The Expanding Role of Subprime Lending in Ohio's Burgeoning Foreclosure Problem

A Three County Study of a Statewide Problem

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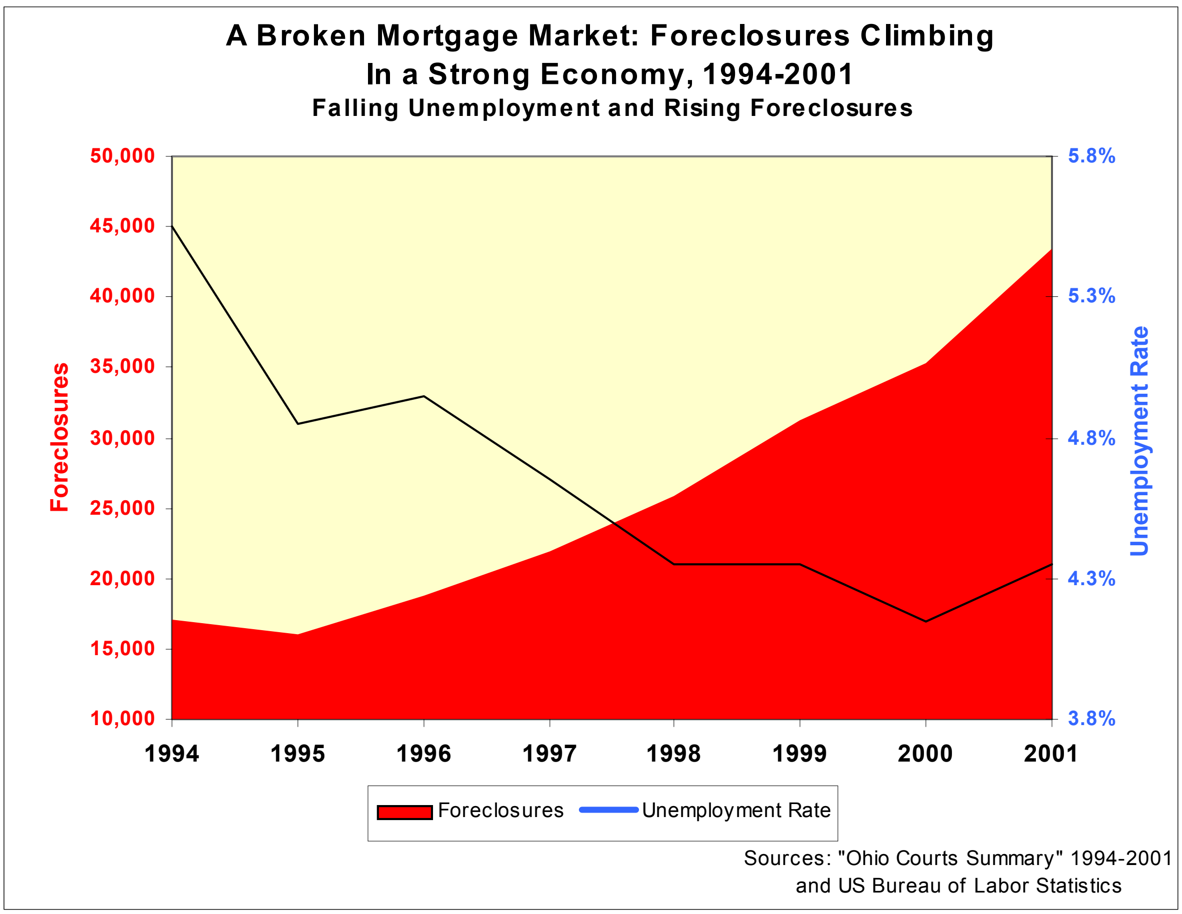
A Three County Study of a Statewide Problem

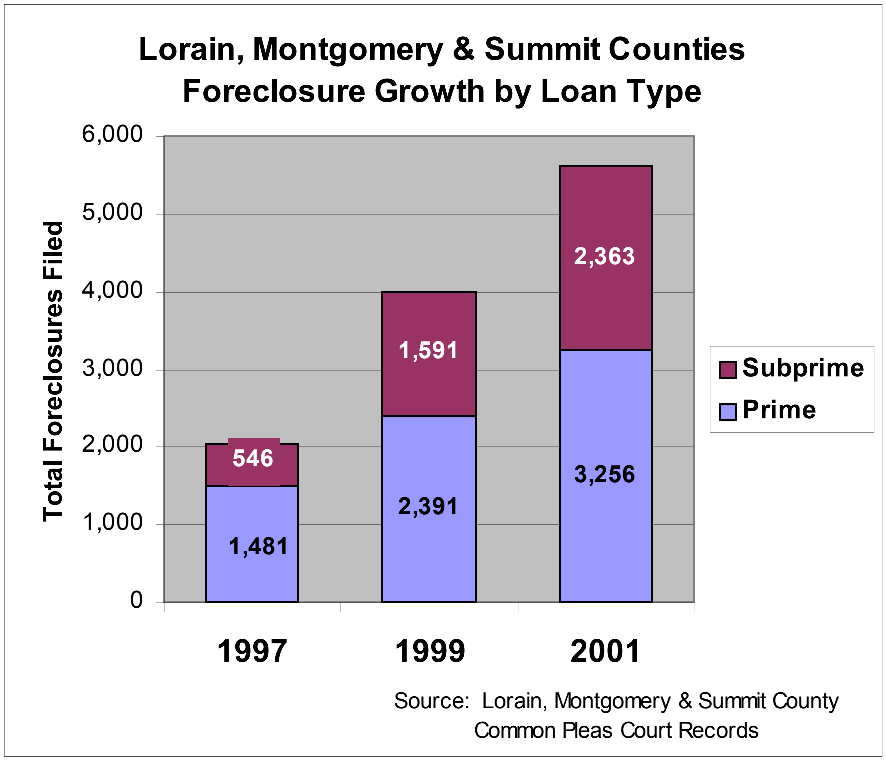
Recently released data from the Mortgage Bankers Association of American[1] confirms what many housing advocates and researchers have long understood to be a serious problem in Ohio: home foreclosures are growing at an unprecedented rate across the state. Following a cooperative effort among numerous Ohio agencies and researchers active in this area,[2] data on home foreclosure filings—including more detailed information about the cases themselves—was gathered from common pleas court records in Lorain, Montgomery and Summit counties. The research effort was designed to learn more about home foreclosures (as distinct from other types of foreclosure cases) and the trends in the three counties over time. The local data from the counties (which taken together are typical of the state as a whole) provides a much deeper understanding of the forces behind the state's unprecedented jump in home foreclosures, and suggests how policy and legal reforms could help to address Ohio's foreclosure issue.

