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Congress Calls Upon Experts to Provide Closer Look at the Non-Prime Mortgage Market

Washington, DC – Today the debate over a uniform national lending standard to address predatory lending entered round two as industry experts, academics and advocates testified before a special joint subcommittee hearing of the House Financial Services Committee entitled “Subprime Lending: Defining the Market and Its Customers.”

This is the second joint hearing to discuss the need for a national lending standard. The first hearing held in November 2003, was focused on addressing the popular misconceptions about the nonprime mortgage market. During the first hearing, CFAL Chairman Steve Nadon offered many thoughtful proposals on how to further enhance pending legislation. Today’s hearing took a closer look at the nonprime market by dissecting the market and its borrowers.

Stergios Theologides, executive vice president of corporate affairs for New Century Financial Corporation, testified on behalf of the Coalition for Fair and Affordable Lending (CFAL). Launched in January 2003, CFAL was formed to advocate uniform federal legislative standards for non-prime mortgage lending. CFAL’s members make approximately one-third of all non-prime mortgage loans.

“It is essential that Members of Congress have an in-depth understanding of the non-prime market and its borrowers as they explore ways to reach a balanced law that protects consumers from bad actors in the marketplace while simultaneously protecting access to credit for non-prime borrowers,” Theologides said. “Through today’s hearing we were able to clarify common misconceptions about the industry and the borrowers we serve. I commend Chairmen Ney and Bachus, as well as the Members of both subcommittees for their diligence in getting to the heart of the debate through these hearings.”

Highlights from Theologides’ testimony below debunk many of the popular claims about the industry.

Key Points from CFAL Testimony

The non-prime mortgage market has played a valuable role in the expansion of homeownership for Americans. The industry has grown from originating 5 percent of American mortgages in 1992, to more than 10 percent as of last year. This growth provided access to credit for those families who do not meet the rigid standards of the prime mortgage market – making the industry a key force in the historic boost in American homeownership to its current level, which exceeds 68 percent.

Non-prime borrower profiles are representative of the population as a whole. SMR Research – a leading data collection and review firm – revealed that 2002 HMDA data supports this claim. Specifically, Hispanics represent 13.7 percent of the population and 14.6 percent of non-prime loans. African Americans represent 11.9 percent of the population and 13.2 percent of non-prime loans. Asians comprise 3.7 percent of the population and 3.9 percent of non-prime loans. Native Americans represent .7 percent of the population and .6 percent of non-prime loans.

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Congress Calls on Experts, Non-Prime Lending

Access to non-prime credit is especially important to minority communities. As a whole, African Americans and Hispanics are much less likely to meet the stringent economic risk criteria of the “prime” market. As well documented by the Census Bureau, Federal Reserve and Labor Department, minorities have lower median incomes, wealth and credit scores, as well as higher unemployment. With the emergence of the non-prime market, many of these higher risk minority borrowers, as well as their Caucasian counterparts, are now able to qualify for affordable mortgage credit.

Restrictive and inconsistent state laws are reducing access to credit for some consumers. A recent law enacted in New Jersey has, in fact, severely limited credit for families in that state. A March 2004 survey of New Jersey mortgage brokers, conducted by the University of Virginia, revealed that cash-refinance loans dropped almost 60 percent, and home improvement lending decreased more than 73 percent.

Only a small percentage of non-prime customers could qualify for a prime loan. Despite past claims by some parties that nearly 50 percent of non-prime customers could be prime customers, current New Century data reveals that more than 96 percent of their customer base could not qualify for a prime loan. The overwhelming majority of borrowers had credit, documentation or loan characteristics that would have precluded them from qualifying for a conforming mortgage under Fannie Mae’s published guidelines.

The non-prime market is highly competitive. Increased competition among the approximately 178 non-prime lenders is working for the benefit of consumers by creating a more favorable interest rate environment. In fact, there is a narrowing spread in interest rates between non-prime and prime. For example, in the early 1990’s the average rate spread between “A-” non-prime loans and prime loans was more than 2.5 percent. Today, it is typically less than 2 percent.

Non-prime lenders deny more than half of their applicants. Critics of non-prime lenders claim that loans are extended to most borrowers without consideration of a borrower’s ability to repay. In fact, industry denied 52 percent of their more than 2.986 million loan applications in 2002. In contrast, prime lenders denied only 13.2 percent.

Non-prime customers benefit from prepayment penalties, and most do not refinance their loans during the penalty term. New Century found that about 75 percent of their customers choose a prepayment penalty to reduce their monthly payments and increase cash flow. Despite the rapidly declining interest rates of the last several years, less than 40 percent of customers with a 2-28 ARM, for example, refinanced during the penalty term.

Non-prime lenders lose on foreclosures. New Century loses more than \$40,000 on an average foreclosure. About 5 percent of the company’s loans enter the foreclosure process, however, far fewer homes are actually foreclosed upon.

For more information on CFAL or a complete copy of today’s testimony, please contact Jennifer Aument at (202) 715-1535 or (703) 861-5810.

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