefly define each mortgage type, highlight the main differences and outline the relative size of each segment. While we originally set out in this report to definitively and accurately slice the mortgage market into the segments highlighted above, we quickly discovered that there is plenty of grey area in terms of defining and reporting lending data. Particular ambiguity surrounds the Alt-A, jumbo and subprime universes, which often have blurred boundaries.

In addition to vague definitions, loan tracking data such as the oft-cited Loan Performance database has its limitations, as it only covers the securitized non-agency mortgage market. We estimate that our data, which combines the Loan Performance database and agency securitization data, captures roughly 75% of the total mortgage market. It is unclear exactly how that remaining quarter of the market shakes out between segments, and any estimates of segment breakouts are just that --- estimates. Historically, one could make the assumption that the majority of non-securitized loans were higher quality mortgages that originators decided to keep on their balance sheets. More recently, however, it is likely that the opposite is true, due to deteriorating investor demand for higher-risk loans.

With the help of the Credit Suisse U.S. Mortgage Strategy team and our industry contacts in the mortgage arena, we present below a brief overview of the major mortgage segments and provide an estimated breakout of purchase originations among the segments. For the purpose of this report, we are focusing in particular on the purchase mortgage market, as refinancings are not incremental for our analysis. The percentage breakouts are estimates based on the various data sources available, providing a reasonable depiction of the purchase mortgage market, and how it has evolved in recent years. A more detailed discussion devoted to alternative mortgage products (i.e. interest only, option ARMs, negative amortization, stated income loans, piggybacks, etc.) is included in the following section of this report.

Exhibit 1 and Exhibit 2 provide a comparison of the current purchase mortgage market versus the market in 2002, as we detailed in our original report on the topic almost four years ago called "*Mortgage Liquidity: Don't Underestimate the Underwriting.*" In that four year time period, the overall share of prime conventional loans declined from an estimated 66% of total purchase dollar originations to 45%, as the surge in subprime and Alt-A lending contributed to the drop in market share.

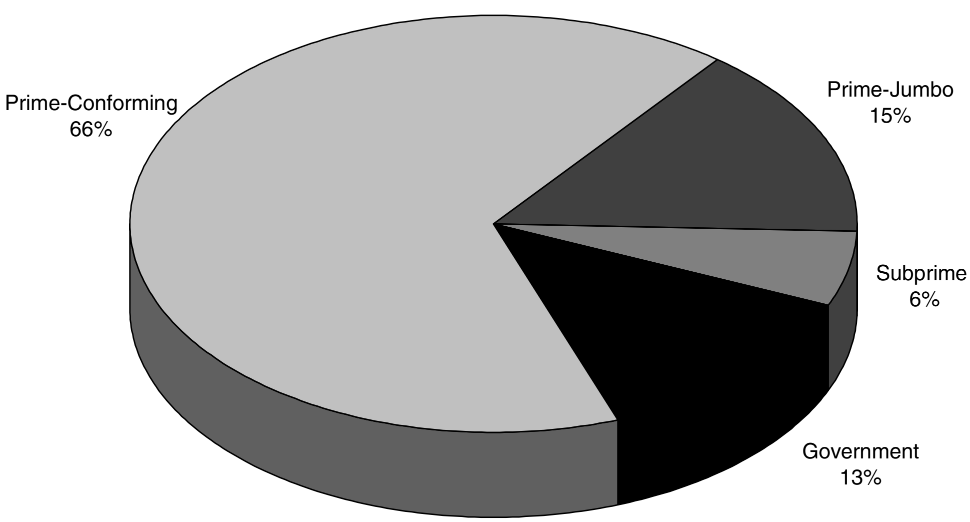
**Exhibit 1: Estimated Purchase Dollar Originations, 2006**




*Source: Inside Mortgage Finance, MBA, LEHC, Credit Suisse U.S. Mortgage Strategy, Credit Suisse analysis.*

**Exhibit 2: Estimated Purchase Dollar Originations, 2002**

Alt-A exposure was approximately 5% of purchase originations in 2002, and was grouped in Prime-Conforming, Prime-Jumbo and Subprime.




*Source: Inside Mortgage Finance, MBA, FHA, FHFB, Credit Suisse analysis.*

lower payments off the bat than traditional adjustable rate mortgages, which has likely contributed to the dramatic shift out of prime, fully amortizing jumbos.

As shown in Exhibit 7, roughly 58% of jumbo borrowers in 2006 took out fixed rate mortgages. Interest-only ARMs were the second most commonly used mortgage product, representing 38% of jumbo purchase originations. Nearly 45% of homebuyers provided full income and asset documentation on their jumbo loan applications, with the remaining share providing limited or no documentation. Last year, 33% of jumbo loans were originated with simultaneous second mortgages. FICO scores remain high in this segment of the market, with the average score last year coming in at 749. The average jumbo loan size was approximately $583,000.

We estimate that the jumbo share of purchase originations was roughly 12% in 2006, down from our 15% estimate in 2002. We note, however, that there is a significant level of ambiguity in the classification of jumbo loans. Historically, any loan exceeding the conforming limit would be considered a jumbo loan. However, with the expansion of the Alt-A market and option ARM product, many of these large loans are now being classified as Alt-A for data reporting purposes. In 2005, Loan Performance, a popular database covering mortgage backed securities, began grouping all of these option ARMs into Alt-A. This can be seen in Exhibit 7, as the "NegAM ARM" share of originations declined from 11.7% in 2004 to 0% in 2006. These incremental loans were reclassified as Alt-A mortgages and have contributed to the growth in that segment of the market.

**Exhibit 7: Characteristics of Purchase Mortgage Originations Backing Non-Agency Jumbo, 2004-2006**

| | 2004 | 2005 | 2006 |
|---|---|---|---|
| ***Product Type*** | | | |
| IO FRM | 0.5% | 9.0% | 16.2% |
| Other FRM | 18.6% | 27.0% | 41.3% |
| IO ARM | 51.2% | 49.9% | 38.0% |
| NegAm ARM | 11.7% | 2.6% | 0.0% |
| Other ARM | 17.9% | 11.6% | 4.5% |
| ***40-Year Mortgage*** | | | |
| 40-Year FRM | 0.0% | 0.0% | 0.0% |
| 40-Year ARM | 0.3% | 0.0% | 0.0% |
| Not a 40-Year Mortgage | 99.7% | 100.0% | 100.0% |
| ***Occupancy Status*** | | | |
| Owner-Occupied | 88.0% | 88.4% | 89.9% |
| Investor | 3.2% | 2.0% | 1.0% |
| 2nd Home | 8.8% | 9.6% | 9.2% |
| ***Documentation*** | | | |
| Full Doc | 50.9% | 47.5% | 44.8% |
| Low Doc | 40.7% | 49.9% | 49.4% |
| No Doc | 1.6% | 2.3% | 5.8% |
| NA | 6.8% | 0.3% | 0.0% |
| ***Simultaneous Seconds*** | | | |
| w/ Simultaneous Second | 21.7% | 26.4% | 32.5% |
| w/o Simultaneous Second | 78.3% | 73.6% | 67.5% |

| | 2004 | 2005 | 2006 |
|---|---|---|---|
| ***Property Type*** | | | |
| Single-Family | 65.6% | 65.8% | 71.5% |
| Condo/Coop | 13.9% | 14.6% | 12.5% |
| 2-4 Units | 1.7% | 1.5% | 1.3% |
| Other | 18.8% | 18.1% | 14.7% |
| ***Loan Type*** | | | |
| FRM | 19.1% | 36.0% | 57.5% |
| 1-Year ARM | 24.3% | 4.3% | 0.0% |
| 2-Year ARM | 0.1% | 0.0% | 0.0% |
| 3-Year ARM | 8.2% | 3.1% | 0.5% |
| 5-Year ARM | 35.9% | 34.1% | 20.9% |
| 7-Year ARM | 7.2% | 8.4% | 9.7% |
| 10-Year ARM | 5.3% | 14.1% | 11.4% |
| ***Other Characteristics*** | | | |
| Avg. FICO Score | 737 | 745 | 749 |
| Avg. Combined LTV | 78% | 79% | 80% |
| Avg. Debt to Income Ratio | 35% | 36% | 37% |
| Avg. Loan Size | $423,142 | $500,053 | $583,430 |

*Note: Beginning in 2005, Loan Performance began classifying all jumbo option ARMs as "Alt-A" mortgages. The above data reflects the non-option ARM jumbo market post 2004.*

*Source: Loan Performance, Inside MBS & ABS, Fannie Mae.*

### Alt-A Mortgages (Estimated 20% of Purchase Dollar Originations)

An Alt-A mortgage, also referred to as an "A-minus" loan, was historically a mortgage for borrowers with limited funds for a down payment and/or blemished credit (such as being 30 days delinquent once or twice in the past year), but the capacity to resolve outstanding credit issues. Alt-A loans carry interest rates that are below the subprime market rate, but higher than the rate on A-loans in order to reflect higher borrower risk (roughly 25-50 basis points higher depending on credit characteristics). Self employed borrowers that could not provide adequate proof of income and assets were also commonly grouped in this category, and charged a higher rate to account for their lack of documentation.

More recently, the Alt-A segment of the mortgage market has evolved to include many of the most risky, “exotic” mortgage products such as option ARMs and limited documentation mortgages. These days, the Alt-A segment is more a function of the type of mortgage product than the credit quality of the borrower.

Although the rapid expansion of the subprime market has been highly publicized and scrutinized, its growth is rivaled by the Alt-A mortgage market, which has expanded from just 5% of total originations in 2002 to approximately 20% in 2006. Through the third quarter of 2006, IndyMac and Countrywide were the largest issuers of Alt-A loans, accounting for roughly a third of the market (See Exhibit 8). As alluded to in our discussion on jumbo loans, much of the growth in this segment of the market has been the result of the shift into exotic mortgage products, which primarily fall into the Alt-A category of mortgages.

**Exhibit 8: Top 10 Alt-A Lenders, 2006**

| Rank | Organization | 2006 YTD | Market Share (%) | Total Origination Volume | Alt-A Share (%) |
|---|---|---|---|---|---|
| 1 | IndyMac | $49,620 | 16.5% | $64,000 | 77.5% |
| 2 | Countrywide Financial | 47,000 | 15.7% | 333,740 | 14.1% |
| 3 | Wells Fargo | 30,050 | 10.0% | 310,890 | 9.7% |
| 4 | Residential Funding Corp | 29,730 | 9.9% | 66,100 | 45.0% |
| 5 | WMC Mortgage | 19,300 | 6.4% | 24,140 | 80.0% |
| 6 | Washington Mutual | 19,050 | 6.4% | 153,630 | 12.4% |
| 7 | GreenPoint Mortgage | 12,310 | 4.1% | 27,120 | 45.4% |
| 8 | Aurora Loan Services | 11,000 | 3.7% | 25,300 | 43.5% |
| 9 | Homecomings Financial | 9,980 | 3.3% | 21,660 | 46.1% |
| 10 | First Magnus Financial | 9,900 | 3.3% | 22,030 | 44.9% |
| | Total Top 10 | $237,940 | 79.3% | $1,048,610 | 22.7% |

*Note: Dollars in millions. 2006 YTD through third quarter.*

*Source: Inside Mortgage Finance*

While we will discuss option ARMs and other exotic mortgage products in greater detail later in the report, an option ARM is simply a mortgage which gives the homeowner a choice of payment methods: fully amortizing over 30 years, fully amortizing over 15 years, interest-only payments, or a payment based on a below-market payment rate which fails to cover even the interest which is due (think of a minimum payment on a credit card). The latter situation is commonly referred to as “negative amortization,” and is a term often used synonymously with this type of mortgage product. Negative amortizing loans accounted for roughly 26% of all Alt-A purchase mortgages in 2006, compared to just 2% in 2003 (See Exhibit 9). That percentage would be even greater (46%) when throwing refinances into the mix as well. Forty year mortgages have also gained prevalence in the Alt-A arena, representing approximately 6% of all originations in 2006.

While credit risk in this segment is often downplayed given the better credit profile of Alt-A borrowers relative to subprime borrowers (i.e. better FICO scores, lower CLTVs), we believe that the significant growth in this segment resulting from its exposure to exotic mortgages leaves the Alt-A mortgage market particularly susceptible to future credit tightening.

