

AMERICAN PREDATORY LENDING AND THE GLOBAL FINANCIAL CRISIS

ORAL HISTORY PROJECT

Interview with

Harold Brubaker

Bass Connections

Duke University

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PREFACE

The following Oral History is the result of a recorded interview with Harold Brubaker conducted by Callie Naughton on March 26, 2020. This interview is part of the Bass Connections American Predatory Lending and the Global Financial Crisis Project.

Readers are asked to bear in mind that they are reading a transcript of spoken word, rather than written prose. The transcript has been reviewed and approved by the interviewee.

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Interviewee: Harold Brubaker
Interviewer: Callie Naughton

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Callie Naughton: I'm Callie Naughton, a graduate student at Duke University and a member of the Bass Connections American Predatory Lending and the Global Financial Crisis team. Today is March 26th, I'm in Durham, North Carolina for an oral history interview with Harold Brubaker, former representative in the North Carolina General Assembly, who is joining me via telephone. Thank you for joining me today.

Harold Brubaker: Thank you for having me.

Callie Naughton: I'd like to start by establishing a bit about your background. I believe you received a Bachelor of Science degree from Pennsylvania State University in 1969, is that right?

Harold Brubaker: It was a bachelor of agricultural economics.

Callie Naughton: Agricultural economics, okay. After college, you then completed a Master of Arts in economics from North Carolina State University in 1971. Is that right?

Harold Brubaker: Yes. A masters of econ at NC State. Correct.

Callie Naughton: In the context of your work life, when and how did you first become involved with residential mortgages?

Harold Brubaker: I'd say it was probably ... back in the late '70s, early '80s. I was involved in starting a savings and loan, stock owned savings and loan in Asheboro, North Carolina. And one of the things we felt the market was lacking was good solid mortgage lending for homeowners. We were not into big jumbo loans, but just small loans for small homeowners in Randolph County, which is in the center of North Carolina, very much a rural county. So, I would say that serving on the bank board and helping initiate the savings and loan was probably my initial contact in getting involved in mortgage lending.

Callie Naughton: Did you stay involved with the savings and loan as your career progressed, or did you just help start it up but then moved on to other things?

Harold Brubaker: I helped start it up and then I developed a real estate appraisal company where we would do real estate appraisals for not only that institution [but other financial institutions]. Then I resigned from the board and started the real estate appraisal business in Asheboro and worked for five, six, seven institutions in the Asheboro area.

- Callie Naughton: During all this time, how would you characterize key changes, if any, in the North Carolina mortgage market from the early '70s to the late '80s?
- Harold Brubaker: Back in that early timeframe. ... you never could apply for a loan where you received 100% cost for your home. Back then, you would need at least about a 20% down payment, or the loan would not be made. And I think as you look through the historical aspect of what happened in the mortgage industry, what happened where we got to in this mix of the downturn in '07 and '08, and I think you can trace it directly to when you started paying mortgage lenders commissions. And so when you started paying commissions, started doing away with a down payment, that's when everything started to go downhill because the potential owner of the property, the individual that was going to be borrowing the money, had no risk they were borrowing 100% of the loan on the house. And I could see that started the deterioration in the industry as a result of these changes.
- Callie Naughton: Before people were paid to originate the way you are describing, how were mortgage loans originated? Did people just walk into the office of your savings and loan and ask for one? Was there marketing happening? How did that work?
- Harold Brubaker: Yes. You walked into your local — at that time, banks really were not into the mortgage industry like savings and loans. I'm speaking of North Carolina now. I think like New York had savings banks that did both mortgages and other type of business. But in North Carolina, the savings and loans were the backbone of the mortgage industry. And you walked in, you sat down with an individual who was considered to be in the loan department and they took all your information. That person was salaried, [their pay] was not based on the number of loans they closed or number of loans they made, quality of loans or lack thereof, or anything else. They were just salaried employees you might say, like a bank teller. A bank teller is not paid on how many deposits they take in a day's time, or how many new accounts they opened up in a day's time, but their salaried. And so, in those days it was all a salary. And that's what I think, [and] why it was a very strong mortgage lending industry at that time.
- Callie Naughton: You mentioned that savings and loans were mostly the institutions originating these mortgage loans. Why weren't banks interested in that part of the market?
- Harold Brubaker: Probably greed hadn't set in yet. Greed had not come in to be a part of the banking industry. And the savings and loans at that time had their niche, the banks had their niche. If you even look at smaller, small loans in the '70s, '80s, probably not in the '90s, but early '90s maybe, banks would [not] even make a \$500 consumer loan. Then they wanted to get out of small consumer loans. They wanted to make the big loans, not the small loans. And then you saw the transition in the financial fields away from banks for a small loan. If you'd walk in, I was told by individual consumers, that, "The Bank won't make me a loan for \$500 or \$1,000. They told me to put it on my credit card, draw it off of a credit card." So we saw this whole transition. Banks, I think, finally looked at the mortgage industry and said, "Ah, so yeah, we don't want to make that \$500 or

