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Predation in the Sub-Prime Lending Market:

Montgomery County

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PREDATION IN THE SUB-PRIME LENDING MARKET

I. INTRODUCTION

The Center for Business and Economic Research (CBER) at the University of Dayton aided Lutheran Social Services, Miami Valley Fair Housing Center and Legal Aid Services of Dayton in their study of Predatory Lending Practices in Montgomery County.

The objectives of the study were to:

1. Characterize quantitatively the extent of the predatory lending problem in Montgomery County and trace its growth over the 1994 to 2001 period.
2. Define the detailed geographic and demographic (ethnic identity, age, gender) pattern of loans with predatory characteristics.
3. Define the set of lenders who are involved in lending that has the characteristics of predation.
4. Define the geographic patterns of mortgage lending by lenders who appear to be involved in predatory lending practices.

To accomplish these objectives, CBER utilized a combination of record searches and interviews with affected parties.

The primary data sources utilized included Montgomery County Clerk of Courts records of mortgage foreclosures, Montgomery County Recorder data on mortgages, Montgomery County Auditor data on property appraisals and bases and Loan Application Register data from the Home Mortgage Disclosure Act.

CBER conducted 31 interviews with a sample of homeowners whose mortgage foreclosures exhibit evidence of predatory practice and 200 interviews with a sample of people who have mortgage loans (not foreclosed) with lenders who have been identified as using predatory practices.

II. BACKGROUND ON PREDATORY LENDING

A. National Context

The expanded securitization of mortgage products in the 1980s led to the realization that it was possible to offer home mortgage loans to borrowers with a higher credit risk at higher interest rates. Such sub-prime loans were a much needed source of credit to many low and moderate income homeowners and the popularity and profitability of the market brought the entry of relatively large financial corporations.

With the expansion of this sub-prime mortgage market, however, several marketing practices emerged that appeared to exploit these low and moderate income households and deepen their financial woes.

The Federal Trade Commission (FTC) has been particularly active in investigating the nature of predatory practices in the sub-prime market. Their investigations describe many of the characteristics of predatory lending practices.[1] The FTC characterized these practices as "quite varied ….they generally aim to extract excessive fees and costs from the borrowers or to obtain outright the equity in the borrowers' home".[2] The four characteristics that the FTC focused on included:

> **Equity Stripping**: Loans based on assets rather than the borrower's ability to repay. These loans have a higher probability of failing and moving to foreclosure.
> **Packing**: Adding single premium credit insurance to the loan amount in a situation where the borrower could assume that the credit insurance was a necessary part of getting the loan.
> **Flipping**: The practice of convincing the borrower to refinance several times in a short period. This refinancing is often not in the borrower's interest.
> **Linkage of loans to home improvement projects** where work is not completed or actual loan terms differ from those discussed verbally.

The Federal Reserve Board is responsible for overseeing Regulation Z: Truth in Lending (the primary regulation that implements the Home Ownership and Equity Protection Act), (HOEPA). In response to the apparent wide scale of abuses, the Board held a series of hearings to consider appropriate revisions to Regulation Z during the 2000-2001 period.

The primary thrust of Regulation Z had been to put more onerous disclosure requirements on all mortgage loans that had annual percentage rates that were 10% above comparable U.S. Treasury Bonds (the HOEPA trigger). For such loans HOEPA disclosure rules require a specification of the APR and the monthly payment three days in advance of the loan closing. They also must provide a warning that the lender has a mortgage on their home and that they could lose their home if they default on the loan. If a lender fails to provide the appropriate disclosures, the borrower has three years to rescind the transaction. Purchasers of such loans on the secondary market inherit the liabilities of the original lender.

These disclosure requirements were sufficiently onerous that they had effectively limited sub-prime interest rates to below the HOEPA trigger. The FTC made a series of policy recommendations in the Federal Reserve hearings that are used here to define what is considered a predatory loan in this report.

[1] "Prepared Statement f FTC before Senate Special Committee on Aging, March 16, 1998 at www.ftc.gov/os/1998/9803/grass5.htm
[2] Ibid p3

The FTC had several recommendations for the Federal Reserve Board but the following three are most important for this study.

1. Prohibit the financing of single premium credit insurance and other loan extras because borrowers are not able to evaluate the costs and benefits of the insurance when it is included automatically with the loan.[3]
2. Ban mandatory arbitration agreements in HOEPA loans. The FTC was particularly concerned that the borrower was signing away legal rights at a time when they were at their most vulnerable. The FTC felt such clauses "undermine the consumers rights to exercise statutory rights conferred by" a host of laws including HOEPA.
3. Lower the HOEPA APR trigger to 8% above comparable U.S. Treasury securities and seek authority from Congress to lower it to 6% above. The FTC felt too few consumers benefited from HOEPA legislation because the trigger was set too high. They had found a pattern of "abusive loan practices that often occur in loans that fall just below the trigger" and many lenders price their loans just below the trigger.

The FTC 6% cutoff figure above a comparable U.S. Treasury Bond would have brought about 25% of the sub-prime loans made in the period from 1995-1999 under HOEPA Regulation.[4]

The real driver of FTC's regulatory recommendation is the desire to halt loans that charge borrowers amounts greater than is justified based on risk analysis and to halt loans that extract equity from the borrower's principal asset, their house[5]. It is almost impossible with current documentation to determine whether a lender judged fairly the borrower's ability to repay the loan. In what follows, the interest rate cutoff is a proxy for loans that are likely to be of that character.

B. Local Context: Rise of Mortgage Foreclosures in Montgomery County

CBER analyzed the rise and geographic spread of Mortgage Foreclosure filings in Montgomery County using Clerk of Court records.

- Over the period from 1994 to 2000, mortgage foreclosure filings in Montgomery County increased from 1,022 to 2,451. (Table 1a and Chart on next page.)

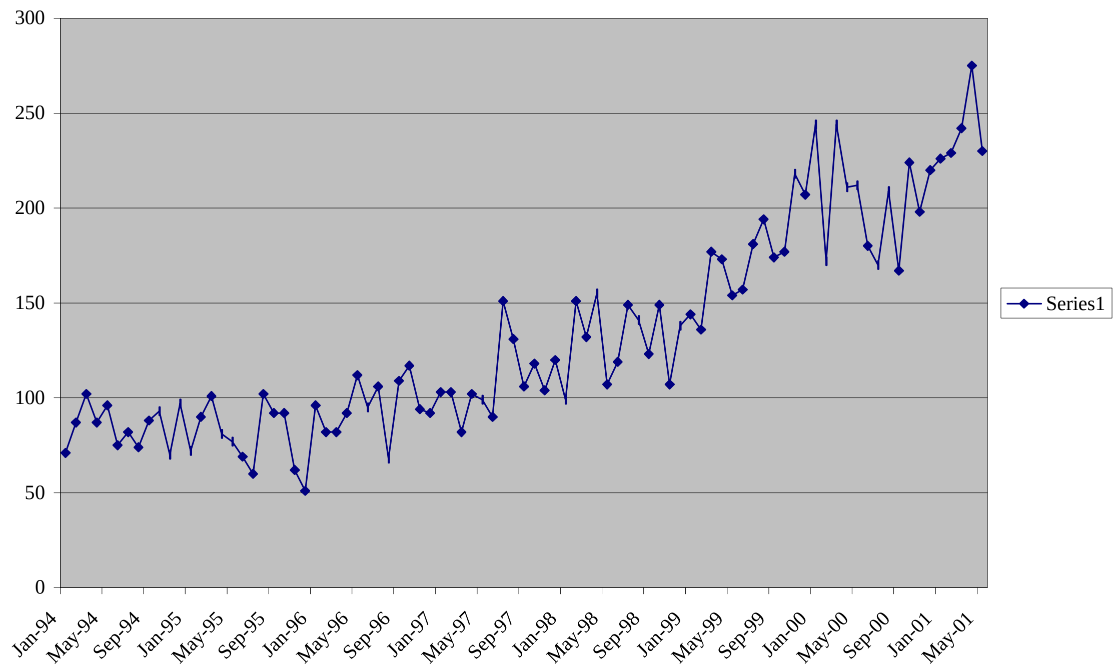
The increase in Mortgage Foreclosure filings really starts to occur in the fall of 1997 and the winter of 1998, (see Table and Chart on next page). While 1997 and 1998 show substantial increases over year before totals, it is the dramatic increase in foreclosures in 1999 to 2,092 foreclosures from only 1,570 foreclosures in 1998 that is particularly striking. Mortgage foreclosures in 2001 appeared to be on pace to exceed those in 2000.

[3] "Prepared Statement f FTC before Board of Governors of the Federal Reserve System, Sept 7, 2000 San Francisco www.ftc.gov/os/2000/09/predatorylending.htm
[4] "The Road to Sub-prime "HEL" was paved with Good Congressional Intentions and the Sub-prime Home equity Market" Cathy L. Mansfield, 51 S.C.L. Rev. 473, 536-37 (Spring 2000)
[5] Where the borrower is unaware that this will be the impact.