As shown in Exhibit 9, low/no documentation loans (stated income loans) represented a staggering 81% of total Alt-A purchase originations in 2006, up significantly from 64% just two years earlier. These loans are also sheepishly referred to as “liar loans” by many in the industry due to the propensity for borrowers to exaggerate their income on loan applications. In addition, the combined loan to value on Alt-A purchase originations was 88% in 2006, with 55% of homebuyers taking out simultaneous seconds (piggybacks) at the time of purchase. Investors and second home buyers represented approximately 22% of Alt-A purchase originations last year, which is the largest non-owner occupied share among the various segments of the mortgage market. Adding to the risk is the fact that 1-year hybrid ARMs represented approximately 28% of Alt-A purchase originations in 2006, setting the stage for considerable reset risk. The average loan size of Alt-A mortgages backing MBS in 2006 was roughly $287,700, while the average FICO score of an Alt-A borrower last year was 717.

These datapoints suggest that the Alt-A market, in recent years, has been a haven for homebuyers and investors looking for exotic mortgage products intended to mitigate the lack of affordability caused by surging home prices. While we are not capable of making a call on the eventual credit performance in this segment of the market (we'll leave that up to the credit analysts), we believe that the Alt-A segment is particularly susceptible to tightening lending standards that may result from increased regulatory scrutiny, as well as a reduced appetite for risk among secondary market investors.

In our opinion, markets that have become significantly exposed to these exotic mortgage products in the past three years, and the mortgage originators/builders that use them to finance their new construction homebuyers will be hit especially hard as underwriting standards begin to tighten, as the incremental demand created by the added liquidity in recent years would likely diminish. Not surprisingly, many of the states that had the greatest share of Alt-A mortgages in 2005 have also served as the primary growth engines for the major homebuilders in recent years. We estimate that Nevada, California, Arizona, Florida and Virginia had the greatest share of Alt-A originations in 2006. These five states are also the top five EBIT generators for our homebuilding universe, representing roughly 75% of total operating profit in 2005. In a survey of our private homebuilders, our contacts confirmed that the Alt-A market is a significant portion of their overall business, representing 18% of home sales, on average, in 2006. In addition, our builder contacts specifically operating in Nevada (30% Alt-A share), California (28%) Florida (27%), and Arizona (20%) confirm that those states have an above average concentration of Alt-A loans of the overall mortgage pie, in-line with our state-by-state estimates. A few builders out west indicated that Alt-A represents up to 90% of their overall business. Suffice to say, any credit tightening in this segment of the market will likely have a negative impact on homebuilder profits. (See Exhibit 10 through Exhibit 12).

**Exhibit 9: Characteristics of Purchase Mortgages Backing Non-Agency Alt-A MBS by Loan Origination Date, 2004-2006**

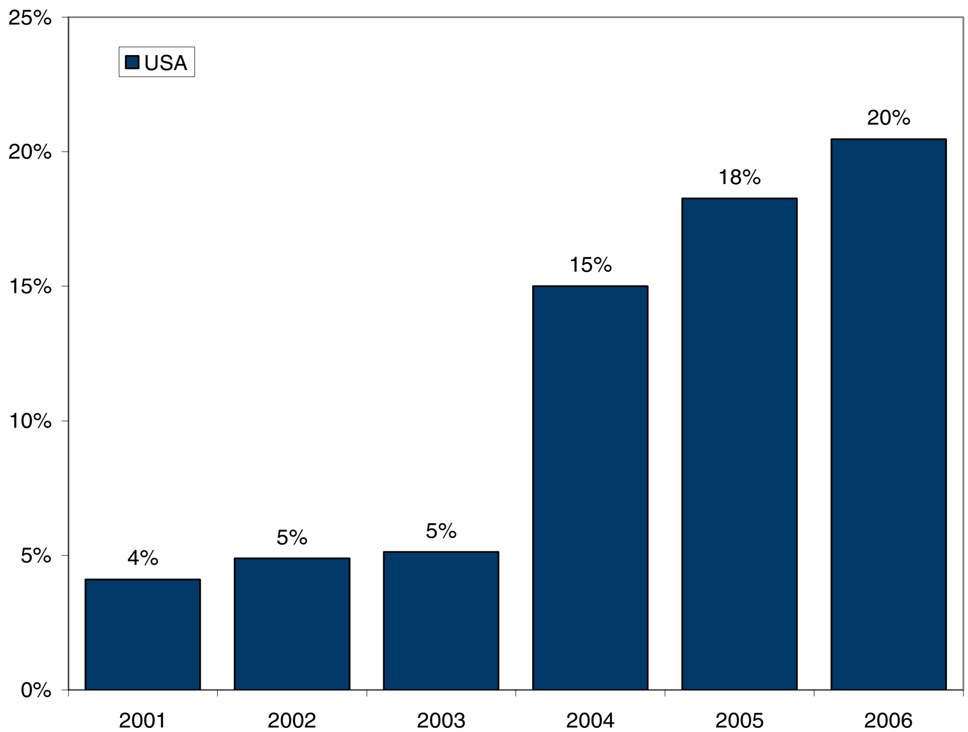
| | 2004 | 2005 | 2006 |
|---|---|---|---|
| ***Product Type*** | | | |
| IO FRM | 3.1% | 10.1% | 14.0% |
| Other FRM | 24.4% | 17.9% | 18.4% |
| IO ARM | 50.6% | 37.5% | 35.2% |
| NegAm ARM | 7.1% | 27.0% | 26.4% |
| Other ARM | 14.9% | 7.4% | 6.0% |
| ***40-Year Mortgage*** | | | |
| 40-Year FRM | 0.0% | 0.0% | 0.2% |
| 40-Year ARM | 0.3% | 2.2% | 6.2% |
| Not a 40-Year Mortgage | 99.7% | 97.8% | 93.7% |
| ***Occupancy Status*** | | | |
| Owner-Occupied | 77.3% | 75.2% | 78.1% |
| Investor | 17.9% | 18.1% | 15.0% |
| 2nd Home | 4.8% | 6.8% | 6.9% |
| ***Documentation*** | | | |
| Full Doc | 34.1% | 26.0% | 18.8% |
| Low Doc | 58.6% | 69.8% | 77.9% |
| No Doc | 5.2% | 3.4% | 3.3% |
| NA | 2.1% | 0.8% | 0.0% |
| ***Simultaneous Seconds*** | | | |
| w/ Simultaneous Second | 39.1% | 46.1% | 55.3% |
| w/o Simultaneous Second | 60.9% | 53.9% | 44.7% |

| | 2004 | 2005 | 2006 |
|---|---|---|---|
| ***Property Type*** | | | |
| Single-Family | 57.0% | 54.6% | 53.3% |
| Condo/Coop | 11.7% | 13.2% | 13.3% |
| 2-4 Units | 7.9% | 6.8% | 7.0% |
| Other | 23.5% | 25.5% | 26.4% |
| ***Loan Type*** | | | |
| FRM | 27.4% | 28.1% | 32.4% |
| 1-Year ARM | 13.7% | 30.9% | 27.6% |
| 2-Year ARM | 10.7% | 5.1% | 3.1% |
| 3-Year ARM | 19.3% | 7.5% | 2.9% |
| 5-Year ARM | 26.0% | 20.5% | 25.5% |
| 7-Year ARM | 1.9% | 3.0% | 4.4% |
| 10-Year ARM | 0.9% | 5.0% | 4.1% |
| ***Other Characteristics*** | | | |
| Avg. FICO Score | 716 | 721 | 717 |
| Avg. Combined LTV | 86% | 86% | 88% |
| Avg. Debt to Income Ratio | 36% | 37% | 38% |
| Avg. Loan Size | $236,564 | $276,617 | $287,717 |

*Note: All distributions are weighted by the dollar volume of mortgage originations.*

*Source: Loan Performance, Inside MBS & ABS, Fannie Mae.*

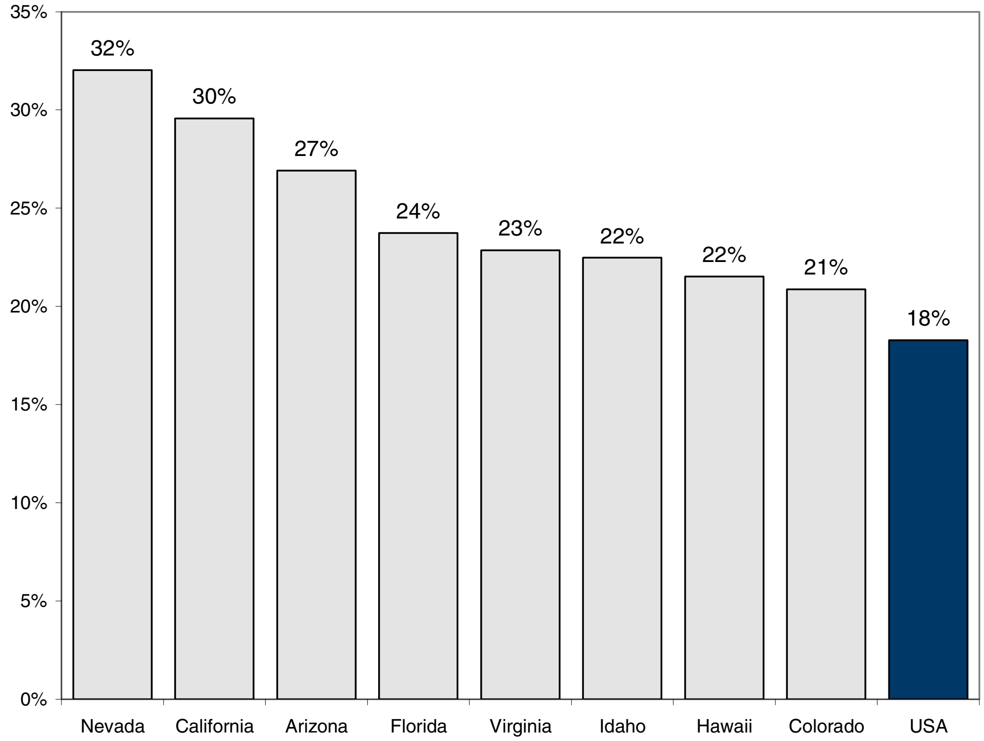
**Exhibit 10: Alt-A Share of Securitized Purchase Mortgage Originations, 2001-2006**




*Note: In 2005, Loan Performance began grouping jumbo option ARMs in with Alt-A mortgages.*

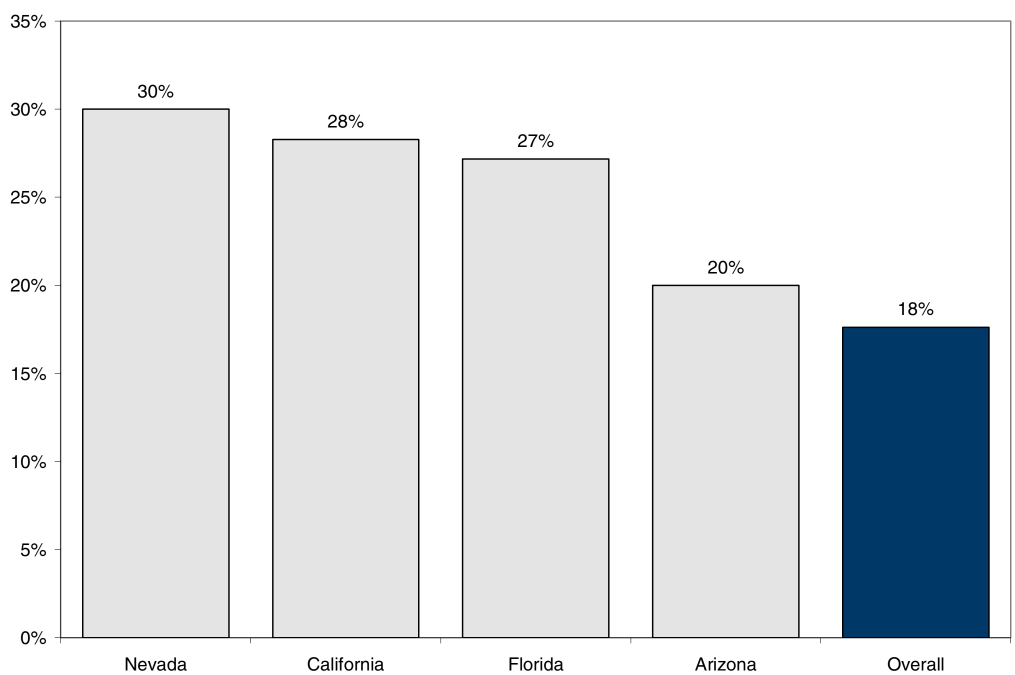
*Source: Loan Performance, Credit Suisse U.S. Mortgage Strategy, Credit Suisse estimates.*