\$1,500 consumer loan. We can make a \$20,000, \$100,000, \$200,000, \$300,000 loan, take the same amount of time but look how much bigger the reward will be.”

And then back in the early days, you didn't have origination fees. That all started getting added on when you started buying and selling loans. You weren't housing the loans, and all that kind of took off. And even in today's world and today's market, I think in North Carolina there's probably only one institution, and that's the State Employees' Credit Union. They do not — I am told this — that they do not sell their mortgage loans. They house every loan and keep it inside. But in the old days, that's what the small savings and loan would do. And you could come into the small savings and loan in a small town like my area in Randolph and [say], “Well, we can't close your loan this month because we've got to wait to have more deposits come in. But we'll put you on the list to do it next month.” But then with the advent of Freddie and Fannie and no documentation loans, I mean, we were just asking for a downfall, no down payments and all that.

Callie Naughton: When you say housing loans, what do you mean by that? ... You use it as a verb. You said that savings and loans were housing the loan, but banks weren't doing that.

Harold Brubaker: Yes, they were keeping the loans in their portfolio. You're asking me previously, “So when did banks start getting into it?” And that's when you started having the advent of Fannie Mae and Freddie Mac, when they were buying the loans from the banks and savings and loans at that time, that's when the whole industry changed. Then savings and loans changed over and became banks as well. And so, when you had the non-housing — when I say housing, that's keeping all your loans in your portfolio, in your institution; currently that's not considered prudent. It's considered more prudent to sell the loan, get it out of your portfolio and have more dollars to be able to lend more.

Callie Naughton: ... How do you think that shift changed the incentives of the people involved in mortgage origination?

Harold Brubaker: It's one word: greed. More money, how do we make more money? How do we make more bucks? Because I can see the process over the years. So the person that was down there when they started getting commissions and how many loans they were closing, so if a potential borrower came in, and maybe there was a negative question on their credit, and probably in previous years you would never make the loan, but, “You know if we get this loan done, I get a little commission, I get more money this month. And of course, the boss above me likes what I'm doing. The boss gets a little commission too because he or she is overseeing all these loan officers, and it all goes right up to the top.” Everybody was getting more money because everybody was getting a little piece of the pie, so to speak. And that's why I said the answer is greed. How to make more money.

- Callie Naughton: You should wear your appraiser hat for a moment: how did you see lending practices evolve during this time? You talk about them deteriorating, but did that happen at every institution? Did that happen to every loan? How did you experience those changes as an appraiser?
- Harold Brubaker: Well, I could see what was happening from the — not being an underwriter, so I was never on that side — but ... in the real estate world. What properties were closing? What [properties] were selling? What prices were they bringing? And again, it came back when you started doing away with a down payment, going from 20% to 90% loan-to-value, 95% loan-to-value and then 100%, and then we get into some situations where an institution would loan you 110% of the value of your property. Well that process was just asking for a fiasco and a disaster. Now, I would assume their argument on the other side: "Oh, but don't you see how properties are appreciating in value? We're having a 10% growth every year!" Yes, but that doesn't happen forever and ever, and that's how we had the crisis, when it hit.
- Callie Naughton: Looking back is always 20-20, but do you think at the time as these things were changing as your loan-to-values were rising from 80%, creeping up closer and closer to 100%, but I suppose at 110%, that should be a red flag? Did you and your colleagues really realize what this meant for the industry, or did it feel incremental at the time?
- Harold Brubaker: Well, I can say that I was a voice in the wilderness. I kept telling the lenders, "You guys are just asking for a fiasco." You'd loan based on the value of the property and what the person who is borrowing the money can afford to repay. The two can go hand in hand, but you also have to make sure that the person borrowing the money, will be in a position to be able to pay the loan, whether they have blips up and down in their income stream. And I had some lenders after the real deep dive in the early 2000s, '07, '08, '09, that said, "Well, you were right" and my comment back was, "Well, why didn't you pay attention?" "Well, nobody else was, why should we?"
- Callie Naughton: You've somewhat answered my next question, which is, when you were raising these concerns, what did your lenders do in response? ...
- Harold Brubaker: Nothing, nothing. Everybody was feeding at the trough. They were all at the trough.
- Callie Naughton: It's hard to go against the grain at times.
- Harold Brubaker: Oh yeah. I guess a corollary would be that in our business world today from the public side and private side, economic grants that states give to companies to move to their state. Why did they do it? Because everybody else was doing it. They all agree it is bad public policy, but they all do it.

