From: "Hirtle Stanley" <shirtle@ablelaw.org> on 08/13/2007 04:05:02 PM

Subject: Home Ownership and Equity Protection

August 13, 2007

regs.comments@federalreserve.gov
Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th and Constitution Avenue, NW
Washington DC 20551

RE: Docket No. OP-1288.
Advance Notice of Proposed Rulemaking re HOEPA

Dear Ms. Johnson:

Edgemont Neighborhood Coalition, Inc. wishes to comment on the Advance Notice of Proposed Rulemaking on HOEPA. HOEPA was the original law especially designed to prevent high cost predatory loans and their consequences. America faces a tidal wave of mortgage foreclosures, particularly due to unaffordable adjustable rate mortgages, which is wreaking havoc in many communities including ours. Strong action is required.

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 "subprime" mortgage lenders, payday 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 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, and is at or near the top of the nation in foreclosures. Montgomery County, Ohio, where we are located, has been at or near the top of the state in mortgage foreclosures. There were approximately 4,000 mortgage foreclosures filed here in 2004 and 2005, 5076 in 2006 and 3056 so far in 2007. This is an increase of 260% in seven years. Local officials have predicted an increase of up to 40% more in the immediate future.

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, resulting in payment shock. These are unsuitable loans for people with fixed incomes, such as most elderly homeowners in our neighborhoods.

Subprime mortgage lending is more prevalent in minority neighborhoods. A 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. A number of recent lawsuits have been filed as more evidence of this discrimination emerges.

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. The Montgomery County Recorder has recently examined the public mortgage documents from these lenders and found a large number of potentially explosive adjustable rate mortgages and prepayment penalties.

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. In some urban areas this reached 40%. This is totally unacceptable risk, both to the borrowers them selves and to their neighborhoods. Foreclosed homes add to the problem of abandoned properties which blight the neighborhood and contribute to crime.

Minority neighborhoods like ours and Midwest areas like ours tend to have home values appreciate less than some other parts of the country. Thus while some borrowers have gotten 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.

While there has been much publicity about the "subprime meltdown," the consequences to the lending industry as a whole have been comparatively minor. Radio commercials here continue to advertise "historically low" mortgage rates. At most the industry is being asked to take a "haircut" and grant some relief to borrowers. However, to the borrower, an unaffordable mortgage is not a "haircut." Her home is probably 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 HOEPA AND THE NEED FOR MORE

We are glad that the regulators are looking seriously at the problems inherent in abusive high cost loans. However it is clear that HOEPA as presently enforced has not solved the problem.

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 on behalf of undercapitalized conduit lenders 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 UNAFFORDABLE ADJUSTABLE RATE MORTGAGES OFTEN RESULT

In such a dynamic, the ability to generate a lower monthly payment is often crucial to selling the loan to the borrower. Adjustable rate 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. It is often a foreclosure waiting to happen.

However borrowers may be facing more of a problem than just teaser rate loans. 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. Loans made in 2005 are adjusting now and more are expected in the future. Thus any adjustable rate mortgage is risky for the borrower. Mortgage loan obligations last for long periods, 30 years in many cases, and elderly homeowners also face probable increases in health care costs and other expenses that pressure their ability to make higher mortgage payments.

Most subprime ARMs are "one sided", that is interest rates can increase over the initial rate 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 DO?

The Federal Reserve Board needs to build upon the protections contained in the recently adopted interagency statement on subprime mortgage lending (Federal Register, July 10, 2007). In particular, the Federal Reserve should apply strong limits and prohibitions to particularly dangerous non-traditional and high-cost loans in order to prevent unfair and deceptive lending in violation of HOEPA. In addition the Federal Reserve needs to become an active voice in providing relief for borrowers.

1) Underwriting to avoid unaffordable adjustable rate loans. America faces a coming plague of foreclosures caused by lending beyond borrower's ability to pay off "exploding" adjustable rate loans. The federal agencies have correctly identified that abusive lenders are underwriting ARM loans at initial low rates, leaving borrowers vulnerable to rapid rate increases.

   a) The recent guidance on subprime lending requires underwriting at the fully-indexed rate. While this is a step in the right direction, The Federal Reserve should also consider underwriting requirements geared at the maximum possible rate or rates above fully-indexed rates. In recent years when the LIBOR or other benchmark rates were low, future interest and payments such as were disclosed on the TILA loan disclosure form were in fact expected to be actually higher. Lenders with superior knowledge of the market were aware of this, while borrowers were not.

   b) The Federal Reserve should consider either some suitable cushion above the fully-indexed rate or the maximum possible rate stipulated in the loan contract. We understand that it was common industry practice to underwrite loans at two percentage points above the fully-indexed rate. Loans should be underwritten to consider a realistic rise in potential payments.

   c) The Federal Reserve should 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 best 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.

d) Adjustable rate mortgages should be presumed to be unsuitable for borrowers on fixed incomes unless the borrower can afford the maximum possible payment.

e) There should be a presumption that a loan is unaffordable if the borrower's debt-to-income ratio exceeds 50%.

