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Subject: Home Ownership and Equity Protection Act

August 18, 2006

Docket No. OP-1253
Jennifer J. Johnson, Secretary
regs.comments@federalreserve.gov.
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Home Ownership and Equity Protection Act Hearings [OP-1253]

Ladies and Gentlemen:

Edgemont Neighborhood Coalition, Inc. wishes to comment on High cost mortgages that could be subject to HOEPA. We are glad that regulators are calling attention to these products which have often been abused by predatory mortgage lenders. However we think that regulators need to take stronger action to prevent abuse.

EDGEMONT NEIGHBORHOOD COALITION, INC.

Edgemont Neighborhood Coalition, Inc. is a nonprofit community organization located at 919 Miami Chapel Road, in Dayton, Montgomery County, Ohio. The group consists of residents of the Edgemont neighborhood, a low-income African American neighborhood in Dayton, who have associated in order to foster pride in their neighborhood and address the issues of crime, youth and adult joblessness, inadequacy of educational opportunities, affordability of utilities, and business and community development.

One issue of importance of the Edgemont Neighborhood Coalition, Inc. has been the availability of affordable financial services in the community. Edgemont has been active in Community Reinvestment Act activities in order that residents have access to mainstream financial services at mainstream prices, and not be relegated to high-cost “fringe lenders” such as payday lenders, “subprime” mortgage lenders, rent-to-own vendors and pawnshops.

In furtherance of these goals, Edgemont has commented on proposed regulations by federal agencies and has appeared as amicus curiae in court cases involving payday lending and predatory mortgage lending. Edgemont has been a party in proceedings in the Public Utilities Commission of Ohio, and has also cosponsored conferences concerning payday lenders and their effects on the community. Edgemont supports the work of the National Community Reinvestment Coalition and of the Community Reinvestment Institute Alumni Association here in Dayton.

In addition to being a community organization, Edgemont Neighborhood Coalition, Inc. functions as a small business, operating an office, community garden and community computer center.

LOCAL CONCERNS

Ohio is the center of the mortgage foreclosure epidemic, Montgomery County, Ohio, where we are located, has lead the state in mortgage foreclosures. Foreclosures are up 250% in six years.

Minority homeowners, particularly women and the elderly, in our community have frequently been the targets of predatory mortgage lending. Predatory mortgage lending is primarily found embedded in the subprime mortgage market. Even when subprime loans do not contain predatory features, their cost appears to be higher than is justified by the increased risk of loss that the lender faces. Freddie Mac also found that a good percentage of people who got subprime loans were eligible for prime loans. These features suggest that credit markets are segregated in practice and this segregation contributes to high loan cost.

Nontraditional mortgage products have been frequently abused in Dayton, particularly variable rate loans with initial teaser rates. These are unsuitable loans for people with fixed incomes, such as most elderly homeowners in our neighborhoods. Other nontraditional mortgage products that have been a problem here are loans with large balloon payments and "spurious open end loans" that do not require payments on principal for the first few years of the loan.

Subprime mortgage lending is more prevalent in minority neighborhoods. A recent study by ACORN found that 23% of all refinance loans to African-Americans in the Dayton/Springfield area were made by higher cost subprime lenders, as opposed to 6% to whites. A study by the National Community Reinvestment Coalition found that African-Americans are more likely to get a subprime loan than whites even if the borrowers' credit scores are the same.

The University of Dayton based study report "Predation in the Sub-Prime Lending marker: Montgomery County – 2001" examined of a random sample of mortgages associated with foreclosure filings and found that a significant minority of sub-prime loans involved with foreclosures exhibit interest rates or other features that are predatory in nature.

Studies from Pennsylvania and North Carolina showed that more than 20% of subprime mortgages will end in the filing of a foreclosure, and most of those will result in loss of a home. Foreclosed homes add to the problem of abandoned properties which blight the neighborhood and contribute to crime.

Minority neighborhoods like ours tend to appreciate less than some suburban areas, and Midwest areas like ours appreciate less than some other parts of the country. Thus while some borrowers can get out of trouble by using their appreciated home value to get a more favorable loan, we can not.

