Statement of

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Before the Financial Services Committee

United States House of Representatives

September 16, 2009

Hearing before US House of Representatives Financial Services Committee - September 16, 2009

Submitted testimony by Edward Pinto, real estate financial services consultant, former chief credit officer of Fannie Mae (1987-1989), and expert in designing sustainable affordable housing programs

Chairman Frank and Ranking Member Bachus, thank you for the opportunity to testify today. I am an expert in the field of affordable lending, having 15 years experience both on the state and national level. I have designed and implemented sustainable affordable housing programs. I am also an expert in credit risk methodologies and loan performance metrics. I was Fannie Mae's chief credit officer from 1987 to 1989. Since leaving Fannie, I have consulted extensively on loan performance risk characteristics.

While at Fannie, I had the pleasure to work extensively with the late Gale Cincotta. Some of you may be aware that Ms. Cincotta was the founder and head of National People's Action (NPA) and is known as the "Mother of the Community Reinvestment Act". Ms. Cincotta had experienced first hand the lending debacles created by the misguided efforts of Washington bureaucrats. She and I collaborated over a three-year period to develop a carefully designed program whereby Fannie would purchase CRA loans originated by local banks. We agreed that these banks needed to have skin in the game by remaining on the hook for a substantial portion of the credit risk. This would keep both the lending rules and decision making local and reduce the risk of creating a national lending debacle. She and I also wanted Fannie to track and evaluate underwriting requirements and risk factors so that default rates could be kept at a low level (contrary to HUD's experience) and we agreed to support efforts to tighten underwriting where warranted.

I'd like to remind you of Ms. Cincotta's repeated warnings to this and other congressional committees. She spent 30 years:

> **"[f]ighting abuse, fraud, and neglect of the FHA program that has destroyed too many neighborhoods and too many families' dreams of home ownership…." Statement by Gale Cincotta before the Subcommittee on Housing and Community Opportunity, April 1, 1998**

She repeatedly warned Congress that poor lending practices led the FHA program to have:

> **"a national default rate 3 to four times the conventional market, and in many urban neighborhoods it routinely exceeds 10 times." Id**

She attributed FHA's "American Nightmare of Foreclosure" to the fact that mortgage bankers and brokers:

> **"take advantage of the fact that they share no risk on these loans to cut corners." Id**

FHA's annual percentage of new foreclosure starts has steadily increased over the last 60 years, from 0.06% in 1951 to 2.36% in 1998 to an estimated 4.4% in 2009.

I also need to tell you that I have spent the last 14 months searching for the facts on what caused the real estate bubble and subsequent mortgage and financial meltdown. I have reviewed over 40,000 pages of documents. The process relative to estimating CRA lending volumes and loan performance was particularly difficult and opaque.

I give you this background because if Gale were here today, she would tell you that the federal bureaucrats have done it again, but this time on a much more massive scale. Because of CRA and Fannie and Freddie's (the GSEs") affordable housing goals, "American Nightmare of Foreclosure" has spread to virtually every congressional district of these United States.

Here are the facts that I believe Gale would want me to report to you:

- **Understanding CRA lending performance is of vital importance because it is now clear that CRA-related single family mortgages totaled trillions of dollars over the period of 1993-2007;**
- **Over time CRA origination volume became a growing and ultimately significant portion of conventional conforming origination volume, growing from an estimated 7% of originations in 1993 to 19% in 2007;**
- **As H.R. 1479 points out, announced CRA commitment volume totaled over $6 trillion since CRA's inception in 1977. Starting in 1992, volume exploded. Over the 17 year period 1992-2008, there were a total of $6 trillion in announced CRA commitments. This is an astounding 680 times the cumulative volume of $9 billion for such commitments over the entire first 15 years of CRA's existence;**
- **Ninety-four percent of this $6 trillion in commitments were made by banks and thrifts that were or ended up being owned by just four banks: Wells Fargo, JP Morgan Chase, Citibank, and Bank of America;**

