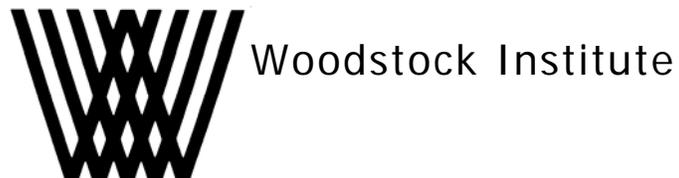


A Lifetime of Assets

Asset Preservation: Trends and Interventions in Asset Stripping Services and Products

September 2006



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The National Community Reinvestment Coalition

The National Community Reinvestment Coalition (NCRC) is the nation's trade association for economic justice whose members consist of local community based organizations. Since its inception in 1990, NCRC has spearheaded the economic justice movement. NCRC's mission is to build wealth in traditionally underserved communities and bring low- and moderate-income populations across the country into the financial mainstream. NCRC members have constituents in every state in America, in both rural and urban areas. The Board of Directors would like to express their appreciation to the NCRC professional staff who contributed to this publication including John Taylor, David Berenbaum, Joshua Silver, Lloyd London, Milena Kornyl, Tim Westrich, Shawna Nelms, Ruth Dickey, and Nathan Marwell.

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Woodstock Institute

Woodstock works locally, nationally and internationally to research, develop and promote ways to bring economic resources to lower-income and minority families and communities. Woodstock's partners include community organizations, local and national economic justice coalitions, academics, policy makers, financial institutions, and foundations. The Board of Directors would like to express their appreciation to the Woodstock Institute professional staff who contributed to this publication including Malcolm Bush, Marva Williams and Nathan Paufve.

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Introduction

This paper focuses on the importance of asset development and preservation. Assets, such as savings, investments or home ownership, are an integral means to family financial stability and growth. However, the increase in high cost consumer and home mortgage debt are a dangerous threat to asset preservation. This paper explores the nature and growing prevalence of these threats as well as a model program to safeguard the assets of lower-income consumers. The Consumer Rescue Fund is a innovative program administered by the National Community Reinvestment Coalition (NCRC) that employs several strategies that enable consumers to preserve home ownership in the face of foreclosure by high cost lenders.

This paper has four sections. It begins with a description of the important role that ownership of assets plays for families and consumers. This section also addresses the challenges that lower-income and minority consumers face in building assets, such as limited or stagnating incomes, adverse public policies that hinder asset development, inadequate savings and investment products, poor access to affordable financial services, prevalence of high cost financial services, and a significant consumer financial management skills gap.

A description of the explosion of consumer and home mortgage products comprises the second section of this report. It includes a depiction of wealth depleting predatory consumer loan and home mortgage and market trends, key features of high cost loans and an analysis of consumers targeted by these products. This section of the paper describes how wealth stripping products not only threaten the assets of individuals and families, but also have profound community impacts. A brief review of the literature as well as summaries of research conducted by NCRC, the Woodstock Institute and other researchers is included.

The third section of the paper describes an innovative wealth preserving program established by the NCRC. Launched in 2001, the Consumer Rescue Fund (CRF) features wealth preserving strategies to assist homeowners with predatory mortgages retain their homes. In partnership with local community-based and counseling organizations, CRF helps consumers in 17 states negotiate loan forbearance and/or modifications. When necessary to avoid bankruptcy and/or foreclosure, CRF staff work with financial institutions to provide refinance loans at or below market interest rates to save families' homes and provide them with affordable loans. CRF, which has helped more than 1,000 consumers, has established a model of industry-community group collaboration and best practices, which has the potential to reach thousands of additional families as it and similar programs attain scale. As a founding partner with NCRC, HSBC North America provides refinance loans for consumers in the CRF program and supports CRF counseling as well as mediation efforts.

The final section of this paper explores legislative and regulatory recommendations for policymakers. In addition, recommendations are offered to consumers, practitioners, and foundations for establishing wealth preserving products and services.

This paper supplements the fair lending research on high cost lending by providing quantitative data on the income, racial and gender composition of CRF loan recipients. It also provides case studies and data on the asset-stripping features of predatory loans in the CRF database.

Benefits of Asset Development

Ownership of assets can enable lower-income families to significantly improve their financial status. Asset accumulation is a measure of an individual's or family's accumulated resources. An asset is anything of economic value, such as homes, or savings, that can be bought, sold, invested, or set-aside for future financial returns.

Assets have vital long-term financial and social benefits. Assets are a source of future income, and can leverage the accumulation of additional assets. For instance, savings can be used as a downpayment on a home or home equity can be used to obtain loans to start a small business or to finance a child's college tuition. Further, the development of assets has benefits for families and communities, such as increasing civic participation and improving household or marital stability.

Asset development is vital to countering two widespread and related trends: the alarming increase in consumer debt and falling savings rates. On one hand, consumer debt is exploding—totaling more than \$2.1 trillion at the end of 2005. In fact, consumer debt for each American age 18 and over is almost \$10,000. A growing proportion of consumers will be unable to pay off these debts, resulting in increased consumer bankruptcies and higher losses for lenders. More than 1.6 million Americans filed for bankruptcy in the 12 months ending June 30, 2005, roughly double the number of filings a decade earlier. On the other hand, the savings rate has decreased from over 9 percent of disposal income to a negative savings rate in 2004.¹ Some researchers attribute increased consumer debt to depleted savings—consumers are relying more on credit cards and other forms of consumer debt and home refinance loans to pay consumer expenses.²

Asset development also impacts an individual's ability to obtain and sustain employment. A poor credit rating can inhibit a consumer's ability to purchase a car, which may be integral to transportation to work in many regions. Further, credit ratings serve as empirical datum by many potential employers that use them to assess an applicant reliability, stability, and other factors. About 35 percent of the companies surveyed by the Society for Human Resource Management pulled the credit reports of current or potential employees in 2005, up from 19 percent in 1996.³ Firms also subject employees to credit screening as a criteria for job promotions. In addition, financial security can also impact a person's ability to maintain employment. Employees with serious credit or money problems often have higher rates of absenteeism, tardiness, wage garnishments, pay advances, 401(k) loans, lost productivity, and theft.⁴

Asset development is also integral to retirement planning and meeting increasing medical expenses. More than 50 million Americans have no retirement savings beyond Social Security, and only half of American workers currently participate in any employer-provided pension plan. Social Security, which most lower-income people rely to fund their retirements, is woefully inadequate at meeting the rising consumer and medical costs that seniors face. As health costs increase, employer medical plans mandate that consumers pay a portion of medical bills and services. In addition, co-payments or deductibles are also increasing. As a result, the proportion

¹ Kish, 2006

² McConnell, Peach & Al-Haschimi, 2003

³ Weston, 2005

⁴ Williams, Haldeman & Cramer, 1996

of low-income, privately insured, working-age Americans with chronic conditions, such as diabetes, asthma or depression, spending more than 5 percent of their incomes on out-of-pocket medical costs jumped from 28 percent to 42 percent between 2001 and 2003.⁵ Many of them wind up in debt and in consequence, resort to bankruptcy for relief. This problem is even more dire for those who are uninsured. Assets, including savings, can allow lower-income people pay high deductibles and other expenses that are not reimbursed.

Disparities in Asset Development

The accumulation of assets by lower-income consumers is particularly important. Efforts to alleviate poverty have traditionally concentrated on strategies to increase the income of lower-income households through employment and training, tax policy, and income redistribution. Recently, policymakers, academics, and practitioners have recognized the importance of empowering poor families to build assets so that they can reach self-sufficiency and as a financial cushion during financial hard times. For lower-income families who often live from paycheck to paycheck, assets can enable them to significantly improve their financial stability. Savings can be used to pay emergency costs, negating the need for high priced consumer loans. Home ownership can facilitate building equity that can be used to finance a child's college education.

It is widely known that the distribution of income is uneven. However, asset distribution is even more disproportionate. In 2001, the top five percent of households owned 59.2 percent of assets in the U.S. This disparity is clearly related to income and race. The average wealth of the poorest 40 percent of the population was \$2,900 in 2001, a 44 percent decrease from 1983. For every dollar of wealth owned by white families, African-American families owned only 19 cents.⁶ African Americans have far less money saved in retirement accounts than whites. Their median amount saved is \$59,000 compared to \$93,000 for whites. African-Americans also contribute less to their retirement accounts monthly.⁷

In times of economic hardship, lower wage workers suffer more significant asset depletion than their more affluent counterparts. In the years prior to the 2001 recession, white, Hispanic, and African-American families were generating wealth through savings, investment, and homeownership. However, during the recession and jobless recovery, Hispanic and African-American families lost over one-quarter of their wealth while the wealth of white families grew slowly at 2 percent.⁸

The wealth accumulated from past generations often provides a substantial head start in life and enables current generations to further increase their wealth. These opportunities to build wealth and assets through the generations are often available for whites but not minorities. According to Thomas Shapiro, young, white middle class-families typically purchase their first homes and begin building significant equity with substantial financial assistance from their family. No such assistance is available for many lower-income and minority first time home buyers.

⁵ Cassil, 2004

⁶ Wolff, May 2004

⁷ Singletary, 2006

⁸ Shapiro, 2004

Women also face challenges to developing assets. Pensions are a case in point. Half of all women have relatively low paid jobs without pensions. Further, those women who do have pensions receive only half the average pension benefits that men receive.⁹ Women also often experience difficulties financing and purchasing homes and small businesses.

Asset development programs that focus on lower-income consumers and families are therefore vital. Individual Development Accounts (IDAs), Earned Income Tax Credit (EITC) and home purchase counseling and purchase programs, provide lower-income people with the support they need to build savings, purchase a home, start a business, pay college tuition, and build other assets.

Why do these disparities in asset development occur? Obstacles to asset development are a complex combination of income disparities, adverse public policies, inadequate savings and investment products. Lower-income consumers also experience poor access to the financial mainstream and an increased prevalence on high cost financial services in their communities. Further, we are witnessing a growing financial skills gap of consumers due to an explosion of complex loan and investment products. In addition, the explosion of asset stripping high cost loans to lower-income and minority consumers is having a significant impact of the asset development of these consumers.

Income Disparities

Despite the strong economic growth and tight labor markets of recent years, income disparities were significantly greater in the late 1990s than they were during the 1980s. A study of family income trends in the US by the Center on Budget and Policy Priorities and the Economic Policy Institute found that in two-thirds of the states, the gap in incomes between the top 20 percent of families and the bottom 20 percent of families grew between the late 1980s and the late 1990s. The authors of the report attribute income disparities primarily to wage stagnation. The incomes of lower-wage workers stagnated or grew slowing in the 1980s and 1990s. In contrast, the wages of higher-income workers grew significantly.¹⁰

Income disparities not only impact lower-income families—they also have community impacts. Areas of concentrated poverty grew from 1970 to 1990 in terms of geographical size, the number of census tracts, total population, as a percentage of overall population, and in terms of the percentage of poor persons living within them.¹¹ The share of all poor people in tracts with poverty rates between 20-30 percent increased from 18 to 21 percent, resulting in increased rates of poverty in inner cities as well as suburban communities.¹² Rural communities are also not immune to high levels of poverty. Almost 20 percent of rural counties had poverty rates of 20% or higher in every decennial census between 1970 and 2000 compared to 4% of urban counties.¹³

Adverse Public Policies

Middle and higher income people get tax breaks for many financial transactions from owning homes to putting money in retirement plans, college funds and health savings accounts. These

⁹ Women's Institute for a Secure Retirement, N.D.

¹⁰ Center on Budget and Policy Priorities and the Economic Policy Institute, 2002

¹¹ Dreier, Mollenkopf & Swanstrom, 2005

¹² Pettit & Kingsley, 2003

¹³ Rural Policy Research Institute, 2006

traditional tax incentives for assets are often not sufficiently strong for people in lower tax brackets, as they lack the income and financial resources to take advantage of them.

Inadequate Savings and Investment Products

There is also a scarcity of good savings products. Savers forego huge sums annually when they keep substantial deposits in low yield savings. According to the Consumer Federation of America, US consumers have over \$1 trillion in low-rate passbook saving, statement saving, and money market deposit accounts earning interest of about 2 percent.

