QUALIFYING ISN'T ENOUGH, ADVOCATES SAY

Buying isn't for everyone

Most foreclosures happen at the intersection of inexpensive homes and easy money

By Binyamin Appelbaum
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Some people shouldn't buy homes, even if they can qualify for a loan.

That's a new warning from a growing number of advocates generally devoted to increasing home ownership among lower-income families in Charlotte and nationwide.

They say people who bought homes under the loosened lending standards of the last decade often agreed to terms that significantly reduced the benefits of home ownership.

Low down payments meant less home equity. High interest rates meant less chance to build equity. And with prices flat or falling in many lower-priced Mecklenburg neighborhoods, some owners tied up their income in property they may not be able to sell soon – at least not for a profit.

They might have done better to rent and invest in a retirement plan.

"We are making some people homeowners who shouldn't be homeowners, and that is an injustice," said Don Phoenix of NeighborWorks America, an umbrella group for community development organizations. "It's the result of too much money chasing people."

The money came from lenders who charge higher prices to people who can't get bank loans, and profit even if some default. Starting in the mid-1990s, the industry exploded as the federal government reduced its regulation of financial services and computers got better at predicting the risk a customer wouldn't repay a loan.

The government itself loosened the standards on its Federal Housing Administration loan insurance program to compete with the high-rate lenders and to emulate their success.

The combination has made home ownership newly possible for millions of Americans. But a growing number borrowed more than they could afford and ended in foreclosure – worse than if they'd never bought a home.

The two kinds of easy-credit loans account for about 20 percent of home purchase loans. But defaults on those loans cause more than half of Mecklenburg's foreclosures, the Observer found.

The mix of easy money and inexpensive homes was particularly volatile here because home prices were slow to increase.

Prices in the Charlotte area increased only 18.98 percent over the last five years, according to a recent Office of Federal Housing Enterprise Oversight report. In lower-priced Mecklenburg neighborhoods, price appreciation was basically flat over that period, the Observer found.

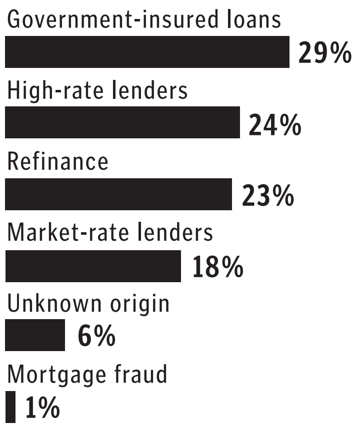
That left many owners trapped in homes they couldn't afford and couldn't sell.

Home ownership advocates caution against too much of a backlash, but they say lenders should be more responsible for determining that borrowers can afford their loans.

In December, five federal agencies proposed a policy addressing some concerns. It would limit interest-only loans that allow people to own a home without building equity. It also would require lenders to evaluate if customers can afford their loan if the interest rate increases.

Most Foreclosures Were Easy-Credit Loans

Three types of easy-credit loans accounted for more than two-thirds of Mecklenburg foreclosures, the Observer found. They are: FHA-insured loans, high-rate home purchase loans and refinance loans.



Based on a 10 percent sample of foreclosures in Mecklenburg County from 2003 through early 2005. (Numbers don't total 100 percent due to rounding.) Government-insured loans include FHA and a small number of Veterans Administration loans.

STAFF CHART

High-rate, refinancing loans tied to foreclosure

FHA loans account for more than a quarter of Mecklenburg County's foreclosures, an Observer analysis found. Here's a look at other lending practices associated with large numbers of county foreclosures.

HIGH-RATE LOANS

A new mortgage industry grew in the mid-1990s, offering loans at higher interest rates to people who don't qualify for traditional loans. Such loans account for about 10 percent of all home purchase loans but result in at least 24 percent of local foreclosures, the Observer found.

The industry says it lends to people more likely to default, and that most borrowers remain homeowners. Critics say the loans may push some borrowers toward foreclosure. The higher rates cost thousands in additional interest payments. Often, the rates also escalate – leaving borrowers unable to keep pace.

Six of 18 houses foreclosed on Rozumny Drive in northwest Charlotte during the Observer's study period from 2003 through early 2005. Three more foreclosed later. All but one of those nine owners used a high-rate loan. Their interest rates ranged between 10.9 and 13.24 percent, compared with market rates around 6 percent.

Read an Observer report on high-rate lending at www.charlotte.com.

