



Fact Sheet on Subprime Lending & Foreclosures

Colorado Bankers Association – August 30, 2007

Purpose – In light of recent fallout from subprime lending and the status of Colorado residential foreclosures lately the Colorado Bankers Association provides this information. The public often thinks *bank* when reference is made to any lender. There are **meaningful distinctions** between regulated banks and less regulated nonbank lenders – especially critical on these issues.



Contents – Overview, Consumer Tips, Explanations, Relevant Facts & Data

Overview

- **General** – Due to high delinquencies and foreclosures recently, investors such as brokerage houses, mutual funds and hedge funds stopped buying nontraditional mortgage products (including subprime and Alt. A) or securities backed by them – because of investors' large losses. This market reaction (national and international) has reduced credit availability, expanded into jumbo and prime mortgage markets where creditworthiness generally is not an issue, has resulted in some lenders raising rates or stopping lending altogether, and even prompted reaction from the Federal Reserve. Watch for more action from federal agencies. In short, the market fueled irrational behavior by some lenders and borrowers.

Background – Lenders sell loans on a *secondary market* made up of GSE's (government sponsored enterprises Fannie Mae and Freddie Mac) and large private investors (investment banks, hedge funds, pension funds...). When lenders sell the loans they originate before they are paid back by the borrower, it frees up funds and allows them to lend more to businesses and individuals. Done responsibly this fuels our economy. Traditionally these have been considered safe investments, and attracted large amounts of investment money.

- **Subprime lending** – Subprime lending (defined below) has a legitimate role and has helped many Americans own homes which otherwise was unlikely. **Problems** arise when loan underwriting (the process of determining who gets credit and on what terms) is faulty, and when there is an undue concentration of risk (e.g. many subprime loans versus other kinds of lending [commercial, consumer, ag]). (**Definitions:** Prime borrowers have the best credit rating, subprime have lower credit ratings, and Alt. A are in between or are jumbo loans to prime borrowers.)

Key Messages

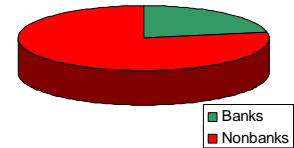
- Current and potentially **distressed homeowners**/borrowers should follow tips (see below) and use counseling services. Those borrowing now should follow other tips to avoid problems (also addressed below).
- Due to the subprime issue there is a **market correction** in progress which will have modest impact on banks. Other less regulated lenders may be affected significantly. Consumers should expect tighter underwriting standards and higher rates for some in the near future. Recent Federal government policy pushed homeownership to record levels (70% of Americans); more subprime loans and higher foreclosures are a regrettable but natural result. Fraud, predatory lending, and sloppy lending are not natural results of that.

Colorado Experience

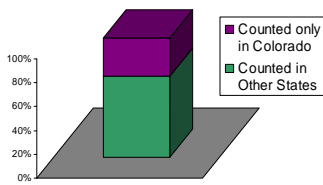
- For a year **headlines** have proclaimed Colorado's #1-in-the-U.S. foreclosure rate. But...
- A February 2007 **Colorado Foreclosure Analysis** by Development Research Partners examined foreclosures filed in Colorado in 2006 (looking at 374 public trustee records of representative, geographically stratified, randomly selected loans). It shows:

- In Colorado **nonbank mortgage lenders file 77%** of foreclosures while nationally they make 42% of residential mortgage loans.
- Banks have a **lower foreclosure** rate than nonbanks. Nationally banks originate 58% of home mortgage loans; in Colorado banks (including affiliates) account for 18%-22% of foreclosures.

Colorado Foreclosures - 2006



Colorado Foreclosures - 2006



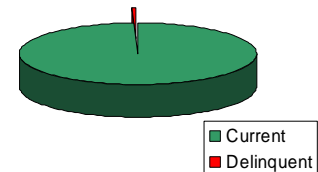
- Foreclosures in Colorado are a significant problem, but the above study found Colorado's foreclosures are **overstated** since Colorado's public trustee system (unique in U.S.) has pre-foreclosure categories (withdrawn, cured, redeemed that collectively account for 32% of foreclosures) that are not counted as foreclosures in other states. There are plans for 2008 legislation to align Colorado's definition with other states.