Mutual funds and retirement plans are often not an option for lower-income consumers. Many mutual funds have prohibitively high minimum opening deposits of \$250 or more.¹⁴ Employer pension plans are not made use of by lower-wage workers for several reasons. They are difficult to understand, may only allow employees to enroll after an extended period of employment therefore lessening their chance of taking advantage of this savings opportunity and are often not transferable to a new employer.¹⁵ Further, employers often make opting out of the pension plan as the default position. In addition, many low wage employers do not offer their employees a savings plan—as a result, two-thirds of tax benefits for pensions go to top 20 percent of the income ladder.¹⁶

Poor Access to the Financial Mainstream

Consumers need affordable means to cash checks, pay bills and save. However, many lower-income and minority consumers have no or a limited relationship to mainstream financial services. One-fifth of lower-income consumers do not have a relationship with a bank or credit union.¹⁷ The rates of the unbanked are even higher for minority consumers. A 2004 survey by the Joint Center for Housing Studies at Harvard University found that 52.4 percent of respondents termed “unbanked” were black and 35.3 percent were Hispanic.¹⁸

Consumers cite a number of reasons for being unbanked or underbanked, including high minimum balances or initial deposits, fair to poor credit ratings, ChexSystems¹⁹ problems, high fees, distrust of financial institutions, lack marketing or inadequate financial literacy. In addition, mainstream financial institutions are hard to find in lower-income and minority communities. A Woodstock Institute study of the Chicago region examined the locations of full service bank branches from 2000-2004. The researchers found that although the number of branches increased significantly, that many communities are underserved:

- Low-income zip codes had less than one office per 10,000 people in 2004; moderate-income zip codes had 1.4 offices per 10,000 people during that period; upper-income zip codes had over four offices per 10,000 people in 2004.

¹⁴ Barr, 2005

¹⁵ American Benefits Council, July 12, 2005

¹⁶ Orszag & Greenstein, 2000

¹⁷ Hilgert, Hogarth & Beverly, 2003

¹⁸ Berry, February 2004

¹⁹ ChexSystems is a network of banks and credit unions that regularly contribute negative consumer information on checking and savings accounts. Negative information usually consists of nonsufficient funds (NSF), bounced checks, and unpaid overdraft fees. This information is shared among member institutions to help them assess the risk of opening new accounts. Approximately 90 percent of U.S. banks use ChexSystems, therefore a listing greatly reduces a consumer’s chances of obtaining a checking account.

- Both low- and moderate- income zip codes have \$111 million aggregate income per full service office compared to less than \$80 million for middle-income zip codes and about \$91 million for upper-income zip codes.
- Predominately minority zip code areas had an aggregate household income of over \$124 million per bank office compared to under \$87 million in predominately white zip codes.²⁰

Similar results were found by a National Community Reinvestment (NCRC) study of the Cincinnati area. Despite the fact that 51 percent of the City of Cincinnati's residents live in low- and moderate-income census tracts, only 28 percent of bank branches were located there. Further, 34 percent of the City of Cincinnati's population resided in predominantly minority census tracts, but only 14 percent of branches were located in these communities.²¹

Prevalence of High Cost Financial Services

Access to affordable services is but one challenge for lower-income communities that have no or little relationships with mainstream financial institutions. These communities are also targeted by check cashers, high cost fringe financial companies that charge up to three times as much for basic financial services. Check cashers are disproportionately located in minority communities. In Chicago, of the approximately 400 check cashers, nearly 100 are located in just 12 communities—all with predominantly lower-income minority residents. Moreover, the ratio of check cashers to banks in these areas is as high as 12:1.²²

Significant Financial Management Skills Gap

An equitable and fair marketplace is predicated on knowledgeable consumers that have the ability to make informed choices. In addition, in order to be more responsible for their own financial well-being, it is important for consumers to understand the basics of the financial landscape as well as more complex concepts so that they can avoid scams, stay out of debt, and build assets. Asset development requires significant person-to-person training and education on budgeting, financial planning, ability to assess the cost of credit, and acquiring fairly priced loans free of abuses. The growing complexity of financial services necessitates that consumers understand the workings of a multitude of savings options (pension plans, mutual funds, money market accounts, certificates of deposits, health and education savings plans, etc). Credit options are also complex, including legal and regulatory concepts such as annual percentage rates (APR), mandatory arbitration, private rights to action, use of universal default by credit card banks, and a multitude of other specifications.

In addition to these issues, the wealth of modest income consumers is being depleted by high cost loans. Lower-income, minority and women homeowners are targeted by predatory lenders for abusive consumer loans and home ownership and refinance loans, which can lead to financial distress, bankruptcy, default and foreclosure.

²⁰ Smith, 2005

²¹ National Community Reinvestment Coalition, 2006

²² Mullen, Bush & Weinstein, March, 1997

Introduction to Asset Stripping Products

During the last 10 years, several consumer and home mortgage products have developed that strip the hard won assets of vulnerable consumers. Consumer products have evolved that leverage a consumer's paycheck, automobile or income tax refund for high cost, short term loans. In addition, checking account overdraft protection programs and credit cards also harm consumers due to high fees and interest rates. All of these fringe and bank products drain billions of dollars from minority and lower income families and communities. There has also been an explosion of predatory home mortgages that disproportionately impact lower-income and minority consumers.

Predatory Consumer Loans

Payday Loans Payday lenders leverage a consumer's paycheck to make high cost payday and installment loans. Despite this lure of quick cash, the costs of payday lending are significant. In Illinois, where no usury laws exist, a one year payday installment loan of \$2,000 costs a borrower over \$4,000 in fees, for an annual percentage rate (APR) of 290 percent.

Payday lenders prey on vulnerable consumers. Payday loan borrowers are 3 times more likely to be debt burdened than other consumers. Over 60 percent of payday loan borrowers are women and African American households are 2.5 times more likely to use payday loans than white households.²³

Auto Title Loans Additionally, consumers may use another asset, their automobile, to obtain expensive, high risk auto title loans. Marketed as small, short-term emergency loans, auto title loans are a trap that lock borrowers in webs of debt. Auto title loans are short-term loans secured with the title of the borrower's car. Most of these triple digit interest rate loans represent a small portion of the value of the automobile and like payday loans, there is very little verification of the borrower's ability to repay the loan. To obtain an auto title loan, borrowers give the lender the title to their car, rather than a paycheck, as collateral for the loan. In return, borrowers often are required to make a series of interest payments and a final balloon payment of the entire loan principal. In addition, many auto title lenders charge a fee for every late payment. If the loan is not repaid, the borrower runs the risk of losing their car, which for many workers is the only transportation to their place of employment.

Refund Anticipation Loans Tax preparers offer enticing but usurious refund anticipation loans (RAL) that are based on a taxpayer's prospective income tax refund. Many lower-income families who benefit from the Federal Earned Income Tax Credit²⁴ (EITC) lose a significant percent of the refund because they choose to get their tax refund via a RAL. These families can least afford the expensive fees involved in a RAL. The alternative is to wait for a short period after filing the federal tax return before receiving a check from the federal government for the full amount of the credit. In 2002, over one-third of all recipients of the EITC chose to use a refund anticipation loan.²⁵ The Consumer Federation of America has estimated the

²³ Westrich & Williams, 2004

²⁴ Approved by Congress in 1975, Earned Income Tax Credit (EITC) is a refundable federal income tax credit for low-income working individuals and families.

²⁵ Feltner, 2005

total cost of tax preparation and the issuance of a refund anticipation loan at \$248 for the average return during the 2002 tax year. This fee included a \$100 fee for tax preparation, a \$40 electronic filing fee, a \$33 application and handling fee, and a \$75 loan fee.²⁶

A 2005 Woodstock Institute study examined 2002 Internal Revenue Service (IRS) data on RALs in Illinois. RAL participation rates among recipients of the federal EITC and the Illinois Earned Income Credit exceeded 38 percent statewide. Further, RALs cost low- and moderate-income taxpaying families over \$64 million in tax preparation and loan fees. In fact, the study found that tax preparers appear to concentrate in communities with concentrated numbers of low-income EITC recipients.²⁷ As a result, not only are RALs stripping the wealth of individual tax payers—they also take income away from lower-income communities.

Overdraft Protection Overdraft protection, a product that is regularly offered to many bank customers as a convenience, has turned into an excessively priced loan program. Also known under the names “bounce protection,” “overdraft privilege,” and “bounce safe,” these products were intended as a courtesy service to save consumers from the embarrassment of a bounced check. However, overdraft protection has evolved into a well-disguised loan product, the key features of which have been concealed by banks in order to extract additional fee income from unsuspecting consumers. These products have seized billions of hard-earned dollars directly from consumers’ checking accounts, all due to mistakes in balancing and an alluring but deceptive loan program.

When a consumer makes a transaction that overdraws the funds currently in an account, the bank still pays for the item, but also assesses an overdraft or non-sufficient funds (NSF) fee. Among the seven largest Chicago area banks, this fee is between \$25 and \$33, with an average of \$29. The fee is assessed for each transaction made when the account is overdrawn. According to a study conducted by the Woodstock Institute, the APR of bounce protection programs of Chicago area banks range from 1600 percent to over 3,000 percent.²⁸ Overdraft protection is a very lucrative product for banks. Total fee income from this product is over \$10 billion every year.²⁹

Lower-income consumers account for most overdraft protection fee income. According to a 2006 study conducted by the Center for Responsible Lending, repeat overdraft protection users are often low-income, single, non-white renters. In fact, the typical repeat user of overdraft protection services is 35-39 years old and has total household income of \$30,000 to \$35,000.³⁰

Credit Cards Credit card use has exploded due to a highly successful marketing strategy: mass, unsolicited mail campaigns. For over two decades, banks have extended credit effectively to anyone with an address, regardless of their income and credit score.³¹ As a result, over the last 20 years credit card debt has almost tripled. Further, from 2000-05 there was a 31percent increase in credit card debt for a total of \$800 billion.³² In addition to this alarming increase in credit card debt, consumer and community advocates take issue with many clauses

²⁶ Wu & Jean Ann Fox, 2003

²⁷ Feltner, 2005

²⁸ Westrich & Bush, 2004

²⁹ James & Smith, April 24, 2006

³⁰ James & Smith, April 24, 2006

³¹ Westrich & Bush, 2005

³² Demos and Center for Responsible Lending, October 12, 2005

tucked into the fine print of credit card contract agreements that double or triple the interest rates and fees of credit cards with little warning or explanation:

Minimum Payments: Banks have decreased minimum monthly payments from 5 percent of balances to 2-3 percent. The consequence is that more principal and interest is revolved and charged during each billing cycle.³³

High Fees: Credit card companies are increasingly relying on income derived from fees, including late fees, balance transfer fees, over-the-limit fees, cash advance fees and foreign exchange fees. As a result, the total revenue from fees increased almost tripled from 1995 to 2004 to \$24 billion.³⁴

High Cost Of Late Payments: Credit card companies benefit from late payments. First, many increase the interest rate on a person's card as high as 34 percent if they make a late payment. Second, credit card banks levy a late payment fee, typically between \$29 and \$39. Third, many credit card banks practice universal default. That is, they may increase the interest rate of a holder's card if they are late in a payment on another unrelated debt.³⁵ The practice began after a rash of bankruptcy filings in the mid-to-late 1990's and has increasingly become standard in the industry.³⁶ Although credit card banks assert that universal default is warranted by the added risk of these consumers, critics allege that the severity of the punishment does not match the risk of default. Universal default has become such a growing consumer issue that the legislature of New York State has approved bill that would ban universal default pricing.³⁷ The bill was subsequently vetoed by Governor Pataki.³⁸

Credit card use can be especially challenging for low wage and minority households. First, they more often carry a credit card balance than other credit card holders. Of those with credit cards in 2001, 84 percent of African-American credit card holders carried a balance and 75 percent of Latinos credit card holders carried a balance. This is very troubling because credit card holders that carry a balance, in effect, subsidize free riders or those that pay off their balances every month. In other words, higher income households are indirectly subsidized by modest income households. Second, minority households tend to experience higher levels of indebtedness. In 2001, one-fifth of credit card indebted African-American household spent nearly 20 percent of their income on debt payments. Those earning less than \$50,000 a year fared even worse. Over 40 percent of their income was spent on debt service payments.³⁹

Subprime and Non-Traditional Loans

Home ownership comprises the most valuable asset most consumers own. Stubborn and persistent disparities and discrimination in home mortgage and refinance lending must be combated in order to create and maintain opportunities for wealth creation for lower-income and minority families.