- **CRA single family origination volume also exploded over the period 1993-2008. Single family loan production originated pursuant to CRA totaled an estimated $2.7 trillion over the period 1993-2008;**
- **Ninety percent of CRA lending was not classified as high-rate subprime, even though much of it had subprime and other high credit risk characteristics: This is because CRA lenders generally, along with Fannie and Freddie (the GSEs), did not classify CRA and affordable housing loans that had high risk characteristics (i.e. low FICOs, high LTVs, or high debt ratios) as subprime so long as they did not contain other features such as higher fees or higher rates, interest only or negative amortization, or low initial payment features with adjustable interest rates. Under this narrow and misleading definition, only an estimated 10% of CRA lending ended up being classified as subprime. Ironically, the reason that these were not high-rate loans was that the big banks and the GSEs were subsidizing the rates, as recent events have painfully demonstrated;**
- **CRA originations were of significant assistance to the GSEs in meeting their affordable housing (AH) goals: It is estimated that the GSEs purchased about 50% of CRA production to help meet their AH goals;**
- **The combination of CRA originations and non-overlapping GSE AH acquisitions totaled over $7 trillion over the period 1993-2007;**
- **There is little in the way of concrete CRA and AH single-family loan performance information on either the bank or national level that tracks yearly loan vintages by such standard metrics as LTV, FICO, and debt ratios;**
- **For a glimpse as to possible overall CRA performance consider the following:**
    - **Third Federal Savings and Loan's (Cleveland) has a 35% delinquency rate on its "Home Today" loans versus a rate of 2% on its non-Home Today portfolio. Home Today is Third Federal's CRA lending program, which targeted low- and moderate-income home buyers who prior to March 27, 2009 (the date it suspended the program's innovative and flexible underwriting requirements due to poor performance) would not otherwise qualify for its loan products, generally because of low credit scores and high LTVs. For the reasons noted earlier it did not classify its Home Today loans as subprime lending, however, it noted that the credit profiles of Home Today borrowers "might be described as sub-prime"[1];**

[1] Third Fed's involvement with CRA represents case study as to how CRA was used to weaken credit standards. Third Fed started its "Home Today" program in 2000 and used it to make loans as those "customers who, generally because of poor credit scores, would not otherwise qualify for our loans products." However, in 2002-2003 Third Fed was targeted by the East Side Organizing Project (ESOP) "for ignoring Cleveland's low-income and minority neighborhoods." ESOP's president, Inez Killingsworth, noted that Third Federal's "2001 Home Mortgage Disclosure Act (HMDA) numbers show that while Third Federal is 'Ohio's leading mortgage lender,' they are redlining a whole section of

- **The Shorebank (Chicago) has a 19% combined delinquency and non-accrual rate for its single-family first mortgage loan portfolio. The Shorebank is the nation's first community development bank. In addition to its 19% rate on single-family first mortgages, it has a 12% rate on its multi-family lending, a 9% rate on its commercial real estate, a 13% rate on its commercial and industrial lending, and a 31% rate on its construction and development lending. All rates are as of 6.30.09. These loan categories account for 98% of its total lending portfolio; and**
- **Bank of America noted on its Q3:08 earnings call with equity analysts that while its CRA loans constituted 7% or $18 billion of its owned residential mortgage portfolio, they represented 29% of net losses, with an annualized loss rate of 1.26%.**

- **There exists a proxy for national CRA performance since approximately 50% of CRA originations since the mid-1990s were acquired by Fannie Mae and Freddie (the GSEs) to help them meet HUD-mandated affordable housing (AH) goals. CRA created the supply and the GSEs created the demand[2]. We do know both the quantity and performance of the GSEs' loans that were AH goals rich. There were two types of AH loans that have special bearing on CRA lending – loans with LTVs above 90% (effectively 95% -100%) and**

Cleveland's east side neighborhoods.". ESOP leader Emma Adams went on to add: "We tried to negotiate in good faith…." Killingsworth added: "We are calling on y'all to take action. We will bring Third Federal to the table and show them how to become a CRA partner, reinvesting in our communities." (found at: http://www.disclosure-us.org/disc-feb2003/esopsummit.html)

Third Fed got the message as its Home Today program started growing by leaps and bounds, more than doubling to $195 million by September 2004 and reaching $299 million by March 2009. By 2007 Third Fed was receiving gushing praise from Killingsworth as she testified before a House subcommittee:

> "(w)e also have a very good relationship with Third Federal Savings & Loan…." (found at: http://oversight.house.gov/documents/20070322180426-24212.pdf)

What Killingworth neglected to mention was that Third Fed's Home Today program had a delinquency rate at September 2006 of 24%. By June 2009, it had risen to 35%. This is on par with the self-denominated subprime delinquency levels. This result is consistent with a 2009 analysis published by the Federal Reserve Bank of Minneapolis which "indicates that subprime loans in ZIP Codes that are the focus of the CRA (those just below the [income] threshold) have performed virtually the same as loans in the areas right above the threshold."