Statewide, the broad outlines of the foreclosure problem have been clear for some time:



- According to Ohio Supreme Court reports, foreclosure filings of all types have increased statewide by 155% between 1994 and 2001.
- This steady rise in foreclosures happened *in spite of* Ohio's falling unemployment rate in the mid and late1990s and is now being aggravated by the rising unemployment levels in the state since 2000.
- Broken out by county, the Supreme Court's aggregated docket reports make it clear that foreclosure increases are not an "urban" problem or a "rural" problem in Ohio. The growth in homeowner defaults is statewide, and the trend is not limited to any particular population, geography or income group.

The newly gathered information from Lorain, Montgomery and Summit counties helps to explain the fundamental anomaly presented by Ohio's rising foreclosure rate during a relatively strong economic period. The aggregated numbers from the three counties for 1997, 1999 and 2001 reflect the state's overall foreclosure increase. More disturbing, the local court records show that the increases in home foreclosures have been even more pronounced since 1997 (177%) than for the statewide increase on all foreclosure types (98%) over the same period.



The three county samples not only confirm an increase in the total number of home foreclosures, but that the growth in homeowner defaults since 1997 has been disproportionately skewed towards subprime loans. Court records from Lorain, Montgomery and Summit counties show remarkably consistent patterns in their foreclosure filings for 1997, 1999 and 2001. When taken together these local court filings demonstrate that:

- Subprime lending is a leading factor in the statewide home foreclosure increase. In the three counties combined, the number of subprime foreclosures[3] more than quadrupled between1997 and 2001, and is expanding its share of homeowner defaults at a much greater rate than "prime," conventional loans
- Loan for loan, subprime lending generated more than three times as many home foreclosure filings as conforming, prime loans. As the market share of subprime lending has grown in Ohio, this disproportionate ratio of loan defaults has begun to undermine whole communities and can no longer be viewed as a tragedy isolated to individual households.
- Conventional prime or "conforming" loan foreclosure filings are also increasing across the state, although at a much lower rate. Since 1997, prime loans have increased in the three counties by 120% vs. 333% for subprime loans.

This summary report will briefly review the existing foreclosure data from Ohio and: explain why the new data was gathered from the local court records of Lorain, Montgomery and Summit counties; the methodology used to compile and "clean" the foreclosure information; suggest caveats about the data; review some of the important recent developments in the mortgage lending industry that help to explain the findings; and finally, suggest possible avenues of legal reform and policy alternatives that could improve the situation for debt-strapped homeowners and foreclosure afflicted communities across Ohio.

Existing Ohio Foreclosure Information Sources and Its Limitations

The Supreme Court of Ohio's "Rules of Superintendence" require that all Ohio courts provide annual statistical reports to the Supreme Court on the state of their local dockets. Every year these docket statistics are then aggregated and released by the Supreme Court in the "Ohio Courts Summary." Under the Rules of Superintendence, foreclosure cases receive treatment as a separate subcategory of civil case for statistical reporting purposes. Under Ohio law, all foreclosure actions must be filed in the Civil Division of the Common Pleas Court of the county where the property is located.

Unfortunately for researchers who want to track only *mortgage* foreclosures, the Supreme Court's annual break out of the "foreclosure" caseload includes an unspecified number of non-mortgage foreclosure cases. These non-mortgage cases include delinquent tax foreclosures, mechanics lien cases, litigation-related debt collection cases (e.g., post-decree divorce cases, condominium owner associations collecting fee arrearages from defaulting residents, and commercial cases that don't involve single family homes.) While all these actions are properly reported by the local common pleas courts as foreclosures, they do not involve the subject of concern here: foreclosed, single family home mortgage loans.[4]

Honing in on Ohio's Home Foreclosures and Causation

Foreclosure research conducted in other states and MSAs suggested that the growth of subprime lending might serve to explain, at least in part, why Ohio's foreclosure caseload has been expanding in recent years.[5] Housing and debt counselors, reinvestment advocates and fair housing enforcement agency staff have all noticed that while the subprime lending industry has grown in Ohio, so has the correlated, albeit more limited, set of broker practices know as "predatory lending." Research from other areas, the strong correlation in time between the expansion of subprime lending and the rise in foreclosures, and anecdotal evidence all suggested that the rise in home foreclosures might be related to the increase in both subprime and predatory lending.

In 2000 and 2001 separate, independently designed studies were conducted on a countywide basis in Lorain, Montgomery and Summit counties, all to a greater or lesser extent focused on the connections between rising homeowner defaults and subprime lending growth in the local mortgage markets.

The Subprime Factor

The traditional (and previously nearly exclusive) mortgage loan product is the "prime" or "conforming" type of loan, available from banks, savings & loans, and many mortgage companies. As a practical matter, until recently, prime loans were the only product available to purchase or refinance a single-family home. These are relatively inexpensive loans, (the current interest rate on a 30 year conforming loan is at an historic low of about 6%) and has been widely available to borrowers with sufficient income, good credit and stable employment histories.