**Exhibit 11: Alt-A Share of Securitized Purchase Mortgage Originations by State, 2005**




*Source: Loan Performance, Credit Suisse U.S. Mortgage Strategy, Credit Suisse estimates.*

**Exhibit 12: Private Builder Alt-A Share of Total Originations, 2006**



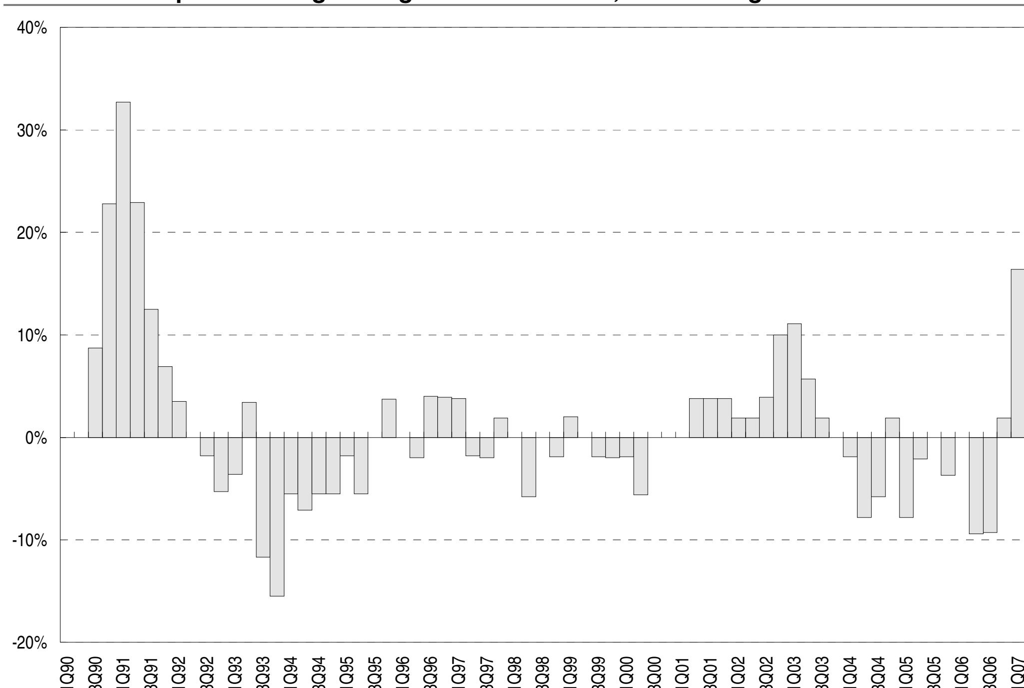

*Source: Credit Suisse analysis.*

# Now That's Exotic…

While it is important to have a basic understanding of the broad mortgage market, as we outlined in the previous section of this report, the rapid shift into subprime and Alt-A mortgages does not come close to telling the whole story of the recent evolution of the industry. By now it is no secret that underwriting standards were severely compromised by mortgage lenders in the past three years. Subprime originators have taken the brunt of the punishment so far, with stock prices plunging and many lenders closing shop. What is not so obvious, however, is whether the risk is confined to these marginal quality subprime borrowers, or if the proliferation of exotic mortgage products and the fallout from the subprime market will create a ripple effect on demand throughout the entire mortgage market food chain.

We have long been of the opinion that the current housing downturn is as much a function of deteriorating affordability as an issue of over supply from fleeing investors and aggressive homebuilders (See our July 2004 report titled *"It's All About the Monthly Payment"*). In order to mitigate the record price increases seen throughout the majority of the country in the first half of this decade, homebuyers became increasingly dependant on exotic mortgage products intended to reduce down payments and monthly payments. In this section of our report, we highlight alternative mortgage products including interest only loans, negative amortization loans (option ARMs), piggybacks/second mortgages, and low/no documentation loans. While these "exotics" aren't necessarily new, they have grown to represent a significant portion of the overall mortgage market in recent years, and we believe that as lending standards continue to tighten, the riskiness of these loans and the quality of the buyers that use them will come under significant scrutiny by lenders and regulators. The majority of our private homebuilder contacts have confirmed a recent tightening in the past three months throughout the entire mortgage landscape, with particular tightening on subprime, low/no documentation loans and high CLTV/piggyback mortgages (See Exhibit 22 and Exhibit 23).

**Exhibit 22: Respondents Tightening Credit Standards, 1990 through First Quarter 2007**




*Note: A negative percentage indicates credit standards are easing.*
*Source: Federal Reserve Board's Senior Loan Officer Opinion Survey on Bank Lending Practices.*

The Federal Reserve's Survey of Senior Loan Officers indicates that 16% of respondents tightened credit standards in the first quarter of 2007, marking the highest level of tightening since the second quarter of 1991. Respondents had reported flat to easing trends in 11 of the prior 13 quarters.

**Interest-Only (IO) and Negative Amortization (Neg-Am) Mortgages**

While piggybacks are used to mitigate the lack of cash available for down payments, interest only and negative amortization loans are used to reduce monthly payments. Contrary to popular belief, an interest-only mortgage is not a new "type" of loan. Instead, it is an option that can be attached to any traditional loan such as an adjustable rate mortgage or a fixed rate mortgage, although the vast majority of interest-only loans are associated with ARMs. The reason for this is that the primary goal of an "IO" mortgage is to minimize monthly costs in the beginning period of a mortgage, and ARMs typically carry lower initial mortgage rates than fixed rate mortgages. An interest-only loan borrower has the option to pay a fully amortized payment or just pay interest costs each month. The option to pay just interest usually only lasts for a limited period of time, at which point fully amortized payments are required.

For example, if a 30-year loan of $300,000 at 6.25% is interest only, the required payment in the first month is roughly $1,560 per month during the initial IO payment period. The required payment on a fully amortized loan would be $1,850, with the incremental $290 per month going towards paying down principal.

The "big brother" of interest only mortgages is the negative amortization mortgage, which in recent years has gained popularity. The neg-am mortgage, which is often used synonymously with "option ARM", provides homebuyers with an extra payment option each month. In addition to paying the fully amortized payment or just interest costs, an option ARM actually allows borrowers to make a "minimum" payment that is less than interest costs. The minimum payment option results in a homebuyer actually having negative equity in their home, absent an increase in the value of the house (i.e. the borrower owes more at the end of the month than it did at the beginning).

Similar to an interest only mortgage, option ARMs only provide borrowers with these payment options for a finite timeframe, which sets the stage for a significant payment shock when payments are recast to the fully amortizing rate at the current interest rate level. Depending on the amount and terms of the loan, monthly payments could increase in excess of 40% upon rate reset on these types of mortgages.

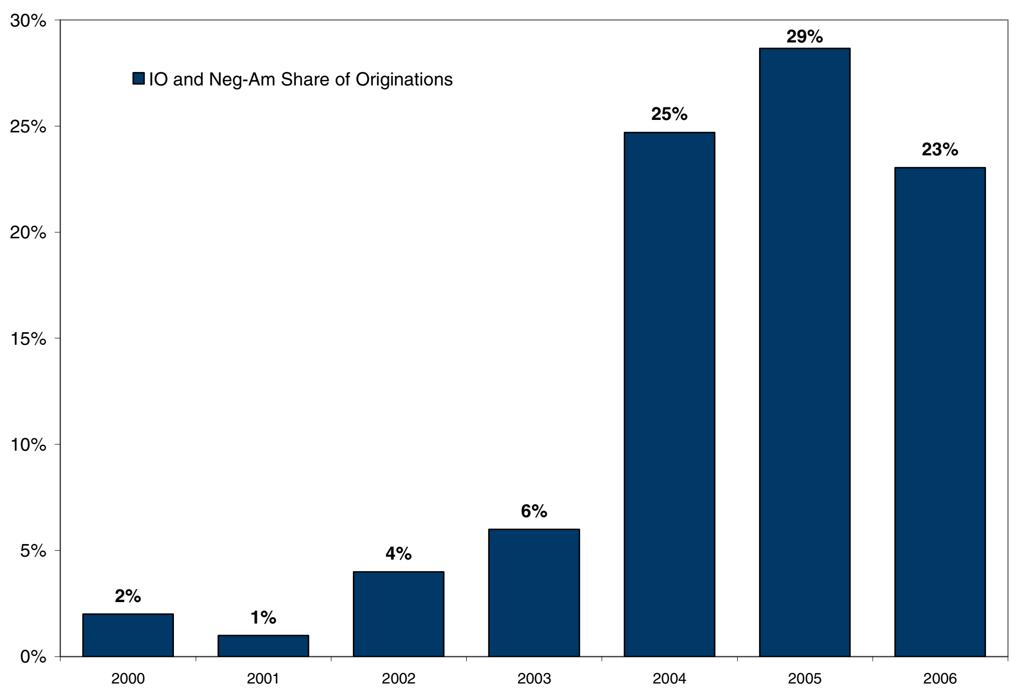
Historically, these mortgage options were ideal for homebuyers with inconsistent income patterns (i.e. Wall Street Bankers) who enjoyed the flexibility of making minimal monthly payments during times of low cash flow, or large principal payments when cash flows were stronger. More recently, however, use of this option has grown tremendously due to its benefits for homebuyers looking to make a quick profit on a home. As the investor share of the market surged from 2003-2005, so did the amount of homebuyers electing the IO or neg-am payment options.

In our opinion, however, a more problematic group of homebuyers that have utilized the interest-only or neg-am options have been those that have used the lower initial monthly payments in order to qualify for a home above their means (or any home in general). In September 2006, the Office of the Comptroller of the Currency (OCC) issued interagency guidance on this topic, urging lenders to qualify non-traditional borrowers based on the fully amortized payment rather than just the interest payments or minimum payments during the initial option period. As demonstrated in our example above, the difference can be quite meaningful (nearly 20% in this case). While it is uncertain exactly how many of the recent option ARM and IO borrowers would have been unable to qualify under these tougher standards, based on our conversations with mortgage lenders, it is clear that they believe it is a cause of concern.

As shown in Exhibit 29, an estimated 23% of total purchase originations in 2006 were interest-only or negative-amortization mortgages. According to our private builder survey, interest-only and option ARMs represented 24% of total home sales in 2006, in-line with our market-wide estimates. This was down slightly from the levels seen in 2004 and 2005, most likely due to the decline in investors in high priced markets, as well as lenders tightening qualification standards in anticipation of the OCC's guidance on non-traditional mortgage lending standards (recall from Exhibit 22 that senior loan officers reported tightening credit standards in 4Q06 for the first time in eight quarters). Nevertheless, IOs and option ARMs still represent a meaningful portion of the mortgage market, and we would expect these incremental originations to decline as lenders continue to tighten standards on the heels of poor credit performance.

As we highlighted in our discussion on Alt-A mortgages, option ARMs have contributed to much of the growth in this segment of the mortgage market in recent years. As shown in Exhibit 30, interest only and option ARM loans represented approximately 62% of Alt-A purchase originations in 2006. Similar to piggybacks, the prevalence of IOs and option ARMs has been disproportionately weighted to high priced MSAs such as the major California markets, Las Vegas, and Phoenix (See Exhibit 31).