³³ Demos, June 6, 2004

³⁴ Demos, June 6, 2004

³⁵ Demos, June 6, 2004

³⁶ McGeehan, 2004

³⁷ Jalili, 2006

³⁸ "Pataki Blasted By Consumer Advocates And Lawmakers On His Veto Of Legislation Limiting Credit Card Rate Hikes," 2006

³⁹ Silva & Epstein, May 11, 2005

Subprime Mortgages and Refinance Loans In theory, a subprime loan has an interest rate higher than prevailing and competitive rates in order to compensate for the added risk of lending to a borrower with impaired credit. Predatory loans are a subset of subprime loans. Predatory loans, which often result in equity stripping and inequalities in wealth, have one or more of the following features:

- 1) Charges more in interest and fees than is required to cover the added risk of lending to borrowers with credit imperfections.
- 2) Contains abusive terms and conditions that trap borrowers and lead to increased indebtedness. These abusive terms include the sale of unnecessary products, balloon payments, and abusive prepayment penalties.
- 3) Does not take into account the borrower's ability to repay the loan.
- 4) Provides kickbacks to brokers.
- 5) Shows evidence of frequent loan flipping.
- 6) Imposes mandatory arbitration.
- 7) Practices fraud, including inaccurate appraisals to justify loan amounts, or inflated documentation of the income of borrowers.
- 8) Violates fair lending laws by targeting women, minorities and communities of color.⁴⁰

Many borrowers that receive subprime and predatory loans qualify for prime loans. Freddie Mac and Fannie Mae have estimated that a third to one-half of borrowers who qualify for market rate loans receive subprime loans.^{41,42} Subprime borrowers who would have qualified for prime loans pay mortgage rates on the order of 2 to 2.5 percentage points higher in the subprime market. On a \$200,000 financed over 30 years, the difference in interest payments at interest rates of 7 percent and 9 percent is over \$100,000. In neighborhoods where subprime lending is prevalent, this represents a loss of billions of dollars.

So what explains why some consumers that have credit ratings suitable for prime loans but receive subprime loans? There is abundant evidence that minority and elderly consumers are targeted by subprime home mortgage and refinance lenders. NCRC examined the home mortgage disclosure act (HMDA) data of ten large metropolitan communities in 2004. The study, which controlled for credit risk and housing market conditions, found that:

- The level of refinance subprime lending increased as the portion of African-Americans in a neighborhood increased in nine of the ten metropolitan areas. In the case of home purchase subprime lending, the African-American composition of a neighborhood boosted lending in six metropolitan areas.
- The percent of African-Americans in a census tract had the strongest impact on subprime refinance lending in Houston, Milwaukee, and Detroit. Even after holding income, creditworthiness, and housing market factors constant, going from an all white to an all African-American neighborhood (100 percent of the census tract residents are African-American) increased the portion of subprime loans by 41 percentage points in Houston.

⁴⁰ National Community Reinvestment Coalition and Rainbow/Push Coalition, 2005

⁴¹ "Fannie Mae Vows More Minority Lending," 2000

⁴² Freddie Mac, N.D.

- Solely because the percentage of the African-American population increased, the amount of subprime home purchase lending surged in Cleveland, Milwaukee, and Detroit. From an all white to an all African-American neighborhood in Cleveland, the portion of subprime home purchase loans climbed 24 percentage points. Similarly there was an 18 percentage point increase in Milwaukee and a 17 percentage point increase in Detroit.
- The impact of the age of borrowers was strong in refinance lending. In seven metropolitan areas, the portion of subprime refinance lending increased solely when the number of residents over 65 increased in a neighborhood.⁴³

NCRC also examined high cost home mortgage lending in Cincinnati. African-Americans Cincinnatians received a disproportionately greater amount of subprime (high-cost) loans than did whites. For example, only 9.59 percent of all-single family loans to whites were subprime, whereas 33.23 percent of loans to African-Americans were subprime. Generally, as income level increases, the likelihood of subprime lending decreases dramatically. That is, while moderate-income households (regardless of their race) in the City of Cincinnati constituted 19.06 percent of households, they received 40.00 percent of total subprime loans made, a ratio of 2.10. In contrast, upper-income households comprised 29.94% of the City of Cincinnati's households but received just 11.36% of subprime single family loans, a ratio of 0.38.

Based on 2004 Home Mortgage Disclosure Act (HMDA) data, NCRC found that minorities and immigrants receive strikingly high numbers subprime loans despite their economic status. Middle and upper income borrowers in white neighborhoods received just 8.3 percent of subprime home purchase loans, while the same income group in immigrant neighborhoods received over 13.6 percent of high cost loans. Markedly, women – regardless of ethnic or racial make-up - received over 32.1 percent of subprime loans made to all Americans even though females compose only 29 percent of the nation's households. In contrast, women received only 24 percent of the prime home purchase loans.⁴⁴

A 2005 Woodstock Institute study found that race is a more determinant factor of high cost loans than income. Lower-income African-Americans in the Chicago area were just over 3 times more likely to receive a high cost loan than a low-income white borrower. Moreover, an African American higher income borrower, earning at least twice the Area Median Income (AMI), was over 5 times more likely to receive a high-cost loan than a white borrower of the similar income. In fact, a high income African American borrower was over twice as likely to receive a high cost loan as a low-income white borrower.⁴⁵

There is further evidence that the financial status of borrowers does not totally explain patterns of subprime lending. Paul Calem of the Federal Reserve, and Kevin Gillen and Susan Wachter of the Wharton School used credit scoring data to conduct econometric analysis scrutinizing the influence of credit scores, demographic characteristics, and economic conditions on the level of subprime lending. Their study found that after controlling for creditworthiness and housing market conditions, the level of subprime refinance and home purchase loans increased in a

⁴³ National Community Reinvestment Coalition, 2004

⁴⁴ National Community Reinvestment Coalition, 2006

⁴⁵ Smith, May 2005

statistically significant fashion as the portion of African-Americans increased on a census tract level in Philadelphia and Chicago.⁴⁶

In addition, women and lower-income borrowers also receive a disproportionate share of subprime loans. In its 2005 study of 331 metropolitan areas, NCRC foundation that subprime lenders outperformed their prime lending peers in terms of issuing a higher percent of their loans to African-Americans, Hispanics, low-and moderate-income (LMI) borrowers, women, LMI census tracts, and minority census tracts. In fact, subprime lenders reached more women in every single metropolitan area observed and reached more African-Americans and LMI tracts in 98 percent of metropolitan areas observed.

This concentration of subprime loans has devastating impacts on lower-income and minority communities due to increased and spatially concentrated foreclosures. Foreclosures, in moderate- and low-income communities, turn what might typically be viewed only as a consumer protection problem in which an individual homeowner is overcharged or even loses their home, into a community development problem in which increased foreclosures lead to property abandonment and blight and destabilized neighborhoods. A 2005 econometric analysis by the Woodstock Institute analyzed the effect of subprime mortgages on foreclosure rates in the Chicago region. The study, which controlled for neighborhood demographics and economic conditions, concluded that subprime loans lead to a foreclosure rate nearly thirty times that of prime loans. The increase in foreclosures has a significant negative effect on neighborhood property values. The authors assert that foreclosures cause a decline in property values by at least 1.44 percent for each foreclosure within one-eighth of a mile of a house in a low- or moderate-income census tract. Given an average selling price of \$111,002, properties in low- and moderate-income tracts lost nearly \$1,600 in value per foreclosure for the average property.⁴⁷

Non-Traditional Loans While subprime loans remain a pressing public policy and consumer issue, the increasing use of non-traditional or exotic mortgages represent a relatively recent risk to asset preservation. Over the last few years, the use of non-traditional mortgages has surged. Initially offered in metropolitan areas with high cost home markets on the east and west coasts, these loans were made primarily to higher income consumers buying homes in rapidly appreciating markets. Non-traditional mortgages include interest only mortgages and option adjustable rate mortgages (ARMs). With an interest only loan, the borrower pays only the interest on the loan during a prescribed period, generally up to five years. Eventually, borrowers begin making principal and interest payments. Option ARMs, which are negatively amortizing loans, allow borrowers to make minimum payments that do not even cover the interest on the mortgage. In addition, many option ARMs begin at a low or teaser interest rate, sometimes several basis points below the long-term APR for the loan.

Non-traditional loans are increasingly popular. Comprising only 0.5% of all mortgages in 2003, 12.3% of mortgages were non-traditional in the first five months of 2006. In high cost markets non-traditional are even more popular, comprising more than 25 percent of all new mortgages made in 2006 in California⁴⁸ and 26 percent of loans in Naples, Florida. In addition, the use of

⁴⁶ Calem, Gillen & Wachter, October 30, 2002

⁴⁷ Immergluck & Smith, June 14, 2005

⁴⁸ Leonhardt, 2006

non-traditional loans is increasing in other markets. In the first quarter of 2006, option ARMs were over half of the loans made in West Virginia and 26% of loans in Wyoming.⁴⁹

The main purpose of these loans is to enable consumers that cannot afford a home or a higher priced home, to achieve home ownership. In theory, the borrower's income will rise to the level where they will be able to make full payments required or that the housing market will increase allowing the borrower to refinance the loan. However, these are risky assumptions given current economic conditions, increasing the possibility that a borrower of a non-traditional loan will lose their home and develop a negative credit history.

Non-traditional loans engender several consumer challenges, especially for lower-income consumers who are increasingly using these products:

Payment shock: Many borrowers of non-traditional products do not have sufficient income to pay fully amortizing loan payments. An option ARM loan of \$400,000 with minimum payments for the first five years can result in a 93 percent increase in monthly mortgage payments in the 6th year and an increase in the principal balance of 11 percent.⁵⁰

Suitability: These loans are often not underwritten to the borrower's current income. Some lenders underwrite to the low initial or teaser rate. In addition, underwriters also assume that home prices will continue to appreciate at a higher rate, and that the borrower will be able to refinance the loan, and build equity, even though they have not made any principal payments on the loan. Consumer advocates have asked regulators to mandate that these loans be underwritten to the borrower's current income and that future events should only be considered if they are predictable, likely and relevant.⁵¹

Pricing: Savings in monthly mortgage payments for nontraditional interest-only loans are not as great as many borrowers believe. The interest rates of fixed-rate interest-only mortgages are usually an additional one-eighth to three-eighths of a percentage point than traditional 30 year fixed rate mortgages. Therefore, on a 30-year \$300,000 mortgage at standard fixed rate of 6.62 percent would require monthly mortgage payments of \$1,920 compared to a 6.75 percent interest only loan with payments of \$1,687. The total monthly savings is only \$233 a month.⁵² In addition, with an ARM the interest rate is not locked in and may increase.

Inadequate Information: Many consumer and community activists are concerned that consumers are often not aware of the nature of non-traditional loans and the risks they carry as well as their impact on family budgets.

Lower-income consumers are particularly vulnerable to nontraditional loans. The loans are being increasingly marketed to consumers who are financially stretched. These borrowers tend to have very low downpayments and are more likely to have a second mortgage.⁵³ In addition, in many of the markets where lower-income people reside the home values are not increasing at a

⁴⁹ "They promise the American Dream: A home of your own -- with ultra-low rates and payments anyone can afford," 2006

⁵⁰ Dugan, 2006

⁵¹ "Proposed Guidance Lacks Punch, 'Unenforcable,' Groups Say," 2006

⁵² Simon, 2006

⁵³ Simon, 2006

very fast rate. As a result, the homeowner is not building equity in the home. Further, there are a growing number of option ARMs made to subprime borrowers. In fact, an estimated \$507 billion in these loans is expected to experience interest rate increases over the next two years.⁵⁴ Further, lenders are making prime and subprime option ARMs loans to borrowers with marginal credit that have other risky characteristics, including high loan-to-value ratios and no income documentation.⁵⁵

Most consumers find the home buying process confusing and challenging due to the financial and legal complexities of mortgage finance products. Subprime and non-traditional mortgage products make the home buying process even more complicated. As a result, consumers experience significant difficulties weighing various mortgage products and understanding the risks of their loans. The information imbalance is weighed heavily in favor of lenders. Therefore, interventions such as credit counseling and home ownership counseling are crucial to asset development. In addition, programs like CRF, which assist consumers experiencing difficulties with loans, including delinquencies and foreclosures caused by high cost fees and terms, are essential to enabling consumers to sustain home ownership.

