NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Testimony of the

National Community Reinvestment Coalition

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Before the House Financial Services Committee

Possible Responses to Rising Mortgage Foreclosures

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Introduction and Executive Summary

Good morning Chairman Frank and Ranking Member Bachus. My name is David Berenbaum and I serve as the Executive Vice President of the National Community Reinvestment Coalition. It is an honor to be here this morning representing Mr. John Taylor, President and CEO of the National Community Reinvestment Coalition, our Board of Directors and as the representative for the over 600 community organizations from across the country that comprise our community based members. We appreciate you convening today's hearing on an issue that all of our members have been both sounding the alarm on and working towards pragmatic solutions for several years.

NCRC is the nation's economic justice trade association dedicated to increasing access to credit and capital for minority and working class families. Over 500 of our members and their affiliates are active in NCRC's foreclosure prevention program. NCRC's members and the "safety net" they represent are quite diverse, yet we all share the common belief that fair lending and community investment – realized through direct service, community development and related social justice activities - promote vibrant communities. Relative to the specific issue of responsible lending and sustaining homeownership, our organizational members 1) support sensible underwriting and work to ensure sustainable loans and celebrate homeownership; 2) challenge the steering of borrowers to abusive loans; 3) work towards accurate and accountable loan servicing; 4) ensure effective rights and remedies for families caught in predatory loans though counseling, advocacy and legal service; 5) preserve essential federal and state consumer safeguards; and 6), reduce foreclosures through assistance to distressed borrowers via participation in NCRC's nationally applauded Consumer Rescue Fund Homeownership Preservation Initiative.

We are on the precipice of a mortgage tsunami of foreclosures unless immediate intervention occurs. The industry has flooded the market with exotic mortgage lending such payment-only Adjustable Rate Mortgages (ARMs), and "hybrid" 2/28 and 3/27 ARMs. Borrowers we counsel every day are overwhelmed when interest rates shoot up after an introductory time period. According to the FDIC's testimony at a previous Senate hearing, interest rates are due to rise for borrowers of one million subprime loans in 2007 and another 800,000 next year.[1] As a result of the abusive lending, the nation is experiencing record foreclosure rates and more than 14% in outstanding subprime loans were delinquent by the end of 2006.[2]

Market failure is rampant and all stakeholders, industry and government alike, are collectively responsible for this failure. The lending industry has created a system in which no one is accountable when the tsunami hits borrowers. Brokers and lenders quickly sell loans into the secondary market. The secondary market has precisely

[1] "Regulators are Pressed to Take Tougher Stand on Mortgages," by Gregg Hitt and James R. Hagerty, Wall Street Journal, March 23, 2007

[2] "Subprime Defaults at Recession Level, FBR Says," Bloomberg News reproduced in the American Banker, February 5, 2007; "Regulators are Pressed to Take Tougher Stand on Mortgages," by Gregg Hitt and James R. Hagerty, Wall Street Journal, March 23, 2007.

diversified risk to the point where no one investor loses significant amounts, even when foreclosures spike. Too many servicers, appraisers, and foreclosure legal specialists have also figured out how to profit from abuses in the dangerous game of mortgage monopoly. The federal government holds ultimate responsibility for allowing the mortgage market to spin out of control.

An immediate fix for the broken marketplace is to stop foreclosures before they further devastate communities and the economy. An important tool is foreclosure prevention efforts and rescue funds.

The focus of NCRC's testimony today will be the success and challenges experienced with our nationally acclaimed Consumer Rescue Fund (CRF). Our intent will be to share how rescue funds operate and how they can play a role in stemming a foreclosure crisis.

NCRC was the first national organization to create a national remedial loan program, and the proof of our success is the excellent dialogue and track record that we have in amicably resolving matters among lenders, servicers, and our community based membership and consumers. In fact, two thirds of the loans that we receive are resolved through direct negotiation with the existing note holder or servicer. This requires extensive file review and interaction with local housing counseling and credit organizations, whom NCRC funds to provide these services.

These direct services are further complimented by our CRF training programs coordinated with the Freddie Mac Don't Borrow Trouble Initiative, our own NCRC Training Academy and numerous other counseling organizations on a national, state, and local level. Further, close to 50% of consumers contact NCRC directly through our website – www.fairlending.com or due to press surrounding the issue. NCRC also works closely with Neighborworks and the National Federation of Consumer Credit Counseling Agencies.

Since its inception, NCRC's rescue fund has assisted over 5,000 consumers, including over 1,600 victims of predatory lending and/or servicing. We have reduced loan payments by an average of $276 per month, reduced interest rates from an average 9.6% to 5.7%, and we have saved consumers over $100 million in equity or fees. We have successfully intervened and have stayed or prevented over 1,000 foreclosures. This year, NCRC will bolster the CRF program by establishing a Community Development Financial Institution (CDFI) that will offer rescue refinance loans.

Recently, we have become focused on the issues of law firms that act as foreclosure mills, profiting from consumer hardship and rushing consumers to homelessness, even as we try to negotiate forbearance agreements for consumers who can afford to stay in their homes. This greed in the legal system as attorneys represent investors or servicers is one of the reasons that we support stronger servicing protections and a foreclosure "stay" that will be discussed further in my testimony.

NCRC has found that the CRF consumers are disproportionately minority and working class Americans who have suffered from multiple abuses committed at all stages of the lending process. Many of these consumers are facing hardship or foreclosure through no fault of their own – simply because they were steered to an inappropriate loan product based on the advice of mortgage professionals. When interest rates increased in 2006, the demographics of consumers began to change as more consumers who were predominantly middle income became concerned about "payment shock" issues. This mortgage tsunami will only gain strength as interest rates rise. We must use this calm in the storm to offer remedial loans now.