Table 1a: Mortgage Foreclosure Filings

Year	Cases
1994	1,022
1995	949
1996	1,145
1997	1,309
1998	1,570
1999	2,092
2000	2,451
2001 through May	1,202

Mortgage Foreclosure Cases Filed, Jan. 1994-May, 2001



As the volume of loan foreclosure filings increased throughout the county, the relative share of suburban jurisdictions increased relative to Dayton (see Table 1b, below). Dayton's percent share decreased from 48% to 40%. Huber Height's share (for example) went from 4.4% to 6.8%.

Table 1b

Mortgage Foreclosure Cases by Geographic Area: Percent of Total, 1994 and 2000

Area	YEAR 1994	YEAR 2000
Dayton	47.7%	39.5%
Kettering	**7.8%**	**9.6%**
Trotwood	8.4%	7.9%
Huber Heights	**4.4%**	**6.8%**
Miami Township/Miamisburg	**4.2%**	**6.1%**
Harrison Township	**5.3%**	**5.9%**
Washington Township/Centerville	**3.4%**	**4.4%**
Clayton/Englewood/Union	3.8%	3.6%
Jefferson Township	**1.5%**	**2.8%**
Mad Riverside	4.6%	2.4%
Oakwood	2.1%	2.0%
West Carrollton	1.7%	1.7%
Vandalia	**0.8%**	**1.4%**
Clay Township/Phillipsburg/Brookville (Partial)	1.1%	1.2%
Moraine	1.0%	1.0%
Butler Township	**0.4%**	**0.9%**
German Township/Germantown	**0.2%**	**0.9%**
Perry Township/Brookville (Partial)/New Lebanon (Partial)	**0.6%**	**0.9%**
Jackson Township/Farmersville/New Lebanon (Partial)	1.0%	0.8%
Total	100.0%	100.0%

Bolded=Increase in Percent Share

Appendix B provides detailed maps of Mortgage Foreclosures over the 1994 to 2000 period for all geographic areas in the county. For each area, a map shows mortgage foreclosures in 1994 in red and mortgage foreclosures in 2000 in green. The maps illustrate the rapid spread of foreclosures across jurisdictions.

C. Local Context: The Role of Predatory Practices in Mortgage Foreclosures in Montgomery County

To determine whether predatory lending played a role in the rise in mortgage foreclosures in Montgomery County three steps are necessary. First, is the rise in foreclosures associated with a rise in sub-prime lending? Following, the differential rise in sub-prime loans is documented. Second, do any sub-prime loans in Montgomery County exhibit predatory characteristics? To examine this a subset of those mortgage foreclosures associated with sub-prime lenders are examined for predatory characteristics. Third, how many of the mortgage foreclosures associated with sub-prime lenders are from sub-prime lenders who have some sampled loans that are predatory in nature? The first section following addresses steps 1 and 3 while the second section addresses step 2. The discussion in the first section utilizes results from the second section to define sub-prime lenders who have sampled mortgages with predatory characteristics.

1. The Role of Sub-prime Lenders in Montgomery County Mortgage Foreclosures

Sub-prime Lending did differentially contribute to the rise in mortgage foreclosures in Montgomery County. Mortgage foreclosures associated with plaintiffs who are identified sub-prime lenders increased at an annual rate (42.8%) that was more than double the rate associated with plaintiffs who are not identified sub-prime lenders, (see Table 2a).[6] The percent of foreclosures associated with sub-prime lenders rises steadily in the 1994-1999 period (from 19% to 48%) and then abruptly falls in 2000 (to 41%) due to stagnation in sub-prime plaintiff foreclosures while prime foreclosures continue to increase.

Table 2a: Mortgage Foreclosures in Montgomery County, 1994-2000 by Plaintiff Lender Status

	Lender			
YEAR	Prime	Sub-Prime	Total	as % of Total
1994	513	118	631	18.7%
1995	488	156	644	24.2%
1996	633	260	893	29.1%
1997	632	303	935	32.4%
1998	787	542	1329	40.8%
1999	1023	959	1982	48.4%
2000	1403	1000	2403	41.6%
Average Annual Growth Rate, 1994-2000				
	18.3%	42.8%	25.0%	

Using information from the next section, sub-prime plaintiffs can be split between those who have sampled mortgages with predatory characteristics and those whose sampled mortgages do not have predatory characteristics (see Table 2b, next page). Those sub-prime lenders with sampled mortgages which exhibit predatory characteristics are associated with the majority of sub-prime plaintiff foreclosures over the period. While the average annualized rate of growth for this subset of sub-prime lenders is somewhat lower than for other sub-prime plaintiffs (41% vs. 47%), they still account for 65% of the sub-prime associated foreclosures in 2000.

[6] Numbers of mortgage foreclosure cases shown for earlier years is fewer than shown in Table 1. Table 1 was created using the Clerk of Courts On-Line reference. Table 2 is an electronic file from the same database. Some earlier records did not show up in this file. Table 2 should be utilized for illustrating the relationship of sub-prime lenders to the rise in mortgage foreclosures. It overstates the rise in overall foreclosures. Note that Prime Lender is a umbrella term for any mortgage foreclosure not associated with an identified sub-prime

Table 2b: Sub-Prime Mortgage Foreclosures in Montgomery County, 1994-2000 by Sub-Prime Predatory Status

	Sub-Prime Lenders			
YEAR	Without Sampled Predatory Characteristics	With Sampled Predatory Characteristics	Total	With Sampled Predatory Characteristics as % of Total
1994	35	83	118	70.3%
1995	43	113	156	72.4%
1996	90	170	260	65.4%
1997	148	155	303	51.2%
1998	245	297	542	54.8%
1999	418	541	959	56.4%
2000	354	646	1000	64.6%
Average Annual Growth Rate, 1994-2000				
	47.1%	40.8%		

2. Predatory Practices in a Sample of Foreclosed Sub-Prime Loans

a) Sample Methodology

In an ideal world, the mortgages (including the associated HUD 1 Note, which would provide accurate information on fees) from a random sample of sub-prime mortgage loans made by each identified sub-prime lender in Montgomery County would be examined for the presence of predatory characteristics. In reality, it is not possible to do that. The Recorder's Office (which does record all mortgages) usually does not have the mortgage instrument itself. What it is possible to do, is obtain the mortgage instruments involved in mortgage foreclosure court cases. Since the increase in mortgage foreclosures is one of the primary symptoms of the problem, this study focused on obtaining a random sample of mortgages associated with foreclosures by sub-prime lenders.

The Montgomery County Clerk of Courts Pro On-Line system contains records for all mortgage foreclosures. An electronic file of those on-line records for the period 1994-2001 was obtained that included:

Plaintiff (company holding mortgage at time of foreclosure)
Defendant Name
Defendant Address
Property Address
Mortgage Amount (sometimes)
Case Disposition
Case Number

This summary information was utilized to obtain a frequency of foreclosures by plaintiff and to allow the geocoding and subsequent mapping of mortgage foreclosures by plaintiff. Plaintiffs were categorized by whether they were a declared sub-prime lender.[7]

To examine a copy of the mortgage instrument itself, off-line legal records at the Clerk of Courts must be utilized. For declared sub-prime plaintiffs, CBER took a random sample of 20 of their mortgage foreclosure cases.[8] If a declared sub-prime plaintiff had fewer than 20 foreclosures, the entire group of cases was examined. For each case in the sample the mortgage instrument was examined for the following information:

Name of Original Mortgage Lender (this may differ from Plaintiff because of sales in the secondary market and mergers and acquisitions among lenders).
Loan Origination Date
Mortgage Amount
Interest Rate
Type of Mortgage (Adjustable or Fixed, and terms of the adjustable)
Any Fees Recorded
Presence of a Balloon Payment Clause
Pre-payment Penalty Clause and Terms
Inclusion of Single Premium Life Insurance
Mandatory Arbitration
Demand Features
Waiver of Other Legal Rights
Other Features

In all, 1,198 individual mortgage instruments were examined out of the 3,054 mortgage foreclosure cases filed in the 1994 to 2001 period with self identified sub-prime lenders as the plaintiffs.[9] Of those 1,198 individual mortgage instruments, 871 were established to have interest rates more than 50 basis points above the average interest rate on a 30 year fixed mortgage at the time the mortgage was made. These 871 foreclosures serve as a sample of sub-prime loan foreclosures.[10]

[7] Sub-prime lending status was determined either by listing on HUD's list of sub-prime lenders or mention of sub-prime lending operation on plaintiff's web site. Obviously, many financial institutions have both sub-prime and prime mortgage operations.
[8] The n mortgage foreclosure cases of each sub-prime lender was assigned a number from 1 to n. Statpro, a statistical add-on to Excel was used to generate a random sample of 20 of the numbers from 1 to n.
[9] There were 8885 mortgage foreclosure cases in all over the period. While it is possible some sub-prime plaintiffs and therefore sub-prime foreclosures were missed, it is unlikely. Financial firms regard sub-prime loans as a legitimate business and had no particular reason to hide that operation.
[10] There are several reasons prime rate loans would have been in the initial sample of sub-prime lender foreclosures. First, the sample could only be of situations where sub-primes were the plaintiffs. In many cases, these loans would have been purchased on the secondary market. Second, many sub-prime lenders also have prime mortgage operations.

b) Mortgage Amount

Median mortgage amount declined steadily for the sample with increases in the interest rate. Mortgages with interest rates below 9% had a median value of $63,200 while those with interest rates above 12% had a median value of $39,250. The median mortgage amount for the overall sample was $51,600.