NCRC's Consumer Rescue Fund

Introduction

Through the national anti-predatory lending Consumer Rescue fund (CRF), NCRC works with victims of predatory lenders so their mortgage payment becomes more affordable and foreclosure can be avoided. NCRC's member groups and their communities are an integral part of this program. The CRF identifies consumers who are in predatory mortgages and fixes the mortgages through mediation with lenders or arranging for refinance loans.⁵⁶ Consumers contact NCRC member organizations participating in the CRF program. In a number of instances, the NCRC members in the CRF program are counseling agencies assisting consumers experiencing delinquency and default on their loans.

NCRC and over 30 participating member organizations in Arizona, Ohio and New York launched the CRF initiative in October 2001 to help victims of predatory loans and/or individuals at risk of foreclosure. Today, the CRF has a nationwide reach, serving consumers in 17 states. NCRC member organizations (counseling agencies, Community Development Corporations, and others) identify families facing foreclosure and/or bankruptcy as a result of problematic loans. Fair lending specialists at NCRC then review loan documents including the Good Faith Estimate, income verification statements, and other forms in order to determine if the loans are in fact predatory. If NCRC staff conclude that the loans are predatory, NCRC staff pursue a number of options.

CRF intervenes in the following manners to turnaround a predatory lending situation:

⁵⁴ Dugan, 2006

⁵⁵ Shenn, 2006

⁵⁶ HSBC North America provides refinance loans for the CRF program and supports CRF counseling. Other sponsors of the CRF program include Select Portfolio Servicing, Inc, the Ford Foundation, Freddie Mac, The Fannie Mae Foundation, Fannie Mae, The JP Morgan Chase Foundation, and The Heron Foundation.

- *Mediation* with the lender or servicer to have abusive terms eliminated and to delay or stop foreclosure proceedings. Mediation is an effective means of assisting consumers since it is less time consuming and resource intensive than refinancing a problematic loan. Also, in a number of cases, a lender will seek to remedy an abusive loan and thus save the costs associated with foreclosure and other legal action. Lenders themselves have often been victimized by unscrupulous brokers or aberrant loan officers who have made abusive loans.
- *An affordable refinance loan.* NCRC has partnered with HSBC North America, which refinances the loans of predatory lending victims. The predatory loans are replaced with market-rate or below market-rate loans. The new loans also do not contain prepayment penalties, balloon payments, or credit insurance.
- *Litigation.* If NCRC discovers a pattern and practice of abusive lending or servicing on the part of a financial institution, NCRC will pursue legal redress when necessary. NCRC has filed complaints with the Department of Housing and Urban Development (HUD) arising from systematic abuses uncovered by the CRF program. The complaint process often ends before a formal trial when a lender makes a commitment to change an underwriting or marketing practice.

As well as re-negotiating loan terms and conditions, CRF staff negotiates over loan amounts in some cases. NCRC will negotiate with lenders to help customers whose appraisals have been inflated or whose mortgage debt are greater than their homes' worth because of predatory loans. NCRC will also attempt to have part of the loan forgiven.

Another critical component of the CRF program is financial education. Victims assisted through the program have numerous conversations with NCRC member organizations and NCRC fair lending specialists. NCRC member organizations and staff guide them through the remediation process and coach them on how to avoid predatory lending situations in the future.

To date, over a thousand consumers have been helped through the CRF's alternative dispute resolution, mediation, consumer counseling and financial education. Through this initiative, NCRC and its members are helping to stop mortgage lending abuses, stave off foreclosures and give victims a fresh start while keeping them in their homes. CRF sends a message of hope to those who have lost equity, security and pride—while identifying new tricks by predators and preparing the ground for legal action against them. Qualifying consumers are provided CRF assistance free of charge.

The CRF program has been instrumental in influencing best practices and public policies. As described below, the CRF program has contributed to best practices and reforms in the servicing of subprime loans, strengthened fair lending enforcement applied to brokers, federal regulatory policy regarding state laws, and best practices and alternative dispute resolution regarding appraisals.

The CRF program will mediate loans made in any state. Refinancing services are currently available in the following 17 states:

Alabama
Arizona
California
Florida
Georgia
Illinois
Indiana
Maryland
Massachusetts
Nevada
New York
North Carolina
Ohio
Pennsylvania
Rhode Island
Texas
Wisconsin

Data Analysis and Case Studies

The next sections of the report include data analysis and case studies. The data analysis involves a sample of loans in the CRF program. The analysis reviews demographic characteristics of the borrowers and their neighborhoods, various types of abuses, the interest rates before and after the refinances, and the equity saved for the borrowers in the sample. Then, the case studies provide vivid detail of the multiple nature of the lending abuses that lead to foreclosure and bankruptcy.

The data in this report is not intended to be a representative sample of the characteristics of predatory lending in the United States or all the CRF cases since 2001. This paper is a first attempt to study and analyze the characteristics of predatory loans in the CRF program. NCRC intends to enhance the analysis in the future with more robust statistical methods and larger samples. Nevertheless, NCRC believes that this first attempt provides valuable information about the attributes of predatory lending and also contributes to the development of programmatic and policy recommendations.

CRF Sample and Data Analysis

The following sample of CRF loans includes 112 cases. This paper also includes a second sample of 69 cases, which provides detail on payment burdens associated with abusive loans. At this point, the CRF data collection effort has been more geared towards assisting consumers and closing cases, as opposed to focusing on research. In future years, NCRC will endeavor to standardize the information collected and increase its research utility.

The dataset with 112 cases contains demographic and financial characteristics of these borrowers includes the following information:

- borrower's name
- borrower's address (removed here for privacy reasons, but the address was geocoded to a census tract category).
- income and minority level of the neighborhood where the borrower resides

- old and new monthly mortgage payments
- old and new interest rate
- loan amount
- lender's name
- year the new CRF loan was funded.

Demographics

Graph 1 shows that the majority of borrowers live in New York and Ohio. In particular, more than half of the borrowers live in New York and 11.6% live in Ohio. New York and Ohio were among the first states in which the CRF originally operated; community groups in these states remain especially active in identifying victims of predatory lending.

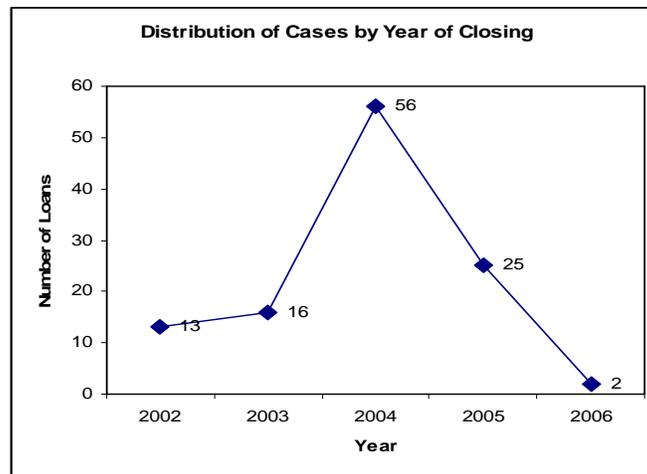
Graph 1

Distribution of Cases by State

State	NY	OH	FL	NC	TX	VA	GA	MD	PA	CA	IL	IN	MA	NJ	NV	TN	WI	N/A	Total
Number	62	13	4	4	4	4	2	2	2	1	1	1	1	1	1	1	1	7	112
Percent	55.4	11.6	3.6	3.6	3.6	3.6	1.8	1.8	1.8	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	6.3	100

The years 2004 and 2005 were the most productive years for the program in this particular sample: 56 loans were funded in 2004 and 25 cases in 2005. The totals for 2004 and 2005 constituted 73% of all loans refinanced in the sample (see Graph 2).

Graph 2



The CRF sample suggests that abusive lenders targeted minority neighborhoods, minority borrowers, low- and moderate-income neighborhoods and low- and moderate-income borrowers. Graph 3 shows the distribution of the cases by income and minority level of neighborhood (census tracts) for the sample of 112 loans. More than half (55.4%) of the borrowers resided in substantially minority census tracts (more than half the population in the census tract was minority according to the 2000 census). In contrast, only about 15.4% of the owner-occupied housing units across the country were contained in substantially minority tracts. The CRF sample, therefore, included a disproportionately large percentage of borrowers residing in

minority tracts. The finding that CRF borrowers disproportionately lived in minority neighborhoods is consistent with previous research discussed above that high cost lending was targeted to minority neighborhoods.⁵⁷ Since minority neighborhoods have received an excessive portion of high cost lending, it is likely that minority neighborhoods experience a disproportionate amount of abusive lending as documented by the CRF sample.

Table 4 reveals that the great majority of the borrowers in the CRF sample of 112 cases were African-American. About 77% of the borrowers in the CRF sample were African-American, 17% were white, and 3% were Hispanic. Most of the borrowers in the CRF sample were minorities residing in minority neighborhoods.

The CRF sample also revealed that a plurality of the victims of predatory lending lived in low- and moderate-income neighborhoods. About 6% of the borrowers resided in low-income neighborhoods and 41% lived in moderate-income neighborhoods as shown in Table 3. Across the country, only 1.6% of the owner-occupied housing units were in low-income census tracts and just 15% were in moderate-income census tracts according to the 2000 census. The finding that borrowers in low- and moderate-income tracts were targeted by abusive lenders in the CRF sample is also consistent with previous research documenting a disproportionate amount of high cost lending in these census tracts.⁵⁸ Borrowers in neighborhoods receiving a disproportionate amount of high cost lending are more susceptible to predatory lending. Abusive lenders take advantage of the absence of robust competition by issuing predatory loans.

A significant portion (28.6%) of the victims in the CRF sample lived in middle-income tracts. However, unlike the situation for borrowers in low- and moderate-income census tracts, the portion of victims in middle-income tracts (28.6%) was less than the portion of owner-occupied housing units (54.7%) in middle-income tracts.

Graph 3

Distribution of Cases by Minority Level of Neighborhood

Minority Level of Neighborhood	Number	Percent
Not substantially minority	38	33.93%
Substantially minority	62	55.36%
N/A	12	10.71%
Total	112	100.00%

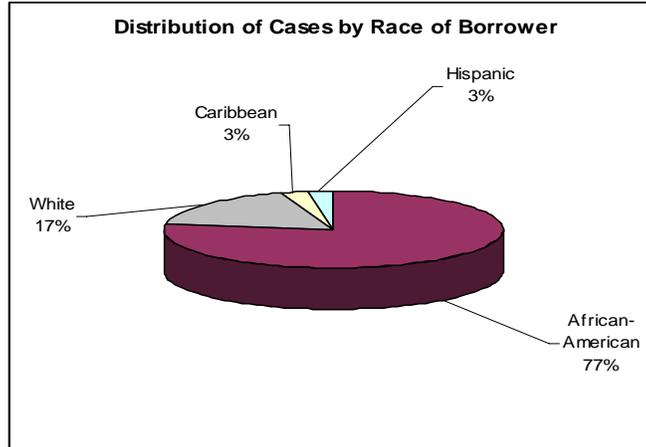
Distribution of Cases by Income Level of Neighborhood

Income Level of Neighborhood	Number	Percent
Low	7	6.25%
Moderate	46	41.07%
Middle	32	28.57%
Upper	15	13.39%
N/A	12	10.71%
Total	112	100.00%

⁵⁷ See, for example, *Homeownership and Wealth Impeded*, NCRC, PRRAC, and the Opportunity Agenda, April 2006, http://www.ncrc.org/policy/analysis/policy/2006-04-20_NCRC-OA-PRRACReport.pdf. See pages 17-19 and 23.

⁵⁸ See the *Homeownership and Wealth Impeded* report and page numbers cited above.