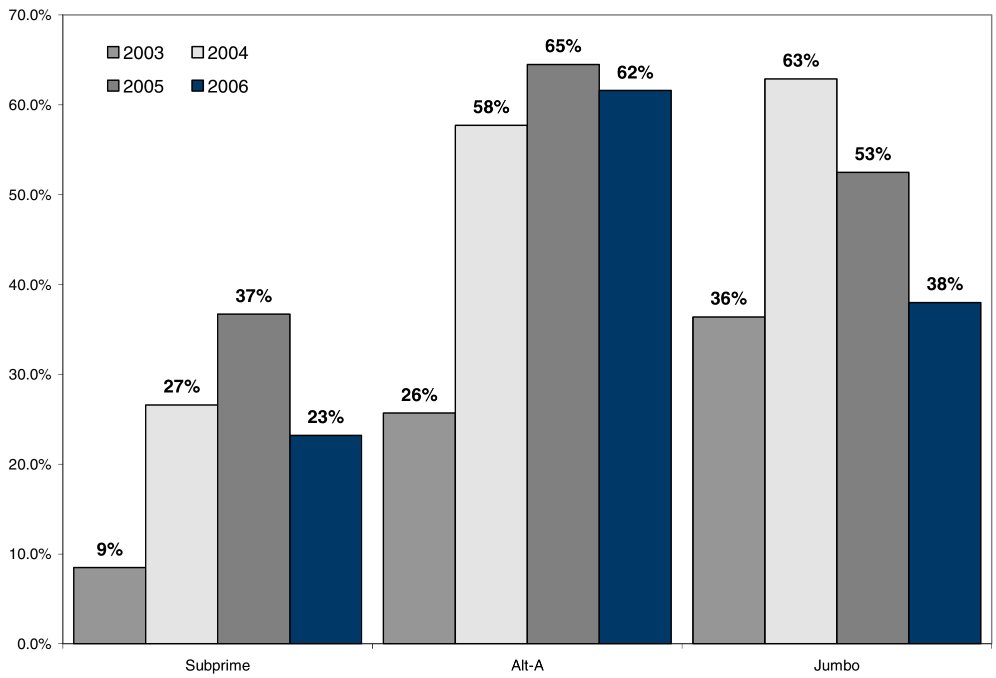
**Exhibit 29: Interest-Only and Negative Amortization Share of Total Purchase Mortgage Originations, 2000-2006**




*Note: Based off of origination dollars.*

*Source: Loan Performance, Credit Suisse analysis.*

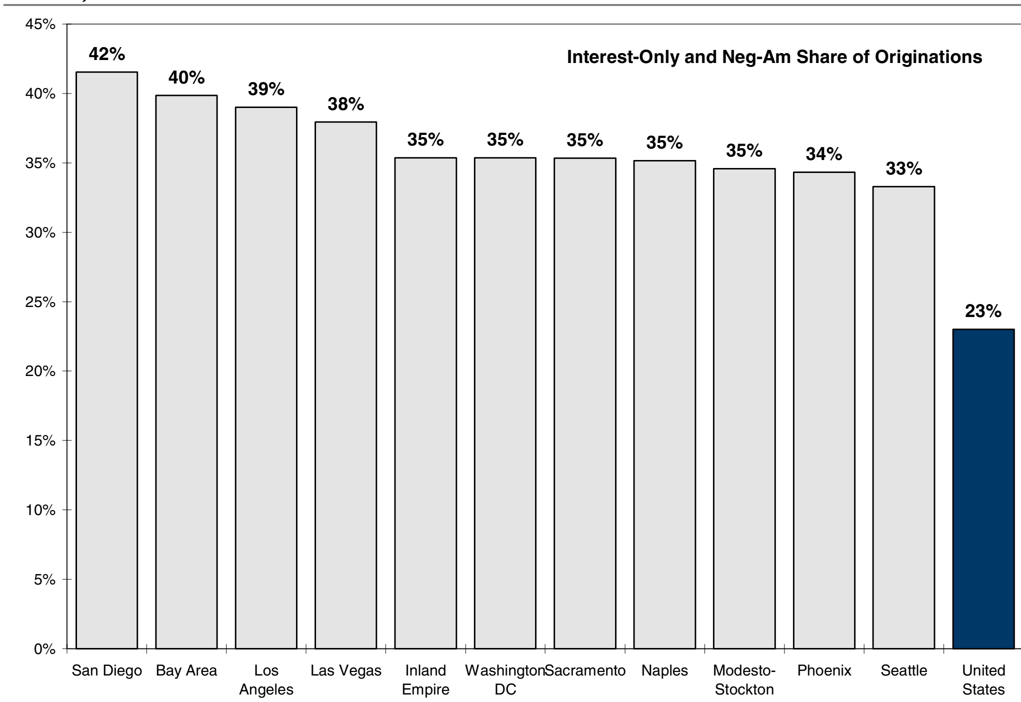
**Exhibit 30: Interest-Only and Negative Amortization Share of Total Purchase Mortgage Originations by Loan Type, 2003-2006**




*Note: Based on origination dollars of securitized loan data.*

*Source: Loan Performance, Credit Suisse analysis.*

**Exhibit 31: Interest-Only and Negative Amortization Share of Mortgage Originations by Market, 2006**




*Note: Based on unit volume.*

*Source: Loan Performance, Credit Suisse analysis.*

**Low/No Documentation Loans**

The third type of "exotic" mortgage that has come under significant scrutiny of late deals with the amount of income verification provided on loan approvals. A lender's documentation requirements pertain to the information about income and assets provided by the borrower and how that information is verified by the lender. Oftentimes when industry participants speak about tightening or loosening lending standards, they are largely referring to the issue of income and asset verification.

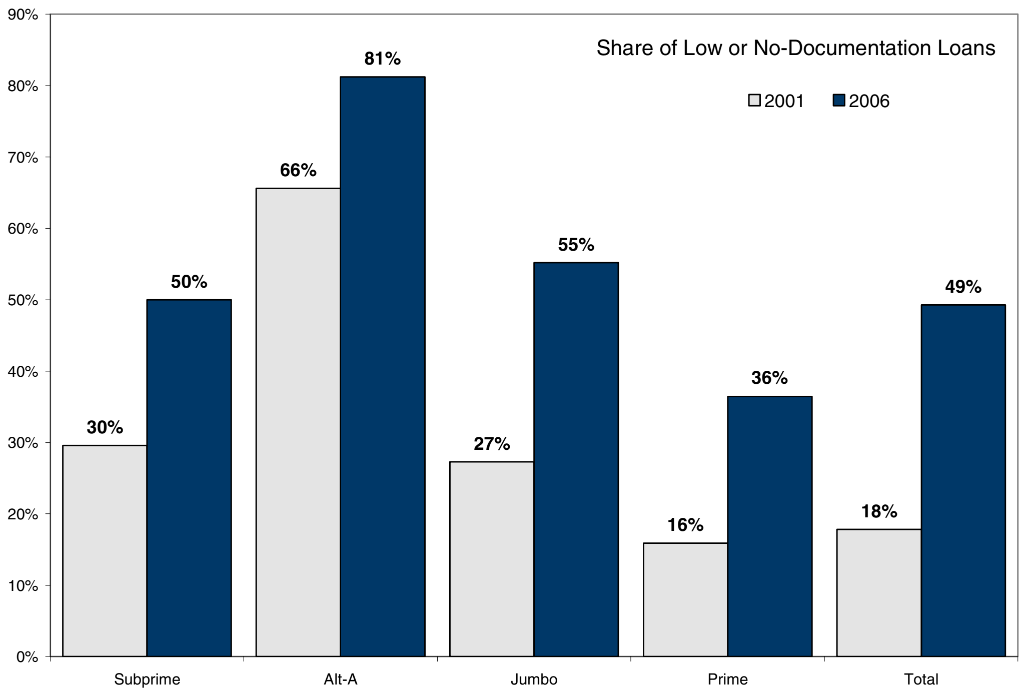
Just five years ago, the vast majority of borrowers provided full documentation of their income and assets, and lenders verified this information in writing with the appropriate third parties (employers, banks, etc.). We estimate in 2001, these "full-doc" loans represented approximately 82% of all purchase originations. Low and no documentation loans were typically reserved for self-employed homebuyers that had difficulty providing or did not want to share information that demonstrated their full earnings potential, or borrowers that had recently moved/switched jobs.

Realizing that the documentation process was quite onerous and time consuming (at least in the opinion of the lenders), more originators began easing their requirements to borrowers that did not wish to/or could not provide full documentation. "Stated income" loans began to gain popularity, which is exactly as the term implies --- the borrower tells the lender what his/her income and asset levels are, and the lender underwrites the loan based on that information. The stated income borrower may provide limited documentation to support his/her income and assets (i.e. pay stub, bank statement, etc.), or no documentation at all (as a growing portion of borrowers have decided to do). To compensate for the added lending risk, originators charge these stated income borrowers a slightly higher interest rate (which had been roughly 25 basis points) depending on the level of documentation. Still, many recent homebuyers preferred these limited documentation options, as low/no documentation loans increased from just 18% of total purchase originations in 2001 to 49% in 2006 (See Exhibit 32). As shown in Exhibit 33, while the share of low/no documentation loans appears to be the highest in former investor hotbeds such as California, Las Vegas and Florida, there is not much of a dropoff in other parts of the country. Based on a survey of our private homebuilders, the percentage of buyers providing limited-to-no documentation was similar on the new construction side of the business to the overall market, with 46% of our contacts' homebuyers, on average, providing low/no documentation on home sales in 2006 (See Exhibit 34).

While the merits of a less time consuming mortgage qualification process can certainly be debated, opponents argue that the process opens the door to fraud. Stated income loans, which are sheepishly referred to as "liar loans" by many, have begun to earn their nickname. A 2006 study by the Mortgage Asset Research Institute sampling 100 stated income loans found that 60% of borrowers had "exaggerated" their income by more than 50%. We have also several examples of stated income borrowers claiming to be self employed, only to have their credit reports indicate that they have been employed within the past two years (most stated income loan programs supposedly require a minimum history of two years of self-employment). In the past few years, nobody bothered to red flag these situations. In recent weeks, however, we are hearing increased anecdotes of the lenders going back to these prospective borrowers and asking for full documentation.

The crackdown on these mortgage products has already begun. Last week, Wells Fargo announced that it has completely discontinued its stated income/limited documentation loan programs in the state of Ohio. The announcement was made in response to the recently enacted Ohio Senate Bill 185, which suggests that certain mortgage products originated in Ohio by non-bank entities may not be included in securitization pools. While this announcement has not received much media attention, we believe it could be a major event if other states pass similar legislation. The Credit Suisse Group of External Affairs and Public Policy believes that this legislation could potentially be brought to the federal level within the next 18 months, implying that we will likely see the share of low and no documentation loans decline drastically throughout the country in the coming months.

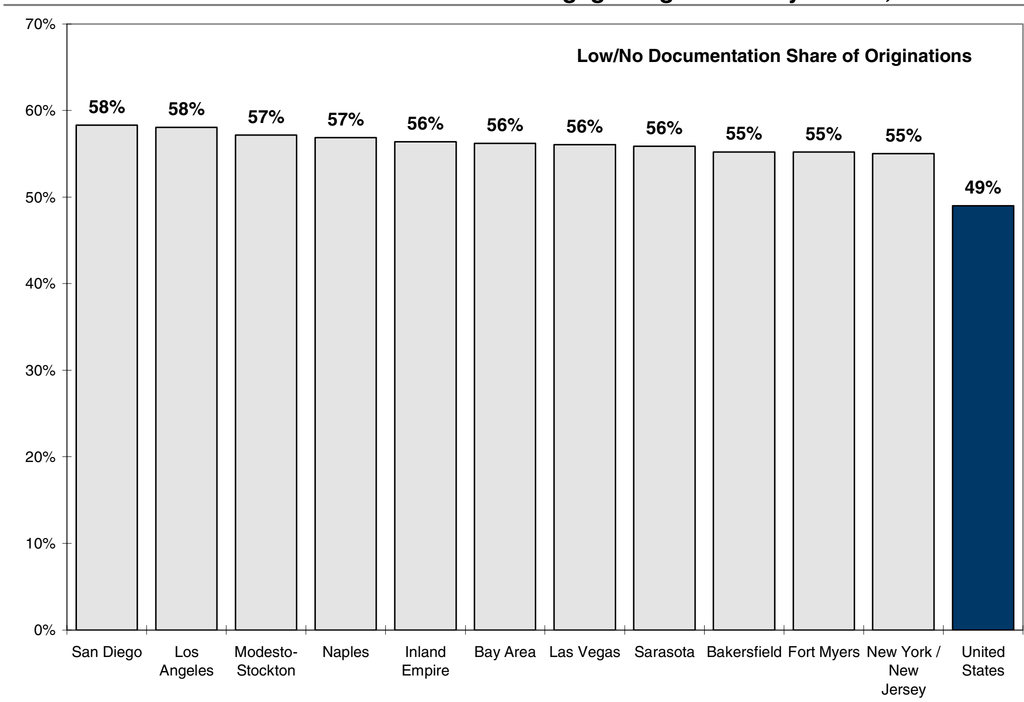
**Exhibit 32: Distribution of Low/No-Doc Share of Purchase Originations, 2001 versus 2006**




