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The Power of Partnership

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STATEMENT ON FREDDIE MAC ANNOUNCEMENT ON SUBPRIME

Lenders One/National Alliance of Independent Mortgage Bankers Calls Freddie move “responsible approach to stabilize mortgage market and minimize borrower exposure to risk”

During the past five years, the mortgage market has undergone substantial change. As home price appreciation accelerated, mortgage lenders responded with creative products to meet the challenge of qualifying borrowers for a home loan. The market for non-traditional mortgages has expanded significantly, from just 2% of originations in 2000 to over 30% in 2005. Similarly, non-prime lending has increased from 5% of the market to over 20%. For the vast majority of borrowers, these loan products have successfully enabled the borrower to successfully purchase and stay in a home.

However, defaults and foreclosures are now on the rise for some products, especially in the subprime market.

Freddie Mac’s decision to tighten standards on 2/28 and 3/27 subprime products represents a responsible approach to bringing stability back to the subprime mortgage market and minimizing borrower exposure to excessive risk.

The 2/28 mortgage product can be especially risky given that the terms of the program include:

- a short fixed rate period,
- an artificially lower start rate (a "teaser rate")
- a pre-payment penalty
- a significant interest rate adjustment.

Borrowers will typically qualify for a 2/28 mortgage based on the starting rate and starting loan balance. Assuming even a reasonable case, a 2/28 mortgage could expose a borrower to significant "payment shock." Payment shock is when a borrower's payment increases well in excess of their ability to pay.

Not every 2/28 loan is inappropriate for every borrower. Borrowers who have a strong expectation of an increase in income (a spouse going back to work, for example), or are using the loan as a cash management tool, might be well suited to a 2/28. But for wage earner borrowers who expect only minimal increases in income over the loan term, certain product features could expose the borrower to significant financial risk. If the borrower qualified at maximum debt to income ratios in year 1 of the loan, the likelihood of the borrower being able to repay this loan once rates increase is diminished. For a borrower in that situation, there is a high risk of default and foreclosure.

The Challenge Ahead for the Mortgage Industry

We believe the real challenge for the mortgage industry going forward is how to accommodate borrowers who are locked into inappropriate loans and move them into more suitable loan products. Many of these borrowers are in these loan products because they did not qualify for conventional financing. Creating safer loan products for which these borrowers can qualify will require the joint efforts of Fannie Mae and Freddie Mac, private investors, mortgage originators, and consumer advocates. We believe that is the best way to reduce defaults and foreclosures, and ensure that borrowers stay in their homes. The member companies of Lenders One/National Alliance of Independent Mortgage Bankers are pledged to be active partners in meeting this challenge.

The National Alliance of Independent Mortgage Bankers (NAIMB) is the voice of the independent mortgage lender on regulation, legislation and government activity. The group was founded by Lenders One, a member owned cooperative of the nation's top 100 independent mortgage bankers. The member companies of Lenders One originate over \$40 billion in mortgage loans annually, collectively comprising the nation's 9th largest mortgage originator. Our members constitute the nation's largest alliance of independent mortgage bankers, representing over 7500 employees serving every state.