Graph 4



The majority of CRF borrowers were low- and moderate- income people. In particular, 51 borrowers (83.6%) out of 61 total (for which income information was available) had incomes below \$45,000 (see Graph 5). In addition, 20 victims (or just over 30%) had incomes below \$25,000. Only 10 borrowers had incomes above \$45,000 among whom 5 borrowers had incomes in the range between \$45,000 and \$55,000. In sum, most of the borrowers were low- and moderate-income and almost half the borrowers resided in low- and moderate-income census tracts.

Graph 5

Distribution of Cases by Income of Borrower

Income of Borrower	Number	Percent
less than \$15,000	6	9.84%
\$15,001-25,000	14	22.95%
\$25,001-35,000	16	26.23%
\$35,001-45,000	15	24.59%
\$45,001-55,000	5	8.20%
\$55,001-65,000	2	3.28%
\$65,001-75,000	1	1.64%
\$75,001-85,000	2	3.28%
Total	61	100.00%

Wealth Stripped and Equity Saved

In order to evaluate the program's impact on preserving equity, NCRC evaluated the interest rates of the previous predatory loans and compared them to the new refinance loans issued through the CRF program (see Graph 6).

In the sample of 112 cases, the loan amount ranged from \$8,000 to about \$400,000. The median principal amount of the loans was approximately \$157,000. The mortgage rates of the previous predatory loans ranged between 5.5% and 17%. The median prior mortgage rate was 9.38%.

Graph 6

Analysis of loan terms before and after refinance

	Principal Amount	Prior Mortgage Rate	New Mortgage Rate	% points difference	Old Monthly Payment	New Monthly Payment	\$ Savings
Average	\$156,986.2	9.58%	5.74%	3.84%	\$1,198.4	\$922.0	\$276.5
Median	\$161,280.4	9.38%	6.00%	3.38%	\$1,165.8	\$941.7	\$224.1

The interest rates of the refinance loans were considerably lower than the rates of the previous predatory loans. The new loans had interest rates ranging between 1% and 8%. The median rate of the new refinance loans rate was 6.00%. The difference between the median rate of the previous loans (9.38%) and the new loan (6%) was 3.38 percentage points, which results in substantial amount of equity saved over the life of a loan.

CRF customers have been able to save millions of dollars of wealth by refinancing out of abusive loans. The average monthly payment was \$1,198 for the abusive loans. For the new refinance loans, the average monthly payment was only \$922. As a result of the refinancing, the average monthly savings was \$276.50, which equates to \$3,318 annually. Assuming a 30 year loan term, the total savings on an average loan would be \$100,000. Given that the CRF program has assisted at least 1,000 victims through either refinancing or loan modifications, the program has saved borrowers approximately \$100 million in equity.

Abusive Loans Beyond Repayment Ability

Another sample of 69 CRF cases included calculations of the monthly housing payment-to-income ratio (front-end ratio) and the monthly total debt-to-income ratio (back-end ratio).

The front-end and back-end ratios of the predatory loans in the CRF sample were considerably higher than common limits in standard underwriting guidelines. The average front-end ratio was about 41% and the median was 35.4%. The average back-end ratio was 50.3% and the median was about 50% (see Graph 7). Standard front-end and back-end ratios for prime loans are 28% and 36%, respectively. The considerably higher ratios of the predatory loans in the CRF sample suggest that the loans were beyond the consumers' abilities to repay, leading to financial distress and/or bankruptcy and foreclosure.

Graph 7

Debt-to-income Ratios		
	Front-end Ratio	Back-end Ratio
Average	40.77%	50.28%
Median	35.43%	49.78%

Compounding the high front- and back-end ratios was the fact that most of the loans in the CRF sample did not have escrows covering property tax payments and hazard insurance. Two thirds of the borrowers in the CRF sample did not have escrow accounts. On top of housing payments and debt levels that were unsustainable, a number of the CRF borrowers experienced payment shock when they discovered that they had thousands of additional dollars in taxes and hazard insurance payments that were not covered by the loans.

Predatory Loan Characteristics – What has Changed and What has Stayed the Same

Since the inception of the CRF in 2001, abusive lenders have adapted their tricks and traps. Some of the core tricks such as fee packing (charging very high fees that strip equity) have remained constant. Another constant is interest rates and fees that are not justified by risk (as reflected in a consumer’s credit score).

Predatory lenders, however, have discarded a number of tricks that have received much public criticism from public officials, regulators, and community activists. CRF staff, for example, report that single premium credit insurance is considerably less frequent than it was a few years ago. Premiums for insurance covering disability, job loss, or death were added to the loan amount; interest was assessed for 30 years for these insurance products that often provided coverage for only five years. Another abusive practice, mandatory arbitration (requiring borrowers to use arbiters instead of the courts) has also appeared less frequently in loans than in previous years. Finally, violations of the federal Home Ownership and Equity Protection Act (HOEPA) are less common. The good news is that much of the decrease of these particular abuses can be attributed to a consensus among industry, regulatory officials, and community groups to rid loans of these practices.

The bad news is that a number of other abusive practices are on the increase. Excessive yield spread premiums (or payments to brokers for securing higher interest rates than the lender would normally charge) are on the rise according to CRF staff. Appraisal fraud has also been increasing.

The other abusive practices that are on the increase include:

- *Misrepresentation to consumer* – Documents required to be shared shortly after a borrower’s application are not shared by the lender until the closing date. These include the Good Faith Estimate (GFE), disclosures of the Annual Percentage Rate (APR), finance charges, and other items mandated by the Truth in Lending Act, and a document

indicating if servicing rights are being transferred (in other words, if the lender/broker will fund or sell the loan). The unscrupulous lender will also not establish escrow accounts for taxes or insurance payments and/or will not discuss the costs of taxes and insurance payments. These payments add substantial amounts to monthly costs and can create substantial financial distress if the borrower is not prepared for them. The incidence of misrepresentation has increased because a lack of transparency by the lender is harder to discover by agencies/lawyers trying to assist the borrowers. For example, it is relatively easy to put a date on a GFE that is close to the time of the borrower's application, although the GFE was not provided until closing.

- *Exotic Mortgages* – Risky loan products, commonly known as exotic mortgages, have increased because housing costs increased. Unscrupulous lenders are trying to concoct methods to qualify borrowers for homes they cannot afford or can barely afford. Stated-income loans forego the usual documentation of a borrower's income level through pay stubs and tax returns. Using stated-income loans, abusive lenders/brokers can readily inflate incomes to qualify borrowers for unaffordable loans. Abusive lenders are also qualifying borrowers for option Adjustable Rate Mortgage (ARM) loans using initial rates as low as 1%. In addition, unscrupulous lenders are underwriting loans using lower monthly payments that cover only interest payments on "interest" only loans. This type of underwriting will eventually present unaffordable situations for borrowers when they need to start paying principal and interest after the expiration of the interest-only payment period on interest only loans or after the expiration of the initial low rates on option ARM loans.

Finally, piggyback loans are becoming increasingly common. A lender will combine an interest only or option ARM first lien loan with a second lien (or piggyback loan). The piggyback loan is often a home equity line of credit (HELOC). The piggyback loan is usually more expensive than private mortgage insurance (PMI) that would be required if the piggyback loan was not made. Risk layering of a number of exotic features – interest-only, option ARMs, piggyback HELOCs, high loan-to-values, stated income – is a recipe for financial disaster for borrowers with limited incomes and/or imperfect credit.

- *Abusive Servicing Practices* – In recent years, servicer abuses have climbed. Servicers may or may not own the loans; they process borrower payments, verify that the borrowers have homeowners' insurance and perform other administrative functions. Abusive servicers do not record borrower payments that are received so that they can charge high late fees. Another predatory practice is forced placed insurance, or assigning expensive homeowners' insurance policies to borrowers whom the servicers allege do not have insurance. According to CRF staff, the force placed insurance can cost as much as \$2,500 as opposed to \$900 for standard policies.

The list immediately below provides a catalogue of the abuses borrowers in the CRF program have encountered. What is alarming is the number of abuses and their ingenuity and variety.

Abuses	Description
asset-based lending	Lenders evaluate a loan application by looking only at the quality of the security or equity, and not at the ability of the borrower to repay the loan
forced placed insurance	Servicer assigns hazard insurance to borrower, coverage is usually much more expensive
HOEPA loan	A loan with a very high interest rate and/or fees that is covered by federal consumer protections. Predators violate the legal protections of HOEPA loans.
Mandatory arbitration	Stipulation that a borrower cannot sue a lender in a court of law, but must use an arbiter
prepaid credit insurance	Insurance financed into the loan that would cover mortgage payments in a case of disability, unemployment, death. Much more expensive than paying monthly outside of loan
abuse of right to cancel	Abusive practices that make it hard for a consumer to cancel a mortgage (ie. abusing right of rescission)
abusive collection practices	Aggressive tactics of collecting late payments
default interest rate	Increasing interest rate in case of delinquency
excessive prepayment penalty	Excessive fee for paying off a mortgage before its maturity
insincere co-signers	Adding insincere co-signers to the application in order to inflate the income of the borrowers. Abusive lenders will add children and other insincere co-signers who cannot contribute to loan payments.
loans made in excess of 100% LTV	When the loan amount exceeds the fair market value of the home
negative amortization	Loan product that requires a monthly payment that does not fully amortize a mortgage loan, thereby increasing the loan's principal balance
flipping	Persuading a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced
fraud	Example: Forging signatures on loan documents
lack of TNB	Lack of tangible net benefits that justify the origination of a new, higher-balance and high-cost loan
targeting/discrimination	Cases when lenders specifically market predatory loans to customers based on race, ethnicity, or age
predatory appraisal	Overestimating the market value of the house
balloon payment	A mortgage that has level monthly payments over a stated term but which provides for a large lump-sum payment to be due at the end of an previously specified term
equity stripping	A case when a homeowner's equity is reduced due to repeatedly refinancing, high fees, and other abuses
home improvement scam	Home improvement costs financed into the mortgage usually paid by a lender to a home improvement contractor directly.
misrepresentation	Misrepresentation of loan terms to a borrower
falsified application	Falsifying loan applications (particularly income level or adding insincere co-signers, etc.)

Stated income	Not requiring full documentation of income from tax forms and paystubs. Reduced documentation or stated income loans increase the chances of fraud.
yield spread premium	Fee paid by lenders to brokers for loans carrying interest rates above a par rate
abusive servicing practices	Servicers not recording payments, force placing insurance, applying high late fees, etc.
unfair terms	High interest rates and loan terms not justifiable by risk (consumer's credit score)
fee packing	Charging undisclosed, improper, and high fees

Borrowers can sometimes deal with abusive loans and make payments on time despite the financial burden involved. The CRF program, however, has assisted a number of borrowers who have experienced temporary hardship and emergency medical issues that make an abusive loan an unsustainable burden. If the abuses had not occurred and the loan had been a responsible prime or subprime loan, the temporary hardship could be overcome. For example, the borrower could have negotiated a forbearance plan with the lender. In the case of predatory lenders, in contrast, the borrower has no opportunity to work with the lender in salvaging the situation. Abuses turn the temporary hardship into a financial catastrophe. The next section presents a number of case studies, some of which involve temporary hardships and abusive lending.

CRF Case Studies

The CRF case studies below illustrate vividly the nature and extent of abuses on predatory loans. In some cases, the CRF program was able to provide financial relief and save homes by arranging for a refinance loan through HSBC North America. In other cases, the situation is still pending. But in still other cases, the CRF program was not able to provide assistance; the predatory loan was so abusive that even below market-rate refinancing was not viable.⁵⁹ While tragic, the inability to provide assistance on some cases illustrates the financial disaster that predatory lending imposes upon families and neighborhoods. The names of the consumers and lenders have been fictionalized for privacy reasons. The circumstances of the loans have not been changed.

Case Study 1 – Brooklyn, New York

Predatory or Problematic Nature: Exorbitant rate, predatory default provision.

Ms. Rosepetal is an African-American mother of two young children. She has lived in her home in Brooklyn for over twenty years, and took sole ownership of the home when her husband passed away in 1995. The home is a four-unit building; Ms. Rosepetal occupies one of the units with her children and had tenants that occupied the other three units. From these tenants she received \$2,060 monthly in rental income. Ms. Rosepetal was also employed as a secretary for a health care company and earned an annual salary of \$20,522 (\$1,710 monthly). Following the passing of her husband, she received Social Security survivor benefits for one son of around \$500 monthly. Thus, in total, her monthly income was around \$4,270.