Starting in the early 1990's "subprime" mortgage loans, designed to serve "credit impaired" borrowers, became increasingly common in real estate-secured lending. Subprime loans are more expensive than conforming prime loans, with both higher fees and interest rates, and are not ordinarily available from banks or other "regulated" depository lenders. Subprime loans are usually obtained from "finance" and specialty mortgage companies, through independent mortgage brokers. To accommodate the higher risk involved in lending to people with credit problems, subprime loans are typically priced from two to up to as much as 15 points higher than "prime" loans with comparable terms. There is a range of opinions among researchers, industry experts and advocates as to whether subprime loans are priced in a manner calculated to cover the increased risks to the lender, or whether they are instead priced a what the market (and unsophisticated borrowers) will bear. In any event, beginning in about 1995, subprime lending took off in the Ohio (and national) market.

While subprime lending has grown tremendously in recent years, it is not a new phenomenon ("finance companies" have served as a credit alternative for lower income people for generations). What is new is the growing share of the mortgage loan market that is controlled by the subprime lending industry.

Connecting the Dots - Methodology

The information contained in this report was gathered as part of a larger effort among researchers who were already working on local foreclosure studies[6] to combine their resources to try to draw more universal conclusions from the research than could be supported by their disparate, one-county-only efforts.[7] After numerous discussions, the involved parties[8] agreed to focus on two crucial and interrelated questions: what proportion of home foreclosures was due to subprime vs. prime lending[9] and what are the emerging trends in the relationship between the two mortgage loan types and the state's increasing foreclosure caseload?

In each county, the local court records were examined for the years 1997, 1999 and 2001 providing a 6-year time span to analyze trends in the Ohio home foreclosure caseload. While the docket information provided specifics on the parties involved in the foreclosure actions along with many procedural details on the lawsuit, each case had to be examined to sort out whether it was a home mortgage foreclosure or some other type of foreclosure. (See "Existing Ohio Foreclosure Information Sources and Its Limitations" above.)

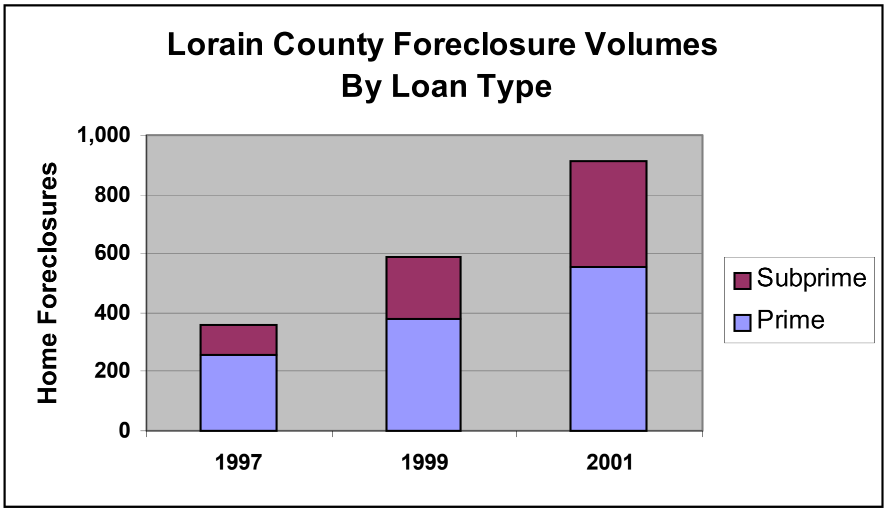
Once a case was identified as a home foreclosure, the task for this study was to determine whether the loan underlying the foreclosure was prime or subprime by comparing the plaintiff in the foreclosure action to the master list of subprime lenders and subprime servicers. After compiling the list of cases and categorizing each foreclosure by loan type, the data had to be cleaned of "repeaters" so only one foreclosure would be counted per property even if their were multiple filings against the same address.[10]

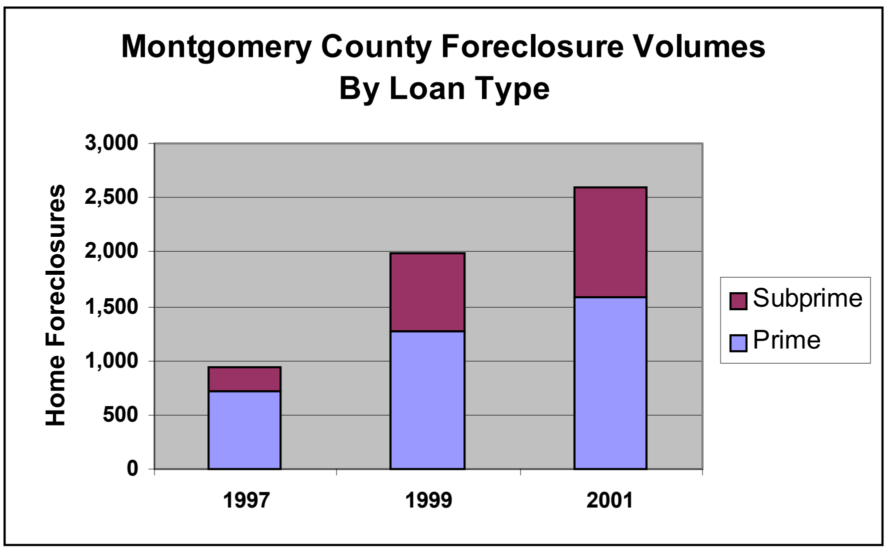
This study attempted to dispense with these non-mortgage and "repeater" mortgage cases, essentially "noise" cases, so as to hone in on the "signal" in the foreclosure case types—bona fide and final foreclosure actions pursued to a legal judgment, ordinarily divesting the homeowner of title and transferring the home to the lender, or a new buyer who agrees to compensate the lender for the outstanding loan obligation.