Our testimony will include a number of case studies, such as a hard-working African American couple, the Wests, who took out a refinance loan to consolidate debt and ended up with unaffordable mortgage payments due to abusive underwriting that inflated their incomes and put them in a 2/28 ARM loan and a piggyback loan at a 13% interest rate. The CRF program has encountered 27 abusive practices and loan terms described in the testimony. Considering that several abuses appear in each and every CRF case, the clear conclusion is that bad loans are responsible for the looming mortgage market crisis, not irresponsible consumers. Regulatory oversight, or the lack thereof, clearly plays a role in the volume of bad loans originated. It is an unfortunate truth that the media has served as a more effective "watchdog" on this issue then the regulators.

The CRF program has been valuable in informing policy and best practices. A few years ago, NCRC's documentation of abuses on ARM loans in the CRF program convinced the Office of Thrift Supervision (OTS) to disallow state-chartered thrifts and mortgage companies from ignoring state limits on prepayment penalties as applied to adjustable rate mortgages. More recently, appraisal fraud documented by the CRF program propelled NCRC and industry leaders to create a Center for Responsible Appraisals and Valuations.[3] Lenders, appraisers, and other industry partners agree to an ethical code and also agree to submit disputes regarding fraudulent appraisals for arbitration. The alternative dispute resolution of the Center promises to expeditiously settle cases of appraisal fraud and to promote industry-wide changes in practices, for example by establishing best practices and avoiding thousands of foreclosures in the area of sub-prime fee based servicing.

NCRC CRF specialists have become extremely adept at negotiating the traps and tricks of abusive servicers and foreclosure attorneys. CRF staff report, however, that increased Congressional attention would be very valuable in putting the industry on notice and increasing their willingness to work out problematic loans. In addition, a national source of financing for rescue funds would assist the CRF program and other community-based rescue programs to significantly increase the numbers of consumers rescued.

[3] See http://www.responsibleappraisal.org/.

NCRC is extremely proud of the work of the CRF in saving the homes of hard-working Americans. At the same time, however, the dimensions of market failure are too pervasive to rely upon loan rescues as only way out of this looming mortgage crisis, although a national rescue fund is imperative. NCRC therefore urges Congress and the regulators to take a series of additional steps: 1) Congress must pass a strong national anti-predatory law, 2) the regulatory agencies must quickly implement their proposed guidance on subprime lending, 3) Congress must enact a stay on foreclosures, and 4) Congress and the Administration must re-tool the FHA program so that it can also serve to rescue thousands of families from foreclosure.

Contrary to the claims of some, the market will not work its way back to "equilibrium." Others have suggested that foreclosures and the "contagion" in the subprime market will not spread to the broader mortgage marketplace. These assertions, however, ignore the fact that millions of borrowers in both the prime and subprime market have been afflicted with exploding ARM loans and that entire suburban and urban neighborhoods have also been devastated by high foreclosures and inflated appraisals. The contagion will spread much quicker and impact the economy faster than laissez faire proponents realize. In order to stop the contagion, strong and comprehensive legal, regulatory, and programmatic changes must occur swiftly.

NCRC calls on stakeholders to do the following:

Enact a Strong Anti-Predatory Law – Abuse is widespread in all stages in the loan process from the broker, loan officer, appraiser to the servicer and secondary market actors. Certain terms and conditions are inherently abusive such as mandatory arbitration, onerous prepayment penalties, and single premium credit insurance. In order to stop the wave of foreclosures, a strong national law is needed to halt the abuses in the origination and servicing of loans. Financial penalties must be swift and certain in order to prevent the evasion of accountability by the various segments of the lending industry. NCRC calls on Congress to enact a strong anti-predatory law building upon the best state laws.

Implement the Proposed Regulatory Guidance – The proposed subprime guidance issued by the federal regulators is necessary but not sufficient as a means to stem the exotic and toxic mortgage lending plaguing American neighborhoods. Lenders must underwrite ARM subprime loans at their fully indexed rate, not the initial lower rate, so that borrowers can afford them. But the proposed guidance only covers a portion of subprime lending conducted by banks. While the Conference of State Bank Supervisors has pledged to persuade states to also apply the guidance to mortgage companies, not all states may do so. In addition, the subprime guidance does not apply to the actions of abusive appraisers, servicers, and secondary market investors. Thus, a national anti-predatory lending law is needed.

Industry Loan Modifications & Servicing Best Practices – NCRC applauds Freddie Mac for adopting the practices outlined in the proposed regulatory guidance on subprime lending. We call upon Fannie Mae and lending institutions to do the same. We also urge the industry to embark upon an aggressive program of secondary review and loan modifications to deal with the millions of ARM prime and non-prime mortgages expected to reset in the upcoming years.

***Stay on Foreclosures* -** In order to assist CRF and other foreclosure prevention efforts, NCRC believes that Congress needs to establish uniform and reasonable time periods for the foreclosure process. Standardization of time periods would be particularly helpful in states with non-judicial foreclosure procedures that often leave borrowers defenseless in their efforts to save their homes from rapid foreclosures. Consumers should receive written notice with a list of HUD certified counseling agencies and legal aid offices in their area before the foreclosure starts and then should receive a stay on the foreclosure proceeding. A stay gives the borrowers who currently have the least ability to find their way to someone to help them work things out with a small window of time. This recommendation does not require any funding and will not impede the market or how it operates.