*Note: Based on origination dollars of securitized loans.*

*Source: Loan Performance, Credit Suisse analysis.*

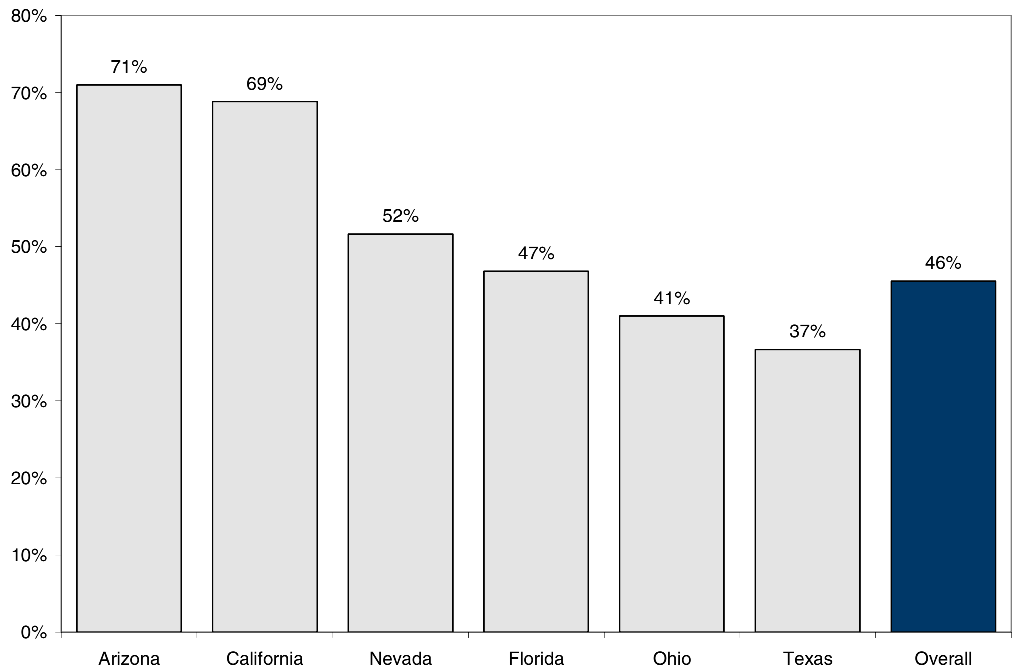
**Exhibit 33: Low/No-Documentation Share of Mortgage Originations by Market, 2006**




*Note: Based on unit volume.*

*Source: Loan Performance, Credit Suisse analysis.*

**Exhibit 34: Private Builder Low/No-Documentation Share of Total Purchases for Select States, 2006**




*Source: Credit Suisse analysis.*

# EXHIBIT I

Home | Loan Center of California, Inc. | About LCC | Login

# LCCJobs.com

Loan Center of California, Inc.
Rateprice.com

Loan Center of California, Inc. is a privately held mortgage bank based in Northern California. The company prides itself on vast utilization of cutting edge technology on both websites - Rateprice.com and eNegAm.com. These production portals are utilized by over 10,000 registered users in California alone.

The company specializes in both the Alt-A niche loans and more popular payment option ARM product. All loan products are exclusive to Loan Center of California. The company stays competitive by maintaining aggressive loan pricing and expanded product eligibility. Within the past 5 years Loan Center has managed to fund nearly 4.2Billion Dollars in loans.

Over the last 10 years Loan Center has created strategic alliances with several of the Top Wall Street firms in the nation. It has several warehouse facilities with a monthly funding capacity of well over 300Million.

In 2006, LCC was named as one of the top 100 places to work in the bay area “2006” – and has already received a nomination for the 2007 competition. Current expansion initiatives include a newly formed Correspondent Lending division and the operation expansion into several states.

Throughout the years Loan Center has hired nothing but the best and most highly qualified managers in the mortgage industry. We are looking for highly motivated and qualified individuals that want to make career in this fast paced company. This is your chance to join this winning team, apply today.

Back

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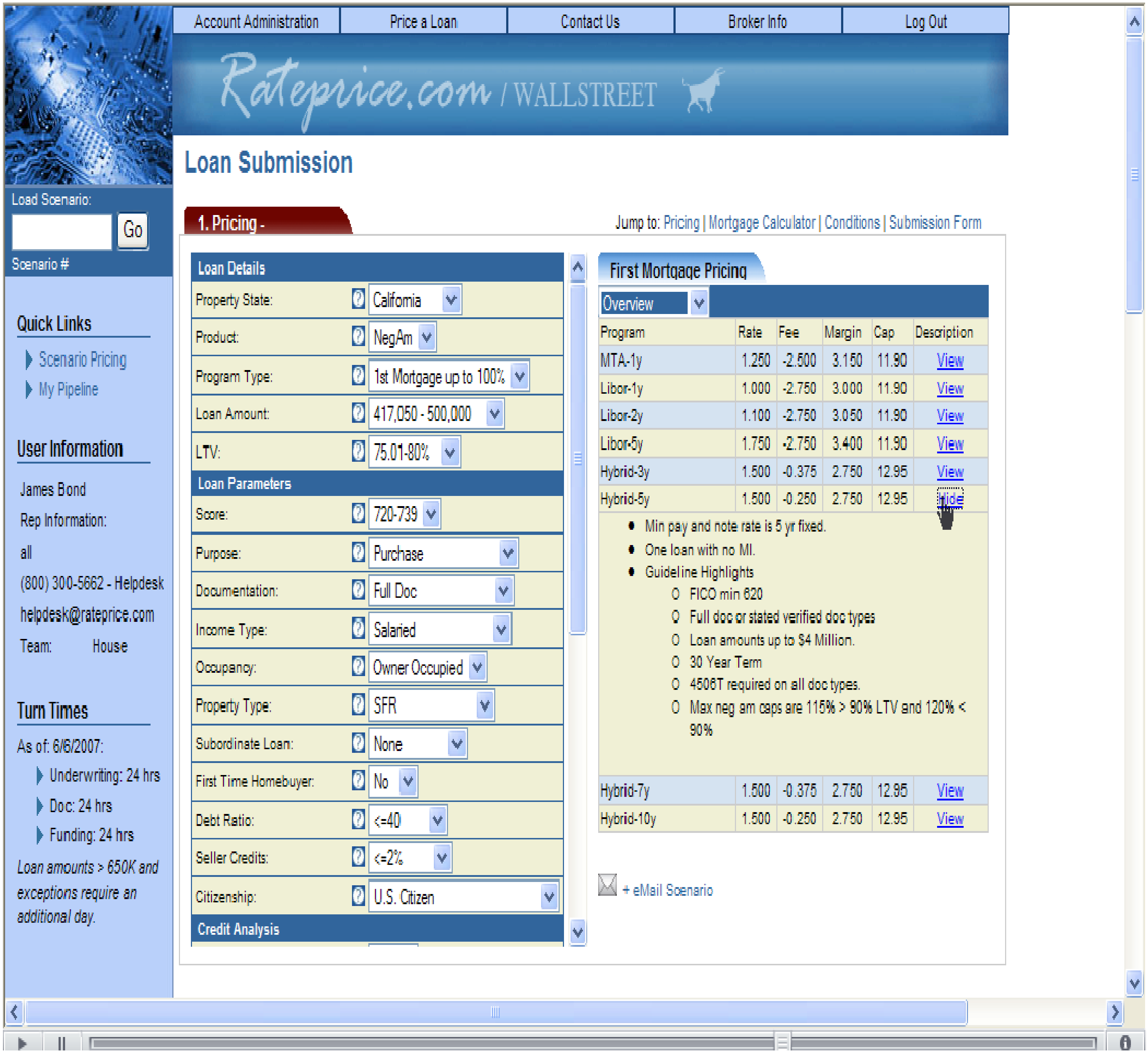
# EXHIBIT J


Account Administration
Price a Loan
Contact Us
Broker Info
Log Out
Rateprice.com / WALLSTREET
Loan Submission
Load Scenario:
Go
Scenario #
Quick Links
Scenario Pricing
My Pipeline
User Information
James Bond
Rep Information:
all
(800) 300-5662 - Helpdesk
helpdesk@rateprice.com
Team: House
Turn Times
As of: 6/6/2007:
Underwriting: 24 hrs
Doc: 24 hrs
Funding: 24 hrs
Loan amounts > 650K and exceptions require an additional day.
1. Pricing -
Jump to: Pricing | Mortgage Calculator | Conditions | Submission Form
Loan Details
Property State: California
Product: NegAm
Program Type: 1st Mortgage up to 100%
Loan Amount: 417,050 - 500,000
LTV: 75.01-80%
Loan Parameters
Score: 720-739
Purpose: Purchase
Documentation: Full Doc
Income Type: Salaried
Occupancy: Owner Occupied
Property Type: SFR
Subordinate Loan: None
First Time Homebuyer: No
Debt Ratio: <=40
Seller Credits: <=2%
Citizenship: U.S. Citizen
Credit Analysis
First Mortgage Pricing
Overview
Program Rate Fee Margin Cap Description
MTA-1y 1.250 -2.500 3.150 11.90 View
Libor-1y 1.000 -2.750 3.000 11.90 View
Libor-2y 1.100 -2.750 3.050 11.90 View
Libor-5y 1.750 -2.750 3.400 11.90 View
Hybrid-3y 1.500 -0.375 2.750 12.95 View
Hybrid-5y 1.500 -0.250 2.750 12.95 Hide
Min pay and note rate is 5 yr fixed.
One loan with no MI.
Guideline Highlights
FICO min 620
Full doc or stated verified doc types
Loan amounts up to $4 Million.
30 Year Term
4506T required on all doc types.
Max neg am caps are 115% > 90% LTV and 120% < 90%
Hybrid-7y 1.500 -0.375 2.750 12.95 View
Hybrid-10y 1.500 -0.250 2.750 12.95 View
+ eMail Scenario

helpdesk@rateprice.com
Team: House

## Turn Times

As of: 6/6/2007:

- Underwriting: 24 hrs
- Doc: 24 hrs
- Funding: 24 hrs

*Loan amounts > 650K and exceptions require an additional day.*

| | |
|---|---|
| Income Type: | Salaried |
| Occupancy: | Owner Occupied |
| Property Type: | SFR |
| Subordinate Loan: | None |
| First Time Homebuyer: | No |
| Debt Ratio: | <=40 |
| Seller Credits: | <=2% |
| Citizenship: | U.S. Citizen |

Credit Analysis

View Product Description

+ eMail Scenario MTA Index: 5.022

## 2. Payment Calc -

Jump to: Pricing | Mortgage Calculator | Conditions | Submission Form

### Payment Calculator

| | |
|---|---|
| Salesprice | 625000 |
| 1st Mortgage Loan Amount | 500000 |

Calculate

| | | | |
|---|---|---|---|
| **1st Mtg. Minimum Payment:** | 1725.60 | **1st Mtg. Interest Only Payment :** | 2916.67 |
| **1st Mtg. Fully Amortized Payment :** | 3326.51 | **Fully Indexed Mtg. Rate:** | 7.000 |
| **1st Mtg. Fully Ammortized Payment (15yr):** | 4494.14 | | |

**1st Mtg Monthly Minimum Payments for Each Year:**

| | | | |
|---|---|---|---|
| **1st Year:** | 1725.60 | **4th Year:** | 1725.60 |
| **2nd Year:** | 1725.60 | **5th Year:** | 1725.60 |
| **3rd Year:** | 1725.60 | | |

(Disclaimer: Calculations by this tool are believed to be accurate, yet are not guaranteed. This calculator should be used only as an estimation, as it does not allow for Taxes or Insurance. For Broker Use Only.)

# EXHIBIT K

Rateprice.com / WALLSTREET

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you need a Rateprice.com login.

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Sign up here:

New Broker Sign-Up

Already a registered user?