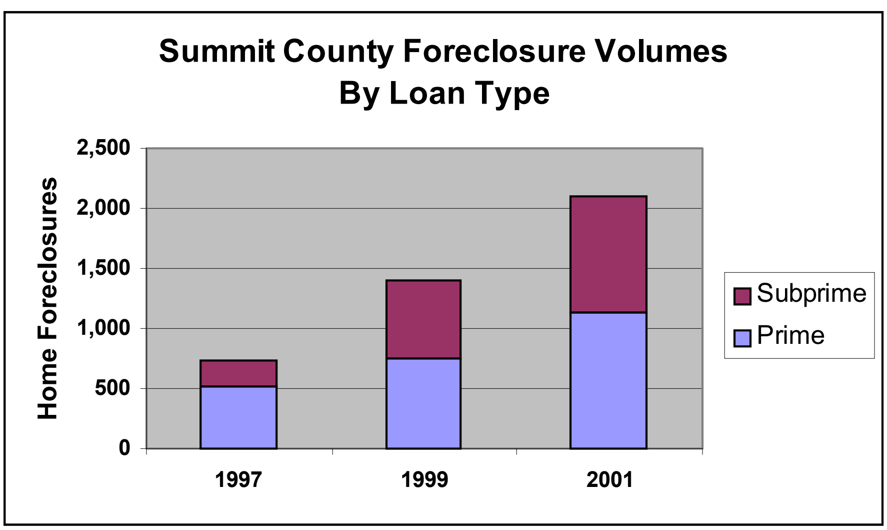
The Prime vs. Subprime Breakouts for the Three Counties

Foreclosure Volumes, By County			
	1997	**1999**	**2001**
Lorain Prime	254	380	552
Montgomery Prime	714	1265	1577
Summit Prime	513	746	1,127
Lorain Subprime	105	211	360
Montgomery Subprime	224	722	1026
Summit Subprime	217	658	977
Total	2,027	3,982	5,619
Percent Increase		96%	177%
Subprime Totals	546	1,591	2,363
Percent Increase		191%	333%
Prime Totals	1,481	2,391	3,256
Percent Increase		61%	120%

The table above breaks out the home foreclosures, by type, for the three counties, for the years 1997, 1999 and 2001. (It is another presentation of the information contained in the stacked bar graph on page two of this report.) The rate of growth for foreclosed subprime loans from year to year far exceeds the rate for prime loans. Remarkable too, is the consistency between the three counties of the disproportionate growth between the two types of loans, and the rate of subprime expansion within each county's annual foreclosure totals.

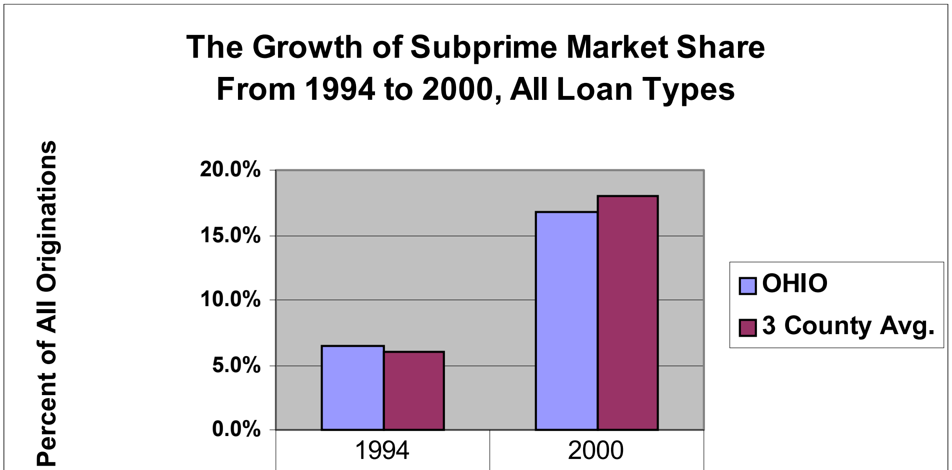

Lorain County Foreclosure Volumes
By Loan Type
Home Foreclosures
1,000
800
600
400
200
0
1997
1999
2001
Subprime
Prime


Montgomery County Foreclosure Volumes
By Loan Type
Home Foreclosures
3,000
2,500
2,000
1,500
1,000
500
0
1997
1999
2001
Subprime
Prime


Summit County Foreclosure Volumes
By Loan Type
Home Foreclosures
2,500
2,000
1,500
1,000
500
0
1997
1999
2001
Subprime
Prime

