NEIGHBORHOOD HOUSING SERVICES OF CHICAGO, INC.

Rebuilding Chicago's Neighborhoods

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May 3, 2007

Jennifer J. Johnson
Secretary, Board of Governors
Federal Reserve Bank
20th Street and Constitution Ave. NW
Washington, DC 20551

Re: Docket No. OP-1278

Dear Ms. Johnson,

Neighborhood Housing Services of Chicago (NHS) is a not-for-profit community development corporation that has served Chicago's neighborhoods for 32 years. Since our founding, we have assisted over 163,000 Chicagoans to purchase, improve, or keep their homes, originated more than $380 million in loans for home improvement, home purchase and refinance, and built or rehabbed more than 25,000 units of affordable housing. We are writing to comment on the proposed Statement on Subprime Mortgage Lending.

Three years ago, the majority of our lending and counseling clients were first time homebuyers; today nearly half are individuals fighting to save their homes from foreclosure. These individuals typically have loans that were unaffordable from the start. They have been wooed into adjustable rate mortgages with very low teaser rates, interest only loans, or given high cost subprime loans even when their credit would have qualified them for a better product. Most of the clients we see are low income and have been homeowners for many years (the median duration in the home is seven years and the median income is $28,000). Based on this experience, we believe there is a need to both clarify and set guidelines for subprime lending products which will safeguard consumers and neighborhoods.

NHS applauds the efforts of the regulatory agencies to provide additional guidance on the appropriate uses of high risk loan products, especially those marketed to subprime borrowers. The guidance effectively defines and identifies the primary issues that are causing increased defaults in the mortgage industry today. Below are our responses to the four questions you have posed at the end of the guidance.

Question 1:
The key to understanding when and where such loan products are appropriate lies in the layering for various risky products together into a single loan. While the loan characteristics that you list

may have legitimate functions in the market, when they are layered together and marketed to clients with weak credit or who simply do not understand them, they become toxic and predatory. The huge default rates now being experienced in the subprime sector can be largely attributed to these risk layered products that are disproportionately marketed to low income and minority groups through loosely regulated channels.

The implied assertion that these risk layered loan products are necessary to serve LMI and credit impaired customers is false. Based on our experience making loans to low and moderate income families and borrowers with impaired credit for over 20 years, there are better ways to serve this community. NHS of Chicago mitigates the risk commonly associated with these borrowers in several ways without adding costs or tricky loan terms to the equation. First, we require that each client take eight hours of home ownership training to learn how to shop for a loan and buy a home. Second, we do not let borrowers inflate their incomes or borrow more money than they can reasonably afford to maintain over the life of the loan. Finally, NHS knows the neighborhoods in which we lend and verifies the appraisal value of each property instead of relying on brokers with an incentive to "round up" home values to sell bigger loans. These prudent practices have allowed us to make affordable loans to LMI and credit impaired borrowers and experience a default rate that is only slightly higher than the national average for conventional lending.

It is true that there is no guarantee that credit impaired borrowers will qualify for other products currently available in the market. However, the answer is not to continue to offer people bad loan terms but rather to harness the creativity of the industry to find new, healthy, sustainable products that LMI and credit impaired borrowers can afford.

Question 2:
The answer to helping families in risky loans is not to refinance them into another, slightly less risky loan to avoid payment shock or some other event engineered into the loan terms. As discussed above, there are affordable and prudent ways to lend to these borrowers that all lenders should consider adopting. Lenders that hold loans which are the result of irresponsible underwriting should be encouraged to modify the loan terms in such a way as to make the loan sustainable, not offer a new loan with different risk factors to the troubled borrower.

Question 3:
While the increase in defaults have been seen mostly in the subprime sector thus far, we believe that offering prime loans with the characteristics you list can also be a risky endeavor. Someone with good credit who qualifies for a good loan may have a better base from which to sustain a mortgage with these types of features, but they do add risk to any loans and appropriate mitigating factors and underwriting standards should be in place. A case can be made that there

are appropriate markets for these creative loans terms individually, but it is a stretch to find an occasion when layering multiple high risk attributes together makes sense.

Question 4:
In the past, prepayment penalty features were added to loans in exchange for offsetting other charges or rates. In this capacity, prepayment penalties could provide a benefit to a knowledgeable borrower. However, more recent evidence suggests the prepayment penalties no longer lower other costs, but appear to be raising potential costs with no evident benefits to the borrower. Particularly alarming is when prepayment penalties make it difficult to extract a borrower from an unsustainable loan, for example an ARM that is resetting. It is unclear how such a penalty serves to benefit a client in any situation. More likely, in such cases the fee was added by a broker or lender who was rewarded with a premium and who never explained the terms of the penalty to the unsuspecting borrower.

Again, we thank the agencies for your efforts to define risky lending practices and products and encouraging lenders to take appropriate actions to mitigate the effects both on their institutions and on the borrowers. We hope rigorous enforcement of this guidance will be applied to ensure healthy and sustainable lending practices at all of the institutions under your purview and work to expand it to all loan delivery channels.

Sincerely,

Bruce Gottschall
Executive Director, NHS of Chicago