A stay on foreclosures could be instrumental in helping industry and consumer representatives deal with the millions of loans resetting and then becoming delinquent. A stay provides sufficient time to modify or refinance loans instead of allowing problematic loans to hurtle towards foreclosure.

Some say that remedial loan programs represent a "bail-out." NCRC strongly and affirmatively disagrees with this over simplification of a very complex issue. Lenders, servicers and securizers first and foremost most work with homeowners to restructure or refinance existing loans. Those who have profited at the expense of consumers should not net the proceeds of a problematic loan, for example a home that has been fraudulently over appraised. It is an appropriate government role to facilitate and ensure an effective and efficient mortgage marketplace. Both the public and private sector should be motivated to collaborate to ensure this.

***FHA Rescue Loans* -** FHA should also be re-tooled so that it can offer refinance loans on a large scale to victims of predatory lending. If FHA could offer these loans on a large scale, it could play a vital role in saving American's homes, reducing high delinquency and foreclosure rates, and saving communities from the devastation of widespread foreclosures and property abandonment. FHA should waive its requirement that a borrower be current in their loan payments so that borrowers victimized by deceptive ARM loans will be able to refinance into FHA products. FHA as a rescue tool would not be a bailout to lenders since they would incur significant loses. Members of Congress are seriously considering this proposal and a number of industry representatives are also favorably inclined to it.

A National Rescue Fund - NCRC believes that a national rescue program administered by not for profit organizations modeled on our experience with the NCRC Consumer Rescue Fund Homeownership Preservation Program must be instituted to save families and communities from the devastation of large scale foreclosures. NCRC agrees with Senator Schumer that a national rescue fund is likely to require hundreds of millions of dollars annually.[4] In fact, a national rescue fund may very well need a few billion dollars each year based on the numbers of estimated foreclosures due to predatory lending.

While Senator Schumer suggested public financing of the rescue fund, NCRC believes that the industry ought to bear the costs for cleaning up their mess. One possible model could be the FDIC deposit insurance fund. Each lender in America is charged an annual fee for a rescue fund. The fee is based on the riskiness of the institution's loan portfolio and the number of foreclosed loans in its portfolio. Lenders would therefore have an incentive to eliminate predatory practices since their contributions to a foreclosure fund would decline as the safety and soundness of their loans improves. Another approach would be to apportion a nominal fee at settlement from the parties to the transaction, including the lender, mortgage broker, title company, and consumer as appropriate, to capitalize a fund.

Finally, NCRC agrees strongly with the recommendations of Senators Schumer, Menendez and Brown that nonprofit organizations receive financing from the rescue fund for assisting borrowers (via refinances and loan modifications) and saving their homes.[5] Nonprofit organizations are regarded as trusted advisors and counselors by communities. Community residents are more likely to ask a nonprofit organization for assistance than other entities, including lending institutions and government agencies.

CRA Modernization

At the same time that Congress is enacting an anti-predatory bill, NCRC also believes that Congress must pass the CRA Modernization Act of 2007, or HR 1289. HR 1289 would strengthen CRA as applied to banks and would apply CRA to non-bank institutions including independent mortgage companies. Federal Reserve research has demonstrated that CRA encourages banks to increase their prime lending, particularly in geographical areas in which their branches are located. CRA, therefore, acts to introduce product choice in traditionally underserved neighborhoods, meaning that these neighborhoods are less susceptible to steering and abusive lending.[6]

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[4] Alison Vekshin, Senators Urge Hundreds of Millions in Subprime Aid via Bloomberg.com, last accessed April 11, 2007.
[5] Bloomberg.com article, op cit and Joint Economic Committee, *Sheltering Neighborhoods from the Subprime Foreclosure Storm,* April 11, 2007.
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[6] Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, *Higher-Priced Home Lending and the 2005 HMDA Data* in the Federal Reserve Bulletin, September 2006.

NCRC's Consumer Rescue Fund

Mechanics of the CRF Fund

Through the national anti-predatory lending Consumer Rescue fund (CRF), NCRC works with victims of predatory lending so their mortgage payment becomes more affordable and foreclosure can be avoided. NCRC's member groups and their communities are an integral part of this program. The CRF identifies consumers who are in predatory mortgages and fixes the mortgages through mediation with lenders or arranging for refinance loans.[7] Consumers contact NCRC member organizations participating in the CRF program. In a number of instances, the NCRC members in the CRF program are counseling agencies assisting consumers experiencing delinquency and default on their loans.

The consumers are families occupying their residences. CRF does not assist investors or consumers experiencing difficulties paying off mortgages on their vacation homes. Qualifying consumers are assisted free of charge. To date, over 5,000 consumers have been helped through the CRF's alternative dispute resolution, mediation, consumer counseling and financial education.

NCRC and over 30 participating member organizations in Arizona, Ohio and New York launched the CRF initiative in October 2001 to help victims of predatory loans and/or individuals at risk of foreclosure. Today, the CRF has a nationwide reach, serving consumers in 17 states. NCRC member organizations (counseling agencies, Community Development Corporations, fair housing organizations, and others) identify families facing foreclosure and/or bankruptcy as a result of problematic loans.

Each of these agencies, every day, hear the cries for help; witness the misery of people, so near their aspirations, topple back into poverty, trying to cling to their homes. We see the threatened neighborhoods, pocked with empty and boarded-up houses; we can attest to the hardship and sadness that either hardship or a problematic loan has wrought.

