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RICK WARTZMAN / CALIFORNIA & CO.

Outside the sub-prime loan box

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California & Co.

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Imagine you're a mortgage lender, and somebody comes to you with a marginal credit record, work experience that includes as many employers as Liz Taylor has had husbands and no Social Security number. Would you hand him a bunch of money to buy a house?

I'm guessing that you wouldn't, especially not this week, what with the ongoing meltdown among sub-prime lenders — those that specialize in making loans to people with shaky credit or erratic incomes.

But Leo Simpser well might. He's managing director of the Hispanic National Mortgage Assn. in San Diego.

Don't let the name fool you. Although it calls itself an "association," HNMA is a privately held, profit-making enterprise. And though it's focused primarily on the Latino community, the company's aim is to provide home loans — at rates much closer to prime than sub-prime — to a range of immigrants and others historically locked out of the market.

There's "a huge business opportunity" in lending to folks who "fall out of the typical box," Simpser says. What HNMA has done is create "a new box that fits these borrowers."

HNMA isn't alone in trying to get beyond a standard credit score to evaluate people's ability to pay their mortgage on time. According to some estimates, more than 50 million consumers don't even have a score because their credit files, as compiled primarily by three big data-collection companies, are short on information or altogether nonexistent.

In such cases, mortgage giant Fannie Mae has issued guidelines that call for examining how faithfully a person has paid the rent and the phone bill over the previous 12 months. And Fair Isaac Corp., whose credit scores are used by most mortgage lenders, and other outfits have been experimenting with alternative ratings derived from a would-be homeowner's checking and savings accounts, utility payments and other factors.

A number of community banks, meanwhile, have also begun to master the nuances of lending to those without long credit histories. They've learned to treat non-cash income (such as government meal vouchers) as a positive and to not necessarily consider a peripatetic employment pattern as a negative. They see regular payments sent to family members in Mexico or Central America as a sign of financial stability. And they appreciate that it may take multiple members of a household to meet a loan obligation.

While using similar criteria, HNMA claims to have gone even further: The company says it has devised an unorthodox mortgage underwriting system that's more comprehensive and culturally sensitive than anything out there — and, in an important leap, to have automated the whole shebang. Its goal is to give financial institutions an efficient way to turn out a high volume of good, solid loans to non-traditional borrowers.

Just how effective all this is remains to be seen. HNMA has been in the market for only about six months, backing roughly \$200 million in mortgages for 1,650 customers thus far.

But the company is advised by an impressive group, including former federal Housing and Urban Development secretaries Henry Cisneros and Jack Kemp. And it has established joint ventures with Deutsche Bank and Wells Fargo & Co.

Those who've been pushing for a more robust — and responsible — mix of financial options for people with low and moderate incomes are intrigued by what's been rolled out.

How HNMA fares is "enormously dependent on the quality of their model" and that "has yet to be proven," says Ellen Seidman, director of the Financial Services and Education Project at the New America Foundation (the think tank where I also work). But Seidman, who was briefed by HNMA representatives in the last few weeks, believes "the concept makes a lot of sense."

If nothing else, HNMA's foray into the mortgage industry is an excellent reminder that the troubles afflicting the sub-prime sector — as punctuated by Irvine-based New Century Financial Corp. teetering on bankruptcy — shouldn't become an excuse to abandon efforts to extend credit to the underserved. The mess is mainly the result of tens of thousands of brokers who, in hot pursuit of their next commission, seduced

these people with perilous, adjustable-rate mortgages whose interest rates can hit as much as 15%. In some instances, the payments due on these time bombs can rise nearly 50% overnight.

Too often, the ARMs being sold were "fundamentally flawed," says Paul Leonard, director of the California office of the Center for Responsible Lending, a research group that figures nearly 20% of sub-prime mortgages originated in the last two years will end in foreclosure — the most dismal showing ever in the modern home-loan market. "They were designed to be refinanced when times were good and foreclosed on when times were bad." On top of that, Leonard adds, underwriting standards became so lax, "if you could fog a mirror you could get a loan."

Not surprisingly, a chorus is now calling for tighter regulation of all aspects of the sub-prime business. And surely this makes sense. Some who received loans over the last few years never should have qualified. And those who will remain dependent on this segment of the market deserve mortgages that aren't going to blow up on them.

But there's another remedy, as well: Find ways to channel people who aren't serious risks to the lender — but whose creditworthiness can't easily be measured — into more conventionally priced mortgages.

"If many of these borrowers had had prime loans" with more favorable interest rates and lower fees attached, "there wouldn't be such a problem" today, says Bob Gnaizda, policy director at the Greenlining Institute, a Berkeley-based organization that advocates on behalf of poor and minority communities. "Nobody should fall through the prime sieve" into the sub-prime soup if they don't have to.

This is precisely the philosophy driving HNMA, which was started in November 2003 by Luis Maizel, a who has long managed fixed-income investments for institutional clients and wealthy individuals. The 56-year-old — who was known by his friends as "The Calculator" when he was growing up in Mexico City — soon brought in Simpser, 32, a Mexican-born, Stanford-educated entrepreneur. He oversaw the team that honed the underwriting model and developed the related technology. That took 2 1/2 years.

Now, HNMA has built relationships with about 25 credit unions, community banks and other lenders that originate mortgages (typically 7% to 9%) using its underwriting system.

Even if all goes smoothly — and there are no guarantees — Simpser acknowledges that the company has a lot to do before it reaches its objective of acquiring \$5 billion worth of mortgages in the next three to five years. "There's a learning curve," he says. "We're trying to understand a culture."

But so far, so good. The rate of loan payments running more than 30 days past due is only about 1%. And best of all, nobody's ARM has been twisted.

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