THE DAILY RECORD

WESTERN NEW YORK'S SOURCE FOR LAW, REAL ESTATE, FINANCE AND GENERAL INTELLIGENCE SINCE 1908

TitleTRACK

Are subprime mortgages making a comeback?

"Bad credit? No money? No problem!" We've all heard these statements spoken by an enthusiastic salesman about a huge lot of vehicles that are just waiting to be driven home by a deserving buyer. But, what about home buying? With a soft real estate market and increased lender competition, the playing field has expanded and diversified into some interesting options for borrowers eager to purchase a home.

Through the mid-90s and early 2000s, the number of subprime mortgages loans rose significantly. As the name indicates, this type of mortgage was being issued to "subpar" borrowers with less than perfect credit ratings. Lower than normal qualification requirements, increased rent costs for surrounding housing, and positive promotion to hopeful borrowers made the subprime loan look attractive to buyers who could not qualify for a conventional mortgage.

A conventional mortgage is usually not offered to these borrowers because the lender views them as having a higher risk of defaulting on the loan. Lenders often charge higher interest rates on subprime mortgages than they do on a conventional mortgage in order to compensate themselves for carrying more risk.

So if these loans were riskier for the lenders, then why would they want to take the chance on approving thousands of loans with the potential for defaulting? Answer: Competition. Due to the increased competition among lenders and less homebuyers on the market, lending institutions had to offer a wider range of mortgage products to a larger audience in order to stay competitive (most of them were online lenders). The snowball effect quickly ensued and lenders began focusing on this type of lending to keep up with other lenders. They started throwing dollars at expensive product marketing and went from approving subprime mortgages every once in a while to approving them regularly.

Between 2000 and 2006, the number of home foreclosures continued to rise. Many studies and analysis suggested a strong

connection between the rise in foreclosures and the subprime mortgage lending practice. According to Inside Mortgage Finance, subprime mortgage originations in their peak year of 2005 were \$625 billion. By the last quarter of 2005, subprime mortgages accounted for 42 percent of homes on which foreclosure was in progress (Source: Center of Responsible Lending).

The federal government's scrutinizing of subprime lender practices caused the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 to be

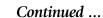
lender practices caused the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 to be born. Under the Consumer Financial Protection Bureau created by Dodd-Frank, mortgage borrowers must meet eight strict criteria including earning enough income and having relatively low debt.

Beginning in January 2014, lenders must now assess the borrower's ability to repay (debt-to-income ratio generally being below 43 percent) for virtually all closed-end residential mortgage loans in order to be a "Qualified Mortgage." If the borrower does not meet the specific QM requirements and later defaults on a mortgage, the borrower can then sue the lender and argue that the bank was in the wrong for approving their loan in the first place. Although subprime mortgages still

exist, this liability risk has been a good deterrent for avoiding them as much as possible, or at the least considering more factors before lending.

With a healthier housing market on the rise, our false sense of security has the potential to create the perfect storm and repeat history. As we move forward from 2013 to present, alternative mortgage options resembling the kind of subprime loans that were being blamed for the foreclosure crisis are starting to slowly emerge back into the market, leaving some experts and regulators alarmed.

Seller financing, for example, is putting homeownership within reach of borrowers who cannot qualify for a conventional mortgage and want to avoid using a bank completely. Notable real





By BOB HILLDaily Record
Columnist

THE DAILY RECORD

WESTERN NEW YORK'S SOURCE FOR LAW. REAL ESTATE. FINANCE AND GENERAL INTELLIGENCE SINCE 1908

Continued ...

estate journalist Broderick Perkins estimated these made up for fewer than 10 percent of mortgages at one point, but that could soon change — investors might be eager soon to cash in on their investment properties now that the housing industry is rebounding and turning in bigger profits than previous years.

Seller financing is when the seller of a property lends money to a buyer to purchase the property. Seller financing is only applicable to the Dodd-Frank act's section 129C ability-to-repay requirements if the seller provides financing more than five times in a calendar year (making them considered a creditor). Finance less than five times and they can avoid the requirements. Carrying a combination of less-than-advantageous terms and what is considered risky lending, some experts say these "lenders" — mostly investment companies flipping homes — are preying on buyers.

They purchase foreclosed properties and sell the home along with home loans to borrowers with subpar credit, sometimes with very little to no down payment on rare occasions. Seller financiers don't want to have a long-term commitment to recoup their money, so they often require balloon payments from their borrowers in order to cash out on their investment quicker.

Some experts see the brighter side of this option — they claim that these loans help the victims of the economic recession and give a home ownership opportunity to those who cannot feasibly save thousands of dollars for a down payment. Additionally, the loans should still give homeowners enough time to rebuild their credit again and obtain a conventional mortgage to pay off the seller-financed mortgage, bringing the borrower back in good standing with the financier.

Other experts see the negative repercussions — borrowers out of foreclosure only a short period of time are being able to qualify for these loans, forcing the borrower to refinance in order to keep up with their payments. If all else fails, the financier will foreclose on them, rinse and repeat with a different borrower in the same circumstances. This combination of balloon payments, high interest rates and the buyer's poor credit are obvious reminders of the lax requirements that caused us to head into the housing bubble in the first place.

Regulators are keeping a close eye on this new trend. About 3 billion of subprime mortgages were issued during the first 9 months of 2013. Wells Fargo, for example, still offers subprime mortgages but now requires their borrowers to present their ability to repay, often requires high down payments and a documented reasonable explanation as to why they even need a subprime mortgage in the first place.

Having the makings of risky pre-crisis loans, it is my opinion that we will reach a disastrous tipping point years from now if lenders continue to market these options to desperate borrowers without the foresight to address the underlying liability risk still looming for both lenders and consumers alike.

The mortgage landscape for the remainder of the year appears that QMs will still be on top, but various other subprime loans will continue to be developed, and potentially new products for borrowers that do not fall under either category. With our eyes on the market, it will be interesting to see what the new era of unconventional lending practices bring to the table.

Bob Hill is the vice president of Business Development for WebTitle Agency, an authorized title insurance issuing agent for First American Title Insurance Co. of New York, Fidelity National Insurance Co. and Old Republic National Title Insurance Co. WebTitle Agency offices are located at 500 A Canal View Blvd., Rochester, N.Y. 14623; and the Executive Office Building, 36 W. Main St., Suite 51, Rochester, N.Y. 14614; phone (888) 250-9056; www.webtitle.us.