Therefore, in the face of the growing mortgage crisis created by market concerns about the performance of non-prime non-traditional mortgage products, the role of the CRF or equivalent programs as a mechanism to sustain homeownership, prevent foreclosure, and give consumers a fresh start could never be more critical. To that end, NCRC has created a "safety net" made up of community based organizations in urban, suburban and rural communities across the nation. These include a diverse group of HUD certified counseling agencies, CDFI's and CDE's, fair housing organizations, CRA coalitions, CDC's and counseling agencies ranging from legal service providers to our network of

[7] HSBC North America provides refinance loans for the CRF program and supports CRF counseling. Other sponsors of the CRF program include Select Portfolio Servicing, Inc, the Ford Foundation, Freddie Mac, The Fannie Mae Foundation, Fannie Mae, The JP Morgan Chase Foundation, and The Heron Foundation.

member organizations in key markets, including the AARP, the NAACP, and Freddie Mac Don't Borrow Trouble initiative, in addition to the aforementioned groups.

Fair lending specialists at NCRC review loan documents including the Good Faith Estimate, income verification statements, and other forms in order to determine if the loans are in fact predatory. If NCRC staff conclude that the loans are predatory or problematic, NCRC staff pursue a number of options.

CRF intervenes in the following manners to turnaround a predatory lending situation:

- *Mediation and Loan Modification* – NCRC will engage in mediation with the lender or servicer to have abusive terms eliminated and to delay or stop foreclosure proceedings. Mediation is an effective means of assisting consumers since it is less time consuming and resource intensive than refinancing a problematic loan. Also, in a number of cases, a lender will seek to remedy an abusive loan and thus save the costs associated with foreclosure and other legal action. Lenders themselves have often been victimized by unscrupulous brokers or aberrant loan officers who have made abusive loans.

- *An affordable refinance loan*. NCRC has partnered with HSBC North America, which refinances the loans of predatory lending victims. The predatory loans are replaced with market-rate or below market-rate loans. The new loans also do not contain prepayment penalties, balloon payments, or credit insurance.

- *Litigation and/or Regulatory Complaints:* If NCRC discovers a pattern and practice of abusive lending or servicing on the part of a financial institution, NCRC will pursue legal redress when necessary. NCRC has filed complaints with the Department of Housing and Urban Development (HUD) arising from systematic abuses uncovered by the CRF program. The complaint process often ends before a formal trial when a lender makes a commitment to change an underwriting or marketing practice.

It is important to note that though the CRF frequently renegotiates loans with the existing note holder or servicer, we also counsel the consumer regarding their rights and options, including potential regulatory enforcement of civil complaints. We also caution borrowers regarding waiver forms that lenders often require. These release forms are a significant impediment in many cases to consumers avoiding foreclosure. Requiring consumers to waive their rights or keep their home is an unacceptable "catch twenty two."

The decision about how to assist borrowers with loan modifications or refinances occurs after an initial analysis of a borrower's situation. During the intake process, CRF staff evaluate a borrower's income and ability to repay. For example, a borrower with limited and fixed incomes and with 2/28 ARM loans and/or some other exotic mortgage will generally need a rescue refinance loan. In contrast, loan modifications are possible for consumers with steady incomes in the prime of their working lives.

The decision to arrange for a loan modification or refinance also depends on the loan's characteristics. An abusive term such as a prepayment penalty that matches or exceeds the reset time period can often be dealt with through a refinance. In contrast, a loan modification can effectively make a loan more affordable by reducing the rate or loan margin.

As well as re-negotiating loan terms and conditions, CRF staff negotiates over loan amounts in some cases. NCRC will negotiate with lenders to help customers whose appraisals have been inflated or whose mortgage debt are greater than their homes' worth because of predatory loans. NCRC will also attempt to have part of the loan forgiven.

CRF staff report that the industry has become more amenable to loan modifications. As more ARM loans have introductory rates re-setting to higher rates, lenders have realized that they do not want to lose customers' business. Recently, CRF staff have executed many more loan modifications than refinances.

As Wall Street plays a larger and larger role in securitizing portfolios, it is our experience to date with loan servicers that loans generally fall into three categories. The first category is cases when the servicer cannot modify the loan in any way without securitzer approval. The second case occurs when the servicer can modify within set parameters that are part of the securitization or special purpose vehicle. The third case is when the servicer has great latitude. Because most loans today are securitized, it demands that both consumer advocates and lenders actively review and discuss files to ensure that we continue to sustain each family in their home.

As these practices become institutionalized by servicers and securitizers alike, we will be able to act proactively to address the foreclosure problem. For example, many lenders and servicers that the NCRC CRF has discuused these issues with are proactively reaching out to mortgage holders who have HELOC's, ARM's, and other non-traditional mortgages to assess if the consumer is interested or better served by a loan modification or refinance to sustain homeownership. This is a positive development. For those loans that require securitizer approval for the modification, it certainly makes sense to modify a loan rather then to foreclose upon it. Any policy activity in this area will also have to examine the tax implications for securitizer and homeowner alike.

The CRF program operates on a first come, first serve basis expect in the case of impending foreclosure. CRF staff prioritize the cases of borrowers receiving foreclosure notices and are usually successful in negotiating a stay of 60 days. This time period has been effective in resolving the foreclosure situation and rescuing the borrower.

Another critical component of the CRF program is financial education and credit counseling that occurs over a period of several months. NCRC staff and member organizations counsel CRF borrowers through the remediation process and coach them on how to avoid predatory lending situations in the future. The counseling occurs before the loan modification or refinance and continues after an intervention to make sure borrowers can succeed in their new loan.