⁵⁹ In a number of CRF intake cases, the mismatch between income levels and home values are just too great, meaning that refinance loans are not possible.

In 1991, Ms. Rosepetal consolidated some home repair debts into a home equity loan for \$91,000 from Acme Funding. Despite the fact that she had a good credit rating, Acme gave her a 15-year loan at an exorbitant interest rate of 14.75 percent (as reported by Freddie Mac, the average rate for a 15-year loan was a much lower 8.75 percent at that time). With these terms, Ms. Rosepetal's monthly payment was \$1,654.92, which was a burdensome 38.75 percent of her monthly income. The Rosepetal family was able to make these payments until long after Mr. Rosepetal passed. In 2002, Ms. Rosepetal had problems with non-paying tenants and had to evict one of them. Because of this loss of income, Ms. Rosepetal was unable to make payments on the loan, and her home went into foreclosure in January 2002. At that time, she filed for bankruptcy in an emergency attempt to avoid foreclosure. However, the loan through Acme had a default provision that increased the interest rate from an already high 14.75 percent to an outrageous 24.00 percent as a result of the foreclosure.

In April 2002, Ms. Rosepetal contacted CRF staff, which got to work collecting documents on her case. She received a refinance loan through the CRF program, which gave her a new loan for \$113,319 at an interest rate of 7.00 percent. As a result, her new monthly payment is \$753.60, a difference of \$901.32 from her old payment of \$1,654.92 and a much more manageable amount. In addition to this reduction, Ms. Rosepetal received a much lower rate, and severed her relationship with the shifty Acme Inc.

Case Study 2 – Long Island, NY

Predatory or Problematic Nature: Steering, shoddy construction, misrepresentation, inflated appraisal.

Mr. and Ms. Gladiolus are an African-American couple living on Long Island. At the time of the incident, the Gladioluses had an annual income of \$59,448 (\$4,954 monthly), a moderate income given the cost of living in Long Island. In 1996, the Gladioluses saw a newspaper advertisement from Smith Homes, a developer building homes in the town of Brookhaven. The Gladioluses contacted Mr. Smith about the possibility of building a home. Mr. Smith showed them several properties; later, the Gladioluses believed he steered them to a lot in a predominantly minority neighborhood. Furthermore, Mr. Smith assured the Gladioluses about many features of their new house and its mortgage: a government subsidy towards the downpayment; the first years' taxes free; a construction package that included high-end cabinetry, appliances, vanities, counters, tile, landscaping, and an alarm system. Mr. Smith also assured them that the neighborhood was free of drug-dealing and prostitution.

Based on Mr. Smith's descriptions, the Gladioluses agreed to purchase the ranch-style home for \$150,000. They signed a contract to purchase the land, building, and other improvements. The Gladioluses did not know that Mr. Smith had arranged for a false appraisal report, which over-valued the property and offered it to the Gladioluses at a substantially higher rate than its fair-market value. Furthermore, Mr. Smith told them that in order to complete the transaction they would be required to obtain a loan from a lender of Mr. Smith's choice. The Gladioluses closed on the home in February of 1997. Mr. Smith selected Acme Mortgage, which offered a 30-year mortgage for \$145,000 at an APR of 10.625 percent. The points, fees, and yield-spread premium (YSP, or fee paid to the broker) totaled \$2,378.60. Total fees were 6 percent of the loan value, an unusually high amount, given that fees typically total 1 percent on prime mortgages (In fact,

Fannie Mae and Freddie Mac have pledged not to purchase loans with fees exceeding 5 percent of the loan amount). Their monthly mortgage payment was \$1,159.54.

The Gladioluses moved in shortly thereafter and found several problems with their new home. The quality of construction was shoddy: some of the walls began to crack, the boiler didn't work properly, and they experienced electrical problems. Furthermore, Mr. Smith did not come through with any of the incentives promised to them, including the rebate and cancellation of taxes. Mr. Smith did not respond when the Gladioluses reported these problems. Moreover, Mr. Smith operated several different companies which handled the sales, construction, and other functions. It was not clear which entity was in charge of what function.

After the first year of the loan, the monthly payment increased significantly. Not until 2004 did the Gladioluses begin to experience difficulty in making timely and complete payments. It was around this time that they contacted the CRF, which went to work collecting documents. The CRF negotiated a 30-year refinance loan at 6.99 percent. This lowered their monthly mortgage payment considerably and saved the family's home.

Case Study 3 – Dayton, Ohio

Predatory or Problematic Nature: Excessive fees, misrepresentation by broker, possible over-appraisal.

Mr. and Mrs. Tulip are an elderly couple living on a fixed income with little savings. At the time of the incident, they lived in a modest home in a small town outside Dayton, Ohio. Their monthly income was \$4,038.53, which includes SSI benefits. In December of 1999, with their savings slowly running out and their ability to pay slowly dwindling, the Tulips refinanced their home.

This refinance mortgage covered the original mortgage on their house, some consumer debt, and allowed them a small amount of cash out (\$2,963). The new mortgage they received was for 20 years with a principal of \$189,125, and carried an APR of 10.863 percent. It thus had a monthly payment of \$1,234.64. Their loan agreement dated December 9, 1999 indicates that their fees were to be 5.5 points (that is, 5.5 percent of the loan), an excessive amount which is much greater than the typical 1 percent of a prime loan (Also, Fannie Mae and Freddie Mac have pledged not to purchase loans with fees exceeding 5 percent of the loan amount). At the signing, the Tulips' broker told the couple that he had to leave to get to another closing, and did not have time to fully explain the terms to them or let them read the contract. When the Tulips hesitated, the broker told them that they had nothing to worry about and would explain the terms later. When the Tulips called in the ensuing days to reach him, their calls were not returned.

In 2002, the Tulips were not able to keep up with their payments and filed Chapter 7 bankruptcy to avoid foreclosure. At that time, their lender voluntarily modified the mortgage (over two years after the closing) to a principal balance of \$129,000, based on a new appraisal. This led the Tulips to believe that the home was overappraised at the time of the refinance in December 1999. Nevertheless, this modification lowered the monthly payment by over \$400 and allowed the Tulips to stay in their house. However, their fixed income was still not enough to keep up with their expenses and they filed for bankruptcy again in 2003, this time Chapter 13.

Case Study 4 – Cleveland, Ohio

Predatory or Problematic Nature: Abusive balloon payment, possible overappraisal.

Mr. and Mrs. Marigold are an elderly couple living in a house in a low-income neighborhood of Cleveland, Ohio. Their monthly income at the time was \$2,824. They lived in their home for over twenty years, and in 1999 received a refinance for a better rate. This new loan was a 30-year mortgage for \$67,500 (based on the value of the home given by an appraiser) with an APR of 11.6 percent. The monthly payment on this mortgage was \$642.

Mr. Marigold fell ill and had to pay large medical bills, causing the Marigolds to miss several payments on their mortgage starting in January 2001. In late 2003, their lender began foreclosure proceedings. At the last minute, the Marigolds entered a forbearance agreement under which they would continue to pay their regular monthly payment, despite the fact that they had missed almost two years' worth of payments. However, this agreement was on the condition that the arrearages, with interest, would become due on April 5, 2004.

Mr. Marigold attempted to refinance out of this situation, both through his original lender and with other lenders, in December 2003. He had hoped to find a mortgage to pay off his principal balance and the additional balloon payment. He was dismayed to have his property appraised at a value of \$59,000, substantially lower than the appraisal of \$67,500 he received when refinancing in 1999. As the new appraisal indicates that property values in the area were stable, it is likely that the refinance in 1999 was fraudulent.

This balloon payment was in the amount of \$29,325 which the Marigolds did not have the funds to pay. At this time, the Marigolds' lender contacted the Consumer Rescue Fund, which got to work collecting documents on the loan. The CRF was able to extend the Marigolds a loan to cover both the original amount and the additional balloon payment, in the total of \$77,000. This loan was for 30 years and carried an APR of 6.99 percent, dramatically lower than the original rate of 11.6 percent. Their new monthly payment was \$511, a much more manageable amount.

Case Study 5 – Charlotte, North Carolina

Predatory or Problematic Nature: Misrepresentation.

Ms. Iris is an African-American single mother with one child living in Charlotte, North Carolina. At the time of the incident, she worked for US Airways and had a monthly income of \$2,022. Ms. Iris decided in late 2004 that she wanted to purchase a newly built home in her area of town. After identifying a new development she liked, its builder referred her to a local mortgage broker from Acme, Inc.

Ms. Iris met a broker from Acme and brought with her a \$50 application fee. When the broker noticed she worked for US Airways, he successfully talked her into surrendering four "buddy passes" – the flight coupons that the airline offers its employees. When Ms. Iris received a follow-up call from her Acme loan processor, it was not about the loan itself, but instead another solicitation for her buddy passes. After another meeting initiated by Ms. Iris and another fee of \$65, Ms. Iris was finally given a preapproval worksheet for a 30-year loan of \$122,000 at 9.5% APR. Because the monthly payment, taxes, and insurance would have been out of Ms. Iris's

price range, she decided to purchase a smaller townhouse home for \$110,890 at 8.625% APR. Believing that everything was going smoothly, Ms. Iris drove by the home a few weeks later only to see that it was back on the market. Upset, she called the builder, who said the loan officer told him that she no longer wanted the property. The next day she got a call from the owner of the brokerage, who apologized not only for this incident but also for the buddy pass incident. He did not, however, offer to remunerate her for the buddy passes.

When Ms. Iris finally went to the closing, several items on the disclosure forms were incorrect. The loan documents showed an APR of 10.0 percent, not the 8.625 percent she was expecting. Further, the fees she had already paid were absent from the disclosure forms. What's worse, the purchase price was over three thousand dollars greater than the amount on the preapproval form. Nevertheless, Ms. Iris agreed to a 30-year adjustable rate mortgage for \$107,235, a monthly payment of \$941.

Despite the fact that the payment was much higher than Ms. Iris anticipated, she managed to keep up with payments for several months. However, US Airways went into bankruptcy and required its employees to take a 21 percent cut in pay with little warning. She was able to catch up by taking a loan from her 401k retirement plan, but nevertheless was not able to sustain such a high payment.

The Consumer Rescue Fund heard about this case in the spring of 2005 and got to work documenting the case. Its funder came through with an especially low APR of 3.00% on the original purchase price. Thus, Ms. Iris's monthly payment was cut from an exorbitant \$941.06 to a much more manageable \$464.83.

Case Study 6 – Oakland, CA

Predatory or Problematic Nature: Flipping, predatory prepayment, stated income loan, mortgage payment out of proportion with income.

Ms. Begonia is an African-American who bought a home in Oakland, California in December 1999. At the time of the incident, her income was \$47,328 annually, or \$3,944 monthly. She has undergone a series of unnecessary refinances, each of which has added a multitude of duplicative fees and has inflated the amount that she owes.

In December 1999, Ms. Begonia purchased her home for \$108,000. Approximately nine months later, she underwent her first refinance, which she thought would lower her rate and allow her to cash out a modest amount of money for roof repairs. Instead, this new mortgage for \$140,250 stripped equity from her by paying off a prepayment penalty without her knowledge. Further, the Good Faith Estimate for this transaction also shows that Ms. Begonia was to be charged lender and broker fees of 5.76 points (5.76 percent of the loan, or \$8,076), an amount much greater than typical prime fees of 1 percent of the loan amount (Also, Fannie Mae and Freddie Mac have pledged not to purchase loans with fees exceeding 5 percent of the loan amount).

In August 2001, less than a year after her first refinance, Ms. Begonia refinanced a second time. The new loan for \$187,500 was adjustable and carried a three-year prepayment penalty. In October of 2003, Ms. Begonia refinanced a *third* time, this time a 30-year fixed loan for \$240,000. The broker and lender fees on the Good Faith Estimate were \$5,745, or 2.4 percent of

the loan. In this refinance, Ms. Begonia received a small amount of cash out to pay off student loans. She refinanced for a *fourth* time in July 2004. On this loan, her income was greatly inflated at \$6,000 monthly, when it in fact was only \$3,944. Consequently, the monthly payment on this fourth and final refinance was \$1,887, which was an overwhelming 47.87 percent of her income.

