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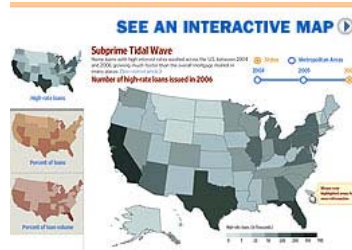
The United States of Subprime

Data Show Bad Loans Permeate the Nation; Pain Could Last Years

By **RICK BROOKS** and **CONSTANCE MITCHELL FORD**
October 11, 2007; Page A1

As America's mortgage markets began unraveling this year, economists seeking explanations pointed to "subprime" mortgages issued to low-income, minority and urban borrowers. But an analysis of more than 130 million home loans made over the past decade reveals that risky mortgages were made in nearly every corner of the nation, from small towns in the middle of nowhere to inner cities to affluent suburbs.

The analysis of loan data by The Wall Street Journal indicates that from 2004 to 2006, when home prices peaked in many parts of the country, more than 2,500 banks, thrifts, credit unions and mortgage companies made a combined \$1.5 trillion in high-interest-rate loans. Most subprime loans, which are extended to borrowers with sketchy credit or stretched finances, fall into this basket.



High-rate mortgages accounted for 29% of the total number of home loans originated last year, up from 16% in 2004. About 10.3 million high-rate loans were made in the past three years, out of a total of 43.6 million mortgages. High-rate lending jumped by an even larger percentage in 68 metropolitan areas, from Lewiston, Maine, to Ocala, Fla., to Tacoma, Wash.

To examine the surge in subprime lending, the Journal analyzed more than 250 million records on mortgage applications and originations filed by lenders under the federal Home Mortgage Disclosure Act. Subprime mortgages were initially aimed at lower-income consumers with spotty credit. But the data contradict the conventional wisdom that subprime borrowers are overwhelmingly low-income residents of inner cities. Although the concentration of high-rate loans is higher in poorer communities, the numbers show that high-rate lending also rose sharply in middle-class and wealthier communities.

Banks and other mortgage lenders have long charged higher rates to borrowers considered high-risk, either because of their credit histories or their small down payments. As home prices accelerated across the country over the past decade, more affluent families turned to high-rate loans to buy expensive homes they could not have qualified for under conventional lending standards. High-rate loans are those that carry interest rates of three percentage points or more over U.S. Treasuries of comparable durations.

The Journal's findings reveal that the subprime aftermath is hurting a far broader array of Americans than many realize, cutting across differences in income, race and geography. From investors hoping to strike it rich by speculating on condominiums to the working poor chasing the homeownership dream, subprime loans burrowed into the heart of the American financial system -- and now are bringing deepening woe.

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The data also show that some of the worst excesses of the subprime binge continued well into 2006, suggesting

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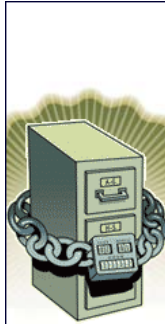
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that the pain could last through next year and beyond, especially if housing prices

remain sluggish. Some borrowers may not run into trouble for years.

"We had an aggressive home-mortgage industry trying to get people into homes they couldn't afford at a time when home prices were very high. It turned out to be a house of cards," says Karl Case, an economics professor at Wellesley College. "We're in the early stages of the cleanup."

The Journal's analysis indicates that some major subprime lenders, such as Washington Mutual Inc.'s Long Beach Mortgage unit, began scaling back or tightening their standards a year or more ago. But commercial banks and thrifts filled the void, helping to sustain real-estate markets that might otherwise have begun cooling.

The data suggest that financial suffering is likely to persist in many parts of the U.S. where subprime lending had surged. Many loans at risk of going bad have not yet done so. As much as \$600 billion of adjustable-rate subprime loans, for example, are due to adjust to higher rates by the end of 2008, which means that more and more borrowers are likely to fall behind.

Last September, Darla Ball, a printer and copier saleswoman, purchased a \$460,000 home in Las Vegas using an adjustable-rate subprime loan with an initial rate of 8.2%. At the time, she says, she expected to refinance before her interest rate resets to 14% next year, which will raise her monthly payments to \$8,000 from \$3,700. But in the past year, she says, prices of comparable homes in her subdivision have fallen to \$310,000, which means she would not qualify for a new \$460,000 mortgage, unless home values go back up to that level, an unlikely scenario. She says she has stopped paying her mortgage and is trying to negotiate with her lender. "I'm going to lose my home anyway," she says, "so why pay?"