NCRC also has an early default and delinquency process. Once every two weeks, HSBC North America provides NCRC with a list of CRF borrowers that have just fallen behind on their payments. A CRF fair lending specialist will then work with these borrowers in early delinquency. The early intervention has been effective. CRF staff have negotiated temporary work-outs and forbearance of payments for a few months. Another arrangement has been adding delinquent payments to the outstanding mortgage amount. For the continued success and expansion of programs like CRF, early delinquency intervention and post loan counseling is necessary.

The CRF program will mediate loans made in any state. Refinancing services are currently available in the following 17 states: Alabama, Arizona, California, Florida, Georgia, Illinois, Indiana, Maryland, Massachusetts, Nevada, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, Texas, and Wisconsin. This year, with support from a growing list of sponsors and new product offerings, the program will be available nationwide.

CRF's Success: At Least $100 million in Equity Saved

The refinance loans of the CRF program have saved borrowers and their communities millions of dollars. In a sample of 112 cases, the median principal amount of the loans was approximately $157,000. The mortgage rates of the previous predatory loans ranged between 5.5% and 17%. The median prior mortgage rate was 9.38%.

Analysis of loan terms before and after refinance

	Principal Amount	Prior Mortgage Rate	New Mortgage Rate	% points difference	Old Monthly Payment	New Monthly Payment	$ Savings
Average	$156,986.2	9.58%	5.74%	3.84%	$1,198.4	$922.0	$276.5
Median	$161,280.4	9.38%	6.00%	3.38%	$1,165.8	$941.7	$224.1

The interest rates of the refinance loans were considerably lower than the rates of the previous predatory loans. The new loans had interest rates ranging between 1% and 8%. The median rate of the new refinance loans rate was 6.00%. The difference between the median rate of the previous loans (9.38%) and the new loan (6%) was 3.38 percentage points, which results in substantial amount of equity saved over the life of a loan.

CRF customers have been able to save millions of dollars of wealth by refinancing out of abusive loans. The average monthly payment was $1,198 for the abusive loans. For the new refinance loans, the average monthly payment was only $922. As a result of the refinancing, the average monthly savings was $276.50, which equates to $3,318 annually. Assuming a 30 year loan term, the total savings on an average loan would be $100,000. Given that the CRF program has assisted at least 1,000 victims through either refinancing or loan modifications, the program has saved borrowers approximately $100 million in equity.

Influencing Best Practices and Public Policy

While offering invaluable help to several thousand consumers and families, the CRF program has also achieved a national impact by influencing industry-wide practices, reforms, and federal policy. NCRC and our lending institution partners have gained much knowledge about predatory lending that has provided insights into needed reforms. Through dialogues between community groups and lending institutions, the CRF program has contributed to a consensus regarding which products and practices should be discontinued and others that should be limited.

One important area of influence has been the servicing of high-cost subprime loans. CRF consumers have encountered a number of abuses in the servicing of their loans including force-placed insurance and the on-time payments not being recorded by servicers. After encountering widespread abuses of this nature, NCRC challenged fee-based servicers to reform their practices. These discussions with servicers also influenced the federal guidelines on servicing that were developed by the Federal Trade Commission a few years ago.

In 2002, the Office of Thrift Supervision (OTS) proposed changing its regulation implementing the Alternative Mortgage Transaction Parity Act (AMTPA) to prohibit state-chartered thrifts and mortgage companies from ignoring state law regarding prepayment penalties and late fees as applied to adjustable rate mortgages and other types of so-called “alternative” mortgages. Using a sample of CRF loans, NCRC was able to document onerous prepayment penalties and abusive fees levied by these lenders. When the OTS issued its final rule prohibiting state-chartered institutions from evading state law on prepayment penalties and late fees, the OTS cited NCRC’s evidence of abuses culled from the CRF program.[8]

More recently, the CRF program, as documented below, has uncovered a pattern of appraisal fraud. The CRF cases and other research of widespread abuses lead NCRC and

[8] Federal Register, September 26, 2002 (Volume 67, Number 187), pages 60542-60555, see footnote 28 which specifically references data collected from the CRF program.

industry partners to establish a Center for Responsible Appraisals and Valuations.[9] Lenders, appraisers, and other industry partners agree to an ethical code and also agree to submit disputes regarding fraudulent appraisals for arbitration. The alternative dispute resolution of the Center promises to expeditiously settle cases of appraisal fraud and to promote industry-wide changes in practices when a critical mass of industry stakeholders participate in the Center.

In addition, the CRF program continues to document the role of abusive brokers. CRF staff indicate that the majority of predatory loans in the CRF program are loans involving brokers. The fee packing and targeting of minority customers in the CRF program suggested that brokers were involved in questionable loan practices. Under a Department of Housing and Urban Development (HUD) grant, NCRC's fair housing staff conducted paired testing in order to determine if the CRF cases indicated patterns and practices of abusive behavior. The testing revealed pervasive discriminatory and predatory practices by mortgage brokers in six metropolitan areas across the country. Between February 2005 and June 2006, NCRC conducted over 100 tests in Atlanta, Georgia; Baltimore, Maryland; Chicago, Illinois; Los Angeles California; St. Louis, Missouri and the Washington, D.C. metro areas. The tests found that brokers quoted different interest rates and fees on the basis of race and steered African-American consumers to more expensive subprime products. The testing project lead to the filing of a civil rights complaint with HUD against Allied Home Mortgage Capital Corporation, the nation's largest privately held mortgage broker/banker.

