# Borrowers find it tough to get a loan following subprime mortgage crisis

*by Emmet Pierce*

There is plenty of blame to go around for the subprime mortgage meltdown that has reduced access to credit and sent lenders scrambling to tighten loose underwriting standards.

"It was a multipart failure," said John M. Robbins, chairman of the Mortgage Bankers Association. "It's not one segment of the industry."

The recent spike in foreclosures and the closure of scores of subprime lending companies was caused by "everybody who participated in making those kinds of loans, from Wall Street that securitized them, to a broker that originated them, or a mortgage banker who funded them," Robbins said.

WHO'S TO BLAME? - The subprime mortgage crisis has many causes but one sure result is that potential borrowers are finding tougher standards for getting a loan. CNS Photo by Cristina Martinez Byvik.
Because of the surge in delinquencies, there's mounting concern that the subprime crisis may spread to mainstream lenders and pull down the economy.

"There is an urgent need to address the epidemic of foreclosures in the subprime market," said Michael D. Calhoun president of the Center for Responsible Lending consumer group.

Lenders and mortgage investors continue to encourage "dangerous loans that go directly against the best interests of some buyers," he recently told Congress.

Not everyone thinks the public needs protection. Federal Reserve Chairman Ben S. Bernanke has cautioned Congress not to overreact by adopting credit regulations that "eliminate refinancing opportunities for subprime borrowers."

The concern is that people whose adjustable loans are about to reset at higher interest rates may not be able to refinance into more affordable loans.

The real estate industry embraced subprime loans as a way to keep buyers in the housing market as home prices soared during the first half of the decade.

Designed for people with low credit scores, subprime loans were more profitable for lenders and mortgage brokers than prime loans. They allowed borrowers to qualify for credit on low, introductory "teaser" interest rates that adjust upward after several years. They carried higher fees because of the greater risk of default.

In many cases such loans were sold to borrowers who could have qualified for cheaper prime mortgages, said Paul Leonard, director of the California office of the Center for Responsible Lending.

When home prices were rising, many consumers didn't think about getting stuck with loans they couldn't afford, said David M. Maiolo, founder of the Fair Lending Alliance, a consumer-protection group. They were counting on rising home values to build equity. But adjustable loans became riskier and more highly leveraged as borrowers chased escalating prices.

OUT OF REACH

"As long as Wall Street was buying these subprime mortgages, lenders were making them," Maiolo said. "They started getting competitive. Stated income, stated assets, 100 percent financing, poor credit: You could have all of those things and still get a loan until very recently."

After housing prices began to soften in San Diego County in late 2005, recent subprime borrowers found themselves unable to sell their homes for as much as they had paid, Maiolo said. Those who couldn't afford rising mortgage payments "ended up walking away from the property."

JUST SAY 'NO'

It's time to acknowledge that the American dream of homeownership isn't for everyone, said Kevin Stein, associate director of the California Reinvestment Coalition, a lending watchdog group.

"Maybe some consumers are not ready for homeownership and the best thing you can tell them is, 'You know what, you can't afford a loan right now,'" he said.

Lending money to people who can't pay it back is predatory, said Stein. Many loan brokers, who are paid on commission, have focused only on the sale, not on whether the borrower can continue making monthly mortgage payments when interest rates adjust upward, he added. "That really sets them up to fail."

Robbins acknowledged that "some predatory lending existed" during the housing boom. "There are always going to be bad players," he said.

Although about 85 percent of outstanding subprime home loans still are performing well, the subprime market is a "mess," said Rick Sharga, vice president of marketing for RealtyTrac, which monitors defaults.

Eager to meet Wall Street's demand for loans that could be bundled and sold to investors as mortgage-backed securities, lenders frequently overlooked bad risks, he said. Some paid for their mistakes by being forced out of business.

"It was a little bit like a feeding frenzy," Sharga said. "Oftentimes the sharks in the middle of the frenzy don't realize they are chewing on their next-door neighbor."

CRAZY PRODUCTS

Stein holds that the main cause of the subprime meltdown was Wall Street's quest for profit. Brokers began selling "crazier" mortgages "in a much more predatory fashion" to meet Wall Street's demands.

Payment-option loans, which allow debt to grow month by month, were offered to keep homes selling as prices became unaffordable to middle-income buyers. Stated-income loans that didn't document personal finances were an invitation for consumers to exaggerate their wealth, he said.

In late 2006 there was a growing realization that all was not well with the subprime market. It was driven home in March by a sharp sell-off in stock markets around the world. Investors from Shanghai to Paris were alarmed by rising defaults in the U.S.

"In some cases investors have called on lenders that were too aggressive to repurchase loans," Robbins said. "Essentially they violated, in some cases, their warranties' representation in the loans that they sold in the marketplace and were forced to repurchase those as a result."

More than 50 subprime lenders around the country have closed, filed for bankruptcy or been sold since the start of 2006, according to Bloomberg data.

## QUICKENING PACE

Because companies that track foreclosures use different methodologies, results can vary. One thing researchers agree on, however, is that the pace of foreclosures has increased dramatically.

Although defaults remain a small part of the outstanding loan pool, their rising numbers here alarm some analysts.

California holds about 22 percent of the debt for all outstanding subprime mortgages in the country, according LoanPerformance. The state had 80,595 combined default notices, auction-sale notices and bank repossessions in the first quarter of the year, more than any other state and 18 percent of the national total, RealtyTrac reported.

"The ultimate loser in all of this is the consumer that has a loan that they just cannot afford to pay and (they) are really scrambling to figure out if they can remain in their home," said Stein.

Robbins shares that concern. "With tightening credit standards, there is a possibility of a credit crunch," he said.

Tighter credit already has affected the housing industry. In May the National Association of Realtors reduced its home sales forecast for the third consecutive month, citing stricter lending practices and a drop in the sale of subprime mortgages.

## FEAR FACTOR

In Congress, lawmakers are considering several bills designed to prevent lending that puts consumers at high risk of default. Feeling the heat, some lenders have announced plans to help homeowners who were sold mortgages they couldn't afford. Consumer advocates are pressuring federal regulators to raise underwriting requirements for loan originators.

The problem might have been avoided if consumers had taken more time to understand the complex mortgage system and the lengthy paperwork that goes along with buying a home, said Sharga.

"We typically are trusting our fortune to a Realtor who we met at an open house who is going to refer us to a lender we may never meet, who is going to tell us what the right lending package is for us," he said.

Government intervention can't replace common sense, he added. Although some people may have been victimized, those who purchased houses and condominiums with risky loans should have known better, he holds.

"It is human nature to have a hard time pointing a finger of blame at somebody who is having their door to the American dream slammed behind them," Sharga said. "I think this is a wake-up call to consumers. You really, really have to be careful what you are getting yourself into."

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