Callie Naughton: ... Just to shift gears slightly, I believe you served as a representative in North Carolina General Assembly representing District 78 in Randolph County, and you were first elected in 1977, is that right?

Harold Brubaker: Right.

Callie Naughton: Can you describe your official responsibilities and how they related to the market for residential mortgages?

Harold Brubaker: Early on, one of the pieces of legislation that I introduced in the '80s [involved] the reverse mortgage for elderly folks who, in most cases, had no family and needed the extra income to take care of themselves. Coming later on in the '80s, we started getting into not only, this will blow your mind, but back in those early days, you did not have regional banks. Banks did not cross state lines. They were only within a state, not across state lines. So, we get into regional banks and then we get into the phenomenal world of national banks. And all the time you had to have special legislation to allow banks to be part of a regional or part of a national. And I recollect at one point in time, I think that was back in the '80s, that some of our U.S banks, North Carolina banks, were very concerned about going international because they were afraid of some of the foreign investors, i.e. foreign banks, who would demand a lower return on value, or rate of return, than U.S banks. As I specifically recall some of that conversation, the Europeans only would require from 3% to 4% or 5% at the max, rate of return, where U.S banks were requiring 7%, 8%, and 9% rate of return.

And so that evolved, it had to be evolved as legislation in those days to go from state banks, statewide banks, to regional banks, to national banks, and then to allow them to be part of the international. So, my involvement was all through that arena of looking at how do we grow the financial industry, which was important to North Carolina. Outside New York, Charlotte was probably the next largest hub of banks, which probably isn't that way today with the slimming down of the banking industry and probably only seven or ten nationwide banks that do the majority of the business. But that was the type of legislation that was occurring back then.

Callie Naughton: And how did the growth of the banking industry, as these savings and loans that are very local, or statewide banks, convert into regional then national banks, how did that change residential mortgage lending?

Harold Brubaker: They began to have larger pools of dollars to invest. Remember, I talked about in ... the old days, and it's not that long ago, 30, 40 years ago, you had the small hometown savings and loan who would say, "We don't have the dollars this month to close your loan, but we'll close it next month. We have you at the top of the list as our money comes in, or deposits." Well, when you became a regional bank and then national, you had more access to dollars, and therefore one of the arguments they would use was that we can now access more capital to provide more dollars for people that want to buy homes in your area. That was the argument.

