

# Subprime Lending: A Net Drain on Homeownership

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## *About the Center for Responsible Lending*

The Center for Responsible Lending is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions.

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## Subprime Lending: A Net Drain on Homeownership

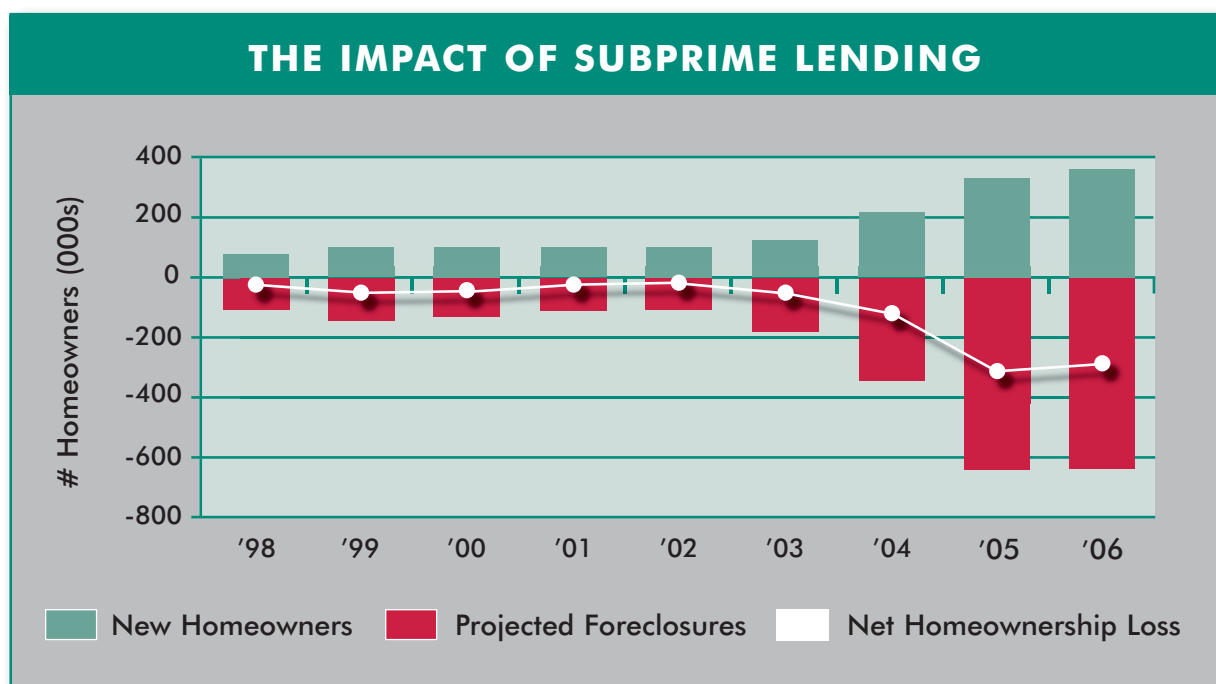
Over the past nine years, the subprime market has produced more than \$2 trillion in home loans, but contrary to industry assertions, these loans have *not* resulted in a net gain in homeownership. Between 1998 and 2006, only about 1.4 million first-time home buyers purchased their homes using subprime loans. In CRL's "Losing Ground" report, we estimated that over 2.2 million borrowers who obtained subprime loans will lose or have already lost their home to foreclosure. Updating the analysis to include subprime originations for fourth quarter 2006

increases the total number of projected subprime foreclosures to 2.4 million.<sup>1</sup>

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The result: Subprime loans made during 1998-2006 have led or will lead to a net loss of homeownership for almost one million families. In fact, a net homeownership loss occurs in subprime loans made in every one of the past nine years.<sup>2</sup>

History has shown that borrowers with lower incomes or blemished credit can be successful homeowners when given suitable mortgages with reasonable terms and fees. But lax underwriting practices, dangerous loan products, and a disregard for affordability have set up vulnerable homeowners to fail. As a result, millions of families with the most to gain from ownership have lost their homes and billions of dollars in equity.



See Table 2 for data points

The implications of this analysis are even more disturbing given the difficulties of recovering from foreclosure. Research indicates that homeowners who give up homeownership for any reason can take more than a decade to get back in—longer for minorities.<sup>3</sup> Thus, these subprime foreclosures represent a loss of opportunity for wealth-building that can carry forward for many years.