CRF Finds that Minority and Working Class Americans Targeted with Loans Containing Multiple Abuses

A NCRC review of CRF cases indicate that abusive lenders are targeting minority and low- and moderate-income borrowers and communities with high cost and exotic mortgages.[10] The graph and chart below reveal that a disproportionate number of CRF customers are people of color and have modest incomes. About 77% of the borrowers in the CRF sample were African-American. Almost half (47%) resided in low- and moderate-income neighborhoods and 83.6% of the borrowers had incomes below $45,000. The findings that CRF customers were mostly minority and low- and moderate-income is consistent with NCRC's research and other studies documenting that a disproportionate amount of high cost lending is directed towards minority and working class communities. Traditionally underserved communities suffer from less product choice and consequently are more susceptible to abusive high cost and exotic mortgage lending.

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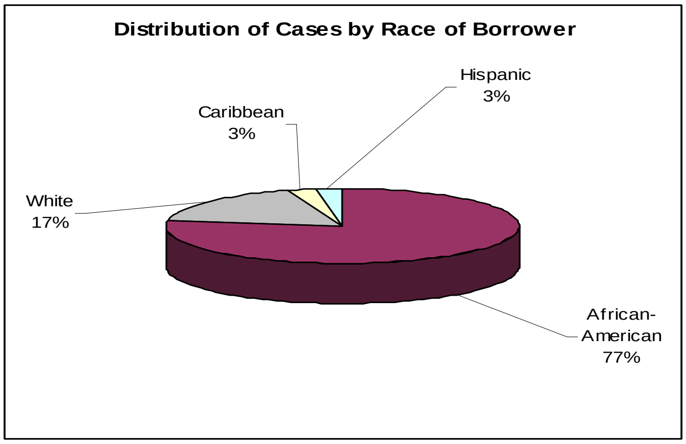
[9] See http://www.responsibleappraisal.org/.

[10] For more detail about the CRF fund, see the report by NCRC and the Woodstock Institute, *Asset Preservation: Trends and Interventions in Asset Stripping Services and Products*, September 2006, at http://www.ncrc.org/policy/analysis/policy/2006/2006-09_LifetimeOfAssets_NCRC-WoodstockPaper.pdf

CRF Cases by Race of Borrower



Distribution of Cases by Income of Borrower

Income of Borrower	Number	Percent
less than $15,000	6	9.84%
$15,001-25,000	14	22.95%
$25,001-35,000	16	26.23%
$35,001-45,000	15	24.59%
$45,001-55,000	5	8.20%
$55,001-65,000	2	3.28%
$65,001-75,000	1	1.64%
$75,001-85,000	2	3.28%
Total	61	100.00%

Multiple Abuses in Exotic and High-Cost Loans in CRF Sample

Minority and working class borrowers confront an array of predatory abuses described in the graph below. The CRF cases also reveal that predatory loans do not usually contain just one or two abusive terms and conditions. More often, a toxic loan in the CRF program contains several abusive features including ARM loans with lax underwriting considering only the initial rates, exaggerated borrower incomes, payments that borrowers cannot afford, exorbitant fees and yield spread premiums, piggyback lending adding excessive debt, and abusive servicing.

While some abuses have declined in recent years such as prepaid credit insurance, most loans in the CRF program have multiple abuses confronting borrowers with loans that they can no longer afford and loan terms they can no longer negotiate. If the loans had just one or two abuses, it would be easier for the borrower to either afford the loan or succeed in modifying the loan with the lender. The multiple nature of the abuses, however, suggest that the predatory lender or broker maximized profit by designing a loan that was destined to fail or to be flipped.

The abuses revealed by the CRF program include the following:

Abuses	**Description**
asset-based lending	Lenders evaluate a loan application by looking only at the quality of the security or equity, and not at the ability of the borrower to repay the loan
forced placed insurance	Servicer assigns hazard insurance to borrower, coverage is usually much more expensive
HOEPA loan	A loan with a very high interest rate and/or fees that is covered by federal consumer protections. Predators violate the legal protections of HOEPA loans.
Mandatory arbitration	Stipulation that a borrower cannot sue a lender in a court of law, but must use an arbiter
prepaid credit insurance	Insurance financed into the loan that would cover mortgage payments in a case of disability, unemployment, death. Much more expensive than paying monthly outside of loan
abuse of right to cancel	Abusive practices that make it hard for a consumer to cancel a mortgage (ie. abusing right of rescission)
abusive collection practices	Aggressive tactics of collecting late payments
default interest rate	Increasing interest rate in case of delinquency
excessive prepayment penalty	Excessive fee for paying off a mortgage before its maturity
insincere co-signers	Adding insincere co-signers to the application in order to inflate the income of the borrowers. Abusive lenders will add children and other insincere co-signers who cannot contribute to loan payments.
loans made in excess of 100% LTV	When the loan amount exceeds the fair market value of the home
negative amortization	Loan product that requires a monthly payment that does not fully amortize a mortgage loan, thereby increasing the loan’s principal balance
flipping	Persuading a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced
fraud	Example: Forging signatures on loan documents
lack of TNB	Lack of tangible net benefits that justify the origination of a new, higher-balance and high-cost loan

targeting/discrimination	Cases when lenders specifically market predatory loans to customers based on race, ethnicity, or age
predatory appraisal	Overestimating the market value of the house
balloon payment	A mortgage that has level monthly payments over a stated term but which provides for a large lump-sum payment to be due at the end of an previously specified term
equity stripping	A case when a homeowner's equity is reduced due to repeatedly refinancing, high fees, and other abuses
home improvement scam	Home improvement costs financed into the mortgage usually paid by a lender to a home improvement contractor directly.
misrepresentation	Misrepresentation of loan terms to a borrower
falsified application	Falsifying loan applications (particularly income level or adding insincere co-signers, etc.)
Stated income	Not requiring full documentation of income from tax forms and paystubs. Reduced documentation or stated income loans increase the chances of fraud.
yield spread premium	Fee paid by lenders to brokers for loans carrying interest rates above a par rate
abusive servicing practices	Servicers not recording payments, force placing insurance, applying high late fees, etc.
unfair terms	High interest rates and loan terms not justifiable by risk (consumer's credit score)
fee packing	Charging undisclosed, improper, and high fees