Subprime Loan Origination Rates

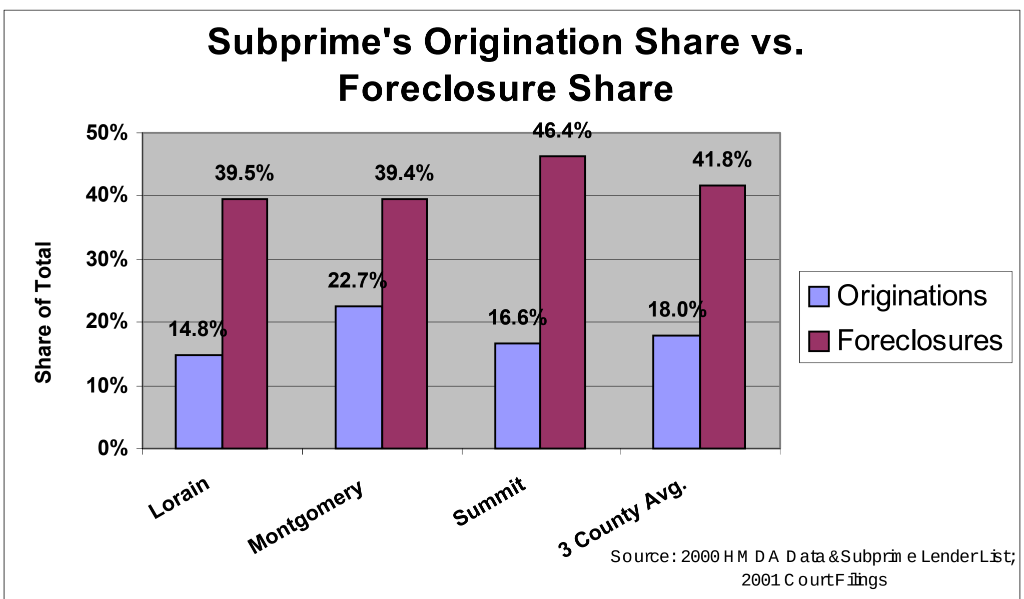
In an effort to understand why subprime loans so consistently increased their proportion in the local foreclosure volumes, we looked at federal Home Mortgage Disclosure Act (HMDA) data for 1994 and 2000 (the most recent year HMDA data was available to OCRP) to measure the growth of subprime's market share in Ohio and in the three study counties. Focusing in on lender market share statistics for loan volumes, for all loan types (when looking at HMDA data, "loan type" refers to conventional home purchase, government home purchase, refinance or home improvement loan categories) we compared each lender doing business in the state or in each of the three counties for the two years, against the subprime lender lists compiled by HUD for 1994 and 2000.[11]



	1994	2000
OHIO	6.4%	16.8%
3 County Avg.	6.0%	18.0%

Here again the sample counties are consistent with the state. More important, the graph above shows that subprime lending has approximately tripled its mortgage origination market share since the mid 1990s.[12]

Focusing on the three counties, we compared subprime's share of 2000 loan originations with their 2001 share of foreclosures:



While not meaning to imply that all the 2001 subprime foreclosures were originated in 2000,[13] by making the comparison between the figures for two adjacent years, we are attempting to draw out a larger point concerning the relationship between subprime lending and subprime default rates. As the table below makes clear, the large gap between the origination share and foreclosure share in the three counties implies that subprime loans are more than 3 times as likely to go into default than prime loans.[14] This estimation has far reaching implications for all of Ohio if subprime's origination share continues to grow at the rates seen in the 1990s.

Originations vs. Foreclosures By Loan Type

Subprime Loans	2000 Loan Counts	2001 Foreclosures	Foreclosure Rates
Lorain	1,337	360	26.9%
Montgomery	4,360	1,026	23.5%
Summit	3,026	977	32.3%
		Avg.	**27.6%**

Prime Loans	2000 Loan Counts	2001 Foreclosures	Foreclosure Rates
Lorain	7,673	552	7.2%
Montgomery	14,871	1,577	10.6%
Summit	15,244	1,127	7.4%
		Avg.	**8.4%**

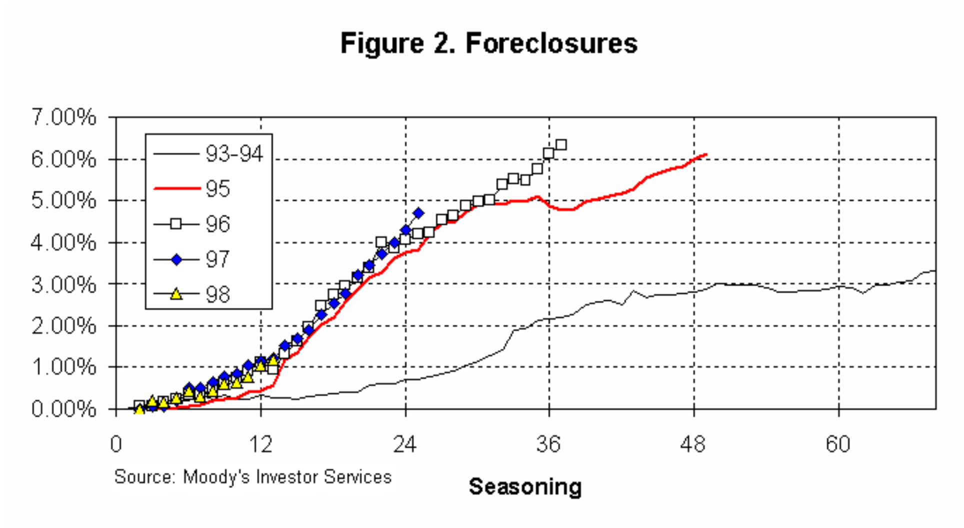
It is expected that subprime loans will default more quickly and readily than prime loans. They are, by definition, serving a riskier borrower. The question raised by this research and other studies from around the country is whether the current apparent default rates on subprime loans are consistent with the public interest. Rampant foreclosures undermine single family homeownership as a tax-favored institution for households to accumulate wealth. Moreover, every foreclosure has negative impacts beyond the family that loses its home. Property values are undermined for nearby homes when entire neighborhoods are saddled with unusually high foreclosure rates. In worst case scenarios, homes are left vacant and, over time, are boarded up or vandalized (or both), an unattractive and value-draining condition for the entire street, not just the affected property.

Subprime Underwriting Problems

By definition, subprime loans are higher interest rate, higher fee mortgage loans that are designed to serve the credit needs of borrowers with imperfect credit histories. While subprime lending has served the laudable purpose of opening up access to credit for people and households that were frozen out of the prime loan products offered by banks and savings and loans, it has created a new set of problems for the communities it serves, including "predatory" lending practices, inconsistent and irresponsible loan underwriting, and allegations of pricing discrimination (too often, it is alleged, prices are not tied to the actual risk of the loan).