2) Stated Income or Low Doc Loans: The Comptroller of the Currency has found that stated income or low doc loans are prone to abuse when predatory lenders and brokers inflate borrowers' incomes to qualify them for unsustainable loans. This type of abuse is most prevalent on subprime loans. Stated income or low doc loans may be suitable for a limited number of borrowers, but are rarely if ever justified on subprime and/or ARM loans. At the very least, the Federal Reserve Board must establish clear protections and procedures for reduced documentation loans including the requirement that pay stubs, tax forms, and other acceptable verification of income must be received by the lender.

3) Prepayment penalties: The Federal Reserve should apply strict limits to prepayment penalties. Prepayment penalties provide windfall profits for lenders and trap borrowers being trapped in abusive and predatory loans.

a) Prepayment penalties must not apply after the expiration of "teaser rate" in adjustable rate loans. At least a 90 day time period is needed so that borrowers have sufficient time to shop for and receive another loan if necessary.

b) For fixed-rate subprime loans, prepayment penalties should not extend beyond two years.

c) Prepayment penalties that exist should be added to the finance charge and be counted towards the points and fees trigger.

4) Escrows for Taxes and Insurance: The Federal Reserve should require escrows for all loans. Brokers and lenders use the absence of escrows to create the illusion of lower monthly payments. This also generates loan flipping opportunities when a borrower discovers he or she is behind on their taxes and

needs a lump sum to catch up.

5) The Federal Reserve should require that underwriting of "subprime" loans reflect the actual risk of loss to the lender, but eliminate the exploitative price increases that industry extracts in order to serve the economically less powerful borrower.

6) Steering prohibition – The Federal Reserve Board should make it an unfair and deceptive practice to steer borrowers qualified for prime loans into subprime loans is. In "Income is No Shield against Racial Differences in Lending" the National Community Reinvestment Coalition documents that middle- and upper-income minorities are significantly more likely than middle- and upper-income whites to receive subprime loans. Moreover, previous NCRC research and other studies reveal that racial disparities in lending do not disappear after considering creditworthiness and other key variables. Borrowers lose substantial amounts of wealth when they are steered into high-cost loans.

7) HOEPA's triggers remain too high. They also need to include other real costs to the borrower such as prepayment penalties and yield spread premiums.

8) Lender and assignee responsibility and duty to repair bad loans– The Federal Reserve should eliminate the present disconnect between the conduct of loan originators and the responsibility for fixing the consequences of that conduct and saving the borrower's home.

a) Lenders should be liable for deceptive and fraudulent practices committed by brokers with whom they do business. Since up to 70% of the loans originated start with brokers, lenders must be motivated to strictly monitor broker behavior.

b) Lenders and brokers must face serious financial penalties if they intimidate or pressure appraisers to meet certain home values. Fraudulent appraisals have contributed significantly to the rise of delinquencies and defaults.

c) The ultimate loan holders and the structured finance agencies that create and fund them, should be responsible for removing predatory features and turning unsuitable loan products into suitable ones. For example if a loan is made for an initial teaser rate that is affordable but then adjusts to a formula rate that is not, the loan should be modified to an affordable fixed rate. The industry should bear the risk of and insure itself against the cost of fixing predatory loans.

9) Access to Justice. The Federal Reserve should support, and direct contractual agreement by lenders in a manner similar to the FTC Holder in due course rule, provisions that insure that borrowers have access to the justice system if their rights are violated.

a) Prohibit mandatory pre-dispute arbitration agreements in mortgages;

b) Loan holders agree to jurisdiction of courts in the borrower's state over any lawsuit to repair predatory features in a mortgage under the laws of the borrower's state or federal law.

c) Elimination of a "holder in due course" defense for assignees;

d) Prohibit waivers of the borrowers' rights.

10) National action to prohibit predatory lending, prevent foreclosures and rescue of borrowers in bad loans. The Federal Reserve should support:

a) A national law that prohibits predatory lending practices by all lenders. The Federal Reserve should look closely at Senator Schumer's Borrower's Protection Act of 2007 (S. 1299) and Representative Ellison's Fairness for Homeowners Act of 2007 (H.R. 3081);

b) Modification or elimination of federal laws like DIDA and AMTPA to the extent that they create openings for predatory lending practices.

c) Eliminate efforts by federal regulatory agencies to preempt state consumer protection laws.

d) Strengthen the Community Reinvestment Act.

e) The Federal Reserve should impose Community Reinvestment Act-type consequences on the use of nontraditional products which put homes at risk.

f) The Federal Reserve should support a national emergency response to save homes and end the foreclosure epidemic;

i) Require responsible use of loss mitigation techniques to save homes where feasible. Require adequate funding and staffing of loan mitigation departments with staff with the knowledge and power to fix loans. 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.

ii) Refinance unsuitable loans including adjustable rate loans into affordable fixed rate loans without predatory features;

iii) Prohibit abusive profit taking by loan servicers, foreclosure attorneys and others;

The industry will argue that some of the limitations described above will cut off access to credit for working class and minority communities. We urge you strengthen the Community Reinvestment Act, expand the FHA programs and increase the roles of Fannie Mae and Freddie Mac to increase the access of credit and capital in ways that are not destructive.

Thank you for consideration of our comments.

Sincerely,

Stanley A. Hirtle
Attorney for Edgemont Neighborhood Coalition
Advocates for Basic Legal Equality
333 W. First St. #500
Dayton OH 45402
937-228-8104
shirtle@ablelaw.org