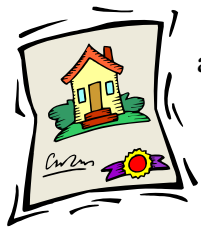


# Money for Life

April 2008

Dear Readers,



Subprime lending is receiving attention in the news as major financial institutions who invested heavily in this commodity now have to deal with increased numbers of foreclosures. Individuals who are current on their home mortgage payments may feel that they are isolated from the impact of this financial situation; however anyone who is using consumer credit is likely to feel the results of the fallout.

Subprime refers to the credit status of the borrower.

- Borrowers have a credit score of less than 620 (credit scores range from 350 to 850 with an average in the U.S. of 723)
- Their housing cost for payment of their mortgage and homeownership can be as much as 55% of their net income
- They are borrowing 90% of the value of the home

Supporters of this form of lending argue that it serves the needs of individuals who have difficulty generating a down payment of 20% and increases the likelihood low-income individuals will be able to own their own home.

Opponents of this form of lending site the increased likelihood that the loans will have elements of predatory lending. They argue that the increased foreclosure rates resulting in the current financial challenges should result in additional federal regulation.

Many of the Subprime loans were issued as adjustable interest rate mortgages (ARM).

Introductory low interest rates allowed individuals to purchase more expensive homes. As long as the housing market was increasing in value the owner's equity or value in the home increased allowing them to switch to a more traditional mortgage with a fixed interest rate (FRM) when the introductory period ended or place the home on the market and sell it for a profit.

Predatory practices often found in the subprime loans include:

- Excessive fees – Points and fees are costs not directly reflected in the interest rates. Typically they are below 1% of the purchase; on predatory loans the fees total more than 5% and create a situation where the owner can never reach 20% equity during the introductory period.
- Abusive prepayment penalties – Up to 80% of subprime mortgages carry these charges for an extended time period. Refinancing forces the holder to transfer the penalties to their new loan and again stop a growth in equity.
- Unnecessary products – Lenders may finance additional insurance and place hidden fees in the transaction.



- Steering and Targeting - Individuals have been steered to the less attractive products even when they could qualify for a traditional mortgage. Professionals involved in this practice realized a greater profit from the subprime mortgage.

Predatory practices have also resulted in clients signing documents that prohibit the borrowers from seeking arbitration if they find the loans were abusive. Loan flipping or refinancing practices resulted in higher interest rates and very little cash for borrowers, but an income stream for the individuals who wrote the loans. Home equity loans to pay unsecured consumer debt have resulted in borrowers owing as much as 110% of their homes value. Subprime borrowers are now faced with situations where they cannot refinance and are turning to foreclosure as a solution.

How is this going to impact everyone?

- Home owners will continue to see downward pressure on the value of homes resulting in a loss of equity in most markets.
- Credit transactions for vehicles and other consumer goods will require a healthier credit score.
- Consumers are less likely to see 0% financing and extended payment periods.

- Non-profit organizations who provide student loans are finding it hard to obtain capital. The results will be added challenges for those wishing to borrow funds for room and board and other expenses for post-secondary education.
- Banks are reining in their lending to other banks, individuals and businesses.



Consumers can curb the current financial challenges by becoming informed of fair and legal practices and using credit wisely. Individuals who are planning to buy a

home can complete the online course *A Place of Your Own* offered by Extension at <http://www.extension.iastate.edu/HomeBuyer/> Additional resources are available from the Department of Housing and Urban Development at <http://www.hud.gov>. Credit resources and materials are available at <http://www.extension.iastate.edu/finances/>

If you believe you are being targeted by predatory lenders contact your state Attorney General office. In Iowa call 1-888-777-4590.

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