REFINANCE LOANS

More than 20 percent of foreclosures in Mecklenburg resulted from defaults on loans taken after the home purchase.

Loans that turn home equity into cash have benefited many Americans. But some homeowners borrow more than they can afford. The problem particularly hits older neighborhoods and often older residents, who may have a lot of equity in their home but live on a fixed income that makes it difficult to keep up with debt payments.

Since the mid-1990s, two-thirds of the 29 homeowners on Peaceful Glen Road, in a 1970s subdivision in southwest Charlotte, borrowed money against their houses, often paying rates over 10 percent. Several borrowed repeatedly. By the end of last year, five had lost their homes to foreclosure.

MORTGAGE FRAUD LOANS

Prosecuted fraud caused about 1 percent of foreclosures in the Observer study. But where it hit, it hit hard.

On Colony Point Lane in Cornelius, a broker, a builder, attorneys and other real estate professionals conspired to falsely inflate property values and lie on loan forms to lure buyers into paying far more than properties were worth. Several have since pleaded guilty. Twenty of 33 houses foreclosed. Many stood empty for months. Renters moved in and out. House values dropped by one-third and more: in one case, from $318,000 at the initial sale to $170,000 after foreclosure.

Jim Hicks, a neighborhood homeowner, watched property values hit bottom about three years ago. "Hopefully we will be fully recovered within a few years," Hicks says.

Read an Observer report on mortgage fraud at www.charlotte.com.

MECKLENBURG FORECLOSURES AT RECORD LEVELS

County FHA loans failing more often

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Almost 2,000 Mecklenburg County residents since 2003 have lost homes they bought with help from the Federal Housing Administration.

The FHA, designed to increase home ownership and strengthen communities, has seen its local foreclosure rate quadruple since 2000.

As of November, FHA loans here are failing at almost twice the national rate.

The failures are a key reason Mecklenburg foreclosures stand at record levels. FHA loans account for more than one in four local foreclosures, according to an Observer analysis. They were associated with more foreclosures than even high-rate loans, the subject of a recent Observer investigation.

The FHA foreclosures clustered in new subdivisions priced for first-time owners. The Observer found at least 18 streets where 20 percent or more of homes have foreclosed since 2003 following a default on an FHA loan. The national failure rate for all loans was about three percent.

Instead of building wealth through ownership, people lost their homes and badly damaged their credit.

Instead of building communities, multiple foreclosures blighted some subdivisions, reducing the values of neighboring homes whose owners may never have missed a mortgage payment.

"Foreclosures beget foreclosures," said William Apgar, who directed the FHA during the Clinton administration. "Every time a loan goes into default, there is collateral damage."

The FHA has helped millions of lower-income Americans by guaranteeing repayment of their mortgage loans. That lets lenders charge lower interest rates and accept lower down payments. But lenders may take more chances because they don't lose money when a borrower defaults.

The Observer found several of the area's largest FHA lenders made hundreds of loans on terms the FHA has since prohibited or now is examining.

In particular, more than 40 percent of failed loans in Charlotte involved an arranged gift from a charity to cover the borrower's down payment. It's a practice the FHA is reviewing because such loans fail 76 percent more often.

Officials at the Department of Housing and Urban Development, which runs the FHA program, said they were aware of the high local failure rate. But they were surprised to learn the foreclosures so often clustered in particular neighborhoods.

Several of the hardest-hit subdivisions were built by Beazer Homes USA Inc., which arranged FHA loans for many of its buyers. In response to an Observer inquiry, HUD said it had launched a review of Beazer's FHA lending in North Carolina.

Beazer makes loans with money provided by other companies, generally banks. The rules are set by the FHA. Beazer earns a fee on each loan.

In a written statement provided to the Observer, Beazer said it had followed the FHA's rules, and that the company providing the money ultimately decides how much a borrower could afford.

MULTIMEDIA DOCUMENTARY

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Jackie Hendricks learns she must leave her home immediately because her lender has foreclosed on her Eastway Drive house in east Charlotte. Go to www.charlotte.com for her story.

"We remain in strict compliance with federal, state and local laws and implement various detection services to ensure the adherence of all regulations," the statement reads in part.

The company added that, as one of the largest local builders of starter homes, the foreclosures affected only a small share of its local customers. The rest of its customers, the company said, "were able to achieve the dream of home ownership."

Looser rules a factor

Over the last decade, HUD loosened eligibility requirements for FHA loans, hoping to increase home ownership. It reduced down payment requirements, allowing people effectively to borrow 100 percent of the home purchase price. It allowed people to borrow more money relative to their incomes. And it increased sales of loans with adjustable interest rates.