Table 3: Median Mortgage Amount by Interest Range

Amount of Mortgage

Interest Range	Median	N
Less than 9%	$63,200	189
9% to 10.5%	$57,183	198
10.5% to 12%	$52,800	218
Greater than 12%	$39,250	266
Total	$51,600	871

c) Mortgage to Property Value Ratio

One of the critical elements of the FTC concerns was a tendency for mortgage brokers to engage in potentially illegal tactics such as inflating appraisal reports and overstating borrower income. While it is difficult to determine whether appraisal reports are inflated, one approach is to explore the ratio of the mortgage amount to the Montgomery County appraised property value.[11]

Table Four provides the median mortgage loan to appraised value ratio by interest rate. The pattern that emerges is of some interest. There are definite signs of inflated property values in the intermediate interest rates within the sub-prime market, with the median loan to value ratio standing at 1.15 for sampled foreclosures with interest rates between 10% and 12%. At the same time there does not appear to be as much evidence of inflated appraised values at higher interest rates; the median loan to appraised value ratio is only .97 at interest rates above 12%. This is not unexpected, lenders who are engaged in equity stripping would not have an interest in providing a loan that is greater than the equity they could strip.

Table 4: Ratio of Loan to Appraised Value by Interest Rate Range

LNRATIO

Interest Range	Median	N
Less than 9%	.98	131
9% to 10.5%	1.14	147
10.5% to 12%	1.15	138
Greater than 12%	.97	194
Total	1.05	610

d) HOEPA Trigger Status

Of the 871 sampled sub-prime mortgage instruments, 255 mortgages (27%) exceeded the FTC's recommended cutoff point for HOEPA status (6% above a

[11] CBER was able to match 610 cases in the 871 cases of the sample to geocoded property value records from the County Auditor's office. Note that appraised property values are for 2000, while the mortgage values are spread over the period from 1994 to 2000. As a consequence the true loan to value ratios at the time the mortgage was made were slightly higher on average.

U.S. Treasury bond of comparable maturity).[12] Note this agrees closely with the FTC's estimate that nationally 25% of the sub-prime market would qualify for HOEPA status with the recommended trigger. Those sampled foreclosed loans above the HOEPA trigger had a lower median mortgage amount, $40,704, than the rest of the sample, $55,990. Consistent with the section above, loans above the recommended HOEPA trigger had a lower median loan to appraised value ratio (.90) than those below (1.07). Again, this would be expected to the extent the goal is to equity strip.

Sampled foreclosed mortgages with interest rates above the recommended HOEPA trigger tended to exhibit a higher percentage of those clauses associated with predatory loans (balloon payments, call on demand, pre-payment penalties, waiver of jury trials, high fees/single life credit insurance) than sampled mortgages below the FTC recommended HOEPA trigger Below, the presence of each of these clauses in the sample is examined in turn.

e) Balloon Payments

A mortgage with a balloon payment allows a borrower to buy a home or refinance a home with lower monthly payments because no equity is accumulated. If the borrower expects an increase in wealth (that allows them to pay off the loan completely) or an increase in income (that would allow them to refinance on more favorable terms when it occurs) before the balloon payment comes due the balloon mortgage may be attractive. The balloon payment might also be attractive to someone who plans to stay in a home only a short period of time. The use of the balloon payment in the sub-prime market however is associated with high interest rates and with situations where the likelihood of increases in wealth or income are unlikely to occur. Often, the balloon payments are hidden in the mortgage so the relationship of the lower monthly payment to the balloon clause is not apparent. In recognition of this HOEPA makes illegal (for HOEPA qualified loans) the use of balloon mortgages that have terms to maturity for the balloon of less than 5 years. The Federal Reserve has suggested that an even longer term limit of 7 years may be appropriate.

Of the 866 sampled sub-prime loans 14% had balloon payments. Of particular interest, 24% of the sub-prime loans with interest rates above the recommended HOEPA trigger but only 11% of those with interest rate below the recommended HOEPA trigger had the balloon payment clauses. The greater use of balloon payments in mortgages above the FTC recommended HOEPA trigger is consistent with the FTC's conclusion that many of the abusive loans were found at interest rates just below the current HOEPA trigger. It is worth noting that of the sampled sub-prime plaintiff **prime** loans foreclosed (and discarded from the sub-prime sample,) only 5% had balloon payments.

[12] To determine if a mortgage interest rate exceeded the FTC recommended HOEPA trigger, mortgage interest rates on sample foreclosed mortgages were checked to see if they exceeded by 6% the interest rate on 30 year treasury securities at the time the mortgage loan was made.

While the HOEPA trigger cutoff is a more precise measure of inappropriately high interest rates since treasury rates did fluctuate over the time period in which the foreclosed mortgages were originated, insight can also be gleaned about the usage of balloon payments by noting their use across absolute interest rate ranges, (see Table 5 below). Use of balloon payments increases steadily as the interest rate rises.

- Only 2% of loans with interest rates under 9% had balloon payment clauses while 23% of those with interest rates above 12% did.

Table 5: Balloon Payment by Interest Rate on Foreclosed Subprime Loans

		Interest Range				
		Less than 9%	9% to 10.5%	10.5% to 12%	Greater than 12%	Total
Balloon Payment?	No	182	178	177	206	743
		98.4%	89.9%	81.6%	77.4%	85.8%
	Yes	3	20	40	60	123
		1.6%	10.1%	18.4%	22.6%	14.2%
Total		185	198	217	266	866
		100.0%	100.0%	100.0%	100.0%	100.0%

f) Pre-Payment Penalty

The use of pre-payment penalties in sub-prime loans has come under FTC scrutiny because it inhibits the refinance at more attractive interest rates for borrowers who reestablish their creditworthiness (through consistent payment) in the initial years of a sub-prime loan. The FTC is particularly concerned because in their experience the initial high interest rate is often sold to the borrower with reassurances that they will be able to refinance at lower interest rates in a short period of time without explaining that the pre-payment penalties will make that difficult. Of the 866 sampled sub-prime loans 59% had pre-payment penalties. As with balloon payments a greater portion of the loans above the recommended HOEPA trigger (75%) had pre-payment penalties than those below the HOEPA trigger (54%). In stark contrast, only 4% of the sampled sub-prime plaintiff **prime** loans foreclosed had pre-payment penalties. Table 6 below documents the dramatic increase in pre-payment penalty clauses as the interest rate rises. Over three quarters (77%) of all loans with interest rates above 10.5 % had pre-payment penalty clauses.

Table 6: Prepayment Penalty by Interest Rate on Foreclosed Subprime Loans

		Interest Range				
		Less than 9%	9% to 10.5%	10.5% to 12%	Greater than 12%	Total
Prepayment Penalty?	No	156	85	47	64	352
		84.3%	42.9%	21.7%	24.0%	40.6%
	Yes	29	113	170	203	515
		15.7%	57.1%	78.3%	76.0%	59.4%
Total		185	198	217	267	867
		100.0%	100.0%	100.0%	100.0%	100.0%

g) Adjustable Rate Mortgages

Adjustable rate loans allow borrowers to access lower interest rates in the short term by assuming the additional risk of inflationary pressures in the long term. For households in a secure financial position such a tradeoff often seems reasonable and adjustable rate mortgages are a common feature of the prime mortgage market. For a sub-prime borrower, the adjustable rate mortgage represents a substantially higher risk because any increase in the interest rate is likely to precipitate payment problems. The concern here is the same as with the balloon payment, inadequate disclosure as to the downside potential associated with the lower monthly payments being offered does not allow the borrower to adequately assess their risks. Fortunately, over the last few years, adjustable rates have not risen because inflationary pressures have not increased. However, the potential harm if they do from the community perspective is easily demonstrated. In the sampled sub-prime mortgages, 32% of those sub-prime loans above the HOEPA target had adjustable rates while 45% of those below the recommended HOEPA target did so. Use of adjustable rates does fall as the interest rate rises, (see Table 7 below) but is still used in a substantial minority (32.2%) of loans above 12%.

Table 7: Type of Mortgage by Interest Rate on Foreclosed Subprime Loans

	Interest Range				
	Less than 9%	9% to 10.5%	10.5% to 12%	Greater than 12%	Total
Fixed	101	105	120	180	506
	54.6%	53.0%	55.3%	67.7%	58.4%
Adjustable	84	93	97	86	360
	45.4%	47.0%	44.7%	32.3%	41.6%
Total	185	198	217	266	866
	100.0%	100.0%	100.0%	100.0%	100.0%

h) Payable on Demand (Call) Clauses

A particularly problematic feature associated with predatory sub-prime loans are payable on demand (call) clauses that allow the lender to declare the loan due at their discretion. This clause provides the borrower no protection against costly forced refinancing or foreclosure. The Federal Reserve Board has proposed banning these clauses in any mortgage loans covered by HOEPA.