[2] For example a 2003 press release noted that in 2002, Fannie Mae stepped up its efforts to help its lender partners with CRA goals. It purchased and securitized $201 billion of CRA loans in 2002, bringing its CRA cumulative total to $394 billion since 2000. CRA acquisitions totaled 25% of Fannie's total loan acquisitions in 2002 and 50% of its AH loans.

loans to borrowers with impaired credit (generally represented by borrowers with FICOs below 660)[3]:

  - **Over the last twenty years, the percentage of conventional purchase money mortgages made with the borrower putting less than 10% down more than tripled from 8% in 1990 to 29% in 2007. At the same time the average LTV on these loans rose from 95% to 97%. CRA and AH drove this result. Since the GSEs' AH goals were established 1993 until 2007, the GSEs acquired $1.18 trillion of loans with less than 10% down. This amounted to 62% of all such loans originated nationwide over the same period. By 2005, most of the GSEs acquisitions of loans with less than 10% down were of the 97% and 100% LTV variety;**

- **Over the period 1997-2007 the GSEs acquired a total of $2.2 trillion in credit impaired loans and private securities backed by credit impaired loans. Again the GSEs were leader in this regard;**
- **Largely as a result of high LTV and credit impaired loans, over the period 1993 to 2008 the GSEs acquired over $2.8 trillion in incremental AH loans over the percentage level achieved in 1992;**
- **As a result of the combined CRA and AH volume explosion that started in 1993, the nation's homeownership rate, after being level for over 30 years, began to grow rapidly from 1994 when it was at 64.2%, to 68% by 2001, and peaking at 69.2% in 2004;**
- **The GSEs' delinquency rate on their $1.5 trillion in high risk loans, 85% of which are goals rich AH loans, is 15.5%. at 6.30.09 This is about 6.5 times the 2.4% delinquency rate on the GSEs' traditionally underwritten loans; and**
- **This flood of high risk CRA and AH lending also drove a house price bubble :**

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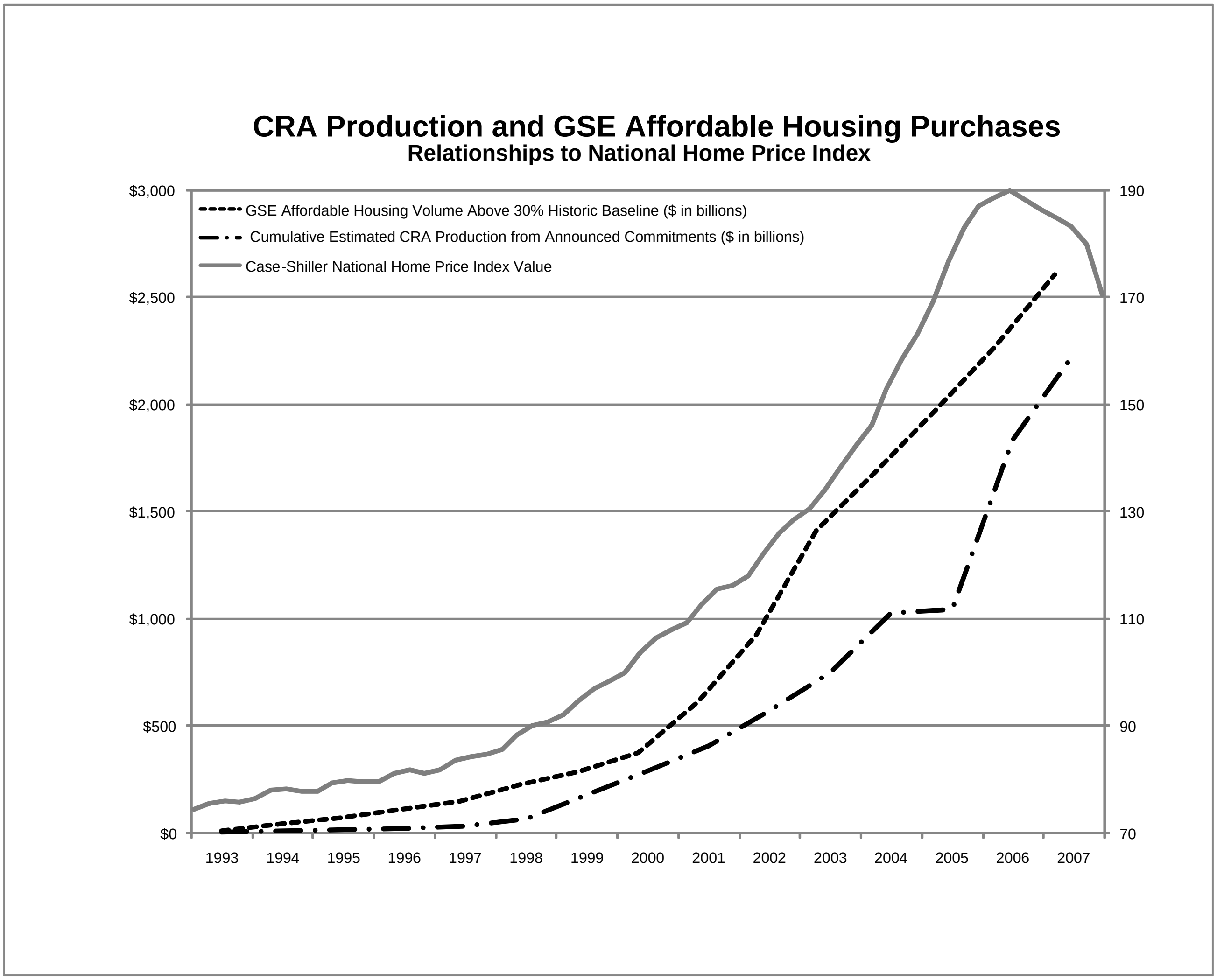
[3] the 1992 GSE Act required the GSEs to undertake a review of their underwriting guidelines and examine:

> "the implications of implementing underwriting standards that—
> (A) establish a downpayment requirement for mortgagors of 5 percent or less;
> (B) allow the use of cash on hand as a source for downpayments; and
> (C) approve borrowers who have a credit history of delinquencies if the borrower can demonstrate a satisfactory credit history for at least the 12-month period ending on the date of the application for the mortgage."

The GSEs' high risk AH acquisitions were made as a direct result of this congressionally mandated review.



In 1998 Ms. Cincotta expressed a wish that FHA's default rate be on par with Fannie and Freddie's. Her wish was granted, but as I have just noted, with a horrible twist. The CRA and AH loans acquired by the GSEs have a delinquency rate par with FHA's rate, which itself has grown by over 60% since Gale's testimony in 1998.

The questions you should be asking are:

Why don't bankers know and disclose how their different products are performing?

Why is it that the Federal Reserve, the OCC, the OTS and other regulators appear to have no idea how CRA loans are actually performing over the last few years. Data from ten years ago cannot be the basis for making decisions on multi-trillion dollar programs.

Why is it that Comptroller Dugan just three weeks ago delivered remarks at the Interagency Community Affairs Conference where he asserted that CRA is not toxic lending, yet he failed to cite any broad-based quantitative evidence?

Why is it after requiring banks to demonstrate that they make extensive use of "innovative and/or flexible lending practices" in order to receive a rating of outstanding, not one regulator had the common sense to track the performance of these admittedly innovative and flexible loans?

Platitudes are not sufficient. I have presented a prima facia case that CRA is toxic lending which leads to unsustainable loans which leads to an unacceptable level of foreclosures.

Gale Cincotta's views on FHA 11 years ago are now equally applicable to CRA and AH lending:

> **"We have been fighting abuse, fraud, and neglect of the FHA program that has destroyed too many neighborhoods and too many families' dreams of homeownership for more than 25 years."**

Section D of H.R. 1479 calls upon the Federal Reserve to create a loan performance database.

I respectively submit that before you take any action on H.R. 1479, you demand that the appropriate regulators request detailed CRA performance data from Wells Fargo, JP Morgan Chase, Citibank, Bank of America, Fannie Mae and Freddie Mac. These six institutions should be able to provide performance information for an estimated 70% or more of outstanding CRA loans.

These programs have subprimed America.

The pain and hardship they have spawned is immeasurable. What is measurable is exactly how the trillions of dollars in past CRA and AH loans are performing.

Once you have that information, it is imperative that you learn from it so that you may implement Gale Cincotta's vision whereby participants in the mortgage lending system have skin in the game. It was this lack of adequate equity and capital by borrowers, lenders, and investors that has put our entire economy at risk.

Only then will America get the sustainable affordable housing programs she deserves.