



## A Snapshot of the Subprime Market

November 28, 2007 - Subprime mortgages are high-cost home loans intended for people with weak or blemished credit histories. Higher interest rates make sense for higher-risk loans to a point, but the subprime market has been rife with problems that are rare in the mainstream prime market: excessive fees, high penalties for refinancing, refinances that provide no real benefit to homeowners, and steering families into more expensive loans when they qualify for a better rate.

In recent years, subprime lenders and brokers flooded the growing subprime market with dangerous mortgages that come with “exploding” adjustable interest rates. The result is a massive epidemic of foreclosures that is harming families, entire residential communities, not to mention the availability of credit at home and abroad.

### The Subprime Crisis Index

Number of families who now hold a subprime mortgage:	7.2 million <sup>1</sup>
Proportion of subprime mortgages in default:	14.44 percent <sup>2</sup>
Dollar amount of subprime loans outstanding:	\$1.3 trillion <sup>3</sup>
Dollar amount of subprime loans outstanding in 2003:	\$332 billion <sup>4</sup>
Percentage increase from 2003:	292%
Number of subprime mortgages made in 2005-2006 projected to end in foreclosure:	1 in 5 <sup>5</sup>
Families with a subprime loan made from 1998 through 2006 who have or will lose their home to foreclosure in the next few years:	2.2 million <sup>6</sup>
Projected maximum equity that will be lost through foreclosure by families holding subprime mortgages:	\$164 billion <sup>7</sup>
Proportion of subprime mortgages made from 2004 to 2006 that come with “exploding” adjustable interest rates:	89-93% <sup>8</sup>
Proportion approved without fully documented income:	43-50% <sup>9</sup>
Proportion with no escrow for taxes and insurance:	75% <sup>10</sup>

Proportion of subprime loans bundled into mortgage-backed securities made to speculators (those who own but don't occupy a home) in 2006:	5% <sup>11</sup>
Difference in delinquency rates between speculators and owner-occupants:	0.1 percentage points, or virtually no difference <sup>12</sup>
Difference in delinquency rates between subprime adjustable-rate and fixed-rate mortgages:	14.7 percentage points <sup>13</sup>
Proportion of completed foreclosures attributable to <u>speculators</u> among all adjustable rate loans made in 2006 and bundled in subprime mortgage backed securities:	7% <sup>14</sup>
Proportion of completed foreclosures attributable to adjustable rate loans out of <u>all</u> loans made in 2006 and bundled in subprime mortgage backed securities:	93% <sup>15</sup>
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Percentage increase of interest rate on an "exploding" ARM resetting to 12% from 7%:	70% <sup>16</sup>
Typical increase in monthly payment (3 <sup>rd</sup> yr):	30% to 50% <sup>17</sup>
Number of subprime mortgages set for an interest-rate reset in 2007 and 2008:	1.8 million <sup>18</sup>
Valued at:	\$450 billion <sup>19</sup>
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Proportion of 2006 home loans to African American families that were subprime:	52.44% <sup>20</sup>
Proportion of 2006 home loans to Hispanic and Latino families that were subprime:	40.66%
Proportion of 2006 home loans to white non-Hispanic families that were subprime:	22.20%

### **Subprime vs. Prime Loans**

Subprime share of all mortgage originations in 2006:	28% <sup>21</sup>
Subprime share of all mortgage origination in 2003:	8% <sup>22</sup>

Subprime share of all home loans outstanding:	14% <sup>23</sup>
Subprime share of foreclosure filings in the 12 months ending June 30, 2007:	64% <sup>24</sup>
Year-over-year increase in foreclosure filings on subprime loans with adjustable rates (2 <sup>nd</sup> quarter 2006 to 2007):	90% <sup>25</sup>
Increase in foreclosure files on prime fixed-rate loans during the same period:	23% <sup>26</sup>
Proportion of subprime mortgages with prepayment penalties:	70% <sup>27</sup>
Proportion of prime mortgages with prepayment penalties:	2% <sup>28</sup>
Estimated proportion of subprime loans made by independent mortgage lenders not affiliated with a federally insured bank	
In 2004	51% <sup>29</sup>
In 2005	52% <sup>30</sup>
In 2006	46% <sup>31</sup>