Debt Trouble

Selected metropolitan areas with high proportions of new high-rate mortgages, 2004-2006

Metropolitan Statistical Area	Number of high-rate loans	High-rate loan volume, in billions	All loan volume, in billions	Percentage high-rate
McAllen-Edinburg-Mission, Texas	17,511	\$1.41	\$3.61	39.1%
Detroit-Livonia-Dearborn, Mich.	112,183	9.84	30.64	32.1
Miami-Miami Beach-Kendall, Fla.	170,938	29.32	92.78	31.6
Bakersfield, Calif.	53,881	8.10	26.75	30.2
Ocala, Fla.	15,085	1.67	6.21	27.0
Stockton, Calif.	46,447	10.66	40.63	26.2
Cape Coral-Fort Myers, Fla.	52,106	8.50	33.17	25.6
Lewiston-Auburn, Maine	3,843	0.40	1.71	23.8
Las Vegas-Paradise, Nev.	149,892	25.70	109.44	23.4
Tacoma, Wash.	42,335	6.07	27.97	21.7

Source: Home Mortgage Disclosure Act data

The Journal compared the fastest-growing high-rate loan markets to the rankings compiled by foreclosure-listing providers RealtyTrac Inc. and ForeclosureS.com. In Stockton, Calif., for example, high-rate loans accounted for 33% of total home-loan volume last year, up from 13% in 2004. During the first half of this year, the Stockton area had 8,169 foreclosure filings, or one for every 27 households. According to RealtyTrac, of Irvine, Calif., that makes Stockton the nation's foreclosure capital.

Seven of the 10 large metro areas now struggling with the highest foreclosure rates -- including Miami, Detroit and Las Vegas -- saw borrowers barrel into high-rate loans much faster than the country as a whole. In a forthcoming study in the Journal of the American Planning Association, Daniel Immergluck, an associate professor at Georgia Institute of Technology in Atlanta, found a similar pattern between foreclosures occurring in early 2006 and cities with high subprime lending in 2003.

There are some less gloomy signs, too. Last year, the number of new high-rate loans fell 2% to about four million, after jumping 88% in 2005. That reflects the collapse of some of the most aggressive lenders and tightening credit standards of others. Slowing home sales have put the brakes on loan demand, and borrowers have grown more wary of mortgages with teaser rates and other gimmicks.

Yet last year's data show that even as the housing market was weakening, some lenders still were eager to make riskier loans. Banks and thrifts grabbed 52% of the market for high-rate loans last year, up from 44% in 2005. SunTrust Banks Inc., of Atlanta, long known as a conservative lender, more than doubled the number of high-rate loans made by its mortgage unit. Smaller banks such as First National Bank of Arizona, part of First National Bank Holding Co. of Scottsdale, Ariz., also revved up their riskier mortgage lending last year.

Joel Gottesman, chairman of First National's mortgage division, says much of the jump reflects borrowers who got second mortgages. The bank has since scaled back that business, he says. SunTrust's increase reflects that it "was comparatively

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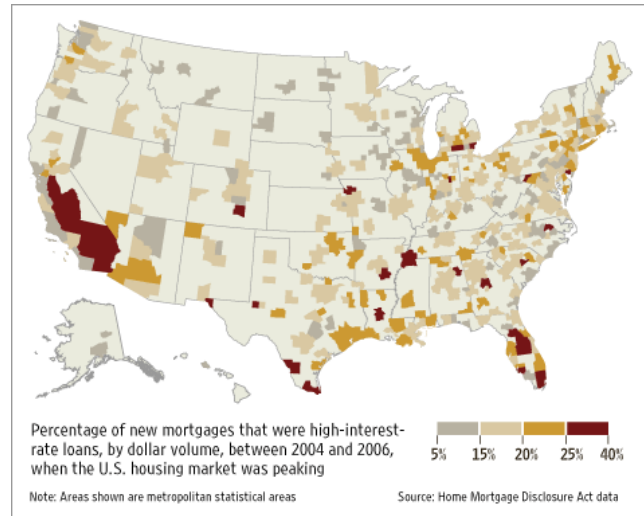
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late getting into this area," says a spokesman. He added that the jump was heightened by changes in interest rates.

Higher-income home buyers began using such loans for larger purchases. Among borrowers characterized in the data as white with annual income of at least \$300,000, the number of high-rate loans jumped 74% last year, the numbers show. The average high-rate loan grew 10% to \$158,000 last year, compared with a 1% rise in the average size of all home loans. The 2006 data include records from 8,886 lenders nationwide, which generate an estimated 80% of U.S. home mortgages.

The high-rate loan data likely understate the potential peril posed by mortgages with low teaser rates. Under federal rules governing disclosure, some subprime teaser loans do not show up as having high rates. Lenders weren't required to report loan-pricing details until 2004.