Home ownership increased but more of the new loan recipients were unable to make their monthly payments. They bought homes and quickly lost them. The FHA projects 11 percent of its 2005 loans eventually will fail, compared with 7 percent of its loans in 2000.

Some local lenders say part of the reason is that HUD is failing to prevent bad loans.

"We'll deny someone for an FHA loan and then a broker (an independent loan seller) approves them for the same FHA loan," said Kim Graham, a Charlotte-based loan officer with BB&T Corp. "I'm baffled as to how that can happen."

HUD says it relies on lenders to report each denial so it can flag repeat applications. The agency also said it can review only a small portion of the loans the FHA agrees to insure. It said the problems highlighted by the Observer would bring a closer look at lending in the Charlotte area.

"We try to tighten up when we see problems," said Dan Rogers, deputy director of the home ownership center for HUD's Atlanta region, which oversees lending in the Charlotte area.

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For-sale signs abound on William Reynolds Drive in northeast Charlotte, where FHA defaults led to nine foreclosures since 2003.

8 foreclose on 1 street

Beazer, an Atlanta company, is one of the largest local builders of starter-home subdivisions, where prices average less than $150,000. The company also operates a subsidiary, Beazer Mortgage, that arranges FHA loans for some buyers.

On some streets in Beazer's local subdivisions, not a single home has foreclosed. But on at least a dozen streets, 15 percent or more of the homes have foreclosed in the last three years.

On Katie Creek Court in University City, for example, Beazer arranged FHA loans for 30 of 32 buyers. Eight of those loans have since ended in foreclosure. "A lot of people just couldn't pay it," said Peggy Morrison, who has kept the home she bought with her husband in 2001.

Six of the foreclosed homes on Katie Creek, and 62 percent of Beazer's defaulted loans in the county from 2003 through September 2005, involved an increasingly common feature of easy credit loans: The home buyer made no down payment.

A nonprofit gives the buyer the required 3 percent down payment. Such charities generally then collect the same amount from the seller, plus an additional payment. The largest, California-based Nehemiah Corporation of America, won a legal challenge allowing the practice.

Critics say the gifts allow people to buy homes before they are ready. Also, they say the absence of a down payment means people lose less by defaulting and therefore are more willing to walk away.

A November, 2005 study by the government accountability office found recipients of down payment assistance were 76 percent more likely to default on their FHA loans.

HUD now says it is preparing to revisit the loophole that allows down payment assistance – and to crack down on companies that sell loans that rely on the gifts. "We know we have problems with down payment assistance programs," said Rogers, of the Atlanta office.

Lenders can pack up shop

The government's ultimate sanction for companies that make bad loans was adopted in the late 1990s: If too many loans from a particular company fail, FHA will no longer insure its loans.

But there is a major flaw. Lenders can make hundreds of loans in a few years, pack up shop before the loans start failing, and escape accountability.

Even when a company is penalized, employees can simply start a new company.

"It's hard to hold individuals personally accountable," said Apgar, the former FHA commissioner. "They just disappear into the night and then come back in different forms."

Homestead USA, a Michigan company, made almost 600 FHA loans in Mecklenburg County in 2000 and 2001. The Observer found that by September 2005, almost 26 percent of Homestead's FHA loans had entered foreclosure – by far the highest rate for any lender in the county.

But Homestead was purchased by Guaranty Residential Lending in 2001. The new company quickly reduced its local FHA lending, and HUD stopped tracking its failure rate. The department says the company would have a clean slate if it applied to resume FHA lending.

In early 2005, the Carr family, which founded Homestead, bought it back from Guaranty. They resumed business as AssuraFirst Financial, and reregistered the Homestead USA brand.

Contacted for comment, Bruce Carr, the chief financial officer, said the original Homestead USA was no longer in business and AssuraFirst had no comment on its practices.

— TED MELLNIK AND LISA HAMMERSLY MUNN CONTRIBUTED.

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If You Fall Behind on Payments

Contact the company that services your loan as soon as possible. Foreclosures cost them money. They may be willing to adjust your payments. You can also contact a counseling agency, which can work with the company on your behalf. In Charlotte, United Family Services offers counseling at (704) 332-9034. Outside Charlotte, you can find a local agency by calling the Department of Housing and Urban Development at (800) 569-4287. You can also contact a national nonprofit, the Home Ownership Preservation Foundation, at (888) 995-4673.