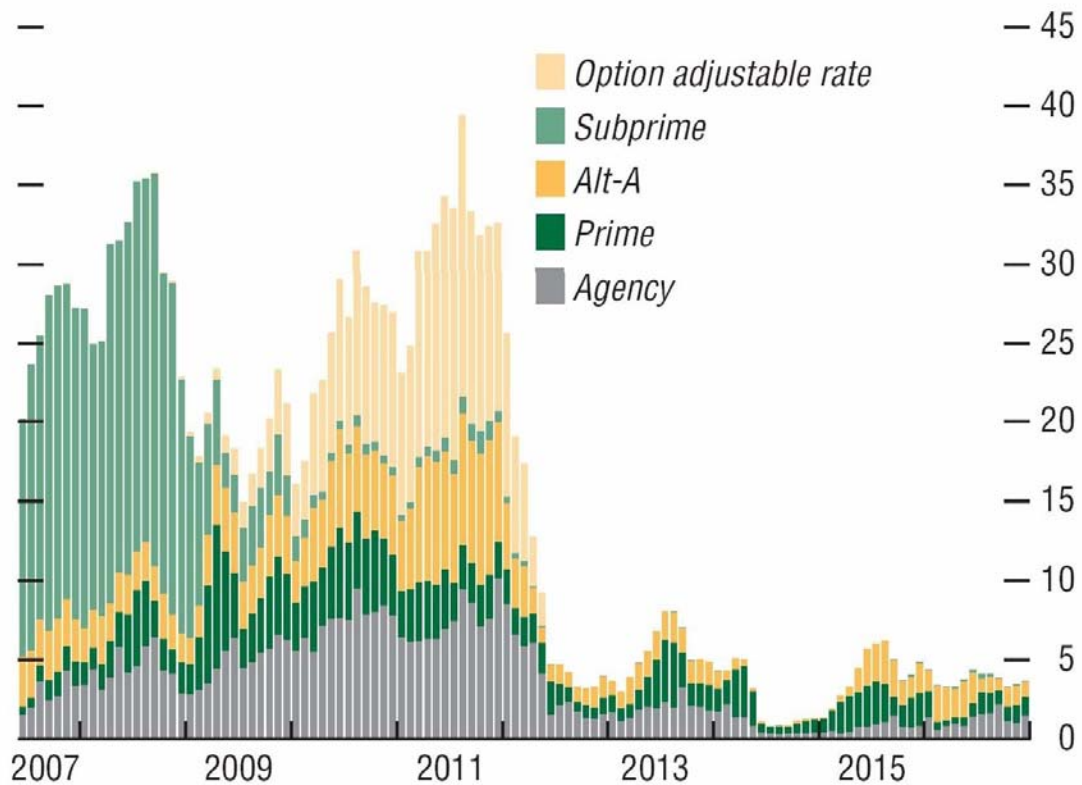
### **The negative effects of subprime foreclosures are spreading.**

- Nearly 45 million homes NOT facing foreclosure will decline in value by an estimated \$223 billion, with most of the decline hitting in 2008 and 2009, as subprime foreclosures lower the prices of surrounding homes.<sup>32</sup>
- . Because of property devaluations caused by subprime foreclosures, 24 states and 42 counties will lose over \$1 billion each in local house prices and tax bases.<sup>33</sup>
- More than 90 subprime mortgage lenders have gone out of business as of July.<sup>34</sup>
- Up to half of the 450,000 families whose subprime adjustable rate mortgages will reset in the next three months will lose their home in foreclosure.<sup>35</sup>
- Foreclosures cost lenders an estimated \$50,000 per home in processing fees, liquidation-sale price cuts and other costs. "In 2003 this translated into approximately \$25 billion in foreclosure-related costs for lenders alone---well before the 2006 foreclosure spike." <sup>36</sup>

## Subprime foreclosures will rise even higher

Many subprime borrowers will face 40% or greater increases in their monthly mortgage payments once their initial "teaser" rates expire and their fixed interest rates reset into higher adjustable interest rates. According to the international finance firm, Credit Suisse, rate resets on subprime mortgages will peak in 2008, and rate resets on "option" adjustable rate mortgages (which are not typically subprime loans) escalate in 2010 and peak in 2011. These resets will trigger continuing waves of foreclosures that spread negative effects throughout the economy.

**Figure 1.7. Monthly Mortgage Rate Resets**  
*(First reset in billions of U.S. dollars)*



Source: Credit Suisse.

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<sup>1</sup> Federal Reserve Board Chairman Ben S. Bernanke, speech on May 17, 2007, based on FRB adjustments to MBA numbers.

<sup>2</sup> Ibid.

<sup>3</sup> Testimony of Emory W. Rushton, Senior Deputy Comptroller and Chief National Bank Examiner, Office of the Comptroller of the Currency, before the Senate Banking Committee (March 22, 2007).

<sup>4</sup> Ibid.

<sup>5</sup> Ellen Schloemer, Wei Li, Keith Ernst, Kathleen Keest, ‘Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners,’ Center for Responsible Lending (December 2006).

