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May 21, 2007

Mr. Craig Cellini
Rule Administrator
Illinois Department of Financial and Professional Regulation
320 W. Washington
Springfield, IL 62786

Dear Mr. Cellini:

I am writing from Woodstock Institute to comment on the notice of proposed amendments to the rule for House Bill 4050. 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 and regulation 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.

The original intent of HB 4050 was to protect vulnerable borrowers from receiving loans with fraudulent or deceptive terms and to reduce foreclosures due to such improper lending. The law was a response to high levels of abusive lending and skyrocketing foreclosures in minority communities across Cook County and the state of Illinois. The law required the Illinois Department of Financial and Professional Regulation (IDFPR) to create a database into which information on all loans originated through mortgage brokers would have to be entered. Borrowers who met certain criteria, based either on their credit history or terms of the loan they were seeking, were required go to a housing counseling session prior to closing the loan. At this session, the borrower was to be provided with information on issues such as the percent of their income that would be applied toward housing costs, whether their loan payments were fixed for the life of the loan or would adjust at some point, and how much they were paying in fees. The goal of this session was to ensure that the borrower understood the terms, affordability, and true cost of the loan they were receiving. After the counseling session, regardless of any recommendation of the counselor, borrowers had the option to move forward with the loan, attempt to renegotiate terms, or back out entirely.

The initial implementation of HB 4050 was applied to ten zip codes on the south and southwest sides of Chicago. Intended to be a four year pilot, the program was suspended after less than five months. This very brief implementation of bill answered very few questions about the viability of such a mandatory counseling law.

We have substantial concerns about the current proposal to expand the scope of HB 4050 without more thoroughly understanding lessons learned from the initial pilot. The proposed amendments to the HB 4050 rules would substantially broaden the types of loans covered. Previously, loans covered under the law were predominantly in the subprime segment of the market. Borrowers with weak credit histories or some combination of middling credit histories and risky loan terms were required to get counseling. This screening process served to limit the number of individuals covered by the law to the most vulnerable borrowers on the basis of a history of problems managing credit or loans with features shown to be deceptive or risky.

The current proposal significantly expands the types of loans covered beyond those that would generally be considered subprime or highly risky. For example, the previous version of HB 4050 required borrowers with a credit score between 621 and 650 who were seeking a loan whose interest rate would adjust within three years to obtain counseling. The current proposal requires all first time homebuyers and any refinancer seeking a loan whose interest rate would adjust within five years to obtain counseling. The new proposal greatly expands the scope of HB 4050 beyond potentially vulnerable subprime borrowers to prime borrowers. Requiring a subprime borrower seeking a 2/28 ARM to attend counseling to ensure they understand that their loan has an adjustable and not a fixed rate seems within the original intent of HB 4050. Requiring a prime borrower seeking a five year ARM, not an uncommon product in the prime market, to attend counseling does not seem like an efficient use of limited resources.

Expanding the types of loans covered and expanding the geography covered by the pilot program from ten zip codes to all of Cook County will greatly increase the number of loans covered by HB 4050. Housing counseling agencies reported completing approximately 1,200 file review sessions during the initial 20 week implementation of HB 4050 in the pilot area. Annualized, this would be approximately 3,100 sessions. Using 2005 mortgage lending data for Cook County and industry estimates on product types, we estimate that by broadening the types of loans covered and expanding the program countywide nearly 19,000 loans could be covered under the proposed amended rules for HB 4050.[1] While we are sympathetic to the concerns that led to proposed geographic expansion, it is difficult to see how the existing infrastructure of housing counseling agencies in Cook County could handle this level of demand for counseling services without significantly watering down the quality of services delivered or having some negative impact on the timing of closing loans.

If the state chooses to move forward with HB 4050, we recommend it seriously consider methods for limiting the number of loans covered by the law. The initial intent of HB 4050 was to protect vulnerable subprime borrowers from receiving loans with fraudulent or deceptive terms. The current proposed rules greatly expands the focus of the law to include many prime loans. Given the limited resources of housing counseling agencies in Cook County, expanding the program in such a way would be a major mistake and undermine the intent of the law.

One way to limit the number of loans covered by HB 4050 and more clearly focus on subprime loans would be to recommend counseling for first time home buyers and refinancers seeking a mortgage where:

- The interest rate will adjust in three years or less or

[1] See Appendix for estimate methodology.