- Callie Naughton: Do you think there's a supply side change when there's more capital available?
- Harold Brubaker: Yes.
- Callie Naughton: Do you think it also impacted the way banks thought about making mortgages? For instance, now they have all this capital, they had to go do something with it?
- Harold Brubaker: Well, I think these cats sat up all night thinking how to make more money. Well, "You know, hey, we can charge it. We could charge a 1% fee," and then it went to two points, one point. Oh, they call them points, they didn't call them fees you know, "fee" is a bad name, so [they] called them points. "Oh, we will have an origination point and then we'll have another point." One time there was like two or three points they'd tack on. And so, if you were borrowing \$300,000 for your house, you'd have \$9,000 in points, plus other closing costs and everything else involved.
- Callie Naughton: How did you learn about these innovations? You've talked about reverse mortgages and fees disguised as points, how are you discovering that?
- Harold Brubaker: I'm an economist. That's my business to know that stuff. I taught macro [economics] for a couple of years at community college and also at [the University of North Carolina at Greensboro] UNCG.
- Callie Naughton: ... What other agencies, state, federal, local, did you work with most closely on issues related to the residential mortgage market?
- Harold Brubaker: My main connection was in the real estate industry, doing real estate appraisals and working with the local financial institutions. That was my main connection
- Callie Naughton: ... What are you saying to local institutions, what are they saying back to you? How are you guys responding together to these changes?
- Harold Brubaker: Well, as two different situations. In the business that I was doing as an appraiser, that was not affected. In my legislative time in Raleigh and being on the House Banking Committee, I was exposed to all of those issues, and I never really brought them back to my district to relate to my local institutions because at the capital level, statewide, we were dealing more at the macro [level], whereas locally, my folks only cared really about micro.
- Callie Naughton: So, in your role then in Raleigh, when you're looking at the macro, are you working with other state agencies, whether that's the Commissioner of Banks or State Treasurer or federal agencies?
- Harold Brubaker: Oh yes. Oh, yes. That's how I got to know Commissioner Smith and he talked me into helping to rewrite the banking laws that hadn't been rewritten in 50 years.

- Callie Naughton: So how did that come about? He came to you and said, "We've got to rewrite these laws?"
- Harold Brubaker: Well, he said, "They're antiquated, we've got to make changes," and we went through them, and I can't remember all the details and I said, "Yeah." We've come a long way in innovative methods of banking, whether it's the internet starting out, etc., electronic transfer. In the early days, I think you were prohibited to have electronic transfers of funds, when now a days that's a joke if you can't electronic transfer funds or be able to go pull up on your cell phone today and transfer dollars from one account to another without having to go to the financial institution. Well, all of that would have been prohibited under the old statutes. And so, you had to modernize and bring them up to date. So, I guess I was thrown into the, as the old saying goes, into the bath tub with all the water and had to learn the technology and learn the scope of the operation quite rapidly.
- Callie Naughton: And when did this happen? When did you start working with Commissioner Smith to change the banking regulations?
- Harold Brubaker: I think around 2010. And a lot of it was also as a result of the financial crisis in '07, '08 too.
- Callie Naughton: I'm sure that changed a lot of things about the industry. Just to anchor us a little bit, back in like early 2000s, North Carolina passed a series of laws including the Predatory Lending Law. Were you involved in any of that?
- Harold Brubaker: ... I remember some of the discussions on it, yes. Which also brings up a very interesting point, I'm glad you asked that question.
- So when the banks started reneging on not doing small loans to people, then you had predatory lenders come in, either licensed or unlicensed, and so all the gurus in D.C, etc., said, "We've got to protect people from borrowing money." Then they started going underground and borrowing money from the guy standing out in the corner, where now today they call them drug dealers, but that was their local lenders in your big cities for people that needed a couple hundred bucks from one paycheck to the next paycheck. But for me, it all goes back to when the banks reneged on what I thought their mission would be to help their local community. But now all of a sudden, they became regional, national, and global, and not paying attention. All the unique projects over the years, for example, that you couldn't redline. You know what I'm talking about when I say redline?
- Callie Naughton: Could you describe that for me? ...
- Harold Brubaker: Let's say, you couldn't redline if you had a group of people in your town that lived in an area that was very low economically, that their incomes were not very high, and so you didn't really want to make a loan over there, so it was

called redlining. You kind of went around that area. Well, ... Congress passed legislation that you cannot redline. And then they came after some laws that you've got to be involved in loaning money in low-income areas. They never hit on the problem of not making banks do small loans, \$500 and up, they were all, what I call, do-gooders looking at trying to figure out how they can make everything better. We want to get big bucks. And so the banks fell in line, "Oh yeah, we'll make a \$30,000, \$40,000, \$50,000, \$100,000, \$200,000 loan. Yeah, sure, sure, sure." And so all this kind of fell in place, but at the same time, you were hurting the small mom and pop who were having trouble making ends meet and needed \$200 or \$300 from one paycheck to the next. And yes, predatory lending is important to keep on top of, whether it's a high dollar loan or at a high rate of interest, but I still go back and say that this all came about because when banks turned away from making small loans, because it costs more to make a small loan, their thoughts, in my opinion, were, "Why should I sit down here at my desk and go through the paperwork to make you a \$500 loan when I can do about the same amount of work and make a \$50,000 loan? And obviously my return on investment for the bank is going to be much more off of \$50,000 than \$500."