Unfortunately, as this report makes clear, the growth of subprime lending is contributing to the tremendous growth of foreclosure filings. Subprime loans are the fastest growing segment of the state's foreclosure epidemic. One issue presented by the correlation between subprime lending and foreclosure growth is whether the large gap we have found in the 2000-2001 period in the threes counties, is an unavoidable consequence of serving the credit impaired borrower. We don't believe that is the case.

We believe that a large part of the problem is the unregulated nature of the subprime lending industry and the intense competitive pressures within the industry to gain market share.



Source: "Credit Performance Update-Home Equities," Tom Zimmerman, *Equity* Magazine © 2000

According to a piece published in a subprime industry trade association journal,[15] this intense competitive pressure within the industry caused huge increases in foreclosure filing rates for subprime loans *made since 1995*. The graph above is taken from the article that analyzed nationally aggregated subprime loan delinquency statistics (the data was obtained from Moody's indices) to trace this destructive trend, by the year the subprime loans were originated. The bottom, or X axis, of the graph tracks the number of months since a subprime loan was originated, while the Y axis tracks the percentage of originated loans in foreclosure. The different lines trace the foreclosure rate for subprime loans *by the year of origination*.

What the graph demonstrates with surprising clarity, is that there was a startling degeneration in the underwriting quality for all subprime loans beginning in 1995. Loans made from 1995 onward are as a group more than 5 times as likely to end up in foreclosure 24 months after closing, than subprime loans originated in 1993 and 1994. The author of the piece posited that,

> During the 1994-'98 scramble for market share, many mortgage-related specialty finance companies sacrificed credit quality for volume. Given the time lag between mortgage loan origination and subsequent credit problems, several years went by before the impact on credit was fully evident.

This post-1994 decline in subprime loan quality is clearly a factor that helps to explain the alarming recent foreclosure increases in Ohio. The author of the piece went on express the opinion that a 1998 subprime industry "shakeout" promised to improve the overall credit quality for subprime loans going forward.

Looking at the 2001 Ohio foreclosure statistics, we do not share in this optimistic prognosis for internal industry reforms serving to redeem subprime's underwriting excesses.

Conclusion and Recommendations

We feel that this study of Lorain, Montgomery and Summit counties demonstrates an alarming correlation between the unprecedented rise in home foreclosures and the recent advent and growing market share of subprime lending in Ohio. We submit that the foreclosure problem has become so severe in recent years in Ohio that it must be viewed as an public problem, to be addressed through the use of public institutions and resources—including if need be, regulatory changes in Ohio law. It will no longer suffice to think of foreclosures as a "private" concern, to be resolved among private parties, using existing market structures and existing laws. If this report demonstrates nothing else, it shows that market mechanisms have failed Ohioans in regard to subprime lending, and our laws are not serving to protect our citizens and their communities.

Whether one conceives of the problem as limited to predatory lending, or intense competition for market share, or "asymmetrical information availability" for consumers bargaining for a loan, one central fact emerges in the new deregulated environment that has fostered the growth of subprime lending: Mortgage brokers who connect subprime borrowers with subprime lenders are not currently held responsible for the quality of the loans that they are originating.

In the pre-subprime mortgage lending industry, most loans were originated by lenders' employees, who had to justify their underwriting recommendations before a loan was made, and if it went into default, after the loan was made. Their continued employment depended upon their ability to write good loans.

With the advent of the newly expanded independent broker marketing system, there is no longer a "nexus of employment" that continues for the broker past the origination date of the subprime loan. As a result, brokers suffer virtually no negative consequences for making bad loans, whether their conduct was simply negligent, or even, criminally fraudulent.

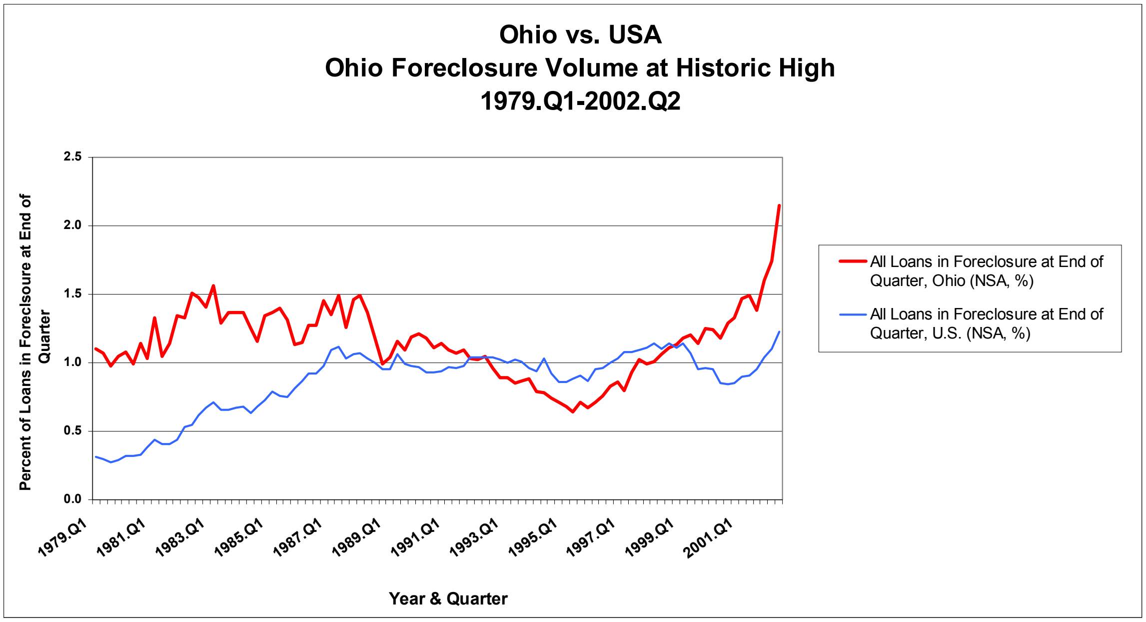
We believe that in the short-term Ohio's lawmakers must resolve to repair this disconnect between mortgage loan brokers and the negative consequences of their work when it is poorly done. One positive step in that direction would be to remove the current exemption enjoyed by "financial institutions" under the Consumer Sales Practices Act. We note that other states have passed more targeted and wide-ranging legislation to address the peculiar abuses associated with "high cost" loans.