These clauses were found in only a small portion (2.7%) of the sub-prime loans sampled. A slightly greater percentage of those loans above the recommended HOEPA trigger (4.2%) than those below the trigger (2.2%) had this provision (see Table 8). The clause was most prevalent for loans above 10.5% with only 4 of the 24 found on mortgages with interest rates below 10.5%. It is worth noting that payable on demand clauses substitute for balloon payments since none were found on any mortgage that had a balloon payment.

Table 8: Relationship of Demand/Call Provisions to Other Aspects of Predatory Loans

		Demand or Call Provision		
		No	Yes	Total
HOEPA Recommended Trigger	Above	226	10	236
		95.8%	4.2%	100.0%
	Below	623	14	637
		97.8%	2.2%	100.0%
Total	Count	849	24	873
	Row %	97.3%	2.7%	100.0%
Interest Range	Less than 9%	189		189
		100.0%		100.0%
	9% to 10.5%	194	4	198
		98.0%	2.0%	100.0%
	10.5% to 12%	207	11	218
		95.0%	5.0%	100.0%
	Greater than 12%	259	9	268
		96.6%	3.4%	100.0%
Total	Count	849	24	873
	Row %	97.3%	2.7%	100.0%
Balloon Payment?	No	719	24	743
		96.8%	3.2%	100.0%
	Yes	123		123
		100.0%		100.0%
Total	Count	842	24	866
	Row %	97.2%	2.8%	100.0%
Prepayment Penalty?	No	351	1	352
		99.7%	.3%	100.0%
	Yes	492	23	515
		95.5%	4.5%	100.0%
Total	Count	843	24	867
	Row %	97.2%	2.8%	100.0%

i) Mandatory Arbitration and/or Waiver of Jury Trial

The FTC in its comments on the proposed changes on Regulation Z made particular note of clauses where legal rights of borrowers are signed away. Again the concern is that the borrower is in an extremely vulnerable situation at the time of the loan closing. This vulnerability makes it difficult for them to resist inappropriate language. Any clause that signs away rights under federal law that were designed to protect consumers struck the FTC as inappropriate.

Locally, such clauses were relatively rare with only 2.6% of the sampled sub-prime mortgages including clauses that waived the right to a jury trial or called for mandatory arbitration. The clauses were about twice as common above the recommended HOEPA target (3.8%) than below (2.2%) or at interest rates greater than 10.5% (3.7%) than below 10.5% (1.5%).

Table 9: Relationship of Waiving Right to Jury Trial/Arbitration to Other Aspects of Predatory Loans

			Waive Jury Trial Clause		
			No	Yes	Total
HOEPA Recommended Trigger	Above	Count	227	9	236
		Row %	96.2%	3.8%	100.0%
	Below	Count	623	14	637
		Row %	97.8%	2.2%	100.0%
Total	Count		850	23	873
	Row %		97.4%	2.6%	100.0%
Interest Range	Less than 9%	Count	187	2	189
		Row %	98.9%	1.1%	100.0%
	9% to 10.5%	Count	195	3	198
		Row %	98.5%	1.5%	100.0%
	10.5% to 12%	Count	210	8	218
		Row %	96.3%	3.7%	100.0%
	Greater than 12%	Count	258	10	268
		Row %	96.3%	3.7%	100.0%
Total	Count		850	23	873
	Row %		97.4%	2.6%	100.0%
Balloon Payment?	No	Count	722	21	743
		Row %	97.2%	2.8%	100.0%
	Yes	Count	121	2	123
		Row %	98.4%	1.6%	100.0%
Total	Count		843	23	866
	Row %		97.3%	2.7%	100.0%
Prepayment Penalty?	No	Count	346	6	352
		Row %	98.3%	1.7%	100.0%
	Yes	Count	498	17	515
		Row %	96.7%	3.3%	100.0%
Total	Count		844	23	867
	Row %		97.3%	2.7%	100.0%

j) High Fees and Single Premium Life Insurance

The recorded interest rates understate the number of loans that would qualify for HOEPA status because HOEPA APRs take into account the fee structure of the loan and most mortgage instruments examined do not record these fees. In a few cases where such fees were recorded there was evidence of excessive upfront fees and of large payments for single family life insurance. These cases were differentially associated with higher interest rate loans, (see Table 10), loans above the recommended HOEPA target, balloon payments and pre-payment penalties.

Table 10: Relationship of High Fees/Single Premium Life Insurance to Other Aspects of Predatory Loans

			High Fees/Insurance Premium		
			No	Yes	Total
HOEPA Recommended Trigger	Above	Count	225	11	236
		Row %	95.3%	4.7%	100.0%
	Below	Count	625	12	637
		Row %	98.1%	1.9%	100.0%
Total	Count		850	23	873
	Row %		97.4%	2.6%	100.0%
Interest Range	Less than 9%	Count	189		189
		Row %	100.0%		100.0%
	9% to 10.5%	Count	194	4	198
		Row %	98.0%	2.0%	100.0%
	10.5% to 12%	Count	214	4	218
		Row %	98.2%	1.8%	100.0%
	Greater than 12%	Count	253	15	268
		Row %	94.4%	5.6%	100.0%
Total	Count		850	23	873
	Row %		97.4%	2.6%	100.0%
Balloon Payment?	No	Count	722	21	743
		Row %	97.2%	2.8%	100.0%
	Yes	Count	121	2	123
		Row %	98.4%	1.6%	100.0%
Total	Count		843	23	866
	Row %		97.3%	2.7%	100.0%
Prepayment Penalty?	No	Count	347	5	352
		Row %	98.6%	1.4%	100.0%
	Yes	Count	497	18	515
		Row %	96.5%	3.5%	100.0%
Total	Count		844	23	867
	Row %		97.3%	2.7%	100.0%

k) Summary on Local Elements of Predatory Loan Practices

Examination of a random sample of sub-prime mortgages associated with foreclosure filings in Montgomery County from 1994 to 2000 suggest that a significant minority of sub-prime loans involved with foreclosures exhibit interest rates above FTC's recommended HOEPA trigger. Further, pre-payment penalties and adjustable rate mortgages are quite common at interest rates where their presence is probably inappropriate. While balloon payments are not as common as pre-payment penalties there was a significant number of mortgages which included them. The degree to which excessively high fees and single premium life insurance are common in the area is unknown. Some mortgages in the sample did note the fees and the life insurance but there was no way to know how often it occurred without showing up on the mortgage instrument. Finally, payable on demand clauses and waiver of jury trial clauses were not significant elements of the sample although they did exist in a small percent of the loans examined.

In summary, strong evidence exists that predatory practices are occurring in the Montgomery County sub-prime market. Loans made above the FTC recommended HOEPA trigger exhibit a wide variety of characteristics associated with predatory practices including pre-payment penalties, balloon payments, payable on demand clauses and waivers of legal rights. The FTC recommended HOEPA trigger is used in this study as the cutoff point for sub-prime loans with predatory characteristics. The single greatest problem for borrowers is that excessively high interest rates (relative to true risk) and the associated monthly payments make equity stripping and or foreclosure more likely. The full negative impact of pre-payment penalty clauses is precisely felt when one would like to get out from under the onerous interest rate burden only to discover that the pre-payment penalty makes it more difficult financially to do so. Waiver of legal rights is problematic precisely at higher interest rates where you may have difficulty making payments and discover you have been mislead as to the nature of the contract.

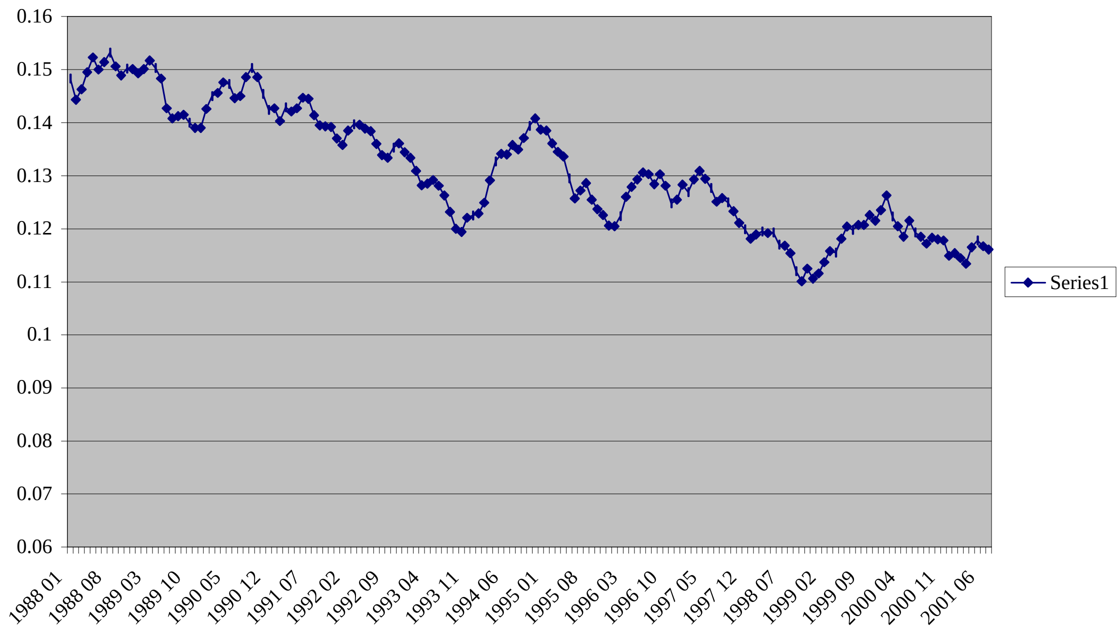
Using the FTC recommended HOEPA trigger as a cutoff point for predatory vs. non-predatory loans is not perfect. There are clearly some sub-prime loans with interest rates below this cutoff point that have predatory clauses and fees. There could be some sub-prime loans above this cutoff point that are justified by the borrower's circumstances and ability to repay. The goal of this study however is to attempt to estimate the extent to which predatory lending is a problem for Montgomery County. The high monthly payments and ubiquitous pre-payment penalties for loans above the FTC recommended HOEPA trigger make this the logical divide.