The sum total of the abuses equals loans that are considerably beyond borrower repayment ability. A sample of 69 CRF cases included calculations of the monthly housing payment-to-income ratio (front-end ratio) and the monthly total debt-to-income ratio (back-end ratio). The front-end and back-end ratios of the predatory loans in the CRF sample were considerably higher than common limits in standard underwriting guidelines. The median front-end ratio was 35.4%. The median back-end ratio was about 50% as shown in the graph below. Standard front-end and back-end ratios for prime loans are 28% and 36%, respectively. The considerably higher ratios of the predatory loans in the CRF sample suggest that the loans were beyond the consumers' abilities to repay, leading to financial distress and/or bankruptcy and foreclosure.

CRF Cases **Unaffordable Loans**

Debt-to-income Ratios

	Front-end Ratio	**Back-end Ratio**
Average	40.77%	50.28%
Median	35.43%	49.78%

Compounding the high front- and back-end ratios was the fact that most of the loans in the CRF sample did not have escrows covering property tax payments and hazard insurance. Two thirds of the borrowers in the CRF sample did not have escrow accounts. On top of housing payments and debt levels that were unsustainable, a number of the CRF borrowers experienced payment shock when they discovered that they had thousands of additional dollars in taxes and hazard insurance payments that were not covered by the loans.

The case studies in the appendix illustrate the multiple abuses on the CRF loans, and how predatory lenders and brokers take advantage of hard-working Americans who are striving mightily to achieve or preserve their American Dream of homeownership. The case studies reveal that aggressive "push-marketing" by predators result in consumers receiving loans that are unaffordable and unsuitable, when tragically an appropriate product would have worked fine.

Removal of Barriers and Expansion of CRF Program

Expansion of the CRF program is clearly desirable and is a goal pursued vigorously by NCRC. Yet, expanding the CRF program is not a simple matter. Expanding a foreclosure prevention program involves the removal of barriers in assisting borrowers and additional sources of financing.

A significant barrier is the difficulties negotiating with abusive servicers and lenders that are rushing to foreclose upon victims of predatory lenders. "Foreclosure mills" are law firms specializing in the quick foreclosure of victimized families. NCRC's experience is that foreclosures can be rapid in states with non-judicial foreclosure procedures. Since a large number of attorneys in foreclosures proceedings are motivated by fees associated with foreclosure, they are not usually interested in dispute resolution. Consequently, when CRF staff contact these attorneys, CRF staff usually do not engage in discussions with attorneys handling the foreclosures but instead ask the attorneys for the names of the lenders involved.

Servicers are also slow to respond to pressing requests to solve disputes. They take their time in providing payment histories. The documents of payment histories are often obscure on purpose so that borrowers and their representatives cannot interpret the payment histories.

Another obstacle confronted by the CRF program is concentration of risk faced by participating lenders. Lending institutions are assuming significant risk in a CRF program since loans often involve moderate to deep subsidies to borrowers with damaged credit. In order to mitigate risk in the program, the CRF program has incorporated early delinquency intervention for CRF borrowers as mentioned above.

A method for mitigating risk is to encourage the participation of more than one lending institution in the program. At this point, HSBC North America is refinancing the entire mortgage. The CRF program originally arranged refinance loans with loan-to-value ratios as high as 100%. Now, the program uses 85% loan-to-value ratios as the underwriting guideline, with some exceptions made on a case by case basis. In order to be most effective in reaching consumers in need, it would be desirable to secure the participation of more than one lending institution in the program. Other lenders could take on second mortgages and/or provide grants so that the loans and grants could once again provide for 100% loan-to-value ratios. The involvement of two or more lenders would therefore mitigate risk and serve a greater pool of borrowers.

NCRC's CRF program will continue to evolve in ways that can most efficiently serve the overwhelming needs for intervention. The CRF program, for example, will expand upon home preservation counseling, that is, counseling that is offered to borrowers after they have purchased their homes and/or have started experiencing trouble making payments. This type of counseling can save an enormous amount of time and resources, since borrowers in trouble often do know they can attempt to voluntarily work out a solution with their lender or servicer, whether it is forbearance of payments or modifying loan terms. CRF staff also recommend that more attention should be focused on home preservation counseling in general. Most counseling is still directed at buying a home rather than maintaining homeownership after purchasing a home.

Later this year, NCRC hopes to establish a Community Development Financial Institution (CDFI). The CDFI will engage in home and small business lending, and an important component of the CDFI will be to offer rescue loans and soft seconds, which are often needed by borrowers. It is hoped that the CDFI will be capitalized by several lenders, who are motivated to solve the foreclosure crisis and who will also be receiving points under the Community Reinvestment Act (CRA) for financing the CDFI.