- The study created a **profile** of a Colorado homeowner in foreclosure in 2006:
 - 77% received their loan from a nonbank.
 - The average loan was \$202,000 and the median loan was \$159,000.
 - Only 2.8 years elapsed from the time of the loan to the time of foreclosure.
 - The original loan amount had been reduced by 3% by the time of foreclosure.
 - 77% of those mortgage loans were adjustable rate mortgages (ARMs).

- Current FDIC data** on Colorado banks (3/31/07 data, last available) is positive, reflects foreclosure activity in Colorado recently (generally not affecting banks) and compares favorably to banks nationwide and in recent years for Colorado banks. FDIC 3/31/07 Colorado bank data:

- All loans past due 30-89 days: .55% (a mere $\frac{55}{100}$ of 1%)
- Past due 30-89 days, secured by 1-4 family residential mortgages: .13% ($\frac{13}{100}$ of 1%)
- All loans past due 90+ days: .12%
- Past due 90+ days, secured by 1-4 family residential mortgages: .03%
- All nonaccrual loans (repayment of loans doubtful, interest no longer accrued): .44%
- Nonaccrual loans, secured by 1-4 family residential mortgages: .05%
- Loan loss allowance (money set aside to cover loans that aren't repaid by borrowers) compared to noncurrent loans: 122% (a strong ratio of reserves to past due loans)

Current FDIC Data on Colorado Bank Loans



Consumer Tips



- In Colorado **80%** of troubled borrowers calling the Colorado Foreclosure Hotline have a **successful** resolution; only 20% result in foreclosure or bankruptcy. We strongly recommend the free hotline certified by HUD (and formed/operated by the Colorado Division of Housing, nonprofits, and lenders) at www.coloradoforeclosurehotline.org (web site active in early September 2007) or **877.601.HOPE** (hotline active now – since late 2006). It has helped thousands of Coloradans. Nationwide 50% of homeowners behind in payments never communicate with their lender. Communication is a **critical** factor in avoiding foreclosure. Use the Hotline.



- CBA provides consumer tips at our public information site: www.financialinfo.org. In addition to 50+ usual consumer financial advice topics (identity theft, loans, credit scores...), we recently added these:



- **Repayment Problems, Possibly Foreclosure** – Tips for current and potentially distressed homeowners/borrowers – don't put your home or credit at risk.
- **Tips on Being a Smart Homebuyer**
- **What Is Predatory Lending? What Tactics Do Predatory Lenders Use?**
- **Warning Signs of Predatory Lending Practices**

- **Existing customers** of troubled lenders should continue to make payments – perhaps to a new owner of a troubled lender. There should be little/no impact on existing loans or escrows.
- **Borrowers in the pipeline** seeking new loans may encounter some nonbank lenders having difficulty honoring some loan commitments. Seek reassurance.
- **New borrowers** (buying or refinancing) may face a challenge to find attractive terms.
 - Prime & Alt-A borrowers should be OK, perhaps encountering a slower process and higher rates, but lenders' losses in this sector have remained fairly low.
 - Subprime/marginal borrowers will have more difficulty finding credit on desirable terms.

Recent Colorado Laws

- In recent years the Colorado Legislature enacted several new mortgage lending laws. **Three major bills** were adopted in 2007, and two others. CBA supported all of them:

HB07-1322	Mortgage Fraud Prevention Act - MARSHALL	Tightens restrictions on mortgage brokers.
SB07-203	Mortgage Broker Licensing - GROFF	Replaces broker registration with licensing.
SB07-216	Mortgage Loan Fraud Practices - VEIGA	Prohibits certain activities for mortgage brokers & originators.
SB07-085	Protect Consumer Real Estate Transaction - VEIGA	Prohibits improperly influencing a real estate appraisal.
HB07-1157	Real Estate Foreclosure - GARCIA	Makes technical corrections to 2006 bill rewriting foreclosure process.