The Federal Reserve Board has found that the median value of financial assets for non-whites is only 1/5 of that of whites. The equity in a family home is the most common financial asset for African Americans. Thus borrowers in our community come to a mortgage transaction at an inherent disadvantage compared to a lender. To the lender, the risk in the transaction is a business risk which it can easily manage by spreading losses over many transactions, improving its servicing, or looking elsewhere for business. Consequences to the lender are comparatively minor. However, to the borrower the home may be her sole major financial investment as well as the center for family life and the social capital that accompanies it.

Unreasonably high cost mortgage loans with predatory features attack the equity in the home, prevent upward mobility and ultimately can result in losing both the home and what the home means to the American dream.

COMMENTS ON NONTRADITIONAL MORTGAGE PRODUCTS

We welcome reexamination of HOEPA. However HOEPA has not provided adequate regulation of high cost loan products.

A problem with regulating predatory mortgage lending is that many mortgage products are suitable for some customers but unsuitable for others. A number of these, such as adjustable rates and balloon payments, became widespread in the inflationary 1970s, and some were given special legal protections at that time. These products were suitable for some borrowers, particularly during a period of inflation. Adjustable rates and balloon payments are good for younger people at early stages of their careers whose incomes are going to increase. They are, however, unsuitable for people on fixed incomes. “No doc” income stated loans may have originated to benefit entrepreneurs who have income but are not paid a salary. However they also enable predatory lenders to make loans that are certain to fail.

Recently it appears that nontraditional mortgage products are proliferating. There are interest only loans, negative amortization loans, and others. This makes it difficult for people who have "old-time" expectations about what a mortgage should be to keep up, particularly when they are getting bad advice from a lender or mortgage broker.

The dynamics of predatory lending are often that lenders or brokers seek to turn the borrower's home equity into fees for themselves. Predatory mortgage lending exists because loan originators can make very large short term profits by selling a borrower on a loan. However these originators have no long term stake in the success of the loan, or in the loan's effects on the community. Mortgage loans used to be made and then held by local banks or savings and loans rooted in their communities. But today many loans are originated by commissioned salespeople and then eventually held by distant institutions, sometimes "securitization trusts" with no real independent existence at all.

In practice, originators profit by making as many loans as possible, whether or not they are suitable for the borrower. Often they do this by finding people who have been refinanced previously and are vulnerable to doing so again, a practice known as "loan flipping." In fact a loan that has been unsuitable and gotten the borrower in trouble often results in repeat business for loan originators.

PREDATORY LENDERS SEEK TO LOWER THE INITIAL MONTHLY PAYMENT NONTRADITIONAL MORTGAGE PRODUCTS MAKE THIS POSSIBLE

In such a dynamic, the ability to generate a lower monthly payment is often crucial to selling the loan. Adjustable rate loans and their cousins interest-only loans have proven to be crucial to selling loans that are otherwise highly unfavorable to the borrower, and getting origination fees. Adjustable rate loans tend to have lower monthly payments than fixed rate loans.

Particularly pernicious is an initial "teaser rate" that is artificially lower than the formula for computing the loan interest. Such a teaser rate generally insures that the loan payment will eventually increase regardless of what changes occur in interest rates generally. A teaser rate that is not sustainable is really a short term loan disguised as a long term loan. We continue to see a high percentage of Adjustable Rate Loans, particularly with initial teaser rates, in our community.

While we have had a relatively long period of comparatively low interest rates, many expect that a costly war, high budget and trade deficits and other economic factors will cause interest rates to go up, and with them monthly payments for ARM borrowers. Thus any adjustable rate mortgage is risky for the borrower. Mortgage loan obligations last for long periods, 30 years in many cases, and elderly people face probable increases in health care costs and other expenses in the foreseeable future.

Many subprime ARMs are "one sided", that is interest rates can increase but not decrease as interest rates fluctuate. This disadvantage to borrowers has not been a factor with historically low rates but is likely to become so as rates fluctuate in the future.

WHAT SHOULD THE FEDERAL RESERVE BOARD DO?