III. DETERMINATION OF LENDERS INVOLVED IN PREDATORY LOANS

The prior section lays out the basic characteristics associated with predatory lending and their prevalence in Montgomery County. In this section, the methodology used to determine the list of lenders involved in such loans in Montgomery County is delineated.

The FTC's recommended cutoff point for HOEPA status (6% above a U.S. Treasury bond of comparable maturity) is utilized to determine the number of sampled mortgages with predatory characteristics and the lenders associated with such loans (see chart below). Note that rate varies depending on the date of loan origination. There is a general tendency for the rate to fall over the period charted as inflationary expectations slowly dissipated.

Cutoff Point for Predatory Lending
(6% above 30 year constant maturity U.S. Treasury Bond)



Of the 1,198 sampled mortgage instruments, 255 mortgages exceeded the threshold interest rate the FTC suggested required much greater disclosure requirements. Companies responsible for at least four of these mortgage loans make the initial list of companies providing mortgage loans that appear predatory. In addition to an examination of the interest rate, each sampled mortgage observation was examined for evidence of other predatory terms (balloon payments, mandatory arbitration, waiver of jury trial, demand features, etc.) While there were many loans with interest rates below the recommended threshold with these characteristics, in all cases they were associated with a company that had already made the list by having mortgages above the interest rate threshold. Further many of the mortgages above the threshold had one or more of these additional characteristics. While one might wish to include the mortgages with these features but lower interest rates in the count of predatory loans by company, there seemed little point.

In addition, it would be useful to note what the extent of fees charged at the time of closing were but these often do not appear on the mortgage instrument. As a consequence, in this study, predation is based on the recommended 6% above a comparable U.S. Treasury HOEPA trigger. The FTC felt these loans were problematic enough to require very high disclosure requirements. From a community point of view, such loans are the best proxy for predatory behavior.

There are two ways to associate companies with the sampled mortgage loans identified as predatory. First, a company may own the original lender. With mergers and acquisitions in the mortgage market, some companies will appear in this category because of loans made by subsidiaries before they were acquired. Second, a company may be associated with one of the sampled mortgage loans identified as predatory because they own the company that was the plaintiff in the foreclosure. The plaintiff may or may not be the original mortgage company because the loan could have been purchased on the secondary market. While it could be asserted that only companies who own the original lender have a responsibility for these loans, it was decided to include as well owners of the plaintiff. Purchasing such loans on the secondary market increases their legitimacy and makes it easier to continue to conduct business in these loans. A refusal to purchase such loans as part of any package of loans purchased would go a long way towards reducing their incidence in the market place.

Table Eleven (see next page) provides the names of companies who currently own the company that made the original mortgage loan identified as predatory. Enclosed in parentheses are the names of the various subsidiaries responsible for the original loan (if the name differs from the company name). The second column in the table indicates the number of sampled mortgage loans that qualified for predatory status.[13] Since the original sample was a sample of 20 loans (where possible) for every sub-prime identified plaintiff, the number of possible predatory loans can only exceed 20 where a company had more than one subsidiary making sub-prime loans over the 1994-2001 period. Companies with more than 4 such loans would certainly seem to practice sub-prime lending in a way that is troubling. An Addendum to the Report provides more detailed information on the characteristics of the sampled mortgages by company.

Table Twelve (see page after next) provides the names of companies who currently own the company that was the plaintiff in the foreclosure case on a sampled mortgage loan identified as predatory. Enclosed in parentheses are the names of the various subsidiaries who were the plaintiffs (if the name differs from the company name). The second column in the table indicates the number of sampled mortgage loans that qualified for predatory status.[14] Again since the original sample was a sample of 20 loans (where possible) for every sub-prime identified plaintiff, the number of possible predatory loans can only exceed 20 where a company had more than one subsidiary making sub-prime loans over the 1994-2001 period. Notice there is a tendency for the sampled loans identified as predatory to be slightly more clustered among the top firms. This is partially due to the fact that sampling could only be done based on plaintiffs rather than original lender. Again, given the sampling process, companies with more than 4 such loans would certainly seem to practice sub-prime lending in a way that is troubling.

[13] Companies that are associated with one such loan are not listed.
[14] Companies that are associated with only one such loan are not listed.

Table 11: Current Owner of Original Lender for Identified Predatory Loans in Sampled Mortgage Foreclosure Cases

	Number of Identified Predatory Loans
HOUSEHOLD INTERNATIONAL (Beneficial Mortgage, Decision One, Household Realty, BancOne Financial Services)	21
WASHINGTON MUTUAL (Long Beach, Fleet))	13
TRANSAMERICA INSURANCE AND INVESTMENT GROUP	13
BANK ONE CORP. (Bancone Financial Services, Bank One)	12
AAMES CAPITAL CORP. (One Stop Mortgage)	11
CITIGROUP INC (Associates Financial, Ford Consumer, CitiFinancial)	11
MORTGAGE CORPORATION OF AMERICA	10
AMERIQUEST MORTGAGE COMPANY	9
AMERICAN GENERAL (Morequity Inc)	9
BANK OF AMERICA (Equicredit, Equifirst, Equity One, Nations Credit)	9
CONSECO INC (Greentree Financial, Conseco)	8
BNC MORTGAGE INC	6
DEUTSCHE FINANCIAL SERVICES (ITT Financial Services)	6
UNITED COMPANIES FINANCIAL CORP	5
H&R BLOCK (Option One Mortgage)	4
OCWEN FINANCIAL CORP	4
STERLING FINANCIAL CORPORATION (Action Loan Company)	4
REGIONS BANK (Equifirst)	3
BAY FINANCIAL SAVINGS BANK	3
CENTEX CORPORATION	3
LENDERS MD INC	3
NATIONAL LENDING CENTER	3
SELECT MORTGAGE GROUP	3
TCF CONSUMER FINANCIAL SERVICES INC	3
AFFINITY BANK (Pacific Thrift & Loan)	2
ALTERNATIVE MORTGAGE SOURCE INC	2
AMERICAN MORTGAGE SOLUTIONS INC	2
AMRESCO RESIDENTIAL MORTGAGE CORP	2
APPROVED RESIDENTIAL MORTGAGE INC	2
BANKERS RESIDENTIAL MORTGAGE CORP (Mercantile Mortgage	2
EQUITABLE MORTGAGE CORP	2
EQUIVANTAGE INC	2
MANUFACTURERS HANOVER MORTGAGE CORP	2
MATRIX BANCORP (Sterling Bank & Trust)	2
MORTGAGE AMERICA INC	2
MORTGAGE LENDERS NETWORK USA INC	2
PROVIDENT BANK	2
STAR BANK	2

Table 12: Current Owner of Plaintiff for Identified Predatory Loans in Sampled Foreclosure

	Number of Identified Predatory Loans
HOUSEHOLD INTERNATIONAL (Beneficial Mortgage, Decision One, Bank, Household Finance, Household Realty, BancOne Financial	33
CITIGROUP INC (Associates, Ford Consumer Finance, CitiFinancial, Source One	29
BANK OF AMERICA (Equicredit,	14
CONSECO INC (Greentree	15
TRANSAMERICA INSURANCE AND INVESTMENT	15
OCWEN FINANCIAL CORP (OcWen Federal Bank, Cityscape	12
WASHINGTON MUTUAL (Ameriquest Mortgage, Long Beach	11
IMC MORTGAGE	9
AMERICAN GENERAL (Morequity	8
H&R BLOCK (Option One	8
AMERIQUEST	7
AAMES CAPITAL CORP. (One Stop	7
MORTGAGE CORPORATION OF	7
Sterling Bank and	6
UNITED COMPANIES FINANCIAL	6
BANKERS TRUST	4
FAIRBANKS CAPITAL CORP (Conti	4
JP MORGAN CHASE (Chase Manhattan	4
PROVIDENT	4
STERLING FINANCIAL CORPORATION (Action Loan	4
THORP CONSUMER DISCOUNT	4
AXA Financial (Alliance	3
BAY FINANCIAL SAVINGS	3
CENTEX	3
EQUIVANTAGE	3
LEHMAN BROTHERS HOLDING (Lehman	3
NATIONAL CITY (Altegra Credit	3
TCF CONSUMER FINANCIAL SERVICES	3
BANK OF NEW	2
FIRST UNION CORP (The Money	2
MORTGAGE LENDERS NETWORK USA	2
WATERFIELD GROUP (Union Mortgage, Union Federal Savings	2
GENERAL ELECTRIC CAPITAL	2
GENERAL MOTORS ACCEPTANCE	2

IV. SURVEY FINDINGS

A. Survey Methodology

CBER conducted telephone interviews with 2 groups of respondents 1) 31 respondents who were associated with one of the sample mortgage foreclosure mortgages determined to be predatory in nature (**hereafter mortgage foreclosure respondents**) and 2) 200 respondents who had closed a mortgage loan with one of the companies responsible for the sampled predatory loans (**hereafter mortgage respondents**) within the last two years.