## Why a Net Loss?

Basic characteristics of the subprime market explain the net loss in homeownership. First, most subprime loans are not used for buying homes, but for refinancing existing mortgages. Until the recent boom in housing prices, the overwhelming majority of subprime loans were refinances.<sup>4</sup> Even in 2006, subprime refinance loans accounted for a majority (56%) of all subprime loans originated. These loans, obviously, do not contribute to new homeownership. Additionally, a significant proportion of subprime purchase mortgages are obtained by existing homeowners buying another home, not first-time homebuyers.<sup>5</sup> Again, this

does not increase homeownership levels. We estimate that overall since 1998, only 9% of subprime loans have gone to first-time homebuyers and hence led to increased homeownership (Table 1).

Second, a sizeable percentage of subprime loans end in foreclosure—a much higher proportion than prime loans. We estimate that 15.6% of all subprime loans originated since 1998 either have ended or will end in foreclosure and the loss of homeownership (Table 2). These statistics include homeowners who bought their homes with prime loans, but have lost or will lose their homes through abusive subprime refinance loans. (Projections aside, we note that a net loss of homeownership has *already* played out for portfolios of

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**TABLE 1: Estimated New Homeownership from Subprime Lending**

Year	Total Subprime Loans Originated <sup>a</sup>	Subprime Loans Used for Home Purchases		Estimated Subprime Loans to First-Time Homebuyers <sup>c</sup> (Homeownership Gain)	
		Number	% of all SP Loans	Number	% of all SP Loans
1998	962,273	293,012	30%	73,253	8%
1999	1,132,280	357,234	31%	89,309	8%
2000	911,369	350,604	38%	87,651	10%
2001	918,557	323,424	35%	80,856	9%
2002	1,046,072	343,530	33%	85,883	8%
2003	1,505,854	483,229	32%	120,807	8%
2004	2,219,547	876,721	40%	219,180	10%
2005	3,259,908	1,297,443	40%	324,361	10%
2006	3,219,749	1,416,690	44%	354,172	11%
<b>TOTAL '98-'06</b>	<b>15,175,609</b>	<b>5,741,887</b>	<b>38%</b>	<b>1,435,472</b>	<b>9%</b>

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seasoned subprime loans, which have previously experienced their peak foreclosure activity.)

Comparing the homeownership gain from subprime lending to first-time homebuyers (Table 1) to the loss of homes caused by subprime foreclosures (Table 2), we see a net loss of homeownership from subprime loans made each year since 1998, totaling almost one million families.

<b>TABLE 2: Net Impact on Homeownership from Subprime Lending</b>					
Year	Total Subprime Loans Originated <sup>6</sup>	Homeownership Gain: Subprime Loans to First-Time Homebuyers (A)	Homeownership Loss: Projected Subprime Foreclosures <sup>8</sup>		Net Homeownership Gain or (Loss) (A) - (B)
			No. of Foreclosures (B)	Cumulative Foreclosure Rate	
1998	962,273	73,253	94,750	9.8%	(21,497)
1999	1,132,280	89,309	144,567	12.8%	(55,258)
2000	911,369	87,651	133,126	14.6%	(45,475)
2001	918,557	80,856	105,464	11.5%	(24,608)
2002	1,046,072	85,883	102,252	9.8%	(16,369)
2003	1,505,854	120,807	181,464	12.1%	(60,657)
2004	2,219,547	219,180	348,345	15.7%	(129,165)
2005	3,259,908	324,361	632,302	19.4%	(307,941)
2006	3,219,749	354,172	624,631	19.4%	(270,459)
<b>TOTAL '98-'06</b>	<b>15,175,609</b>	<b>1,435,472</b>	<b>2,366,901<sup>10</sup></b>	<b>15.6%</b>	<b>(931,429)</b>

## Lost Homeownership for African-Americans and Latinos

Subprime lenders frequently assert that subprime loans have been a boon for African-American and Latino families in particular, but that's not the case: Both populations also experienced a net loss of homeownership due to these loans.

<b>TABLE 3: Impact of 2005 Subprime Lending on Homeownership by Race/Ethnicity</b>			
	African-Americans	Latinos	Other Borrowers
2005 Subprime Originations <sup>11</sup>	505,286	570,484	2,244,617
Number of Subprime Loans to First-Time Homebuyers (Homeownership Gain)	50,925	72,981	200,455
Projected Foreclosures on 2005 Subprime Loans (Homeownership Loss) <sup>12</sup>	98,025	110,674	423,723
<b>Net Homeownership Gain or (Loss)</b>	<b>(47,101)</b>	<b>(37,693)</b>	<b>(308,061)</b>

## An Urgent Need to Act

Regulators and Congress have hesitated to curb abusive and reckless lending practices, citing a concern that stronger consumer protections might reverse the gains in homeownership. The poor record of subprime loans shows that this fear is misplaced. In fact, states that have passed stronger laws in recent years have reduced targeted practices without reducing access to home loans.<sup>13</sup> By acting now, policymakers will help ensure that mortgage loans pave the way to sustainable homeownership that truly benefits families and their communities.