Case Study 7 – Middle Island, New York

Predatory or Problematic Nature: Misrepresentation, steering, inflated appraisal.

Mr. and Mrs. Smith are an African-American couple living in Middle Island, New York. In 2000, Mr. Smith responded to a local newspaper advertisement offering Burns homes for sale. This advertisement offered the promise of providing affordable housing to qualified individuals under the federally-insured FHA program. The Smiths responded to the advertisement and contacted Mr. Burns about the possibility of building and purchasing a home. After meeting the Smiths, Mr. Burns steered them to purchase a home in an area with a predominantly minority population. Mr. Burns then represented the home as being in a drug-free and prostitution-free neighborhood, with features such as high quality construction, upgraded cabinetry, vanities, counter tops, tile and paint, a full basement, landscaping and an alarm system. In addition, Mr. Burns promised them an appliance package, a government subsidy toward the mortgage, the first year's taxes free, and a rebate at the end of the first year of the mortgage.

The Smiths agreed to purchase the home for \$197,000, and entered into a contract with Mr. Burns to purchase the land, buildings and improvements. They were then told by Mr. Burns that in order to finalize the transaction, they would need to secure a loan from a lender of Mr. Burns' choice, who selected Johnson, Inc. The Johnson, Inc. loan came with an interest rate of 8.5% and monthly payments of \$1942. The Smiths combined monthly income was \$7,528.

The Smiths were unaware that Mr. Burns had conspired for the preparation of a false appraisal report that intentionally appraised the value of the property at an amount substantially higher than the fair market value of the property. This deception proved to be the first in a long string of abuses against the Smiths, as almost every one of Mr. Burns' promises proved to be false. The Smiths never received a rebate, and the house was plagued with a myriad of problems, including but not limited to: a cracked foundation, faulty plumbing, grading problems, and no landscaping. Due to a provision in the mortgage that Mr. Burns failed to explain, the monthly mortgage payments rose over \$200, to \$2187, raising their debt-to-income ratio to 29%. They were even deceived about the neighborhood; despite Mr. Burns assurances, the neighborhood was frequented by drug dealers and prostitutes. Although they were purportedly represented by an attorney prior to contract on their transaction with Mr. Burns, the attorney was selected by Mr. Burns. Moreover, they were not given the opportunity to meet with this attorney prior to contract.

When the Smith's monthly mortgage payment increased significantly after the first year of the loan, they began to experience difficulty in making timely and complete payments. The plaintiffs sought legal aid, and were referred to the Consumer Rescue Fund by their lawyer with hopes of obtaining a reduced mortgage while the law firm continued litigation. With the help of the Consumer Rescue Fund at NCRC, the plaintiffs were able to secure a loan of \$192,400 to

payoff the first mortgage in full at 7% rate, 360 month term, with new payments of \$1,279/per month equaling \$293/per month in payment savings.

Case Study 8 – Akron, Ohio

Predatory or Problematic Nature: Fee packing, misrepresentation

Ms. Bean, a resident of Akron, Ohio, refinanced her mortgage in March of 2000. She expected the transaction to improve her financial situation and her credit. However, the promises her broker made turned out to be empty.

When Ms. Bean refinanced through a broker, she paid off her existing mortgage and a car loan. She was told that her new loan would reduce her monthly payments by \$300. The mortgage and car payments combined were around \$930 at the time. The new mortgage payment was \$729, which saved Ms. Bean only about \$200. When Ms. Bean asked about why the payment was higher than the lender had originally mentioned, she was told that it was because they had paid off her delinquent taxes. In fact, the disbursement for taxes was only \$ 1,207, a relatively small amount that would not have increased the proposed payment by \$100. At the time, Ms. Bean's monthly income was \$3,608.

This refinance also contained abusive broker fees. Ms. Bean was charged a loan discount of \$782, broker's compensation of \$4,729 and a processing fee of \$125. In total, these fees were 7.2% of the loan amount, an unusually high amount, given that fees usually total 1 percent on prime mortgages (Also, Fannie Mae and Freddie Mac have pledged not to purchase loans with fees exceeding 5 percent of the loan amount). The total settlement charges amounted to 8.8% of the loan amount. This loan also contained a balloon feature, which Ms. Bean did not fully understand when refinancing.

Some time after the refinance, Ms. Bean over-extended finances in an attempt to satisfy other outstanding consumer debts. This, in conjunction with some minor home repairs, caused her to take out several payday loans. The vicious cycle of fees caused Ms. Bean to eventually become delinquent on her mortgage. She was given a forbearance agreement, and eventually had her loan modified in December 2003.

The loan modification, however, still contained abusive features and involved questionable servicing practices. Ms. Bean's credit report reflects that she had a thirty-day late payment, and that she had resolved it. No foreclosure was initiated. However, when the servicing on Ms. Bean's loan transferred in July of 2005, she received a letter indicating that the outstanding collection costs on her account totaled \$3,191. It is not understood why this amount was not included in the loan modification. Ms. Bean has been attempting to satisfy the outstanding amount by including extra funds in her monthly payment. Although her loan has been modified, she has had to make payments that are higher than anticipated.

Ms. Bean contacted the CRF to help alleviate her financial distress. Working together, CRF was able to secure Ms. Bean a new mortgage at a principle of \$75,000 and an interest rate of 6.39%. With monthly savings totaling a hundred dollars and an improved interest rate by 1.61 percentage points, Ms. Bean found financial relief for her predatory mortgage.

Case Study 9 – Peabody, MA

Predatory or Problematic Nature: Misrepresentation, Abusive Servicing, Fraud regarding borrower income, Inappropriate Collection Practices

Ms. Lytle, a resident of Peabody, MA, obtained a refinance in October 2002 because she was ordered to do so in a divorce settlement. NCRC's investigation of her 2002 finances showed her gross income from employment was \$49,524, a monthly amount of \$4,127. On her mortgage application, however, her gross monthly income was inflated to an amount of \$4,425. Ms. Lytle was told by her broker that she would be getting a loan with a fixed 8% rate. However, at signing, she was presented with documents for an adjustable 9.75% loan. Ms. Lytle did not receive any preliminary disclosures to indicate that she was getting an adjustable mortgage, which is a violation of the Truth In Lending Act. Her mortgage application was signed and dated on the same day that her closing papers were, which supports this allegation. Ms. Lytle also never received a good faith estimate.

With the higher rate, she knew she could not afford to pay for very long. When the time came to sign, she felt that she had no other options because she had been ordered to refinance her ex-husband off her mortgage by the divorce court judge. She had been given 90 days to do so, and figured she did not have enough time to apply and close a loan with another lender. At the time of the application, her net income was only \$2200 monthly yet she was approved for a loan with housing expenses of \$2,100 (which includes payment, taxes, and insurance). Further, Ms. Lytle thought that she could later refinance her loan to a lower, market rate, but with the high payment she was given, no other lender could finance her. Ms. Lytle soon defaulted on her loan (July 2003), despite her intentions to make a fresh start after her divorce. Loan Center collection agents have called her up to thirteen times in one day regarding her default. The Fair Credit Reporting Act prohibits excessive collection tactics such as this. After the harassing calls, the lender commenced the foreclosure process.

An additional problematic issue was the way the loan was structured, making it unaffordable. The initial rate on the ARM (adjustable rate mortgage) was 9.75%. The index used in calculating Ms. Lytle's new rate at the time of the projected change (November 2004) was the six-month LIBOR, which was about 1.5789. Historically, this index has not gone low enough for Ms. Lytle's rate to change for the better, and if it were to change today, the loan's APR would increase to 11.125%. Coupled with the fraud on the application, this ARM structure indicated a blatant disregard of Ms. Lytle's ability to pay.

Ms. Lytle contacted the CRF, hoping that they could help refinance her mortgage. Fortunately, the CRF was able to help Ms. Lytle, and secured for her a new mortgage at a principle of \$210,000 and interest rate of 6.99%. At 2.76 percentage points lower than her previous rate, Ms. Lytle not only saved over four hundred dollars a month, but also no longer had to fear interest rates rising to double-digit levels.

Case Study 10 – Austin, TX

Predatory or Problematic Nature: Misrepresentation, Lack of Escrow Account, Pricing beyond Risk, Inflated Appraisal

Ms. Stanton of Austin, TX is a single mother of three children who refinanced her home mortgage in August of 2002 because she wanted to take advantage of lower rates. Before the refinance, her mortgage at the time was at 8% fixed, and her total monthly payment was \$746, of which \$403 was principal and interest. When Ms. Stanton refinanced, she took a small amount of cash out and paid down a credit card. She was told that her rate would be lowered, and that her new mortgage payment would be \$746. Ms. Stanton believed that this new payment, like her former one, would include taxes and insurance. She thought that she would be paying down the credit card and that her payment would be virtually the same.

At the time of Ms. Stanton's signing, she believed that her new lender, Absolute Loans, would be collecting for taxes and insurance. Her financial difficulties began when her taxes came due and she was unprepared to pay them. It was only then, some time after her loan closed, that she reviewed her loan documents and found that she had a 14.35% interest rate.

A review of her credit report shows the extreme financial strain she had been under. Several new collections had been added in the past few months from credit cards, because she had attempted to pay her mortgage company, Absolute Loans, before anything else. Her credit profile before this mortgage showed moderate problems, but nothing that would cause Absolute Loans to charge her the exorbitant 14.35% interest rate. She also had three different HUD 1 disclosure forms for the loan, and she did not know which one was valid.

Ms. Stanton's mortgage application showed a monthly income of \$1,883. Ms. Stanton has verified that this was accurate at the time. Her total housing expense was calculated at \$945.40. This was 50.2% of her gross income, whereas 30% is considered reasonable. Ms. Stanton's loan application shows some inconsistencies: her three children were not listed on the application even though they had always lived with their mother. Also, the original cost of her home was shown as \$89,000, while Ms. Stanton actually purchased it for \$54,959. Ms. Stanton believes that her home was overappraised at \$88,000, and that the information on her application was made up to support the overappraisal.

Another aspect of the unaffordability of Ms. Stanton's mortgage was the actual terms of the loan. Her note showed an initial interest rate of 14.35%. Her loan's interest rate was due to change on September of 2006. The loan's rate would never be lower than 14.35%, and over its life could increase to as high as 21.35%. These terms were especially oppressive when compared to the mortgage she had before.

Case Study 11 – Lakeland, Florida

Predatory or Problematic Nature: Misrepresentation, Pricing beyond Risk, Inflating Borrower Income, Excessive Prepayment Penalty

Ms. Davis of Lakeland, Florida obtained a refinance in the fall of 2003. Her intention was to obtain enough cash out to pay off a car loan she had at the time. She obtained about \$21,000 cash out as she planned, but got into a bad loan in the process.

One of the troubling aspects of Ms. Davis's loan was that she was charged excessive fees. Her HUD 1 shows \$5406 (4%) being charged to discount the rate, a lender's charge of \$150 for document preparation and \$535 for processing. Ms. Davis never received a Good Faith Estimate or any other initial disclosures. Instead, she was told by a Brightside Loan's representative that she would be getting better than 6.375% with two points. Not receiving disclosures is a violation of the Real Estate Settlement Procedures Act (RESPA). She was also instructed to falsify the dates on some of the documents she signed at closing by indicating that they were signed earlier than they were.

At the time of Ms. Davis's application, she was also told that she would close within a week. When this time came, she called the Brightside Loans office because she was concerned that she did not have documentation indicating what her rate and terms would be. She spoke with her loan officer, who indicated that Brightside Loans had to again determine her credit and that her score had dropped because of that. There should have been no reason for her loan officer to pull her credit again, and even so, her score could not have dropped significantly from a few inquiries. Ms. Davis was told that her loan was now subprime, and that her loan would have either a higher rate or higher fees. While she was upset, she was afraid that she would not be able to afford her current mortgage payment along with her car loan for very long, so she opted to continue so that she would get the cash out. CRF staff analyzed Ms. Davis's credit and concluded that she could have been "referred-up" to a better loan product. Her credit file included a minor amount of credit card debt and her mortgage. There were a few derogatory items, which were all medical collections. These collections should not have been given much weight in her qualification process.

