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Subprime Lending Hurts Homeowners

by Anne Moore Odell

The Center for Responsible Lending contends that subprime lending has led to a net loss in homeownership.

SocialFunds.com -- Not since the Great Depression has the mortgage market faced harder times, asserts a new report from the Center for Responsible Lending (CRL), a non-profit based in Durham, NC. CRL's report, "Losing Ground," follows subprime mortgages from 1998 though 2006 and reports that these mortgages led to a net loss in homeownership in every year studied. Created by Self-Help, one of the nation's largest community development financial institutions, CRL conducts research and helps create policies to protect homeownership.

Foreclosures are rapidly rising as a result of subprime mortgages. Shockingly, more than 36 subprime mortgage companies have failed since the start of 2007. The Federal government is hearing testimony as regulators try to figure out what steps are necessary to stop the failure of subprime loans and to protect consumers from these confusing and often predatory lending practices.

Subprime loans are high-interest rate loans that are offered to people who do not qualify for market rate mortgages. Often, traditional lenders have turned these borrowers away because of low credit ratings or other factors that suggest to traditional lenders that borrowers could default on their loans. The extra percentage points of interest often mean thousands of dollars worth of additional interest payments over the life of the mortgage. Many times, the interest rates start low and then skyrocket, leaving borrowers unprepared to make their payments. African-Americans, Latinos and women are especially negatively affected as they make up a disproportionate share of subprime mortgages.

"Our analysis shows that subprime loans made during 1998-2006 have led to a net loss in ownership for almost one million families," said Mary Moore, CRL Senior Communications Associate. "This analysis includes a conservative projection of foreclosures that have not yet occurred, but even without using projections, subprime loans have led to a net loss in ownership."

"This CRL analysis in combination with other CRL work peels back the myth that predatory lending helps low-income and low-wealth homebuyers by 'democratizing credit,'" Mark Pinsky, President & CEO, Opportunity Finance Network told Socialfunds.com. The Opportunity Finance Network is a network of private financial intermediaries that work to identify and invest in opportunities that assist low-income people in the US.

"The current implosion among predatory lenders is evidence that bad lending produces bad results. Good lending to good people, however, produces good results. A decline in homeownership due to mortgage lending suggests that bad lenders are providing the wrong products," Pinsky added.

The CRL Issue Paper "Subprime Lending is A Net Drain on Homeownership" stresses that the majority of subprime loans do not go toward buying a home. Instead, these loans are used to refinance existing loans. CRL estimates that first-time homeowners make up only 25% of all subprime loans in 2006. 15.6% of subprime loans end in foreclosure, according to CRL.

The National Fair Housing Alliance (NFHA) has been following the subprime mortgage lending scandal as the NFHA helps people to find housing and fight discrimination in the housing market. "In communities like Toledo, where the foreclosure rate has increased by over 400% since 1998, it stands to reason that the onslaught of foreclosures would have a net negative effect on homeownership rates," said Lisa Rice NFHA Vice President.

The Toledo Fair Housing Center conducted an analysis of each foreclosure filing in Lucas County from 1998 through 2003 and was able to map where foreclosures had been filed utilizing a GIS mapping program. "It was clear that a disproportionate number of foreclosures were occurring in predominately African-American and Latino neighborhoods," Rice concluded.

"Early on, it was commonly held that the subprime mortgage market opened up access, serving as a stepping stone to prime loans," CRL's Moore said. "The reality of the modern subprime market is the fact that borrowers rarely, if ever, enter the prime market even if they've made their monthly mortgage payments on time. The subprime market is a refinance market that siphons home equity from families instead of building wealth through affordable and sustainable homeownership."

There are complex reasons why many of the subprime loans are not repaid, ending in people being ejected from their homes. Disregard for whether or not a borrower can afford the loan in the first place and expensive loan products are two major reasons. Negligent underwriting practices are another. The loans themselves involve pages of complex paperwork and many borrowers are unable to fully understand the terms of their loan.

"Keep in mind that the typical sales pitch used to pawn more risky loans off on consumers involved quick peddling, switching terms and conditions at the closing table, and not fully informing consumers of the true impact and nature of the loans they would ultimately be receiving," NFHA's Rice explain. "The consumers that we see in our foreclosure prevention programs were not notified of the impending dramatic increases in their mortgage payments. Many were not even informed that their taxes and insurance would not be escrowed."

Countless homeowners with previously bad credit or low incomes have successfully fulfilled their mortgage terms. Nevertheless, all borrowers and especially borrowers rebuilding their credit need reasonable terms and fees.

On March 27, CRL President Mike Calhoun testified in front of the US House Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit. He recommended that federal regulators tighten requirements on subprime mortgage lending requiring the Federal Reserve Board to step in and strengthen protections or for the Federal Trade Commission to address current abuses. Calhoun also urged policymakers to hold the industry accountable for its actions and to implement a six-month moratorium on starting foreclosures on subprime loans so homeowners can find solutions to their financial situations.

Pinsky spoke to Socialfunds.com about the groundswell among policy makers to protect good consumers who are being hurt by bad lenders and bad loans: "Stronger standards are one step that will mitigate, but not eliminate, predatory lending. I suspect that Congress will find ways both to rein in abusive lenders who masquerade as public-minded creditors and encourage, and reward responsible mortgage lending. It won't be easy and no amount of policy action can remediate the billions of dollars of wealth that predators have stolen from low-income and low-wealth borrowers."

"What we have now in the lending market is a wild, wild west mentality where anything goes as long as the originator can get the consumer to sign on the dotted line," Rice said. "These types of lenders have to be reigned in. This is why it is so important for Congress to pass effective anti-predatory lending legislation."

News is breaking daily on the subprime mortgage failure. New Century Financial Corporation filed for bankruptcy protection April 2, the biggest subprime mortgage lender to date to go under. What this failure in subprime mortgages means for the US economy leaves many wondering and worried. What it means for lower income people has already been made clear—more families kicked from their homes, more communities struggling.