Sign In using your registered email address as your username:

Username:

Password:

Remember Me

Sign In

Lost Password

Home | Doing Business w/ LCC | Product Info | Tutorials

## Hybrid Option ARM is LIVE on Rateprice.com/WALLSTREET

**Primary Residence**
**Purchase & R/T Refi**

**Full Doc**
100% LTV w/ 700 FICO to $500K (1-2 unit)
95% LTV w/ 620 FICO to $500K (1-2 unit)
90% LTV w/ 620 FICO to $650K (1-2 unit)
90% LTV w/ 680 FICO to $1Mil (1-2 unit)

**Stated/Verified**
95% LTV w/ 680 FICO to $650K (1-2 unit)
90% LTV w/ 660 FICO to $650K (1-2 unit)
90% LTV w/ 620 FICO to $500K (1 unit)
90% LTV w/ 700 FICO to $1Mil (1 unit)

**Primary Residence**
**Cash Out Refinance**

**Full Doc**
95% LTV w/ 680 FICO to $500K (1-2 unit)
90% LTV w/ 620 FICO to $650K (1-2 unit)
80% LTV w/ 660 FICO to $1Mil (1-2 unit)

**Stated/Verified**
90% LTV w/ 660 FICO to $500K (1-2 unit)
75% LTV w/ 640 FICO to $650K (1 unit)
80% LTV w/ 720 FICO to $1Mil (1 unit)

**Turn Times as of: 6/21/2007:**

- Underwriting: 48hrs
- Doc: 24hrs
- Funding: 24hrs

*Loan amounts greater than 650K and management exceptions require an additional day.*

07 • **Products Updated 6/21/2007**

Loan Center of California, Inc.
Rateprice.com

Thursday, June 21, 2007 | Privacy Policy
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# EXHIBIT L

**Aaron Krowne <akrowne@gmail.com>**

# Loan Center of California - breaking news

4 messages

PRIVILEGED - AUTHOR'S NAME REDACTED **Wed, Mar 21, 2007 at 4:10 PM**

To: akrowne@gmail.com

Please read the email I am pasting to this regarding Loan center of Calif. I believe I the info to be correct.

PRIVILEGED - AUTHOR'S NAME REDACTED

\>
\> PRIVILEGED - AUTHOR'S NAME REDACTED
\>
\>
\>
\>
\> In other words, Ed's yellow Lamborghini and 2 million dollar home in a
\> gated
\> community are more important to him than honoring his written and spoken
\> word with loan officers and your clients. Since Ed won't return our
\> calls,
\> we can only assume he's sipping cocktails at the club, sneering at the
\> little people: The clients that met all underwriting criteria, and
\> thought
\> they had loans that were locked, and the same loan officers who helped him
\> buy all of his fancy shit these last few years. Pathetic is such an
\> understatement....this is the stuff that should make the evening news.
\>
\>
\>
\> P.S. Ed, thanks for sending someone to our retreat....the 2 grand
\> sponsorship is going a long way toward helping us making things right with
\> the clients you just screwed over...
\>
\>
\>
\> ______
\>
\>
\> Sent: Wednesday, March 21, 2007 10:18 AM
\> Subject: Loan Center of California
\>
\> To all FPF LO's
\>
\>
\>
\> Here's what I know:
\>
\>
\>
\> Apparently Loan Center has failed to lock a large portion of their
\> pipeline.
\> As such, (at this moment), Ed Blanche the owner has made a business
\> decision
\> not to fund these loans. Aside from the shear lack of ethics, this is a
\> very poor business decision. I have calls into the owner, however, I
\> wouldn't hold my breath. I would further assume that they are on the way
\> out.
\>
\>
\>
\> Let me know if you have loans their, we'll need to find a new game plan.

# EXHIBIT M

Hard Money Loans

Hard Money Loans for California real estate investors and property owners.

# Archive for March, 2007

## Sub-Prime Shakeout

Friday, March 23rd, 2007

Well, the lender closings continue this week with a number of banks closing up shop or halting fundings on loans that have already been approved. One that surprised me a bit was the Loan Center of California. I thought that they were primarily an A paper lender, but news this week from some colleagues indicated that they were not funding loans that had been approved and docs had been signed. That takes a really special operation to do things like that. Bottom line if you are currently seeking financing for a new purchase or a refinance loan with a "smaller" lender, you may want to double check and make sure that everything is on the up and up before you paint yourself into a corner.

Technorati Tags: Sub Prime, Loans, Finance

**Related:**

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Winds: SW at 26 mph
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Loan company lays off 20
Published 03-27-2007
SUISUN CITY - Loan Center of California, Inc. a mortgage lender with offices in Suisun City, laid off 20 employees Monday and pulled the funding on several loans approved to local brokers. In a writte...

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DAILY REPUBLIC

ONLINE PUBLICATION



9:00 pm Currently: 76 | RealFeel® High: 72 Humidity: 41 Winds: SW at 15 mph

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Mon. Jun 18, 2007



# Loan company lays off 20

By Ines Bebea

SUISUN CITY - Loan Center of California, Inc. a mortgage lender with offices in Suisun City, laid off 20 employees Monday and pulled the funding on several loans approved to local brokers.

In a written statement, Ed Blanch, CEO of Loan Center of California, said that due to current market conditions, his company decided to lay off the 20 employees, which he says was 'less than 20 percent of its work force' and to curtail certain funding 'due to the evaporation of the liquidity of certain loans on the secondary market.'

'The mortgage industry has been under tremendous pressure over the past months,' wrote Blanch. 'This is resulting in the closure of several large- and medium-sized subprime and Alt-A lenders.'

For the past 10 years, LCC a wholesale mortgage company has specialized in Alt-A and MTA first and second home loans in Solano County. MTA loans are adjustable mortgage loans normally used by borrowers with a poor credit history. Alt-A loans are mostly used by borrowers with a strong credit history. As a wholesale lender, LCC made funds available to brokers, who then forwarded the money to the borrowers.

The sudden lack of funding has left broker companies such as First Priority Financial, Novo Mortgage Group and others in the state scrambling for funds to loans that were approved for home owners or buyers.

'We had eight loans that were worth $5 million to $8 million with them,' said Mike Soldati, vice president of operations for First Priority Financial. 'What we are left with now is seeking funds for loans that they decided not to close on.'

Soldati speculated that the funding was pulled because LCC underpriced its loans and its investors estimated the potential financial loses, then decided not to make the money available. Soldati added that First Priority was notified by phone on Thursday about LCC pulling the funds without any further explanations.

Novo Mortgage Group, which lost more than $50,000 worth of loans, has decided to permanently end all work with LCC.

'We will never work with Loan Center again,' said Tony Alfano, chief operating officer and commercial division president of Novo Mortgage Group. 'The situation is extremely frustrating for us and our borrowers. We have to start from scratch, get them back on track, and reshop for loans.'

Reach Ines Bebea at 427-6924 or ibebea@dailyrepublic.net.

Happening this week in your neighborhood!
- Toddler Parentin...
- Baby Bounce
- “Beat the Heat”
- Toddler Time
- and more...
Submit your event

Local Shopping
CLASSIFIEDS
Announcements
Automotive
Business Opportunities
Commercial Property
Employment/Services
Garage Sales
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Obituaries Forms
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Columnists
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# EXHIBIT O

# THE MORTGAGE LENDER Implode--Meter

*Tracking the housing finance breakdown: a saga of corruption, stupidity, and government complicity.*

**Imploded - Ailing - News - Forum - About**



# Latest count of major US mortgage lenders that have croaked since late 2006:

PayPal DONATE

# 59

(why?)

# lenders have now gone kaput

**New:** Defrauded? Check out our legal help sign-up.

*Last addition: April 18, 2007. Latest imploded: Loan Center of California, Home Capital, Inc., Home 123 Mortgage, Homefield Financial, First Horizon Wholesale ...*

### Quote Of The Week

"... the Fed's efforts to stabilize system profits are a profoundly riskier proposition in today's environment where profits are largely dictated by financial sector expansion (as opposed to capital investment). With corporate profits, household income, asset prices and economic growth now all dependent on ongoing leveraged speculation and rampant financial sector ballooning, sophisticated market players aggressively seek their outsized share of profits with comfort knowing the Fed has no alternative than to sustain the boom." — Doug Noland, "More Minsky", in his April 13th, 2007 Credit Bubble Bulletin.



### Top 25 Subprime Lender list

(as of Q2 2006; from the Mortgage Banker's Assoc. ~~Red~~ are

### Resources

MortgageMinister
Mortgage Misfit
Defrauded? Get Help.
Servicer scam alert

### Founder's Pages

autoDogmatic (blog)
Wall Street Examiner (blog)
Aaron Krowne's Furl archive
The Fed "gallery of shame"
Chavez Watch
PlanetMath
Home page

### Blogroll

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Russ Winter
Charles Hugh Smith
Peak Economy
Max Gardner's Bankruptcy Blog
Sacramento Real Estate Stats
Bakersfield Bubble
The Kingsland Report
David Lereah Watch

shutdown and/or bankrupt, ~~**blue**~~ are no longer operating independently) -

1. Wells Fargo [not doing much subprime anymore; also not #1 due to reclassifying servicing business]
2. HSBC Household Finance [HSBC's subprime erased at least half of '06 earnings]
3. ~~**New Century**~~ [funding pulled; lending halted, lawsuits, criminal probes, impairments]
4. Countrywide [subprime to hurt results; layoffs]
5. ~~**Fremont General**~~ [2007-03-02; residential subprime activities ceased]
6. Option One [H&R Block; mounting losses; up for sale]
7. ~~**Ameriquest**~~ [ACC's formerly-major retail subsidiary]
8. WMC [subsidiary of GE Money; layoffs, subprime causes $373mln hit to Q1'07 profits]
9. Washington Mutual [some branch closures starting late 2006]
10. CitiMortgage [tightening standards]
11. ~~**First Franklin**~~ [acquired by Merrill Lynch from National City for $1.3bln]
12. GMAC [Major layoffs in ResCap; Looming writedowns subprime loan portfolio and residual]
13. Accredited Home [in a serious cash crunch]
14. BNC [Lehman bros. subsidiary]
15. ChaseHome Finance
16. Novastar [announced impairments; likely no dividends in 2007, no taxable income through 2011; shareholder lawsuits]
17. ~~**OwnIt**~~, 2006-12-07 [partially-owned by Merrill and BofA]
18. Aegis [not doing subprime anymore]
19. ~~**MLN**~~, 2006-12-29 [Much of the sales force has gone to Lehman]
20. EMC
21. ~~**ResMAE**~~,2007-02-13 [acquired by Citadel (still operating)]
22. FirstNLC [almost totally shut down]
23. Decision One [owned by HSBC; rumored to be up for sale]
24. ~~**ECC/Encore**~~ [fire-sale bought out by Bear-Stearns]
25. ~~**Fieldstone**~~ [2007-02-16, bought by C-Bass]

(Partly based on information from here. See a list of major Alt-A lenders here.).