Callie Naughton: As a legislator, what sorts of tools did you have to combat these problems?

Harold Brubaker: Well, you had to look at the legislation that was being introduced, and you had to look at who's it going to help, who's it going to hurt, and you had to weigh the good against the bad and hope for a result somewhere in between.

Callie Naughton: What were some steps that you took in the state legislature to combat this? ...

Harold Brubaker: Yeah, a little bit of like what we call now, and in some large cities, unlicensed pharmacist, unlicensed vendors. So you will look at what the loan amounts were going to be, that there's not excessive rates for the rate of return. By the same token, if a lender is not going to be able to make a profit then he or she is not going to make the loan. And that's why the banks got out of making small loans and kind of, you might say, threw all that process out to the street, therefore, you had predatory lending and everything else. And so the role of government was to make sure – you want to be able to have dollars available for people to borrow, but you don't want to have them at exorbitant rates. And so you had to make sure you looked at what the percentage of interest was, you don't want to have a lot of pile-on of late fees, late payment fees and all of that. So again, you've got to do the balancing act.

Callie Naughton: It sounds like you have a lot of trade-offs between things like sending credit to low income borrowers and making sure it's not at high rates and making sure it's the right dollar amount to that borrower. How do you — and quality of those loans as well — how do you balance those trade-offs? ...

Callie Naughton: They are [complicated], that's why a lot of the legislation was basically put in under the Commissioner of Banks' jurisdiction, so someone could be paying attention and that's why you had the banking commissioners' auditors go into

your small loan companies and make sure they were complying with the law. So your check and balance was your banking commissioner, at least in North Carolina. And I'm sure other states had the same thing.

Callie Naughton: ... What was it like to have a public position during the housing boom? Because despite the dip in the late '90s, the housing market was very strong for a long time, and there's lots of people who have spoken after the crisis that it felt so good. Like how could things have gone wrong? And yet it did. Just to think about those good years, what was it like to be in a public position and so worried about challenges in the industry?

Harold Brubaker: There were a lot of good years. And that's when, again, as I said initially, that when we started doing away and lowering the amount of down payments, started paying commissions, everybody kind of got greedy wanting more and more and more, and that's when the whole industry started deteriorating and going downhill. And then, bam, because properties were overvalued, loans were bigger than the value of the property, and when it went downhill fast, people were underwater. And, in some cases, could probably not ever recover, or take 10 years to break even on it. So, when I look back on that time in the legislature, there were times where there was a maximum of how much you could have a second mortgage for your house. That was back in the '80s and '90s. But after 2007 and 2008, it was more [about] looking at how can you protect this from not happening in the future. The problem for us as state leaders at that time, was all of that was handled in Washington. Whether it was the Federal Home Loan Bank, Freddie Mac, Fannie Mae, etc., all those were the ones that set the parameters for all the loans because they were housing all those mortgages. They were buying all those mortgages that were being made throughout the entire state. So it was kind of ... exasperating from the standpoint as a state legislator, you really couldn't do anything about it, because it was all national policy and that was very, very frustrating.

Speaker 5: Were you able to communicate upstream to national policymakers about this? And if so, who did you try to reach even if you weren't able to reach them in the end?

Speaker 4: No. The problem was if you went upstream to Fannie Mae and Freddie Mac and those guys had stock, they were making money, they were part of the problem. They were all part of it. So you couldn't talk to them, and they would look back down and say "Well, you're just from one state. You don't understand the national implications of it." Well, yeah, I sure do. So obviously, the federal policy makers really didn't want to pay attention to state policy makers. Our banking commissioners over the years had more influence, if any, on the feds, by trying to get their attention. And the banking commissioners over the years would relay the fears and the problems that the legislators thought about and hopefully tried to relay them on to Washington.