I. Underwriting. Lenders should be required to evaluate the ability to the borrower to repay the loan under any likely scenarios, particularly for "initial teaser rate" ARM loans. However lenders should also have to evaluate for other foreseeable changes that could increase the monthly payments or decrease the borrower's income. This is particularly true when debt to income ratios are high, as is often the case for borrowers on fixed incomes. These include:

1. The maximum possible interest rate for an ARM. These are often quite high, even if actual rates have not been that high for decades.

2. The interest rate changes that are reasonably probable based on the majority of predictions in the financial press and the lender's own business planning.

3. The payments expected to result when periods of negative amortization, resulting from initial low or minimum payments, increase the loan balance.

4. The payments expected when a supposedly "open end loan" begins repaying principal as well as interest.

5. The borrower's income includes temporary or sporadic income sources that can not reasonably be expected to be there in the future.

6. "Gross ups" of relatively low fixed incomes like social security, while in theory preventing discrimination based on source of income, in effect overstate the ability to pay and understate the debt to income ratio for those on the lower income scale.

II. Disclosures. The Federal Reserve should particularly reexamine the ARM disclosures under TILA such as the "Consumer Handbook on Adjustable Rate Mortgages" that have been approved for lenders to use or modify. The disclosures that are used presently are often incomprehensible to the average borrower. At worst they can describe a loan that is much more benign than the one that the borrower is considering, and are therefore deceptive about the risk the borrower faces.

Disclosures should be required which show both when and what the greatest amount that borrowers may be required to pay to avoid default on the mortgage - in other words, the maximum-minimum monthly payments, and the soonest possible date these payments may be required.

Please remember that written disclosures tend to be of less useful in protecting borrowers than some expect. Many borrowers have low reading levels and even those who don't may be from a culture that makes decision based on personal contact with trust generated by spoken and unspoken cues rather than by reading complex and unfamiliar documents. Also a loan closing can be a pressured and chaotic event where a borrower may not feel in control of the situation.

III. Stated income loans. Stated income loans constitute closing the lender's eyes to the ability to repay. This is an invitation to abuse. Furthermore since the income is not verified, it is impossible to look at the loan and say whether or not there has been abuse. While there are conceivable situations where someone is self employed and will have problems documenting their income, regulators should require at least some alternative means of verification of potential income and comparison to other debt and living expenses. This should be used conservatively, if at all, and not be routinely applied say to people who primarily receive fixed incomes but supposedly have some small business on the side. Stated income loans are particularly suspect in the subprime market due to the prevalence of predatory lending there.

IV. Dangerous products. Some products provide for "risk layering" with multiple mortgages. These are dangerous, particularly in places like inner city Dayton where home values do not appreciate rapidly. Any loan that does not escrow taxes and insurance is also a dangerous product.

V. HOEPA improvements. The Federal Reserve Board should close loopholes in HOEPA.

1. Include yield spread premiums as broker's fees. They are broker's fees, generally obtained by secretly upselling the

borrower a higher cost loan. Disputes over whether these are paid at closing have caused some courts to consider them outside the points and fees trigger and the definition of a finance charge. In fact like every other charge they are paid at closing and then the borrower pays for them with interest over the life of the loan. There is no excuse for not including them.

2. Include the maximum prepayment penalties toward the points and fees triggers. Prepayment penalties are found primarily in the subprime market. They are a cost imposed on a borrower who refinances. Borrowers are usually unaware of them and pay no attention to them. Lenders use these to take advantage of their superior knowledge of the market. They should be considered a high cost item.

VI. Require a net tangible benefit for all loans.

VII Foreclosure avoidance. Too many homes are being lost in foreclosure. In part this is because lenders are making riskier loans, particularly in times when high paying jobs are being lost and health care costs are increasing. Lenders have changed their business models to make loans that are riskier to borrowers. They need to change their models of dealing with default so that people do not lose their homes due top periods of hardship. In particularly loans should be modified and unaffordable or unnecessary fees, particularly large lump sums like fees to foreclosure attorneys, need to be reduced.

VII. Community Reinvestment Act. Regulators should impose Community Reinvestment Act consequences on the use of high cost nontraditional products which put homes at risk. Regulators should particularly scrutinize this when, as often happens, the lender using the risky nontraditional products is a subprime affiliate of a regulated depository.

Thank you for consideration of our comments.

Sincerely,

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