Is more needed? We don't think so. As this market correction occurs, we are concerned about unintended consequences from further legislative changes.

Banks versus Nonbanks: Regulation, Examination, & Relationship Focus

- **Bank Involvement**
 - Banks in general have limited origination of subprime mortgages, don't hold many in their loan portfolios, and don't own significant mortgage backed securities. (If such securities are owned they usually are AAA rated or backed by the GSEs and focus on prime mortgages, not subprime.) We believe banks (including affiliates) will be impacted little compared to many other parties.
 - Some banks do have relationships with nonbank lenders. Some banks provide lines of credit and other banking services, sell them loans banks originate... Also some banks have affiliated companies– subject to regulation by the Federal Reserve under the Bank Holding Company Act.
- **Banks and subprime loans** – Banks generally don't deal much with the subprime market and to the extent they do banks do so responsibly due to these distinctions:

- Banks foster **relationships**; they want healthy customers involving many services (checking, savings, credit/debit card, car loan, student loan, business loan, mortgage loan, 401K, safe deposit...). Therefore banks have cautious underwriting and promote customers' financial health, including providing financial literacy services. Banks and bankers serve businesses and consumers in good times and in bad.
- Banks' multi-decade and multi-product customer relationships focus on promoting the **customers' financial health** rather than maximizing profit from one/few transactions as is the case with other lenders.
- Prudent **loan origination** practices (called underwriting) are used and many of those loans are retained by the bank which has ongoing contact with the customer.
- Banks have **diversified** loans and income sources and diverse strong balance sheets due to the relationships described above. Banks are a permanent part of the community; last year banks in Colorado voluntarily gave \$47 million to local charities and causes.
- Banking is based on **trust**. Banks earn *trust* and prosper as a result; without it they don't.
- As a **heavily regulated** business, banks have rigid capital requirements, are subject to hundreds of regulations regarding loan quality and bank health, and are routinely examined to assure safe and sound banking practices and compliance with laws.

Other Parties

- ⊕ Some **nonbank mortgage lenders** will not be able to fund new loans since Wall Street has reduced credit due to subprime risk and the spillover to other lending. These transactional lenders often have little loan diversity and less regulation and examination, and investors who previously purchased loans from these lenders may push back the bad loans (and losses) to these lenders. Some bankruptcies and distressed buyouts of these lenders are possible.
- ⊕ **Mortgage brokers** have no stake in the loans or the loan losses. They had no skin in the game. Reduced mortgage loan activities will reduce demand for brokers.
- ⊕ **Institutional owners** (funds, GSEs) of pools of mortgages may experience losses in their portfolios (maybe major), may attempt push back of loan losses to loan originators (turmoil, legal fees), and probably will have higher standards for any new loan purchases.
- ⊕ Builders and housing **related businesses**/suppliers may see a drop in home demand due to tighter credit, impacting labor and suppliers. Banks monitor loans to these sectors carefully.
- ⊕ When the **Federal Reserve** announced its recent discount rate cut it said "Financial market conditions have deteriorated, and tighter credit conditions and increased uncertainty have the potential to restrain economic growth going forward... [The Fed] judges that the downside risks to growth have increased appreciably...and is prepared to act as needed to mitigate the adverse effects on the economy arising from the disruptions in financial markets." Watch for more action from the Fed and the federal government.

Other Interesting Items

- ⊕ A foreclosure can cost a **neighborhood** up to \$220,000 in reduced property value on nearby homes. One study showed a drop in home value of at least .9% for each foreclosure within $\frac{1}{8}$ mile of the home.
- ⊕ A foreclosure can have direct costs of \$34,000 on **local government**: lost taxes, inspections, court actions, police & fire efforts, potential demolition, unpaid water/sewage...
- ⊕ Lenders also lose money when a property goes to foreclosure. No one wins when a loan goes south. Lenders rarely recover the full principal and associated costs in a foreclosure and certainly don't make a profit. By law, any profit if ever realized must go to the homeowner.