The relaxation of credit standards by home lenders has been years in the making. The Community Reinvestment Act, a 1977 federal law, prodded banks to extend more credit in communities where they operated. That warmed many of them to lower-income and minority borrowers. The Federal Housing Administration, a New Deal-era mortgage insurer targeting buyers with little or poor credit, began losing market share to aggressive subprime lenders. These commercial lenders usually charged higher interest rates but promised less paperwork, faster approval and no-money-down loans that seemed more affordable to many borrowers.



Ambitious lenders such as Seattle-based Washington Mutual's Long Beach Mortgage, which between 2004 and 2006 made \$48 billion in high-rate loans, used armies of outside brokers to push subprime loans into the suburbs. (A company slogan: "The Power of Yes.") The result was a mortgage bonanza that reached every racial and ethnic group, income level and geographic area.

By 2005, a list of subprime-lending specialists compiled by the Department of Housing and Urban Development had grown to 210 lenders, from 141 in 1996. Their combined loan volume grew tenfold during the same period.

"Old industrial cities like Philadelphia have a poverty problem, and that's why people had to use subprime loans," says Kevin Gillen, a research fellow at the Wharton School of University of Pennsylvania. But in pricey areas such as Miami, where the high-rate market share jumped 25 percentage points from 2004 to 2006, subprime loans didn't have a downscale reputation. They were seen as the answer to sky-high housing costs. "They are different groups, but subprime served both of them," Mr. Gillen says.

It used to be that high-rate borrowers weren't allowed to stretch as much as conventional borrowers on loan amounts, a reflection of their higher credit risk. But as home prices rose throughout the U.S. in the early 2000s, lenders grew more willing to let high-rate borrowers get bigger loans as measured against their annual incomes. In 2005, borrowers who got high-rate mortgages to buy one- to four-family homes were loaned 2.1 times their reported annual income, on average, according to the data. That was 4% higher than regular borrowers.

Kristine McMahon has a six-figure income as a mortgage broker and lives in a four-bedroom home in East Hampton, N.Y., valued at more than \$2.7 million. Yet Ms. McMahon, who works for Manhattan Mortgage, chose a subprime loan for herself when she refinanced last year to turn some of her home equity into cash. Ms. McMahon says that at the time of the refinancing, a conventional lender would not allow her to take out as much cash during the refinancing as her subprime lender, New Century Financial Corp., which is now operating under bankruptcy-court protection. Ms. McMahon chose a subprime loan that carried a fixed-rate of 6.45% for the first two years before turning into an adjustable rate. She plans to sell the house before the higher adjustable rates kick in.

Lenders also extended more "second-lien" mortgages -- many of them "piggyback" second loans that borrowers used to cover down payments. Such second-lien loans climbed to 22% of all mortgages last year, up from 12% in 2004. Piggybacks are considered far more likely to default than a standard mortgage.

Lenders did little to discourage speculation by real-estate investors, which contributed to rising home prices. Last year, 13% of all high-rate home loans were for properties not occupied by owners, up from about 9% in 2004, the data show. Experts say such properties are higher foreclosure risks than homes lived in by their owners.

Who will be left holding the bag for mortgages that go sour? Wall Street bought lots of subprime loans and packaged them into securities for sale to investors. The data show that lenders shifted even more of their riskiest loans to investors as the boom began to fizzle.

About 63% of high-rate mortgages originated in 2004 were sold that same year, compared with 68% of all home loans, the data indicate. Last year, about 73% of new high-rate loans were sold, compared with 67% of all home loans. Last year, the

average high-rate loan carried an interest rate that was 5.6 percentage points higher than a Treasury security of comparable maturity -- up from 5.3 points in 2005 and 4.8 points in 2004.

In the hardest-hit areas, the numbers could batter borrowers, lenders and builders for years to come. This year, through July, the rate of mortgage-default and foreclosure-auction filings in Lee County, Fla., where Fort Myers is located, was second-highest in the U.S., according to ForeclosureS.com. The inventory of unsold homes has swelled to about 15,000, and some investors who had hoped to flip houses at a profit are walking away from sales contracts for purchases they don't want anymore or can't afford.

"We view Fort Myers as likely the worst housing market in the country," J. Larry Sorsby, executive vice president and chief financial officer of Hovnanian Enterprises Inc., complained last month. In March, the Red Bank, N.J., company took a \$93 million pretax charge because of the mess in Fort Myers. Last month, it slashed prices on certain homes there as part of a three-day, nationwide "Deal of the Century" sale.

Next week, foreclosure auctioneer Hudson & Marshall of Texas Inc. will try to unload about 70 houses in or near Fort Myers that were taken back by lenders. Low-ball bidders who miss out will have plenty of second chances: More than 300 other foreclosed homes in Florida are for sale in the auction.

--James R. Hagerty contributed to this article.

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