- For a first lien mortgage, the loan's APR is 3 percentage points above the Treasury rate of a security of comparable maturity and meets at least one of the following conditions:

  - The loan permits interest only payments
  - The loan may result in negative amortization
  - The loan relies on stated income
  - The loan is financed at 100 percent
  - The loan contains fees greater than 5 percent of loan amount
  - The loan includes a prepayment penalty

Screening loans in such a way would reduce the number of loans covered by the law and more effectively focus HB 4050 and the resources of counseling agencies on borrowers seeking higher cost loans with potentially risky features.

During the initial implementation of HB 4050, housing counseling agencies reported that the law was effective at helping borrowers understand the terms of their loan. The agencies report that over half of borrowers who attended counseling sessions were applying for loans that would put them at high risk of default, and 38 percent of borrowers were applying for loans where their debt-to-income ratio would be over 50 percent. The agencies also report that 9 percent of loans contained indicia of fraud and that "an overwhelming majority" of borrowers receiving adjustable rate loans thought they were receiving fixed rate loans.

While this indicates that HB 4050 was successful at providing borrowers with critical information on their mortgages, it remains unclear what happened to borrowers after they left the counseling sessions. The state has access to this and additional information that has been entered into the Predatory Lending Database. We ask that the Department of Financial and Professional Regulation analyze this data to more fully understand the effectiveness and need for HB 4050. While HB 4050 was not in place long enough to truly understand its long term impact on access to credit or the local real estate market, information is available on the outcomes of the counseling sessions. These should be thoroughly considered before moving forward.

Additionally, the state should consider the efficiency of preventing risky and potentially abusive lending practices through a mandatory counseling law as opposed to other types of legislation and regulation. While such laws have appeal in educating and empowering borrowers, if not implemented in a prudent and focused manner such a law could be a significant waste of resources and ineffective at meeting its legislative intent of protecting vulnerable home owners and preventing foreclosures.

Sincerely,

Geoff Smith
Research Director

GS/bab

Attachment

Appendix

Estimating the Demand for Counseling Under the New HB 4050

The new iteration of HB 4050 covers loans to first time home buyers and refinance loans on owner occupied properties that have certain characteristics. The proposed regulation would cover all of Cook County, and all loans to first time home buyers and refinances would be considered regardless of borrower credit score. To understand the potential volume of loans that may be referred for counseling, we examined 2005 Home Mortgage Disclosure Act data and, as available, industry estimates about the percent of loans with different features that might be covered.

First Time Home Buyers

In 2005, state regulated mortgage lenders originated 35,243 home purchases to owner-occupied properties in Cook County.[2]

We estimate that 36 percent of these loans went to first time home buyers:[3] 12,687

- Using only the ARM trigger (the most inclusive), we estimate that 21.6 percent of these loans have adjustable rates:[4] **2,740**
- Fixed-Rate, Interest Only Loans account for 8 percent of the market:[5] **1,015**

Of these 35,243 home purchase loans, 16,400 used a second, junior lien home purchase loan. Based on 36 percent of these loans being to first-time home buyers: 5,904

- Assuming that 78.4 percent of these loans will be fixed rate (and therefore not covered under the ARM trigger): 4,629
- Assuming that 42 percent of these first-time home buyers finance 100 percent:[6] **1,944**

An estimate of first time home buyer loans covered by HB 4050: 5,699

Refinance Loans

In 2005, state regulated mortgage lenders originated 44,661 refinance loans on owner-occupied properties in Cook County.

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[2]Home Mortgage Disclosure Act data (2005).

[3]National Association of Realtors survey (2006) cited in http://www.marketwatch.com/News/Story/survey-finds-percentage-first-time-home/story.aspx?guid=%7B94A34A1B-6FCF-44B5-98D1-B8BB100ABCB3%7D&dist=morenews.

[4]Loan Performance analysis cited in http://www.realestatejournal.com/buysell/mortgages/20060821-simon.html.

[5]Estimate cited in http://wwwazcentral.com/hb101/articles/0419newmort0419.html.

[6]National Association of Realtors survey (2005) cited in http://www.lendingtree.com/cec/yourhome/yourmortgage/new-mortgage-options.asp.

- Based on the ARM trigger, we estimate that 21.6 of these loans have adjustable rates: **9,647**
- Fixed-Rate, Interest Only Loans account for 8 percent of the market: **3,573**

An estimate of refinance loans covered by HB 4050: 13,220

An estimate of total loans covered by HB 4050: 18,919

This would require housing counselors to handle 1,577 clients per month