Given the scope of the problem, other publicly supported solutions will be required to better educate borrowers and to rebuild communities already devastated by high concentrations of home foreclosures. But among the public policy alternatives available to Ohio's legislators in the short term, we believe that the single most important factor in the industry that needs to be addressed is this "disconnect" between cause and effect. If the fraudulent, defaulting, or simply negligent mortgage broker or originating lender is allowed to escape the consequences of their own actions (and even profit from their wrongful conduct) no real change for the better can be expected to occur. Bad loans must cause negative consequences for the brokers and lenders who originated them.

Under the current system in Ohio, that does not happen.

NOTES

[1] The Mortgage Bankers Association tracks a large sample of mortgages that includes "government backed" as well as conventional mortgages. About 5% of the MBAA sample is comprised of subprime loans. The historical graph for pending foreclosures goes back to 1979 and shows that the recent quarters have pushed the Ohio foreclosure numbers well past the dark days of the 1980s when the Ohio economy was reeling from the economic shocks of the de-industrializing shift to a service sector economy.



Source: Mortgage Bankers Association of America, "Data on Demand."
All loan types, not seasonally adjusted.

[2] Collaborators in this effort include COHHIO for grant and in-kind project support; the Center for Business and Economic Research at the University of Dayton which supplied data on the Montgomery County foreclosures as part of its ongoing foreclosure research; Lorain County Reinvestment Coalition for its data from the Lorain County common pleas court records; Fair Housing Contact Service for their help in securing Summit County data and sharing recommendations on methodology; the Metropolitan Strategy Group for their mapping assistance and advice on the study's design; and Policy Matters for their collaboration on the report drafting and cooperative sharing of data from the Sheriffs Sale study. However, the authorship and responsibility for this report, both its contributions and shortcomings, belongs to the Ohio Community Reinvestment Project. We would also like to thank and acknowledge the many unsung court officials who patiently assisted us in our efforts to gather information from the common pleas court records. They helped us notwithstanding the strain these additional foreclosure cases were causing on their own limited administrative resources. Our special thanks to the Ohio Supreme Court's Statistical Reporting Section and the Common Pleas Courts and Clerks offices of Lorain, Montgomery and Summit counties.

[3] Throughout this report we shall be referring to" prime" and "subprime foreclosures." As the methodology discussion will make clear, the difference between the two types of foreclosures revolves around the distinction drawn between the identity of the plaintiffs who filed the foreclosure cases in the local common pleas courts of Lorain, Montgomery, and Summit counties. Technically then, "subprime foreclosures" should be referred to as "loans foreclosed by plaintiffs who are identified subprime lenders or subprime servicers," and "prime foreclosures" should be referred to as "loans foreclosed by plaintiffs who are not identified subprime lenders or subprime servicers." For obvious reasons, we will be using the simpler, shorthand phrases to distinguish the two types of foreclosures throughout the report.

[4] Although not the subject of this study, it appears from our limited sampling that the "non-mortgage" foreclosure caseloads have held relatively constant over the period 1994 to 2001. Across the state during this period, we estimate that the level of non-mortgage foreclosure cases might vary between 4,000 and 7,000 of the total filings, per year. While the tax delinquency caseloads seemed to be in decline, the other non-mortgage foreclosure types appeared to increase slightly, and the two trends combined to produce a relatively flat rate of increase over the period.

[5] A good summary of the existing foreclosure research done in Chicago, Atlanta, Boston, and Baltimore is contained in "Subprime Foreclosures: The Smoking Gun of Predatory Lending?" by Harold L. Bunce, Debbie Gruenstein, Christopher E. Herbert and Randall M. Scheessele. The paper can be obtained from the HUD website at: http://www.huduser.org/publications/pdf/brd/12Bunce.pdf.

[6] In Lorain County, the Lorain County Reinvestment Coalition reviewed the common pleas court docket for the years 1995, 1997, 1999 and 2001 to determine the prime/subprime breakout on the foreclosure caseload for the county. In Montgomery County, the Center for Business and Economic Research at the University of Dayton, conducted extensive research on the foreclosure caseload to measure the extent and dynamics of predatory lending practices in the Dayton area. To help support this study, CBER did additional work to identify the prime/subprime filers in Montgomery County for 1997, 1999 and 2001. In Summit County, the Fair Housing Contact Service was (and is) working with researchers from the University of Akron and Kent State University to begin measuring the disparate impact that Summit County foreclosures are having on minority and lower income neighborhoods in the Akron area. The Clerk of Court for Summit County provided electronic foreclosure case files containing relevant docket information that were reviewed and analyzed to determine the plaintiff type for a prime/subprime breakout for 1997, 1999 and 2001. The Summit foreclosure caseload was then "de-repeated" using a formula derived from a sample of prime and subprime filers to establish benchmarks for "double count" cases against the same defendant.

[7] Together, Lorain, Montgomery and Summit comprise about 12% of the population of Ohio (1,386,625 of 11,353,140 in the state). On the basis of sample size alone, the characteristics of the foreclosure filings examined in the three counties should fairly reflect the profile for the state during the six-year period examined. Further, the three counties are both typical and "manageable" (from a data gathering perspective) and rank as the 4th, 5th and 9th largest in the state---Montgomery, Summit and Lorain---respectively. All three counties are relatively "urban" in character, but Lorain County, is only little more than half the size (Pop. 284,664) of Montgomery and Summit, which both claim over half a million residents. The following table compares various economic, employment, housing and race and civic demographics for the three counties and summarizes the "Three County Average" in the right column for comparison against the statewide benchmarks.