Testimony Appendix

CRF Case Studies

Case Study 1 – Miami, Florida: Steering into Over-Priced and Unsuitable Loan, Fasifying income, Stated-Income and Exotic Mortgage Loan

In January of 2006, Ms. Jean-Simon of Miami, Florida was seeking to become a first-time homeowner. She had a good credit score of 747, and she had a modest income of $3,200 per month. She was a hard-worker, holding a full-time job at the University of Florida and two part-time vendor jobs at local sports stadiums. Incredulously, her mortgage broker pressured her to not use a first-time buyer program through Miami Dade County or other government programs. She was told these programs "take too long" and "require too much paperwork"

The broker falsified Ms. Jean-Simon's income to $5,000 per month. In other words, her income was exaggerated by 56%. The total loan amount was for $170,000 and was financed at 100%. Her first loan was an option ARM (four payment options, with the lowest being "negative amortization"). The maximum rate on the option ARM was 9.95%. To make matters worse, she had a piggyback loan, which was a line of credit with a maximum rate of 11.75%. Because her income was falsified, she could only afford the minimum payment. Therefore, she was increasing her principal balance through negative amortization.

Case Study 2 – Trevose, Pennsylvania: High Broker Fees, Steering, 2/28 ARM, Abusive Servicing

Sixty-nine year old Gladys Christian refinanced her home twice in her 31 years of homeownership. She used her cash equity from both transactions to pay for a car and to make home improvements. The second refinance, however, presented Ms. Christian with more problems than benefits. Ms. Christian's loan settled at the cost of over $10,000 in broker and third party fees, and also generated high monthly payments. Despite Ms. Christian's good credit history, she was qualified for an 8.9% two-year fixed, twenty-eight year adjustable rate mortgage that could climb as high as 15.90%.

Even though Ms. Christian was retired, she used her 33 years of experience in nursing to continue provide nursing services for the elderly. She used this income along with her pension and Social Security payments to keep up with her payments in order to avoid serious delinquencies on her loan. She only called Legal Aid of Southeast Pennsylvania for assistance when she became ill, missed a payment, and struggled to manage this delinquency with her lender's servicer. Rather than work out a forbearance plan, her lender and servicer initiated foreclosure proceedings.

Case Study 3 – Belgium, Wisconsin: Falsified Income, Hybrid ARM, Piggyback Loan, Risk Layering

In September 2006, Duane and April West, a vibrant young African-American couple, contacted NCRC because they could no longer afford their mortgage payments. Although the West's both worked full time jobs (Duane works for Enterprise Rent-a-Car, and April works as a loan closer for a title company), they knew that they were one or two months away from missing their mortgage payments and sinking into foreclosure.

Upon reviewing the West's loan documents, CRF staff noticed the loan had layers of financial risk. First, the West's loan relied on a combined household income that was falsified by 66%. Second, the Wests hoped their refinance loan would pay off their car note, but the loan only increased their indebtedness, left them with an unpaid car note, and not enough funds to pay off any other debt. Third, the two refinance loans were usurious and predatory. The first loan was a two-year fixed, twenty-eight year adjustable rate mortgage combined with a five-year interest only period. The second, piggyback loan was a balloon mortgage with a 13% rate. While severe payment shock was built into these refinance loans, the couple had enough experience to realize that the income falsification was presenting them with unaffordable loans before the reset.

Case Study 4 – Oakland, California: Flipping, high fees, predatory prepayment, stated income loan, ARMs, mortgage payment out of proportion with income.

Ms. Smith is an African-American who bought a home in Oakland, California in December 1999. Her income was $47,328 annually, or $3,944 monthly. She has undergone a series of unnecessary refinances, each of which has added a multitude of duplicative fees and has inflated the amount that she owes.

In December 1999, Ms. Smith purchased her home for $108,000. Approximately nine months later, she underwent her first refinance, which she thought would lower her rate and allow her to cash out a modest amount of money for roof repairs. Instead, this new mortgage for $140,250 stripped equity by paying off a prepayment penalty without her knowledge. Further, the Good Faith Estimate for this transaction also shows that Ms. Smith was to be charged lender and broker fees of 5.76 points (5.76 percent of the loan, or $8,076), an amount much greater than typical prime fees of 1 percent of the loan amount. Also, Fannie Mae and Freddie Mac have pledged not to purchase loans with fees exceeding 5 percent of the loan amount, and 5 percent is often the threshold in anti-predatory lending laws, triggering additional protections.

In August 2001, less than a year after her first refinance, Ms. Smith refinanced a second time. The new loan for $187,500 was adjustable and carried a three-year prepayment penalty. In October of 2003, Ms. Smith refinanced a *third* time, this time a 30-year fixed loan for $240,000. She refinanced for a *fourth* time in July 2004. On this loan, her income was greatly inflated at $6,000 monthly, when it in fact was only $3,944.

Consequently, the monthly payment on this fourth and final refinance was $1,887, which was an overwhelming 47.87 percent of her income.

CRF Encounters Entire Devastated Communities Due to Predatory Loans and Appraisals

In the communities of Staten Island and Long Island, New York, the Consumer Rescue Fund is assisting over 100 New York City police officers and fire fighters who purchased homes from an unscrupulous housing developer and mortgage broker. The broker manipulated the origination system by quickly dumping the fraudulent loans onto the secondary market. For these heroic public employees, the American dream of owning a home has now become their nightmare.

Lastly, but importantly, NCRC's CRF program is intervening in a significant number of cases where borrowers have been victimized by appraisal fraud. A sample of CRF loans revealed that about one fifth of the homes were overvalued by more than 50% of their true value, and two thirds of the homes were overvalued by 15-50% more than their true value.[11] Inflating appraisals leave borrowers with unaffordable loans that they are unable to refinance because the loan amounts are higher than the true value of their homes, especially as the housing market cools in the next few years. The results are too often theft of homeowner wealth, equity stripping, and/or foreclosure.

[11] See NCRC's report, *Predatory Appraisals: Stealing the American Dream*, June 2005, http://www.ncrc.org/responsible-appraisal/pdfs/AppraisalReport.pdf