The Mortgage Fraud Blog
The Credit Shrink
Dr. Housing Bubble
Global House Price Crash
The Great Depression of 2006
Housing Derivatives

**Syndication**

RSS feed



# Top Mortgage Banking Bust News and

# Commentary:

- 2007-04-18: Foreclosures reported up 47% in past year (RealtyTrac) - *I suspect this explains the healthy-looking "sales" in the Midwest...*
- 2007-04-18: WaMu Offers $2B to Help Subprime Loans - *They damn well better.*
- 2007-04-18: Calculated Risk: Downey Reports - *The only "bright spot" is somehow a $10 mln reduction in loan-loss set-asides, even though non-performing assets are now up to almost 1%.*
- 2007-04-18: Blogger: Washington Mutual Dead Fish Float To The Surface - *Among the shockers, $300 mil in negative-amortization "earnings", which is nearly half of reported real earnings. This is a must-read; the shenanigans are becoming impossible to hide.*
- 2007-04-17: Housing Slump Takes a Toll on Illegal Immigrants - *Hidden job loss; nonetheless, very real.*
- 2007-04-17: New-home Builders Use Auctions as a Way to Spur Sales - *"We auctioned 23 condos and sold 23 condos at an average discount of 15.3 percent off the original asking prices."*
- 2007-04-17: Homeowner default notices jump 123% - *California carnage that would make Ah-nold blush...*
- 2007-04-17: Limited options for subprime woes, lawmakers hear
- 2007-04-17: Fears over Treasury losing control of gold left in its vaults - *The hi-jinx of supporting paper currency and assets by dumping gold is being exposed in Britain. The prudent might want to have more than 0% of their wealth in the mainstay yellow metal.*
- 2007-04-17: GMAC Shuffles ResCap Leadership; Former Aegis CEO Jumps In - *"GMAC Financial Services said today that it will restructure its real estate finance operations at Residential Capital, LLC (ResCap). The company's announcement comes as the lender faces what industry insiders say is a ``big hit'' from the downturn in subprime lending."*
- 2007-04-17: Foreclosure pace nears decade high - *"So far, the effect on home values has been muted. But as the number of move-outs, evictions and forced sales continue to increase, some economists say they will soon start to push prices down."*
- 2007-04-17: Wells Fargo 1Q Profit Grows 11 Percent - *"Still, like other banks, Wells Fargo saw some signs of worsening consumer credit and reported that net charge-offs and nonperforming assets rose in the January-March period from a year earlier."*
- 2007-04-17: Foreigners ease off some buying - *"Net international buying of U.S. long-term securities slowed in February from the previous month, as investors purchased fewer American stocks and agency bonds."*
- 2007-04-17: M&T Bank first-quarter profit falls 13 percent - *The official word...*
- 2007-04-17: Credit Suisse to Acquire LIME Financial - *I can just hear the umpire saying "safe!!!"*
- 2007-04-17: Residents miss more mortgage payments
- 2007-04-16: Citi Business Stronger - *I hope for their sake delinquencies are done rising!*
- 2007-04-16: Subprime Mess Produces Unqualified Victims: Michael Lewis - *Lewis has some good points; though I think we'll find all parties were just as susceptible to a common delusion and deception.*
- 2007-04-16: WMC Fundings Free Fall - *"Quarterly production was off more than 60*

*percent from the previous period..."*

- 2007-04-16: U.S. Homebuilders Face Bankruptcy Risk in '08, Lawyers Say - *We here at the Implode-O-Meter are shocked—**shocked** to hear this!*

(older news)



# List of the Defunct Lenders:

This is our list of lending operations that have "imploded" (see also ailing lenders). "Imploded" is somewhat subjective and does not necessarily mean operations are ceased permanently: it can mean bankruptcy filing, possibly-temporary halting of major operations, or a last-ditch acquisition. **Important:** If you are planning on doing business with any of these companies you should inquire with them on whether they can still meet your needs. Many are still operating in some capacity.

The Companies include all types (prime, subprime, or a mix of both; retail or wholesale; subsidiaries and entire companies). The list, with links to stories and whatever details we have available (most recent first) follows:

- 2007-04-18: **Loan Center of California** - Wholesale Non-Prime Lender (no MSM story yet)
  A source from the company who asked to remain anonymous sent in the following this morning:

  > Effective immediately Loan Center of California a Solano County; California based Wholesale lender is closed. After two surges of sweeping layoffs only a skeleton crew remains to sweep up the mess. I was a credit officer whom was just laid off. The company defrauded thousands of borrowers and committed mortgage fraud on several layers for years prior to my employment. Dept of Corporations has a pending audit and the owner Edwardo Blanch is seeking bankruptcy protection due to nearly $60million in no income loans still on the books. No one is willing to buy the company and several investors have pulled there funding. The company specialized in Alt-A 100% loans including 100% Non-owner occupied; 100% Zero Fico; 100% Negative Amortization. They even did 100% financing for documented illegal aliens with no credit history. The companies credit policy was so skewed it took me nearly a year to re-adjust their logic only to find the owner was secretly booking fraudulent loans that have now jeopardized the company. There website requires a login and there are no current programs available and no pricing. There have been no new loan submissions or fundings for April. The website is www.rateprice.com 1-800-300-5662 the companies ten year history is now over with nearly 150 employees at one time; gone.

  That pretty much says it all. Stay tuned for more.

- 2007-04-16: **Home Capital, Inc.** - Online Retail Lender (no MSM story yet)
  Many have written in today to report that this Atlanta-based online retail lender is defunct. Word is that they've filed Chapter 11, and have let go of all the sales staff.

  Their emphasis seemed to be non-prime 1st and 2nd originations; I'm not sure how much prime they did, if any.

  Their web site is still up. More details forthcoming as we receive them.

  **Update, April 17:** One of our regular correspondents writes in with this transcription of the phone message left on Home Capital's system:

  > Today is April 17. Home Capital has ceased its operations. If you are a customer in process, it is our intention that you will be contacted by a Home Capital representative with in the next 3 to 5 business days via phone or email regarding the status of your application. We do NOT have associates covering the telephones. However you may send an email and we will do our best to answer it in the next 3 to 5 business days.

- 2007-04-13: **Home 123 Mortgage** - Retail Subprime Lender (New Century Subsidiary) (no MSM story yet)
  Oops, we forgot to declare Home 123 officially imploded. Silly us! Let the record show that, as of New Century's bankruptcy filing April 2nd, their retail subsidiary Home 123 also ceased operations. A rather definitive statement to this effect is posted on their web site:

  > New Century Mortgage Corporation and Home123 Corporation are unable to continue the origination or funding of mortgage loans, and no new loans are being accepted. We are committed to helping borrowers who have been affected by this. We are in the process of contacting customers and brokers to inform them that we're returning their loan applications, and to assist them in obtaining funding for pending loans.

  Some scuttlebutt on the topic of whether employees are being retained/paid.

- 2007-04-12: **Homefield Financial** - Alt-A Lender (Wholesale) ( story )
  According to their web site:

  > Homefield Financial, wholesale division, would like to thank all of the mortgage brokers that have submitted broker packages and/or loan application packages to it. It is with great regret that Homefield announces that the Homefield wholesale division will no longer be accepting broker applications for consideration of a broker/lender relationship, and/or loan application packages for loan approval.

  They have taken down the rest of the web site, but here is a description of the company courtesy of the Google cache:

  > Welcome to Homefield Financial, an INC 500 Company

> Homefield Financial, Inc., established in 1998, is a fast growing and dynamic national mortgage lender specialized in Alt-A and non-conforming products with special emphasis on Interest Only, Stated and No income Documentation, and Option ARM products. We're committed to providing our brokers new and exciting programs at FASTER service speeds than our competition.

The page also lists as news from august last year that Homefield had just introduced a 5-year pay option ARM product (hot-dog!) and expansion into the state of Virginia.

I can't think of a better illustration of the trade-off between speed and prudent lending... *and this is not even sub-prime*!

- 2007-04-11: **First Horizon Wholesale** - Non-Prime Wholesale Lending Unit ( story )
  Many have written in with news that this subsidiary of First Horizon National has thrown in the towel. Here is an excerpt from a typical AE letter that went out to brokers:

  > Effective immediately, First Horizon WHOLESALE Non-Prime is no longer in business. Due to the current conditions in the sub-prime market, we do not have the resources needed to lend in a non-prime market. For loans already in process, we will do everything we can to get them closed for you by end of April. Please keep in mind, last day for refinances to close is April 25th. Anything that does not FUNDin April will not be closed.
  >
  > Please note: There are NO changes with the Conforming or Equity Lending divisions of First Horizon. Please feel free to continue to send loans to your conforming and HELOC Account Executives as these changes do not effect them in any way.

  This link has more on First Horizon in general; though not much about the shuttered division.

  More details on impact if and when we get them.

  **Update, April 12, 2am:** We hear that First Horizon is still doing non-prime retail.

  **Update, April 16:** Just noticed MortgageDaily has confirmed this.

  **Update, April 17:** We are hearing that First Connect is the name of First Horizon's sub-prime subsidiary and that it is the main portion which shut down.

- 2007-04-11: **Platinum Capital Group** - Mortgage Banker (no MSM story yet)
  **Update, April 12, 2am:** Management of the company has contacted us and informed us that Platinum is still around. As we determine details of their remaining business, we will updated and potentially remove this entry.

  Multiple sources report that this company has ceased lending, at some point within the past month. It appears to be based on Manhattan Beach, CA. While the main web site seems light on info, there is a link to a press release from last November which says that Platinum funded $2 billion in 2006, and at some point was named the Los Angeles Business Journal's "#1 fastest growing privately held company in Los Angeles".

No word yet on the credit quality mix of the lending, or the solvency of the overall company. That would probably depend on how much of Platinum's lending was funded by its own depositors.

- 2007-04-09: **First Source Funding Group (FSFG)** - Mortgage Banker ( story )
  The following notice was just forwarded to us:

  > IMPORTANT ANNOUNCEMENT!
  > March 09, 2007
  > First Source Funding Group, Inc. ("FSFG") will cease to conduct mortgage banking operations effective immediately. We can no longer accept loan submissions and/or requests for rate locks and/or loan documents. That being said, we harbor the utmost concern for the needs of our customers and we will attempt to accommodate existing transactions to the extent possible. Subject to the availability of funds, FSFG will make every effort to proceed with funding of locked loans with loan documents drawn and released on or before March 8, 2007. From everyone at First Source Funding Group, we wish to thank all of the individuals and companies that have contributed to our success over the past five years.
  >
  > -FSFG Management

  The web site is still up. More details as they come to us.

  **Update, April 16, 2007:** MortgageDaily confirms.

- 2007-04-10: **Alterna Mortgage** - Alt-A Wholesale Lender (no MSM story yet)
  Received word and some confirmation of this one over the past few days. I'm not clear on the size of this shop, so it is being provisionally added for now. Here is their web site (still functional, for now). Here is an excerpt from a letter from an AE at Alterna who had to leave:

  > Just reaching out to share some important news about the abrupt ending of Alterna Mortgage late last week.
  >
  > If you do not already know -- every Alterna employee was given our notice of dismissal and that funding was being immdiately haulted on Wednesday afternoon last week.
  >
  > This came just 2 days after an extensive product meeting to address the market shift and major operational changes that would assist as well. Unfortunately the partners of the firm were not able to weather the level of buybacks that were being called due to the massive guideline changes now dictated by the secondary investors and had to immediately close the doors... leaving myself and several other AE's with no options and a full pipeline of approved loans.

Here is some text reproduced from their "about" page describing their offerings:

> Alterna is an aggressive wholesale ALT-A lender specializing in alternative documentation programs. We offer incredible service, products, and pricing. These are a few examples of products we are currently featuring. Please contact an Account Executive for complete details on our programs.
>
> - 100% (80/20) Financing, Full or Stated, 620 Scores - Great Pricing!
> - Up to 100% CASH-OUT
> - Investor properties as high as 100% (80/20) or Up to 4-units
> - Alterna NO-DOC - Up to 100%
> - Multiple doc-type options
> - No Property Seasoning Requirements (most programs)
> - First time homebuyer programs
> - We use your tri-merge credit report and score

A little too aggressive, it seems...

- 2007-04-09: **Solutions Funding** - Sub-prime Lender (no MSM story yet)
  We are lacking detailed information on this Jacksonville, FL-based company (and its website isn't the most informative), but it does appear pretty conclusive from this internal email that has been forwarded to us that they have suspended business:

  > Unfortunately our efforts to find a purchaser for the company have failed to this point. As a result, we will cease accepting new applications effectively immediately. Additionally, other than loans scheduled to close today, no loans in the pipeline will be closed. We are in discussions with several lenders about moving our existing pipeline to one or more of these companies for them to handle the completion of closing these loans.
  >
  > A notice will be going out to all our broker customers informing them of our suspension of business at this time.
  >
  > Today will be the last day of employment for all employees, with the exception of a few people who have been asked to remain to clear out the existing pipeline and manage an orderly wind-down of the company.
  >
  > All employees will be paid through today. Additionally, all sales commissions owed to sales employees will be paid in the regular payroll next week.
  >
  > ...
  >
  > I can't tell you how sorry I am that it has come to this.
  >
  > Joseph P. Bryant
  > Chief Executive Officer

- 2007-04-05: **People's Mortgage** - Retail Lending unit of Webster Bank ( story story )

  The Connecticut-based bank is jettisoning its mortgage operations and at least some of its loan holdings, taking a $2.3 million charge for the first quarter. Apparently an early signal of this should have been the sale of some People's Mortgage offices on March 30th (second news item above).

  More on various charge-offs from the first story:

  > Webster also said quarterly pre-tax earnings will be cut by $4.7 million, or 5 cents per share, from payroll tax and retirement plan costs, while restructuring-related severance charges will reduce earnings by $2.2 million.
  >
  > Net charge-offs will total $5.4 million, triple the year-earlier level, **hurt by losses on Florida residential construction loans** where Webster sees a "high probability of loss based on borrower delinquency and market deterioration."

  The last part is particularly interesting—more evidence that even if the housing bubble was localized (e.g., to Florida, California, DC, Boston, Denver, ...), apparently the financial impact is not.