<sup>6</sup> Ibid.

<sup>7</sup> Ibid.

<sup>8</sup> David W. Berson, ‘Challenges & Emerging Risks in the Home Mortgage Business,’ presented at The National Housing Forum, Office of Thrift Supervision (December 11, 2006).

<sup>9</sup> FBR Investment Management (Sept. 28, 2007).

<sup>10</sup> See, e.g., ‘B&C Escrow Rate Called Low,’ *Mortgage Servicing News Bulletin* (February 23, 2005).

<sup>11</sup> Bank of America Securities, ‘MBS/ABS Trading Analytics’ (September 26, 2007) (report generated from Loan Performance, Inc.).

<sup>12</sup> Ibid.

<sup>13</sup> Ibid.

<sup>14</sup> Ibid.

<sup>15</sup> Ibid.

<sup>16</sup> FDIC Chairman Sheila C. Bair in *New York Times* op-ed (Oct. 19, 2007).

<sup>17</sup> Ibid. And special report by the Joint Economic Committee, ‘Sheltering Neighborhoods from the Subprime Foreclosure Storm,’ 2007.

<sup>18</sup> Joint Economic Committee special report, ‘Sheltering Neighborhoods from the Subprime Foreclosure Storm,’ 2007.

<sup>19</sup> Bair, *ibid.*

<sup>20</sup> CRL analysis of the 2006 Home Mortgage Disclosure Act (HMDA) data reported by the Federal Financial Institutions Examination Council, at <http://www.ffiec.gov/hmda/default.htm>.

<sup>21</sup> Ibid.

<sup>22</sup> Statement of Scott M. Polakoff, Deputy Director, Office of Thrift Supervision before the Senate Banking Committee, March 22, 2007; Souphala Chomsisengphet and Anthony Pennington-Cross, ‘The Evolution of the Subprime Mortgage Market,’ *Federal Reserve Bank of St. Louis Review*, Jan./Feb. 2006.

<sup>23</sup> Federal Reserve Board Chairman Ben S. Bernanke, speech on May 17, 2007, based on FRB adjustments to MBA numbers.

<sup>24</sup> CRL calculations based on MBA Delinquency survey.

<sup>25</sup> National Delinquency Survey, Mortgage Bankers Association, ‘National Delinquency Survey,’ (2<sup>nd</sup> Quarter 2007).

<sup>26</sup> Ibid.

<sup>27</sup> See, e.g. David W. Berson, *Challenges and Emerging Risks in the Home Mortgage Business: Characteristics of Loans Backing Private Label Subprime ABS*, Presentation at the National Housing Forum, Office of Thrift Supervision (December 11, 2006). According to MBA data, there was a 69.2% penetration rate for prepayment penalties on subprime ARMs originated in 2006. Doug Duncan, *Sources and Implications of the Subprime Meltdown*, Manufactured Housing Institute (July 13, 2007). A recent CRL review of 2007 securitizations showed a penetration rate for prepayment penalties averaging over 70%.

<sup>28</sup> See Berson, *id.* A recent MBA analysis shows that 97.6% of prime ARMs originated in 2006 had no prepayment penalty, and 99% of 2006 prime fixed rate mortgages had no penalty. Doug Duncan, *id.*

<sup>29</sup> Robert B. Avery, Kenneth P. Brevoort, Glenn B. Canner, ‘The 2006 HMDA Data,’ *Federal Reserve Bulletin* v93 (September 12, 2007).

<sup>30</sup> Ibid.

<sup>31</sup> Ibid.

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<sup>32</sup> “Subprime Spillover: Foreclosures Cost Neighbors \$223 Billion; 44.5 Million Homes Lose \$5,000 on Average,” Center for Responsible Lending Issue Paper (November 13, 29007).

<sup>33</sup> Ibid.

<sup>34</sup> James B. Lockhardt III, “Housing, Subprime and GSE Form: Where are We Headed?” speech at the Exchequer Club of Washington, D.C. (July 18, 2007).

<sup>35</sup> See Christopher Cagan, cited in Ivry, Bob, “Subprime Borrowers to Lose Homes at Record Pace as Rates Rise” (Sept. 19, 2007), Bloomberg, available at: [http://www.bloomberg.com/apps/news?pid=email\\_en&refer=finance&sid=akOEPec30TR4](http://www.bloomberg.com/apps/news?pid=email_en&refer=finance&sid=akOEPec30TR4).

<sup>36</sup> Joint Economic Committee special report, “Sheltering Neighborhoods from the Subprime Foreclosure Storm,” 2007.