The objectives of the survey are to supplement quantitative data on the spread of predatory lending with information on the marketing approaches used in the local market. Several of the questions asked in the two surveys were the same. In those situations we report the results for both surveys to compare and contrast the results for those whose mortgages went into foreclosure with those whose mortgages are still reasonably fresh. The 200 respondents who closed on their mortgages within the last 2 years should have reasonably fresh memory of the circumstances surrounding the initial marketing of the loan and the loan closing.

B. Results

1. Initial Contact with Company

Thinking back to the initial interaction with this mortgage company, were you actively looking for a mortgage company or did they contact you?

- Thirty-nine percent of initial contacts for the mortgage foreclosure respondents but only thirty-three percent of the initial contacts for the mortgage respondents were initiated by the lender.
- Of those contacts initiated by the lender the great majority were by phone (71% for mortgage respondents and 89% for mortgage foreclosure respondents.)

2. Type of Mortgage

Was the loan for a home purchase, a refinance of a mortgage or a home equity loan?

- Slightly less than half of mortgage foreclosure respondents and mortgage respondents loans were for refinancing (45% and 49% respectively).
- About a third in each case were for home purchases.

Table 13: Purposes of Sub-Prime Loan for Survey Respondents

	Mortgage Foreclosure	Mortgage
Home Purchase	32%	33%
A Refinance of a Mortgage	45%	49%
A Home Equity Loan	23%	19%
Total	100%	100%
Sample Size	31	200

3. Location of Loan Paperwork and Closing Activity

Respondents were asked where the paperwork was done and where the closing took place.

Most often, paperwork was done at the mortgage company office although a substantial minority was reportedly done at the respondents home (see Table 14).

Table 14: Location of Loan Paperwork

	Mortgage Foreclosure	Mortgage
At your home	19%	30%
At the mortgage company (	58%	49%
Other	23%	23%
Total	100%	100%
Sample Size	31	200

Respondents who did the loan paperwork neither at the mortgage office or at home reported doing it over the phone (14 of 200 mortgage respondents). A few reported meeting at a restaurant.

While the majority of loan closings took place at the mortgage company office or at a title company, a substantial number took place at the respondent's home, (see Table 15 below).

Table 15: Location of Loan Closing

	Mortgage Foreclosure	Mortgage
At your home	10%	30%
At the mortgage company (	58%	46%
Title Company	26%	27%
Other	7%	12%
Total	100%	100%
Sample Size	31	200

4. Terms at Closing

Were the loan terms at closing the same as discussed during the loan application process?

- For 45% of mortgage foreclosure respondents and 24% of mortgage respondents the terms at closing were different than had been discussed during the process.

As a follow-up respondents were asked how the terms were different.

Seven of the fourteen mortgage foreclosure respondents who indicated the terms were different indicated there were either hidden fees or charges of some type. One noted specifically that there were $3,000 in hidden charges, another mentioned a $750 insurance fee. One respondent on discovering there was a balloon payment was told it wasn't a problem because they would refinance anyway.

Among the quarter of mortgage respondents who noted the terms were different, 60% indicated the fees were higher while another 30% indicated the interest rate was higher.

Reinforcing the FTC's point that the closing meeting is a situation where the borrower feels vulnerable, 12 of the 14 mortgage foreclosure respondents and 68% of the mortgage respondents who noted differences in terms at foreclosing accepted the differences.

As a follow-up, respondents were asked:

Thinking about the amount you originally intended to borrow, did the mortgage company encourage you to borrow:

a) Less than that amount
b) About that amount
c) More than that amount
d) Made no suggestion about the amount to borrow

- Nineteen percent of mortgage respondents and forty-two percent of mortgage foreclosure respondents were encouraged to borrow more than they intended, (see Table 16).

Table 16: Amount Mortgage Company Encouraged You to Borrow Relative to Your Plan

	Mortgage Foreclosure	Mortgage
Less than that amount	0%	5%
About the same	39%	32%
More than that amount	42%	19%
Made no suggestion	19%	45%
Total	100%	100%
Sample Size	31	200

5. Broker Involvement

A mortgage broker was involved in 39% of the loans for mortgage foreclosure respondents and 47% of the loans for mortgage respondents.

6. Refinancing Abuse

Mortgage foreclosure respondents were asked how many times they had refinanced in the prior 5 years and who had suggested it[15].

A total of 12 of 31 had refinanced once, 11 of 31 had refinanced twice, and 8 of 31 had refinanced three times.

In only 3 cases had it been suggested by the mortgage company.

This does suggest that refinancing was an active phenomenon in the mortgage foreclosure cases but it does not suggest that mortgage companies themselves were the drivers.

7. Role of Home Improvement Projects in Loans

Since suspect home improvement projects had been involved in some predatory loan situations, respondents who had refinanced or gotten a home equity loan were asked whether a home improvement project had been involved and if so, how it had turned out.

- In 39% of the mortgage foreclosure cases, a home improvement loan was involved (30% of mortgage respondents). In 2 cases mortgage foreclosure respondents noted that the work either cost more than they were told it would or that it did not get completed. In general, mortgage respondents had not had difficulty with completion

[15] This question was not asked of mortgage respondents who were selected because their loan closing had occurred within the last 2 years.

or the cost of their home improvement projects. In those cases where they reported difficulty, it was not clear whether the difficulties were linked to the loan.

8. Tax Payment Record of Mortgage Companies

Mortgage respondents were asked if the mortgage company was responsible for paying taxes and insurance as part of the loan agreement. In 32% of the cases, mortgage companies were responsible. Asked if those payments were made on schedule, 89% of the relevant respondents indicated they had been.

9. Credit Rating of Respondents

Respondents were asked:

Which of the following best describes your credit rating at the time you took out the loan? Fine, Somewhat damaged, Very damaged?

- 59% of mortgage respondents and 58% of mortgage foreclosure respondents indicated their credit had been fine at the time they took out the loan. Only 8% of mortgage respondents and 3% of mortgage foreclosure respondents indicated their credit was very damaged.

While self-assessments of credit are problematic, the relatively high percent of those who indicated their credit was fine suggests that some were inappropriately placed in sub-prime loans.

10. Property Appraisals in the Loan Process

One element of the predatory loan market has been appraisal processes that present a distorted view of the value of the property. Respondents were asked:

Would you say that the appraised value was: [Rotate order of asking]

a) Higher than a fair estimate of the value of your property
b) Lower than a fair estimate of the value of your property
c) Pretty close to a fair estimate of the value of your property

- Forty-three percent of mortgage foreclosure respondents and twenty-one percent of mortgage respondents indicated the appraisal of their property was higher than a fair estimate of the property's value. Some mortgage foreclosure respondents reported brokers indicated they should over-report their income to help the loan be approved.

Table 17: Appraised Value Relative To a Fair Estimate

	Mortgage Foreclosure	Mortgage
Higher	43%	21%
Pretty Close	47%	70%
Lower	10%	9%
Total	100%	100%
Sample Size	31	200

11. Lender Treatment of Borrower

Respondents were asked to characterize their treatment by the lender.

Mortgage respondents (who have closed within the past 2 years) in general made positive comments about their treatment. Only 18% had comments that could be characterized as negative. Most positive comments focused on how helpful the lender (or broker) was during the process of getting the loan. Negative comments were often associated with concern over the terms offered or discourtesy during the loan application process.

Slightly less than half of the mortgage foreclosure respondents (14 out of 31) had negative comments about their treatment by the lender or broker. In general, these comments captured distress about the loan terms or the tactics used. Three respondents noted that they had been rushed to sign, indicating they had been told it had to be done that night.

12. Precipitants of Foreclosure

Mortgage foreclosure respondents were asked *what caused your loan to get behind*? Medical bills were associated with 13 of the 31 foreclosures (overlapping with other problems). Job Loss was associated with 7 of the 31 foreclosures. Other bills (beyond medical) were involved in most of the other cases.

13. Mortgage Lender Role in Foreclosure

In 7 of the 31 cases (23%), the mortgage lender did try to work out a payment plan before filing for foreclosure. In only one case did a respondent report that the mortgage lender informed them about housing counseling that was available to them to avoid foreclosure.

