From: "Christian Spano" <cdspano@comcast.net> on 04/03/2008 10:25:02 AM

Subject: Regulation Z

Dear sir or madam,

I believe the Sub-prime crisis has many culprits. Punishing brokers will allow lenders to offer LESS service then they already do to homeowners. Moreover, before you point the finger at the brokers you should look in the mirror. Where is our tax relief? Where is our insurance relief? These are all components. I wrote this article a few months ago, but it's still appropriate.

Sub-Prime Debacle Has Many Culprits
By Christian D. Spano

The economy has taken front seat as *the* issue of the 2008 presidential campaign and for good reason. Americans are panicked at the notion that we stand on the cusp of a major recession; due in no small part to the sub-prime crisis of 2007. While federal, state and even local politicians are castigating the mortgage lender to a public perception somewhere between a Chinese toy manufacturer and a Canadian pet food company; only a petroleum executive would garner more scorn in today's society than a mortgage banker. Citizen groups, campaign strategists and television pundits have drilled into the psyche of people, fallaciously, that the Mortgage Lenders, who tricked unsuspecting borrowers into hazardous adjustable rate mortgages, bare the sole brunt of guilt in the sub-prime market. Not only is this incorrect, it insults the intelligence of some borrowers who actually did ask the right questions.

What did the sub-prime market exactly do? It relaxed traditional lending policies to allow for more homeownership. Coupled with down payment assistance programs, borrowers didn't need any cash, good credit or even much salary to buy giant luxury homes with these programs. It was absolutely conceivable for a young couple making around $50,000 a year in combined income to purchase a $300,000 home with initial mortgage payments totaling less than $1000 a month. Since the initial payment was so low, the normal rental history requirement was no longer applicable. Borrowers were only qualified on the initial principal and interest payment (not the one it would likely adjust to) further illustrating the immense difference from what one can qualify for versus what one can afford. To further bring down the initial payment and squeeze more home into the loan, Builders were even paying down the interest on the borrower's loans so that they could move units faster. Loaded with pre-payment penalties and other devices that delay the inevitable, these products were designed to sell homes…quickly.

The so-called "liars loans" which allowed brokers to "state" the income of the borrower as opposed to documenting it were developed to absorb the risk associated with non-verifiable income. Some folks just can't get a W2 to show what they actually make in cash flow for many reasons. The effect of which is systematic discrimination against small business owners and entrepreneurs that need as many tax exemptions as possible. Corporations make money hand over fist, however when it comes to accounting and taxes, they cry poor louder than anyone. Why then shouldn't we expect the same (winning) strategy from a successful small business. The more money they show, they more they'll be taxed. Unfortunately, what really occurred is that many of the fraudulent loans made in the 90's were impossible during the current decade because of improvements in information technology. Simply put, with the internet as a tool, it became easier for underwriters to identify the fraud. The stated income loan became the new de-facto home of fantasy land.

No income / No asset loans were sexy…and they even had a sexy name: "NINA." NINA wasn't cheap. Borrowers paid a high built-in premium for the NINA option. They were never meant to be a "liar's loan", however, extensive use made the pricing more competitive than it should have been. This is an area that the lenders and brokers bare almost sole responsibility. Some small brokers were prosecuted for committing fraud on these stated loans. However, the impact of the litigation wasn't enough to be an effective deterrent.

Mortgage brokers sell loan products but they don't make them, neither do lenders. Loan products are made by capital markets (many European) that determine the amount of risk involved in designated lending portfolios and create demands based on parameters that they set. At that point mortgage lenders lend based on what they can move. The greed of the world banks created the accelerated effect of bringing down lending guidelines to the lowest common denominator. The same folks that were ousted out of Bare Stearns are the same ones lauded as geniuses during the height of the market. Many beaks were wet by the deluge brought on by one of the hottest builder booms ever. Everyone turned the other way as the industry used proposed tax and insurance figures (that weren't even close to reality) to pre-qualify new construction home buyers.

The mortgage lender was just one small piece of the puzzle. If the product wasn't available, lenders wouldn't sell them. You wouldn't blame the car dealership if the entire model line was found defective, would you?

The politicians and local governments did pretty well from the sub-prime market. For six straight years property values soared nationwide. Tax revenue was at record levels. The builder boom's exponential effect of raising the existing values as well as adding more contributors to the tax base brought the public coffers to the highest levels in recent memory. No politicians were worried about where it was coming from or what was generating the income at the time. As real estate taxes went up, so too did the cost of insurance. Mortgage payments often include the taxes and insurance which in some cases can double the amount owed. Many politicians talked the talk when it came to tax and insurance rate reform but very few if any delivered anything meaningful. Most politicians and local governments are in fact resisting any noticeable tax relief -- threatening loss of services.

The forgotten culprit is the borrower. Since borrowers vote, and this is an election year, they will get the benefit of the so-called bail out. The bail out thus far is an FHA program appropriately titled FHA Secure. The bail out will actually encourage more defaults than it avoids. For example, the borrower must have been delinquent after the adjustment and must have a debt to income ratio that *exceeds* fifty percent. Here's a very likely scenario. John and Jane Homeowner go to their local mortgage broker, assuming there still is one, and applies for an FHA secure loan. Jane says, "Our option arm is going to adjust next month and we really can't afford it. We've been staying on top of all of our bills the best we can because we don't want to fall behind, however, I don't think we can afford to make our mortgage payment when it adjusts next month."

After reviewing the guidelines the crafty mortgage broker responds, "Well Jane, the best thing you can do is skip your next mortgage payment all together and run up some more of your credit cards, otherwise you won't qualify the program." Only the most irresponsible borrowers will be allowed to use the bail out program.

As lenders eliminate tens of thousands of jobs, as mortgage brokerage businesses close out offices, as tax revenues fall short and home values sink into a dark recessionary abyss; we can take comfort in knowing that the government is doing everything they can to protect their votes. The industry shouldn't wait on the government. As intimated in congressional hearings, reforms will require even more disclosure to the borrower. To normal folks, this means 75 pages of rapid fire signatures instead of 50 on your loan application documents. The next step would be basic and remedial math classes for all borrowers, paid for on behalf of the lender. As one might chuckle, think about some of the asinine disclosures signed prior to the sub-prime crisis. One FHA disclosure in fact read "I have thought about a home inspection prior to signing a real estate contract." After every situation affecting the mortgage industry, the response has always been more disclosures. If the borrower didn't read the first ARM disclosure they signed, why would they read the second one?

Most of you reading this probably signed your disclosures like this:

6:00 Fight traffic and rush to meet husband and kids at the mortgage lender to apply for the loan

6:30 Arrive at the lender's office to cranky husband and bored kids

7:00 After repeating everything spoken on the phone about the rate and what we need to get prior to closing, we start signing docs. Fed kid another soda and chips from the lender's vending machine. One more and they'll be peeling paint from the wall.

7:30 just got done explaining the good faith estimate and the Truth in Lending. A million fees…he claims none of them are his. A super huge interest rate that he claims won't be the note rate…okay. If the other documents take this long, we'll never catch American Idol. Husband is texting on his blackberry and our mortgage broker keeps getting phone calls from another client at their closing. The kids are on defcon5, if we don't get them out within 15 minutes and get them some real dinner, they will explode into a full-on ADHD attack.

7:45 two more disclosures signed….that's it, let me sign the rest and pretend to get the context of them by reading a few words here and there. At this point, I'll sign on to it and review the details later.

The solutions for the industry start at the very top. European and American capital markets are the ones needing regulation. If trickle down economics works; perhaps trickle down regulation might as well.

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