



## Just the Facts: Homeownership Suffers Under Subprime Lending

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The Mortgage Bankers Association (MBA) has attacked a recent study by the Center for Responsible Lending (CRL) showing that subprime lending from 1998-2006 has led or will lead to a net LOSS of homeownership for almost one million families. **However, The MBA critique merely recycles several of its arguments that have already been discredited.** Here are CRL's specific responses to the critique:

MBA: *"The percentage of foreclosures in the subprime market is far below the rates cited by CRL, and not all of these foreclosures result in the borrower losing the house."*

CRL Response:

**In comparing its National Delinquency Survey foreclosure rates to the CRL foreclosure statistics, the MBA knowingly presents an "apples to oranges" comparison but fails to disclose this to policymakers.** MBA's lower foreclosure statistics reflect only the percentage of outstanding loans that are in foreclosure at a specific point in time, while CRL's statistics measure the performance over the life of the loans.

- Cumulative foreclosure rates—such as the ones calculated by CRL—are commonly used by mortgage lenders, investors, insurers, and rating agencies to predict the risk and profitability of a given set of loans. **The MBA "point in time" foreclosure statistic masks the extent of the foreclosure problem** because it fails to include the high number of subprime loans that were originated recently and have yet to enter their peak foreclosure years.
- Our study considered delinquent loans that were cured by refinancing or selling a home, but **CRL's foreclosure estimate covers ONLY loans that ended with borrowers losing their homes through or during foreclosure.**
- **CRL's 19.4% foreclosure projection is very likely conservative, as Lehman Brothers recently forecast a 30% rate of families losing their homes to foreclosure on 2006 subprime loans.<sup>1</sup> CRL's estimate is also consistent with findings from recent studies by researchers at the St. Louis Federal Reserve and University of North Carolina.**

MBA: *"CRL ... assumes a worst case scenario of economic conditions, interest rates and home prices to inflate its 'facts.'"*

CRL Response:

- **The economic forecasts were developed Moody's Economy.com, not CRL.** Moody's Economy.com is an independent provider of economic and financial research to over 500 clients worldwide. Its client base is "primarily composed of large corporations, including

virtually all major commercial and investment banks and insurance companies; many agencies of the Federal government; various agencies of many State and Provincial governments; institutional investment and money management and advisory firms; other consulting firms; major ratings agencies and major federal agencies.”<sup>2</sup>

- According to Moody’s Economy.com, these forecasts were derived from two econometric models that incorporated “a wide range of variables...including, but not limited to, everything from low mortgage rates and more aggressive mortgage lending, to solid demographic trends and a better job market, to constraints on the supply of new housing.”<sup>3</sup>

MBA: “CRL’s latest analysis mixes apples and oranges combining performance data on refinance loans with data on purchase loans. This confused approach is the only way [CRL] could generate a “net loss” in terms of homeownership.”

CRL Response:

- CRL’s study simply quantified how subprime lending contributed to an increase in homeownership (i.e., new homeowners) versus a decrease in homeownership (homes lost through completed foreclosures). This is a perfectly valid—apples to apples—comparison.
- Projections aside, a net loss of homeownership has ALREADY played out for portfolios of seasoned subprime loans (which have previously experienced their peak foreclosure activity), as the number of completed foreclosures in those years has outstripped the number of new homeowners created.
- As explained in CRL’s “Losing Ground” report,<sup>4</sup> we expect the number of subprime foreclosures on loans originated in 2005-2006 to be significantly worse than past experience because (1) the number of subprime loans originated was much higher in later years, and (2) the proportion of foreclosures will be higher due to risky ARM products and lower house price appreciation.

MBA: “Contrary to many perceptions that subprime loans are just a way for people to refinance their way out of a other debt problems, many consumers use subprime credit to purchase a home. In the first half of 2006, 45 percent of subprime originations were for purchase of a home. 25% of these purchase loans were by a first-time homebuyer.”

CRL Response:

- **Based on the MBA’s own statistics cited above, only 11 percent of subprime loans made in the first half 2006 went to first-time homebuyers and thereby increased homeownership** (45 % of subprime loans are for home purchase times 25% first-time homebuyers). CRL used comparable estimates in its analysis, and determined that only 9% of subprime loans originated from 1998-2006 have gone to first-time homebuyers. **Unfortunately, among those same loans, over 15% ended, or will end, with**

**borrowers losing their homes through foreclosure. That will result in a net loss of homeownership, not a gain.**

MBA: “Subprime loan performance is fundamentally a result of local economic conditions, not the loan terms or the product.”

CRL Response:

- It is not an either-or proposition. Local economic conditions can affect house price appreciation and unemployment levels, which affect foreclosure rates. However, subprime loans typically include features that are known to increase the rate of foreclosure.<sup>5</sup> Economic studies and empirical research have shown that the incidence of foreclosure escalates quickly due to low down payments as well as “layered” risk factors (e.g. high debt-to-income ratios, adjustable interest rates, etc.) – exactly the types of loans that have dominated the subprime market in recent years.<sup>6</sup>
- In reports on subprime problems, even the business press has focused on loose underwriting standards and payment shock resulting from interest rate resets on risky adjustable-rate loans.<sup>7</sup>
- If it were solely local economic conditions that influence subprime loan performance, then there would be little distinction between the performance of subprime loans and FHA loans, which are also aimed at riskier borrowers. However, the MBA’s own statistics show subprime loans perform worse than FHA loans in the same market.<sup>8</sup>

	% of Outstanding Loans in Foreclosure at end of 4Q 2006	
	Subprime	FHA
Northeast	4.74	2.61
North Central	8.17	3.35
South	3.90	1.86
West	2.62	1.23
United States	4.53	2.19

1 *Mortgage Finance Industry Overview*, Lehman Brothers Equity Research, p. 4 (December 22, 2006).

2 Moody’s Economy.com website at <http://www.economy.com/home/easyanswers.asp>.

3 Mark Zandi, Celia Chen, Brian Carey. *Housing at the Tipping Point: The Outlook for the U.S. Residential Real Estate Market*. Moody’s Economy.com, p. 6 (October 2006).

4 *Losing Ground: Foreclosures in the Subprime Mortgage Market and Their Cost to Homeowners*, Center for Responsible Lending at <http://www.responsiblelending.org/pdfs/foreclosure-paper-report-2-17.pdf>.

5 *Losing Ground*, p. 21.

6 For more details on previous studies of mortgage delinquencies and defaults, see Appendix 1 of *Losing Ground*.

7 See, e.g., James R. Hagerty, “Payment Woes Worsen on Riskiest Mortgages,” *Wall Street Journal* (April 4, 2007); “Subprime Problems Spread to Other Major Lenders,” *Inside B&C Lending* (March 2007).

8 *National Delinquency Survey, Fourth Quarter 2006*. Mortgage Bankers Association.