14. Demographics of Respondents

Unsurprisingly, (since they are more likely to be homeowners), the majority of respondents were in their middle ages. For both groups a small percent of respondents were over 65.

Table 18: Age of Respondents

	Mortgage Foreclosure	Mortgage
18-29	3%	9%
30-44	32%	39%
45-64	58%	40%
65 and up	7%	12%
Sample Size	31	200

Income ranges represented covered the full gamut, but mortgage foreclosure respondents were skewed toward the lower end of the income distribution. Note that while only 38% of mortgage respondents had household incomes below $40,000, 65% of mortgage foreclosure respondents did.

Table 19: Household Income of Respondents

	Mortgage Foreclosure	Mortgage
Under $20,000	36%	10%
$20,000-$40,000	29%	29%
$40,000-$60,000	26%	25%
$60,000 and up	7%	34%
Refused	3%	3%
Sample Size	31	200

As with household income, educational attainment of mortgage foreclosure respondents tended to be lower than for mortgage respondents. While only 31% of mortgage respondents had a high school degree or less, 45% of mortgage foreclosure respondents reported a high school diploma or less.

Table 20: Educational Attainment of Respondents

	Mortgage Foreclosure	Mortgage
Less than High School	16%	6%
High School Graduate	29%	25%
Some College	39%	38%
College Graduate	13%	24%
Post College Degree	3%	8%
Total	100%	100%
Sample Size	31	200

While African-Americans were slightly over-represented among mortgage foreclosure respondents, the difference is not significant.

Table 21: Ethnic Identity of Respondents

	Mortgage Foreclosure	Mortgage
African_American	29%	23%
Eurpean-American	61%	75%
Other	10%	2%
Total	100%	100%
Sample Size	31	200

15. Summary of Survey Results

Results of the two surveys suggest that some of the same practices associated with predatory lending practices at a national level are occurring in the sub-prime market in Montgomery County:

About one third of contacts were initiated by the lender/broker. Most of these occurred over the phone.

Forty-five percent of mortgage foreclosure respondents and twenty-four percent of mortgage respondents reported new fees and other charges were presented at the closing.

Forty-two percent of mortgage foreclosure respondents and nineteen percent of mortgage respondents reported encouragement by the broker or lender to increase their borrowing.

While a substantial minority of respondents indicated a home improvement project was involved with the loan, it is not possible to tell whether inclusion of a home improvement project created additional difficulties for most respondents.

Almost 60% of mortgage foreclosure and mortgage respondents reported that their credit was fine at the time the loan was made. Even assuming that the bulk of these people were unaware of their true credit rating, it still suggests that some people with good credit histories have been steered into sub-prime loans.

Finally, 43% of mortgage foreclosure respondents and 21% of mortgage respondents believed the appraised value of their properties was high relative to a fair value. Inflated appraisals have been part of the pattern of abuses nationally in the market.

The effectiveness of sub-prime marketing is illustrated by the generally positive tenor of comments by mortgage respondents about their lender. Despite problems with high fees and lack of disclosure prior to closing, most respondents were pleased with their lender. Their comments indicated they were most impressed by the personal attention they got, the idea that the broker would take care of everything, and the demonstrated willingness to explain. These comments on personal attention and courtesy go a long way toward explaining the appeal of these firms in the market.

V. ROLE OF SUB-PRIME LENDERS IN THE MONTGOMERY COUNTY MORTGAGE MARKET

A. Examination of Loan Application Register Data

Loan Application Register Data for 1998 and 1999 is available for many of the sub-prime lenders (but not all) associated with the sample mortgages with predatory aspects. This data allows an analysis of the ethnic and income makeup of the average borrower of these firms relative to the overall market.

Using 1998 and 1999 Loan Application Register data that financial institutions are required to report as part of their Home Mortgage Disclosure Act requirement, the percent of all mortgage loans in Montgomery County extended to borrowers at different income levels and different ethnic identities can be compared to the percent of a particular financial institution's loans extended to borrowers at particular income levels and ethnic identities.

Most of the sub-prime lenders examined are doing two to five times as many loans with borrowers whose household income is 50% or less of median household income in comparison to the overall market and two to four times as much as the overall market with borrowers whose income is 50% to 80% of median household income (see Appendix Table 1).

For example, in 1998, only 4.3% of the mortgage loans in Montgomery County went to borrowers whose incomes were below 50% of median household income and only 10.9% went to those whose income was between 50%-80% of median household income, so that only 15% of loans in the market overall went to those with incomes below 80% of the median Meanwhile 18% of Aames Capital's mortgages were with borrowers whose incomes were below 50% and another 20% were with borrowers whose incomes were from 50% to 80% of median income, so that 38% of Aames' mortgages in Montgomery County were going to people with household incomes below 80% of the Median. As a consequence, Aames share of its loans in those two markets were 4.27 and 1.86 times as great as for all mortgage companies as a group. United

Companies Lending (owned by Aegis Mortgage Company) had 56% of its mortgage loans in Montgomery County going to those whose incomes were below 80% of the median household income. Associated with that heavier concentration on low income borrowers is a heavier concentration in low income census tracts.

Most of the sub-prime lenders examined are doing three to four times as many loans with African American borrowers in comparison to the overall market (see Appendix Table 2). Associated with that is a geographic concentration in census tracts that are heavily minority.

For example, in 1998, 11.9% of the mortgage loans in Montgomery County went to minority borrowers In contrast, 36.7% of Aames Capital's total mortgages were with minority borrowers. As a consequence, Aames concentration of its loans in the minority markets were 3.08 times as great as for all mortgage companies as a group. United Companies Lending (owned by Aegis Mortgage Company) had 69% of its mortgage loans in Montgomery County going to minority borrowers. Perusing the list of sub-prime borrowers for whom LAR data is available, there are several who are heavily concentrated in the minority market relative to lenders as a whole.

B. Evidence on Sub-Prime Mortgage Patterns from Recorder's Office Data

An electronic file of mortgages associated with sub-prime lenders whose sampled loans contained predatory characteristics was obtained from the Montgomery County Recorder's Office for the years 1994-August 2001.

The initial goal was to provide a complete characterization of the geographic spread and relative market share of each of these companies. Limitations on the legal description available and problems with associating each lender with the appropriate name leave the file incomplete in two ways. First, some lenders fail to be captured in the name search process utilized. For example, The Money Store is known to be a major player in the market, yet few mortgages are in the file with that name. The same is true for Aames Funding. Second, legal descriptions cannot be associated with geocoded parcel ids for a subset of the mortgages obtained. For most mortgages where this occurred, a jurisdiction could be assigned. For approximately 10% of the mortgages in the file it was not possible to locate the jurisdiction. While both of these factors limit what can be indicated from the database, it still provides some sense of the relative size of most of the players involved and where they are doing loans.

Appendix Table 3 provides information by Lender on mortgages recorded in Montgomery County by year for each sub-prime lender whose sampled loans had some predatory characteristics. As can be seen, the Citigroup subsidiaries (Household Realty, Associates, Citifinancial, Ford Consumer Finance) have dominated the market over the period with 37% of the mortgages made by this group of sub-prime lenders. Household International (Beneficial Mortgage, Decision One) is a distant second (13.1%) and City Loan Financial is a distant third (12.3%).

As evidenced by the mortgage foreclosures there was a significant increase in activity up to 3,946 mortgages by this group of sub-prime lenders with the 1997 calendar year after relatively stable activity from 1994 to 1996 at around 2,900 mortgages in each year. Of interest, this value increase through 1998 (to 4,316) and then declines slightly in 1999 and 2000 with a further decline apparent in 2001.

Appendix Tables Four and Five provide data information on sub-prime mortgages associated with predatory loans recorded in Montgomery County by year for each geographic area. Data is incomplete for Kettering and Huber Heights. As a consequence, in Appendix Table Five, geographic market shares by year are calculated excluding Huber Heights and Kettering from the total.

Dayton: For the group of lenders covered here, the high water mark of sub-prime lending in Dayton occurred in 1998 with declines in absolute numbers in 1999 and 2000, (see Appendix Table Four). It should be noted that the amount of sub-prime lending by these firms in 2000 was still greater than in the pre 1997 period. Dayton’s market share of these mortgages remained relatively constant at 47%-48% over the period from 1994 to 1999. In 2000 and 2001 its market share declined to 45% and then 41.6% respectively.

Other Jurisdictions: The pattern of increase in jurisdictional market shares over the 1999-2001 period is somewhat complex. There are several jurisdictions whose absolute numbers are relatively stable from 1998 to 2000 after rising in the period from 1994 to 1998. Clayton, Harrison Twp., Miami (which includes Miamisburg and Miami Township), Riverside and Washington Twp. are all examples where increases in the absolute number of mortgages done through 1998 are followed by relative stability. Their market shares tend to increase over this period as Dayton’s declines.

Jefferson Township’s share peaked at 4.4% in 1997 and then declined over the next few years to 2.3% in 2000. The patterns exhibited make one wonder whether Dayton’s and Jefferson Township's numbers decline precisely because there are no exploitable borrowers left.