Another problematic issue with Ms. Davis's loan was that her income was inflated on her application. At the time, Ms. Davis was making \$12.55 an hour, working forty hours per week. Her base pay was therefore \$2,175 per month. She also averaged about an extra \$100 per month in overtime. Her mortgage application, however, listed her monthly income as \$2,416. Ms. Davis's employer recently cut her hours to 36 per week. This had caused her additional financial hardship, but she had managed to remain current on her mortgage. On top of all the abuses, Ms. Davis had an excessive 5 year prepayment penalty.

Influencing Best Practices and Public Policy

While offering invaluable help to several hundred consumers and families, the CRF program has also achieved a national impact by influencing industry-wide practices, reforms, and federal policy. One important area of influence has been the servicing of high-cost subprime loans. As described above, CRF consumers have encountered a number of abuses in the servicing of their loans including force-placed insurance and the on-time payments not being recorded by

servicers. After encountering widespread abuses of this nature, NCRC challenged fee-based servicers to reform their practices. These discussions with servicers also influenced the federal guidelines on servicing that were developed by the Federal Trade Commission a few years ago.

In 2002, the Office of Thrift Supervision (OTS) proposed changing its regulation implementing the Alternative Mortgage Transaction Parity Act (AMTPA) to prohibit state-chartered thrifts and mortgage companies from ignoring state law regarding prepayment penalties and late fees as applied to adjustable rate mortgages and other types of so-called “alternative” mortgagors. Using a sample of CRF loans, NCRC was able to document onerous prepayment penalties and abusive fees levied by these lenders. When the OTS issued its final rule prohibiting state-chartered institutions from evading state law on prepayment penalties and late fees, the OTS cited NCRC’s evidence of abuses culled from the CRF program.⁶⁰

More recently, the CRF program, as documented above, has uncovered a pattern of appraisal fraud. In a report issued during 2005 entitled, *Predatory Appraisals: Stealing the American Dream*, NCRC documented that in 54 CRF cases experiencing appraisal fraud, 65% of the cases involved fraudulent appraisals inflating home values by 15% to 50% and another 22% of the cases had faulty appraisals inflating home values 50% to 100%. The great majority of borrowers in this sample experienced monthly mortgage costs increasing 20% or more due to the inflated appraisals. The CRF cases and other research of widespread abuses reviewed by the study lead NCRC and industry partners to establish a Center for Responsible Appraisals and Valuations.⁶¹ Lenders, appraisers, and other industry partners agree to an ethical code and also agree to submit disputes regarding fraudulent appraisals for arbitration. The alternative dispute resolution of the Center promises to expeditiously settle cases of appraisal fraud and to promote industry-wide changes in practices when a critical mass of industry stakeholders participate in the Center.

In addition, the CRF program continues to document the role of abusive brokers as shown by the case studies above. CRF staff indicate that the majority of predatory loans in the CRF program are loans involving brokers. The fee packing and targeting of minority customers in the CRF program suggested that brokers were involved in questionable loan practices. Under a Department of Housing and Urban Development (HUD) grant, NCRC’s fair housing staff conducted paired testing in order to determine if the CRF cases indicated patterns and practices of abusive behavior. The testing revealed pervasive discriminatory and predatory practices by mortgage brokers in six metropolitan areas across the country. Between February 2005 and June 2006, NCRC conducted over 100 tests in Atlanta, Georgia; Baltimore, Maryland; Chicago, Illinois; Los Angeles California; St. Louis, Missouri and the Washington, D.C. metro areas. The tests found that brokers quoted different interest rates and fees on the basis of race and steered African-American consumers to more expensive subprime products. The testing project led to the filing of a civil rights complaint with HUD against Allied Home Mortgage Capital Corporation, the nation’s largest privately held mortgage broker/banker.

Expansion and/or Replication of CRF Program

NCRC believes that the CRF program has been valuable on a number of different levels. First and most importantly, the program has saved families’ homes and millions of dollars in equity

⁶⁰ Federal Register, September 26, 2002 (Volume 67, Number 187), pages 60542-60555, see footnote 28 which specifically references data collected from the CRF program.

⁶¹ See <http://www.responsibleappraisal.org/>.

for borrowers. Second, NCRC and our lending institution partners have gained much knowledge about predatory lending that has provided insights into needed reforms. Through dialogues between community groups and lending institutions, the CRF program has contributed to a consensus regarding which products and practices should be discontinued and others that should be limited. For example, the CRF program has uncovered a number of abuses in the servicing of high cost loans, leading to best practices and reforms embraced by major fee-based servicers and guidelines issued by the Federal Trade Commission (FTC). The CRF program has contributed to best practices in subprime lending and in alternative dispute resolution.

Third, while the CRF program is a collaboration between NCRC and lending institutions, it also contributes to enforcement when necessary. As mentioned above, NCRC has filed complaints with HUD such as the case against Allied Home Mortgage Capital Corporation when the CRF program uncovers systematic abuses or discrimination by lenders.

Expansion of the CRF program is clearly desirable and is a goal pursued vigorously by NCRC. Yet, expanding the CRF program is not an easy task. Lending institutions are assuming significant risk in a CRF program since loans often involve moderate to deep subsidies to borrowers with damaged credit. In order to mitigate risk in the program, the CRF program has incorporated early delinquency intervention. Once every two weeks, HSBC North America provides NCRC with a list of CRF borrowers that have just fallen behind on their payments. A CRF fair lending specialist will then work with these borrowers in early delinquency. The early intervention has been effective. CRF staff have negotiated temporary work-outs and forbearance of payments for a few months. Another arrangement has been adding delinquent payments to the outstanding mortgage amount. Thus, for the continued success and expansion of programs like CRF, early delinquency intervention is necessary.

Another method for mitigating risk is to encourage the participation of more than one lending institution in the program. At this point, HSBC North America is refinancing the entire mortgage. The CRF program originally arranged refinance loans with loan-to-value ratios as high as 100%. Now, the program uses 85% loan-to-value ratios as the underwriting guideline, with some exceptions made on a case by case basis. In order to be most effective in reaching consumers in need, it would be desirable to secure the participation of more than one lending institution in the program. Other lenders could take on second mortgages and/or provide grants so that the loans and grants could once again provide for 100% loan-to-value ratios. The involvement of two or more lenders would therefore mitigate risk and serve a greater pool of borrowers.

NCRC's CRF program will continue to evolve in ways that can most efficiently serve the overwhelming needs for intervention. The CRF program, for example, will expand upon home preservation counseling, that is, counseling that is offered to borrowers after they have purchased their homes and/or have started experiencing trouble making payments. This type of counseling can save an enormous amount of time and resources, since borrowers in trouble often do know they can attempt to voluntarily work out a solution with their lender or servicer, whether it is forbearance of payments or modifying loan terms. CRF staff also recommend that more attention should be focused on home preservation counseling in general. Most counseling is still directed at buying a home rather than maintaining homeownership after purchasing a home.

Lastly, another model worth replication is the State of Pennsylvania's Homeowners Emergency Mortgage Assistance Program (HEMAP). Perhaps the only program of its kind in the nation, HEMAP provides loans to borrowers experiencing temporary hardship (the loans make borrowers' mortgage payments current). Counseling agencies work out forbearance agreements with lenders and also counsel families regarding their financial situations. The program is funded by State appropriations and repayment of HEMAP loans. This type of program should be expanded to include intervening in predatory lending situations. In addition to state appropriations, lenders could receive favorable consideration on their Community Reinvestment Act (CRA) exams for financing loan pools and/or participating in programs like CRF.⁶²

Conclusion of CRF Section

The CRF program provides enormous benefits on many different levels. It has saved homes and has saved approximately \$100 million in equity since the program's inception in 2001. The CRF's alternative dispute resolution, mediation and refinancing saves enormous time and resources. At the same time, however, CRF has also contributed to litigation when systematic abuses or discrimination are uncovered. Furthermore CRF has informed best practices as well as legislative and regulatory reforms. The multiple nature of abuses on CRF loans suggests that borrowers of high cost loans are often not in a position to negotiate the best deal for themselves in enormously complex lending transactions. These borrowers are often in desperate situations following temporary hardships and/or are unfamiliar with the lending process. Strong consumer protections in national and state legislation therefore are needed. Counseling, while extremely valuable, is unlikely to reach all the borrowers needing counseling across the country in the near or medium term. And it is all the better when collaborative programs like CRF contribute to policy changes based on consensus building between industry and community organizations regarding which products have no place in the marketplace and which products or loan terms should have limitations. Finally, the CRF experience has provided valuable insights into how to expand the CRF program as well as other similar efforts across the country.

Policy Recommendations

Preserving assets from wealth depleting products and loans is a very complex process. As this paper describes, low and stagnating wage levels are a persistent challenge. However, beyond providing income supports there are prescriptions that can enable lower-income consumers to grow and preserve assets.

Public Policies to Encourage Savings and Asset Development

The New America Foundation has established a comprehensive agenda of public policies to encourage lower-income consumers to develop assets. They include a national Children's Savings Account, enabling recipients of the EITC to link their refunds to savings accounts, expanding the Section 8 Homeownership Voucher Program, and promoting savings bonds.⁶³

Improving Savings and Investment Products

The current offering of savings and investment products are often inaccessible to lower-income people. An increase in higher yield savings options, particularly those facilitated by employers, could increase the savings rate. Lowering the minimum opening deposit for mutual funds could

⁶² See http://www.phfa.org/hsgresources/faq.aspx#hemap_q6. Last accessed August 30, 2006.

⁶³ New America Foundation, 2006

also help lower-wage workers save for the future. Further, automatic enrollment has been found to increase participation in retirement plans, particularly among lower-income workers.⁶⁴ Employers should be encouraged to adopt inclusive policies for pension plans, including a requirement to ‘opt out’ as opposed to the current default position of ‘opt in’.

Increasing Access To Affordable Financial Services

The Community Reinvestment Act (CRA) service test assesses bank records of opening and closing bank branches and the availability of products and services. However, unlike the lending test which utilizes Home Mortgage Disclosure Act (HMDA) data to determine how well a bank performs, the service test does not assess how well a bank penetrates lower-income communities. It is imperative that the service test include an examination of bank customers and deposits by income level of customers to determine whether banks are effectively reaching low-income consumers. Further, an examination of the location of bank branches as part of the CRA examination could point to disparities in communities of color or low-income areas. Finally, the federal agencies have recently stipulated in the CRA regulation that illegal and abusive loans will penalize banks through lower CRA ratings. The examiners, however, need to be more transparent on CRA tests, clearly describing how they scrutinized bank loan files to determine if abusive lending occurred.

CRA needs to be modernized to apply to large credit unions, independent mortgage companies, insurance firms and securities companies. Applying CRA to non-bank financial institutions is critical in terms of increasing access to wealth building opportunities and assets for minorities and low- and moderate-income families. Harvard University and Federal Reserve economists have documented that CRA has increased lending to minorities and low- and moderate-income families.⁶⁵ It would be a reasonable assumption that applying CRA to non-bank financial institutions would likewise increase access to additional financial products, including investments and other asset-building products.

Regulating High Cost Financial Services

Regulating the high cost products described in this paper is a complex proposition. Products like payday and auto title loans are regulated by states. Others, like home mortgages, may be regulated by both state and federal policymakers. In addition, the features of consumer loans are very different from home mortgages. However, basic and strong consumer protections implemented at the federal level are crucial, including limitations on certain loan terms and conditions that are prone to abuse and requiring lenders to document the borrower’s ability to repay the loan.

Narrowing the Financial Management Skills Gap

Financial education is an area where conservatives and liberals agree. Conservative policymakers and academics, as well as high cost lenders, talk about the importance of personal responsibility in avoiding high cost products and high levels of debt. However, effective personal responsibility can not occur in a vacuum. Consumers require skills and information to navigate an increasingly complex financial landscape. It is particularly important to begin financial education with children, so that basic values, such as saving and investing are developed at an early age. Appropriate and updated curricula for adults on basic financial management and loan products is also critical. Further, curricula must apprise consumers of

⁶⁴ New America Foundation, 2006

⁶⁵ Joint Center for Housing Studies, Harvard University (2001 & 2002), and Bostic and Robinson (2003).

their rights in a financial transaction and give them the ability to identify and assess the long-term risks of financial products. In addition, programs should be developed to help reach these consumers at the workplace, through community organizations collaborating with responsible financial institutions.

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