  Hat tip to Twist from Housingdoom.

—> **See the whole list (49 more)**

# Ailing Lenders:

The following lenders and lending operations haven't shut down, but they're significantly-downsizing or are otherwise in manifest financial (and/or legal) distress. Unfortunately, most of the industry now falls under this description, so I am forced to reserve this list for the more glaring cases. Watch this list—some of its members may move to the above one.

- 2007-03-14: **Option One** - Non-Prime Lending Unit of H&R Block ( story story story )

  Option One is a top-10 subprime lender. H&R block has been looking to jettison this manifest liability for the better part of a year; in their own reports they list Option One under "discontinued operations".

  H&R has delayed filing their latest quarterly report due to Option One-related write-downs, $29 mln of which will be added to Q3 2006.

  Berkshire-Hathaway has been selling shares of H&R block. Perhaps Buffett connected the dots to the CDO "financial weapons of mass destruction" underlying this business.

- 2007-03-14: **Accredited Home Lenders** - Non-Prime Lender ( story story story )

  In the same kind of liquidity crunch that has taken out numerous other non-prime lenders. Margin calls have hit it for $190 mln in 2007. The company is now exploring firesale-type options, workforce reductions, and just "the kindness of strangers" in general. Stay tuned.

The stock has tanked from about $20 to $4 in March.

**Update March 16th:** Accredited has managed a fire sale selling off loans at a discount to buy some time to consider "strategic options". By strategy, they mean scrambling to find a someone to take their business over.

- 2007-03-05: **Ocwen Loan Servicing** - Lender & Servicer (no MSM story yet) A reader sends in this report on a former bank and now only loan servicer & lender, which seems to have been largely predicated on fraud:

  > OCWEN LOAN SERVICING
  > Orlando, FL
  > 1-800-746-2936
  >
  > Services loans for the former Aames Home Loan dba Aames Funding Corp. They used to be a bank, OCWEN FEDERAL, until they ran afoul of the OCC. Now they're just one of the worst predatory loan servicers and lenders. Here's a sampling of the litigation they're currently facing:
  >
  > Borrower Class Action Lawsuits:
  > Over 500 separate class action lawsuits have been combined into one jumbo class to be heard in the Northern District of Illinois. Former employees testifying about how OCWEN intentionally defrauds borrowers -- it's built in to their software which was designed by this IT guy who is blowing the whistle.
  >
  > Employee Lawsuit(s): Settling in favor of the Plaintiffs
  >
  > Investor and Supplier/Vendor Lawsuit(s): Just getting started
  >
  > U.S. Federal Government Lawsuit(s): According to OCWEN's SEC filing, they are being sued by the U.S. in the amount of $700 million +. Suits arose after one of their subsidiaries filed for bankruptcy protection in the District of Delaware Bankruptcy Court for that amount - $700 million in debt. Here's the part the Feds and the investors are upset about: This subsidiary transferred ASSETS to OCWEN just before filing on their liabilities. That's called a fraudulent conveyance.
  >
  > Other Lawsuits: Everyone's suing them.
  >
  > According to the SEC and OCWEN's own report, their net worth is $325 million--oops not enough to satisfy the Feds and investors. Borrowers who were defrauded and wrongfully foreclosed are at the bottom of this 'crumby' food chain.
  >
  > According to Moody's Rating Service, they've decided not to rate OCWEN's stock--this after downgrading it. The $325 million may be a negative $325 million by this time.
  >
  > SOURCES

> My online sources included the public records found at Moody's, the SEC, Delaware District Bankruptcy Court, George Miller, Trustee, and The Rip-Off Report and others.

Looks pretty bad.

- 2007-03-02: **Doral Financial Corp.** - Mortgage Lender ( story )
  The company swung to a net loss of $117 million in 2006, from a gain of $13.2 million in 2005. It needs to refinance $625 million by July or it faces a terminal cash crunch.

  More on recent scandal and errors from the article above:

  > Last year, Doral agreed to pay a $25 million penalty to settle fraud charges with the U.S. Securities and Exchange Commission. Doral did not admit or deny the allegations.
  >
  > The SEC said Doral overstated profit by about $921 million over several years. The mortgage company's former senior management is accused of manipulating the underlying assumptions for mortgage-sale related gains that helped the company generate 28 straight quarters of record profit.

  Doral's lending unit is actually "Doral Mortgage". I'll put up information on the relative size of that unit as it becomes available. However it seems a foregone conclusion that the influence of Doral Mortgage is enough to potentially crater the entire company.
- 2007-01-25: **Evergreen Investment/Carnation Bank** - Subprime builder and financer ( story story )
  This duo, operating chiefly in Ohio, built homes and financed them for marginal borrowers. Evergreen appears to be the main operation, with Carnation just serving as a financing partner. Recently Evergreen hit the skids as investors apparently figured out it was insolvent, yet still operating. The pair of companies is now being sued by investors and investigated by local, state, and Federal authorities. Here are some stories:
  - Investigators search mortgage company
  - Law suits against Evergreen Investment Corp.
  - Sheriff says raid was bigger -- Carnation Banc search includes 2 other sites

  I get the feeling these companies' days are limited.

—> **See the whole list (5 more)**

(link to this site as: ml-implode.com, lenderimplode.com, or mortgageimplode.com)

# EXHIBIT P

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# Loan Center of California - GONE

newtopic postreply autoDogmatic Banter Forum Index -> Mortgage Lender Implode-O-Meter Discussion

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| Author | Message |
|---|---|
| **Aaron**<br>aD: Milton Friedman Liberal<br><br>Joined: 24 Jan 2007<br>Posts: 521<br>Location: Atlanta, GA | Posted: Wed Apr 18, 2007 7:22 pm Post subject: Loan Center of California - GONE quote<br><br>This came in this morning:<br><br>"Effective immediately Loan Center of California a Solano County; California based Wholesale lender is closed. After two surges of sweeping layoffs only a skeleton crew remains to sweep up the mess. I was a credit officer whom was just laid off. The company defrauded thousands of borrowers and committed mortgage fraud on several layers for years prior to my employment. Dept of Corporations has a pending audit and the owner Edwardo Blanch is seeking bankruptcy protection due to nearly $60million in no income loans still on the books. No one is willing to buy the company and several investors have pulled there funding. The company specialized in Alt-A 100% loans including 100% Non-owner occupied; 100% Zero Fico; 100% Negative Amortization. They even did 100% financing for documented illegal aliens with no credit history. The companies credit policy was so skewed it took me nearly a year to re-adjust their logic only to find the owner was secretly booking fraudulent loans that have now jeopardized the company. There website requires a login and there are no current programs available and no pricing. There have been no new loan submissions or fundings for April. The website is www.rateprice.com 1-800-300-5662 the companies ten year history is now over with nearly 150 employees at one time; gone. "<br><br>I've gone ahead and posted them as imploded. Any other info I get will be added to the entry. |

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newtopic postreply **autoDogmatic Banter Forum Index -> Mortgage Lender Implode-O-Meter Discussion**

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# EXHIBIT Q

# Home Loan Center Of California Closes Doors

No details yet but they are a large broker with 600 million in bad loans. Closed this morning.

Update:

-----Original Message-----
From: ****************
To: ******************
Sent: Wed Apr 1# 0#:##:00 2007
Subject: This is what happens when things are not managed properly

* 2007-04-18: Loan Center of California - Wholesale Non-Prime Lender (no MSM story yet)

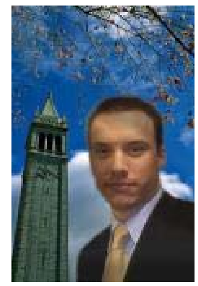
A source from the company who asked to remain anonymous sent in the following this morning:

Effective immediately Loan Center of California a Solano County; California based Wholesale lender is closed. After two surges of sweeping layoffs only a skeleton crew remains to sweep up the mess. I was a credit officer whom was just laid off. The company defrauded thousands of borrowers and committed mortgage fraud on several layers for years prior to my employment. Dept of Corporations has a pending audit and the owner Edwardo Blanch is seeking bankruptcy protection due to nearly $60million in no income loans still on the books. No one is willing to buy the company and several investors have pulled there funding. The company specialized in Alt-A 100% loans including 100% Non-owner occupied; 100% Zero Fico; 100% Negative Amortization. They even did 100% financing for documented illegal aliens with no credit history. The companies credit policy was so skewed it took me nearly a year to re-adjust their logic only to find the owner was secretly booking fraudulent loans that have now jeopardized the company. There website requires a login and there are no current programs available and no pricing. There have been no new loan submissions or fundings for April. The website is www.rateprice.com <http://www.rateprice.com/> 1-800-300-5662 the companies ten year history is now over with nearly 150 employees at one time; gone.

END______________________++++++++++++++++++++++++++++++

I am merely passing the info on

Posted by John Hudson on 04/18/2007 10:50 AM | Comments (6) | home loan center |



**John Hudson**
Brentwood, CA
More about me...

Office Phone: (925) 513-6112
Cell Phone: (925) 354-9964
Email Me

**Links**

- The Ledger

**Tags (Tag Cloud)**

- fha benefits (2)
- rebate card on mortgage (2)
- stale listings (2)

**Archives**

- May 2007 (9)
- April 2007 (30)
- March 2007 (11)

### 6 Comments on Home Loan Center Of California Closes Doors

The first of many?

04/18/2007 by Lisa Hill

Already been 60 +

04/18/2007 by John Hudson

---

Wow...more and more each day.

04/18/2007 by Luisa Orellana, Escrow Officer

---

Where did you hear this? I know it's sad, but this kind of thing is very good for us mortgage professionals. It sets us apart as trusted mortgage leaders.

04/18/2007 by Jacob Morales

---

Jacob good comment. I personally feel the damage is already done. Personally everyone can stay in this line of work it doesn't effect me.

04/18/2007 by John Hudson

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Loan Center of California screwed me in March. I'm a Grade A-borrower and planned to purchase a condo in February. I "locked in" a loan product offered by LCC (4.875% fixed for 10 years) on 2/24/2007. Two days before they were supposed to fund my "locked in" loan, they pulled the loan and refused to honor the "locked in" rate placing my offer in jeopardy of defaulting on the agreed contract. My broker "pulled a rabit out of a hat" and got me another lender within 24 hours at 5.875%. LCC the next day offered me a loan through my broker at 7.25%. I am sad for the employees, but very happy this bait-n-switch, dishonest company is going out of business. Karma rules!

04/20/2007 by Alex Pierce

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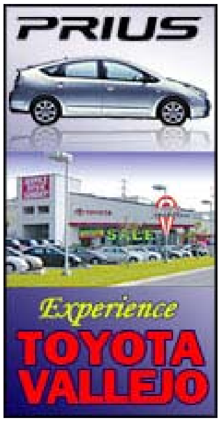


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# More workers let go from Suisun mortgage lender

By Ines Bebea

SUISUN CITY - Loan Center of California Inc., a mortgage lender with offices in Suisun City, has laid off another 23 employees.

This is the second time the company has laid off employees in the last two months. In March, LCC laid off 20 employees and pulled funding from loans approved for local brokers.

News of the latest layoffs was accompanied by allegations of financial misconduct posted on a Web site called www.mortgageimplode.com. The Web site alleged that Ed Blanch, chief executive officer of LCC, was seeking bankruptcy protection, that the company was being audited, and that it gave 100 percent financing to undocumented immigrants with no credit history.

'The only thing that is accurate is that we did lay off 23 people,' said Casondra Jeans, corporate manager for LCC. 'We are not closing, have no intention of closing and we are not looking to sell the company.'

According to Jeans, mortgageimplode.com is a Web site visited daily by brokers and investors researching lenders.

'All day we had investors calling our office and asking what was going on because of that site,' Jeans said. 'We believe that the information was posted by a disgruntled employee, and we are in the process of pursuing legal action against the Web site.'

The reasons for the layoffs were the same as stated last month in a written statement by Blanch, Jeans said. Blanch attributed the downsizing to the decline of the mortgage lending market and liquidity of loans in the secondary market.

As a wholesale lender, LCC made funds available to brokers, who then forwarded the money to borrowers.

In recent months, many secondary lenders have declared bankruptcy or closed their operations across the country due to the slow down on the housing market, foreclosures, and the inability of borrowers to make payments on their loans.

Reach Ines Bebea at 427-6934 or ibebea@dailyrepublic.net.

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