Note that if 1998 represents some high water mark of predatory loan practices, mortgage foreclosures may continue to rise (independent of the general economic weakness) for just a few more years. The decline in sub-prime lending by these firms should cause a decline in mortgage foreclosures at some point but note that the overall volumes continued above pre 1997 levels at least through calendar year 2000.

VI. CONCLUSION

The unprecedented rise in mortgage foreclosure filings in Montgomery County in the late 1990s is associated with the dramatic increase in sub-prime lending. As an examination of the geographic distribution of foreclosures indicates, the problem is increasing faster in suburban communities than in Dayton. There is an element of the sub-prime market that operates using tactics that are predatory in nature. These tactics, (in the words of the FTC), lead to excessive costs for borrowers and strip equity from their homes. The consequences are not, however, just felt by the homeowner who falls prey to these tactics. Equity wealth flows out of the community. The increase in foreclosures in low and moderate income neighborhoods destabilize the life of the community and impose external costs in all the areas where foreclosures have increased.

The rapid increase in foreclosures in the late 1990s occurred in the context of a booming economy. The current economic weakness will undoubtedly accelerate the increase in mortgage foreclosures the county is experiencing. Actions this year to ensure that creditworthy borrowers receive appropriate loans with interest rates that reflect the true costs of borrowing could have a substantial impact on foreclosure rates in Montgomery County over the next 5 years. The recent fall in mortgage rates could represent an opportunity to move thousands of sub-prime borrowers to lower fixed rate mortgages.

Addendum: Portrait of Sub-Prime Lenders with Sampled Loans Exhibiting Predatory Characteristics

Introduction: Explanation of Data Sources

As indicated in the main report, for each plaintiff in a mortgage foreclosure that identified themselves as a sub-prime lender either to HUD or on a company web site, a random sample of 20 mortgage foreclosure cases was drawn. The original mortgage instrument in the case documents was examined for interest rate, fees, prepayment penalties, balloon payments and other clauses of interest.[16] It would have been more appropriate to draw a sample of loans from the population of mortgages associated with each lender as the original lender or current owner of the original lender, but the County Court database does not permit that approach.

In Appendix Table 6, the analysis is based on sample mortgages that have been assigned to the company that is the current owner of the original lender on a foreclosed mortgage loan.

There are thirty-seven companies for which sample details are provided (see Appendix Table 6). These thirty-seven companies are on the list because they are the current owners of a company that made at least 2 sampled loans whose interest rates exceed the FTC recommended HOEPA trigger (interest rate 6% above a treasury security of similar maturity at time of origination). Seven companies that have been active in acquisition of sub-prime lenders have more than 20 mortgage loans in their sample because the original sampling was based on sub-prime plaintiff. Nine companies have between 16 and 19 loans sampled. This occurs when a sample case number was not available. When possible a substitute case number was drawn. Almost half of these companies have 4 or fewer loans in the sample. This occurs either when their population of foreclosed loans was that small or because they were never listed as a sub-prime plaintiff but showed up in the sample when the original mortgage was examined. Note that for almost half of the companies we have 4 or fewer loans that constitute the sample.

Degrees of Predation

While in the popular press it is common to refer to lenders as predatory (or not), an examination of Appendix Table 6 should make clear that it is far easier to determine that a loan has predatory characteristics than that a lender "is" predatory. Most of the lenders examined have some loans that have no objective predatory characteristics other than a high interest rate. All of the lenders have some loans that exhibit more than one of the characteristics associated with a predatory loan. In what follows, the discussion proceeds by characteristic to note distinctions between firms.

Above FTC Recommended HOEPA Trigger

Very few of the lenders listed had all of their sampled loans at interest rates above the FTC recommended HOEPA trigger and those six who did had 4 or fewer sampled loans. Among

[16] If an identified sub-prime plaintiff did not have 20 mortgage foreclosures in Montgomery County over the 1994-2001 period, the entire population of mortgage foreclosures was examined

those sixteen companies with more than 10 sampled loans, one company, Transamerica Insurance & Investment Group, had 77% of its sample loans above that rate while seven companies (Washington Mutual, Household International, Bank One, Bank of America, Mortgage Corp. of America, American General, Conseco) had between 39% to 60% of their loans above the HOEPA trigger. It should be noted that sampled loans were categorized as above the recommended HOEPA trigger without good information on fees from the mortgage document. If information on fees was available, additional sampled loans would have made the recommended trigger. Certain types of fees are considered in setting that trigger in the marketplace. The result is that other sampled loans may have qualified for the trigger if full information was available. There were three companies with more than 10 sample mortgages that had a relatively small percent of their sampled sub-prime loans above the recommended HOEPA trigger (Centex, 17%, Mortgage Lenders Network USA, 12%, and Provident Bank, 9%).

Waiver of Jury Trial

Waiver of Jury Trial Rights clauses were associated with only a small group of companies. Almost half of United Companies Financial Corporation's mortgages (42%) had this clause; Ocwen, Bank of America, Deutsche Financial, Conseco and Manufacturers Hanover had a few sampled mortgages with this clause as well.

Prepayment Penalty

Prepayment Penalty clauses were ubiquitous in this group of sampled loans. Almost all lenders had pre-payment penalties with a substantial majority of their loans and eleven of the thirty-six companies had pre-payment penalty clauses on all their sampled loans. While ubiquity in this group might lead one to regard such clauses as acceptable, recall that almost no prime loans had such clauses and the FTC's concern with such requirements was precisely that the borrower's weak bargaining position at the time of close would make it difficult for them to resist such clauses.

Balloon Payment

Balloon Payment Clauses were surprisingly common with twenty-two of the thirty-six lenders having some sampled mortgages with balloon payments. Bank of America (50%), Mortgage Corp of America (35%), Conseco (33%), and Mortgage Lenders Network USA (53%) all had a significant volume of sampled balloon loans. There were several companies with smaller sample totals whose loans often had balloon clauses, (Bay Financial, National Lending Center, Bankers Residential Mortgage, Lender MD).

Payable on Demand Clause

Only four of the thirty-six companies had payable on demand clauses in their sampled mortgages (American General, 81%, Transamerica Insurance, 6%, Aames Capital, 2%, and Citigroup, 7%). Only one of these, American General, appeared to make a general practice of it.

High Fees or Single Premium Life Insurance

In general, fees and sale of single premium life insurance are not recorded on the mortgage instrument. As a consequence, it is not clear how wide-scale these features are in the sub-prime market. What is captured here are simply occasions where such fees or premiums were noted on the mortgage instrument. Four of the thirty-six companies had sampled mortgages with such entries for excessive fees or single premium life insurance (Household International, Transamerica Insurance, Citigroup, and Deutsche Financial).

Adjustable Rate Mortgages

The percent of sampled loans that are adjustable rates tends to vary inversely with the percent of loans that are above the FTC recommended HOEPA trigger. As noted in the main report, the percent of adjustable rate loans falls as the interest rate rises. There are, however, individual firms with a very high percentage of adjustable rate mortgages who have a significant percent of their sampled loans above the FTC recommended HOEPA trigger (Ameriquest, Washington Mutual, BNC Mortgage). The adjustable rate issue is difficult to judge. In times when current inflation is lower than expected future inflation, adjustable rate mortgages allow individuals to access lower interest rates in exchange for taking on more of the inflation risk. This has been a gamble that has worked well in recent years because inflationary pressures have been moderate. These adjustable rate loans potentially could cause significant trouble for low and moderate income people if market based inflationary expectations did turn out to be correct.

Median Loan to Value Ratio

For most sampled mortgages, CBER was able to obtain the County Auditor's appraised property valuation to compare to the mortgage amount. The official property valuation might, for existing homes understate their value by 20%, (although these appraisals are to be closely tied to true market value). In that case one would not expect to find any loan to value ratios higher than 1.2.

Two different critiques have been leveled against sub-prime lenders. One critique is concerned that sub-prime lenders are doing asset based lending that strips equity from low to moderate income homeowners and forces foreclosure. This strategy is only effective to the extent the property value is greater than the mortgage value. There is no public data that would show to what extent such equity stripping occurs because no data is available on foreclosure defendants' income.

The second critique is that unscrupulous brokers in league with unethical appraisers inflate appraised property values at the time of loan origination so as to increase the permitted size of the mortgage and obtain higher fees. Note that the ultimate holder of the mortgage in the secondary market is defrauded in this process when foreclosure reveals the lack of true value. The borrowers might be seen as short run beneficiaries of this particular gambit in that they access more capital. In the long run, without the means to pay the higher payments associated with the larger mortgage, their risk of bankruptcy increases.

There are several companies whose median loan to value ratios are 1.2 or greater. This means that at least half their loans have mortgages that exceeds an objective appraisal of the property. Particularly noteworthy in this regard are:

Bank of America	1.52
American General	1.43
Conseco	1.43
H&R Block (Option One Mortgage)	1.26
Centex Corporation	1.46
Mortgage Lenders Network USA	1.34

While other companies also show relatively high median loan to value ratios, the sample sizes are relatively small.