Callie Naughton: I just want to go back for one second to clarify [something] for the record. When you say a second mortgage, could you describe what you mean by that, and could you explain what's good or bad about it?

Harold Brubaker: Let's say you have a house that's worth \$300,000. And you bought the house and you borrowed \$250,000, and you had it now for 10 years or so, and you paid it down to a \$200,000 loan. You also wanted some money to buy a car, and so you didn't want to mess with that first mortgage because over the years the interest rate went up. So you had a lower interest rate on your first mortgage that's now a \$200,000 balance, but your house is now probably worth \$350,000 and so you'd have a good \$100,000 worth of equity you wanted to tap. So you would go to the lending institution and borrow what's referred to as a second mortgage or [what is] commonly referred to today as a "line of credit" or "equity line" in your house.

Callie Naughton: And why would a borrower take out a second mortgage instead of like a personal loan, or a car loan, or some other form of financing?

Harold Brubaker: Well, because at that time the tax laws changed. The tax laws said that you could have a second mortgage of up to \$100,000 on your house, and you could use it to go on vacation, you could use it to buy a boat, you could use it to buy anything, and that interest, because it's tied to your house, is deductible on your tax return. So tax policy was what geared it to borrowing their money. If you went out and bought a car from a car dealer and they financed it, you could not deduct that interest. But if you borrowed the money in your home equity line, you could deduct the interest. ... The policymakers at the national [level] have always been screwed up when it came to policy, encouraging you to borrow more money on your house instead of getting out of debt and have a debt-free home, encourage you to borrow more money on your house because it's tax deductible. You can now itemize. Now, the past year or two, the federal tax law has now changed that you can't [take the interest deduction unless it was spent on the house].

Callie Naughton: When you say "predatory," we both use that word in the conversation, what do you mean by that?

Harold Brubaker: I'd say predatory when you have someone that's trying to charge 100%, 200%, 300% rate of interest.

Callie Naughton: Over the last decade, we have seen a number of different narratives emerge to explain the financial crisis. How do you understand what caused that crisis?

Harold Brubaker: Oh, it's simple. I don't mean to be repeating myself; it's when you started paying commissions to loan officers and started reducing the amount of down payment. My philosophy, if you couldn't put 20% down payment on a house, you shouldn't own it. If we'd had that policy, we wouldn't have had the financial crisis.

Callie Naughton: Why do you think banks did that? Banks or lenders. Why did they move towards commissions? Why did they let LTV [loan-to-value] deteriorate in that way?

Harold Brubaker: Greed, greed, greed. It's called greed. Make more loans, everybody's making more money. Hey, so they can afford to go to Duke! Great school. We love their basketball team.

Callie Naughton: To what extent do you see your personal experience is adding something important to our understanding of what happened in the run-up to 2007, 2008?

Harold Brubaker: I think, because in my business, my professional life of being a real estate appraiser, I saw the properties people were buying. I saw the amount of loans people were borrowing on the property, and the lack of down payments. And it didn't take a rocket scientist to sit there and say, "This cannot go on forever and ever. It's going to be a bubble that's going to bust." And so I'd say I had a unique seat at the table, if you will, of watching what was going on in '07 and '08 when the bubble happened.

Callie Naughton: Looking back on the crisis over a decade later, what do you see as its most important lessons for mortgage originators and state level policymakers?

Harold Brubaker: They haven't learned a thing. Haven't learned a thing. Still doing a 100% loan-to-value, still paying commissions, which is how they make their money. It was unheard of in the '70s and '80s of a "loan origination office." Now you have a cottage industry. They're not a bank, they just set up a business and they do loan origination and then take that loan and sell it to either banks or Fannie Mae, Freddie Mac. That was unheard of in the '70s, '80s. You never had origination offices like that. You always went into the savings and loan or the bank and sat down and made a loan application. So, no, policymakers haven't learned a thing, haven't learned a thing from it because we're still back to the 100% loan-to-value, we're still paying commissions, so everybody wants to close the loan out, even though maybe the borrower was delinquent on a number of payments and shows they do not have a good aptitude for taking care of their personal finances, but "Let's go ahead and make the loan, because we don't own the loan, we're selling this loan. Someone else has the risk." So that's why I say – no. They haven't learned a thing.

[END OF SESSION]