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May 7, 2007

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: **Docket No. OP-1278**

Dear Ms. Johnson:

I am writing from Woodstock Institute to comment on the proposed interagency statement on subprime mortgage lending. Woodstock Institute is a Chicago-based nonprofit research and policy organization that for over 33 years has promoted access to affordable and responsible financial services in lower-income and minority communities. In the area of subprime and predatory mortgage lending, Woodstock Institute conducted some of the first research documenting the disproportionate concentration of subprime loans in minority communities; the relationship between increased levels of subprime loans and skyrocketing foreclosures in minority communities; and the impact that foreclosures have on neighborhood property values. Woodstock Institute has also worked closely with local, state, and federal policy makers to craft legislation limiting some of the most abusive practices in the subprime industry and worked with regulated financial institutions to promote responsible, prime lending in minority neighborhoods.

We support the terms of the agencies' proposed guidance, but note that without rigorous regulatory enforcement, the value of such guidelines is greatly reduced. Additionally, these guidelines must be applied to all lenders, including mortgage finance companies.

In recent years, underwriting standards in the subprime market have substantially eroded while the equity position of subprime borrowers has declined and the debt burden on subprime borrowers has increased. In 2000, 23 percent of subprime loans were low doc loans that required limited documentation of borrower income or assets. In 2006, this number increased to nearly 43 percent. Meanwhile, the equity positions of subprime borrowers worsened. In 2000, 35 percent of subprime borrowers had loan-to-value ratios greater than 80 percent. By 2006, this number had increased to nearly 63 percent. Over the same period, the average debt-to-income ratio for subprime borrowers increased from 38.6 percent to nearly 42 percent.[1]

This increasing looseness in underwriting standards is a substantial concern given the growing use of risky mortgage products in the subprime market. One of the most troubling products are adjustable rate mortgages with low, introductory interest rates that

[1] Source LoanPerformance, UBS taken from "The U.S. Subprime Industry in Turmoil" by Thomas Zimmerman. March 2007. See www.aei.org/events/eventID.1468/event_detail.asp#

Woodstock convenes the Chicago CRA Coalition and is a member of the National Community Reinvestment Coalition and the Community Development Financial Institution's Coalition

are fixed for a period of two or three years, but adjust rapidly afterwards. These adjustment have the potential to significantly increase a borrower's monthly payment often to unaffordable levels. These 2/28 and 3/27 ARM loans have become increasingly popular in the subprime market. In 1999, such loans made up roughly 53 percent of the subprime market. In 2006, however, these loans made up nearly 77 percent of all subprime mortgages.[2]

The loose underwriting standards, risky mortgage products, and borrowers being stretched increasingly thin combined with a slowing housing market and a growing incidence of fraud has lead to a record surge in the levels of mortgage defaults and foreclosures. In the Chicago region, foreclosures increased by over 36 percent between 2005 and 2006 and are expected to grow even faster in 2007.[3]

The interagency statement on subprime lending addresses many significant abuses in the subprime industry and if adopted by lenders, would substantially tighten standards in the subprime market. We agree that:

- When underwriting subprime loans, lenders must consider all monthly housing related payments. This includes the monthly costs of principal, interest, real estate taxes, and insurance. Lenders should not exclude the costs of taxes and insurance from debt-to-income calculations to artificially keep monthly housing costs down.

- Lenders should be required to verify a borrower's income. Only in rare circumstances when substantial mitigating factors exist should stated income or low documentation loans be used.

- For mortgages with a low initial payment, but subsequent higher payments and adjustable rates, lenders should underwrite loans to the fully indexed rate and not the teaser rate in the loan's initial period.

- Lenders must clearly inform borrowers of the terms of a loan and any feature that may result in payment shock. Borrowers must be made aware of the true cost of any future adjustments in payment, balloon payments, and prepayment penalties.

- Prepayment penalties should not extend beyond initial reset period and allow borrowers sufficient time to refinance.

- Borrowers must be informed of the costs associated with real estate taxes and insurance. We also encourage lenders to require escrow accounts for these costs as is the case in the prime mortgage market.

- Lenders should not provide additional incentives to third party originators for originating higher cost products or loans with risky features. Such incentives serve to incent brokers to steer a borrower into such products even if the borrower may qualify for a lower cost product.

- Lenders must rigorously monitor relationships with mortgage brokers to ensure that brokers are originating loans in the best interest of the borrower and are putting borrowers in appropriate and affordable products.

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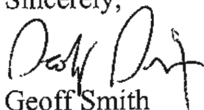
[2] Ibid

[3] Smith, Geoff. March 2007. "Foreclosures in the Chicago Region Skyrocketed in 2006." Woodstock Institute: Chicago, IL. See www.woodstockinst.org/component/option,com_docman/Itemid,260/task,doc_download/gid,748/

We believe that responsible underwriting guidelines and the disclosure a mortgage's full cost should be applied to all loans, not strictly subprime ARMS. We also believe that these guidelines should be applied to all mortgage lenders. Such qualification standards should help subprime borrowers obtain appropriate and affordable loans and should not restrict access to credit responsible subprime loans. Borrowers who have obtained inappropriate subprime ARMs should be given every opportunity to refinance into an affordable product or have the loans modified to make them affordable.

While the above guidelines will improve underwriting in the subprime market, this statement by itself is insufficient to stem abuses in the subprime market and stop rising default and foreclosure rates. Rigorous enforcement of these guidelines and proactive, rather than reactive, actions by regulatory agencies is necessary. To this point, the regulatory response to abuses in the subprime market has been inadequate, and the agencies have passively allowed the situation to reach its current crisis stage. Going forward the agencies must aggressively use their power as regulators to ensure that borrowers are getting affordable loans that are appropriate to their current economic situation.

Sincerely,



Geoff Smith
Research Director

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