All Figures for 2000	OHIO	Counties: Lorain	Montgomery	Summit	Three County Avg.
Population	11,353,140	284,664	559,062	542,899	
Unemployment Rate	**4.1%**	5.1%	3.8%	4.0%	**4.3%**
Avg. Weekly Wage	**$618.35**	$603.75	$657.67	$626.22	**$629**
Per capita Income	**$27,171**	$25,712	$28,113	$29,187	**$27,671**
Dependency Rate	**14.0%**	13.9%	13.7%	13.9%	**13.8%**
White	**85.0%**	85.5%	76.6%	83.5%	**81.9%**
Minority	**16.0%**	17.6%	24.1%	17.0%	**19.6%**
% Homes Owner Occupied	**64.2%**	70.5%	59.7%	66.3%	**65.5%**
Vacancy Rate	**7.1%**	5.0%	7.7%	5.7%	**6.1%**
High School Graduation Rate	**86.3%**	86.9%	79.1%	88.3%	**84.8%**
% 2000 Voters	**63.6%**	61.6%	63.9%	65.6%	**63.7%**
Employment by Sector					
Agriculture, Forestry	**0.8%**	0.0%	0.8%	0.7%	**0.5%**
Mining	**0.2%**	0.0%	0.0%	0.1%	**0.0%**
Construction	**4.5%**	6.0%	4.1%	4.3%	**4.8%**
Manufacturing	**19.8%**	28.5%	20.9%	18.8%	**22.7%**
Transportation & Utilities	**4.4%**	3.7%	5.8%	5.2%	**4.9%**
Wholesale/Retail Trade	**25.0%**	22.4%	22.8%	26.7%	**24.0%**
Finance, Ins., Real Estate	**5.5%**	2.7%	4.3%	4.9%	**4.0%**
Services	**27.6%**	23.3%	31.7%	28.8%	**27.9%**
Government	**12.0%**	13.5%	9.6%	10.5%	**11.2%**

Source: Ohio "County Profiles" and US Census

[8] In addition to the groups listed in note 4, the study planning efforts included the Metropolitan Strategy Group, which is currently conducting foreclosure research in Cuyahoga County and the Ohio Community Reinvestment Project, a statewide CRA collaborative sponsored by the Coalition on Homelessness and Housing in Ohio (COHHIO) to assure that the research would comply with standards to facilitate ongoing state-level foreclosure and housing policy research efforts.

[9] From their prior experience sorting through court records in Lorain and Montgomery counties, staff at LCRC and CBER worked up a master list of plaintiffs in foreclosure actions that both parties felt was a very strong indicator of an underlying subprime loan. The name of the lender foreclosing in an action as the "primary plaintiff" was matched to a list of subprime lenders prepared by HUD. This annually compiled list, while not foolproof, allows for researchers to distinguish those lenders who do more than half their originations in subprime loans from lenders who primarily make conforming prime loans. For this study, the HUD subprime lists for the years 1993 through 2000 were combined to create one list of 467 subprime

lenders. However, because the HUD lists only contained the originators of subprime loans, and many actions are filed by subsequent holders in due course, mortgage servicers or ABS trustees, an additional 17 plaintiffs were added to this combined list of subprime originators, producing a subprime "master list". While this procedure is designed to create the greatest certainty possible given the limited resources available to researchers in this field, it does not pretend to be perfect or exact. However, the bias overall, tends to *undercount* subprime loans, and to that extent, the conclusions drawn from the research will logically be more conservative than if the bias was to *overcount* subprime loans.

[10] Some subprime lenders have recently begun using foreclosure actions, not as a final procedure for collection on a defaulted loan, but as a delinquency management tool. The idea is to try to "train" late-paying borrowers to keep up with their monthly payments. These actions, filed to discipline the borrower more than to actually take title in the home, sometimes result in multiple filings against the same homeowner in the course of a single or multiple years. Further, prime lenders sometimes file foreclosure actions and later settle with the homeowner and dismiss the action, only to re-file again at some later date. Finally, depending on the court and counting methods used by the officer responsible for reporting the cases to the Supreme Court, some foreclosures would be double counted when a homeowner filed for bankruptcy in federal court, thereby temporarily suspending the foreclosure proceeding. The foreclosure case would "revive" after the bankruptcy was concluded. In some courts this revived case might be counted as a new filing even though it proceeded under the original case number and with the original judge.

[11] The HUD subprime lender methodology is described at "1998 HMDA Highlights," Housing Finance Working Paper No. 9, U.S. Department of Urban Development, Office of Policy Development, Oct. 1999. The subprime lender lists are available on the web at: www.huduser.org/publications/hsgfin/workpapr9.html and www.huduser.org/datasets/manu.html. Also, see Note 9, above.

[12] Because many of the lenders in the subprime lending industry don't report under HMDA, (e.g., Beneficial Mortgage Company of Ohio and Household Realty Corporation) we believe that the HUD list methodology is biased downward in its subprime market share estimations.

[13] Although other studies have found that subprime loans tend to go into default much sooner after closing than prime loans, see, "Subprime Foreclosures: The Smoking Gun of Predatory Lending?" Note 4, above.

[14] The gap between subprime origination rates and subprime foreclosure rates has been observed in other studies but to lesser degrees. See "Smoking Gun," page 268.

[15] The National Home Equity Mortgage Association (NHEMA) is a trade group for the "non-prime" home equity lending industry, and claims 300 members who represent 70% of the industry. The piece quoted here appeared online (but it is no longer available on the NHEMA website) as part of their publication, *Equity* magazine. "Credit Performance Update—Home Equities," Tom Zimmerman, © 2000.