### Notes

- <sup>1</sup> All figures in this analysis cover only loans to owner-occupants in the 50 states and the District of Columbia secured by a first-lien on a single-family home, condominium, townhouse, or a unit in a planned development. 1998-2004 figures are derived from a proprietary database of subprime loans sold in the secondary mortgage market between 1998 and 2004. We modified 2005-2006 estimates from *Inside Mortgage Finance* and SMR Research Corporation to account for these criteria.
  - <sup>2</sup> Our numbers are conservative for two reasons. First, the proprietary database used consists of loans sold on the secondary market, and contains a higher proportion of subprime loans used for home purchase than the overall subprime market. Second, the foreclosure projections were developed by CRL for its recent study *Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners* (see full cite in note 8 below), and are based on conservative assumptions. Since that report was published in December 2006, other analyses suggest that foreclosures in the subprime market could actually be higher than CRL's projections. See, e.g., Lehman Brothers projects 30% losses over time for subprime loans originated in 2006 (*Mortgage Finance Industry Overview*, p. 4. Lehman Brothers Equity Research. December 22, 2006). If Lehman Brothers' foreclosure projections for 2006 are incorporated with CRL's projections for prior years, the total number of subprime foreclosures originated 1998-2006 climbs to 2.7 million households.
  - <sup>3</sup> Donald R. Haurin and Stuart S. Rosenthal, *The Sustainability of Homeownership: Factors Affecting the Duration of Homeownership and Rental Spells*, p. 43 HUD Office of Policy Development (December, 2004), at <http://www.huduser.org/Publications/pdf/homeownsustainability.pdf>
  - <sup>4</sup> Data on subprime loans used for home purchase versus refinance were derived from the proprietary database for 1998-2004, and from SMR Research Corp and *Inside Mortgage Finance* for 2005-2006. The specific percentages by year are shown above. Totals may not add to 100% because a small percentage of loans in the database are listed as "other purpose."
- |                      | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|----------------------|------|------|------|------|------|------|------|------|------|
| % Subprime Refinance | 67.2 | 66.9 | 60.4 | 64.8 | 67.1 | 67.9 | 60.5 | 60.0 | 56.0 |
| % Subprime Purchase  | 30.5 | 31.6 | 38.5 | 35.2 | 32.8 | 32.1 | 39.5 | 40.0 | 44.0 |
- <sup>5</sup> Douglas Duncan of the Mortgage Bankers Association testified on February 27, 2007 before the U.S. Senate Committee on Banking, Housing, & Urban Affairs that "based on first half 2006 data, nearly half of non-prime borrowers, or 45 percent, utilize nonprime loans to buy homes. One in four of these purchases was by a first-time homebuyer." (See p. 5 at [http://banking.senate.gov/\\_files/duncan.pdf](http://banking.senate.gov/_files/duncan.pdf))
  - <sup>6</sup> See note 1 for information on the source of these numbers.
  - <sup>7</sup> Our analysis applied the percentage of loans to first-time homebuyers cited by the MBA (25%, see note 5) consistently to subprime purchase loans for all years 1998-2006. We believe this is a conservative approach, as the percentage of first-time homebuyers served in earlier years was probably below this figure.
  - <sup>8</sup> Ellen Schloemer, Wei Li, Keith Ernst, and Kathleen Keest, *Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners*, Center for Responsible Lending at 16 (December 2006), available at [www.responsiblelending.org](http://www.responsiblelending.org). The statistics for 2006 have been adjusted upward to reflect inclusion of fourth quarter 2006 numbers, which were not included in original report published December 2006.
  - <sup>9</sup> See *Losing Ground* (note 8), p. 22.
  - <sup>10</sup> CRL's original foreclosure projection of 2.2 million for subprime loans originated from 1998 through 2006 did not include Q4 2006 data. See *Losing Ground* (note 8), p. 22.
  - <sup>11</sup> HMDA statistics for the total market are slightly lower than statistics shown in Tables 1 and 2, because not all subprime lenders are required to report under HMDA regulations.
  - <sup>12</sup> Assumes a 19.4% foreclosure rate as calculated for all 2005 subprime originations—see Table 2. This is a conservative estimate, as communities of color receive a disproportionate share of subprime loans, and the clustering of foreclosures in these markets is likely to cause a "feedback loop" that further depresses home values in the market and spurs additional foreclosures.
  - <sup>13</sup> Wei Li and Keith Ernst, *The Best Value in the Subprime Market: State Predatory Lending Reforms*, Center for Responsible Lending (February 23, 2006), available at [www.responsiblelending.org](http://www.responsiblelending.org).