

First signs of foreclosure crisis loomed in '05

Lax guidelines prove to be 'too good to be true'

By Tom Charlier

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During the very year the local housing market peaked, when new home sales totaled more than \$900 million in Shelby County alone, Meribeth LaBarreare noticed the first signs of trouble.

"Around 2005, we started seeing these loans that were too good to be true," said LaBarreare, president of the Memphis Mortgage Bankers Association.

"They went outside the box. ... They basically had no guidelines."

Mirroring the problems experienced across the nation, the lending practices that LaBarreare and others noticed in Memphis helped fuel a full-scale mortgage crisis. Since 2005, there have been more than 23,000 foreclosures in the county.

As was the case elsewhere, the problem rested largely in the subprime loans issued by out-of-town mortgage firms. Companies that include First Franklin Financial, Long Beach Mortgage Co. and Wells Fargo were among the lenders issuing the most loans that later went into foreclosure.

Subprime lending, in which borrowers with credit or income problems pay more onerous terms for mortgages, became especially widespread in Memphis.

A study by the Center for Community Building and Neighborhood Action at the University of Memphis found subprime loans peaked in 2005, when 15,080 of them represented 38 percent of all mortgages in the county. That compares to a national rate of 14 percent.

The loans were characterized by relaxed guidelines for borrowers and immense profitability for some lenders.

Typically, 100 percent financing was available.

"A buyer could get in with basically no money," said Kevin Ruby, executive vice president of Community Mortgage Corp. in Memphis.

Large out-of-town investment houses typically looked to local firms to find customers, and they competed by offering ever-more enticing terms for borrowers.

"The investors come to us. ... We put their product on the street," Ruby said.

"Whoever had the most lenient guidelines for your borrower that day got the loan."

Once the loans were issued, they'd typically get sold and bundled into mortgage-backed securities issued by Wall Street firms. That explains why Deutsche Bank National Trust is by far the leading foreclosing institution in Shelby County even though it doesn't rank among the top originating lenders.

"None of the lenders was servicing their own mortgages," said Webb Brewer, director of advocacy for Memphis Area Legal Services, who has been examining subprime lending practices in anticipation of a possible lawsuit against lenders.

"It's kind of like the Wizard of Oz -- you don't know who you're dealing with."

Brewer and others reserve their sharpest criticism for mortgage brokers as opposed to the more closely regulated bankers. He said the loans generated "extraordinary" fees for brokers, who, in addition, received a "yield spread premium" that grew in relation to the size of the loan.

Brewer calls it a veritable kickback. "It really gave the broker an incentive to put the person into the highest-cost loan that they could."

As the housing market boomed and mortgages proliferated, lenders became less vigilant about checking the income, assets and employment of borrowers, industry officials say.

"I think when the volumes were so high, a lot of the lenders were not able to do the quality of loan-underwriting that they'd usually do," said Staci Blackwell, underwriting counsel for Fidelity National Title Group in Memphis.

The poor underwriting also meant some lenders got away with "fronting" the money needed by borrowers for deposits or closing costs. Typically a significant sum -- say \$5,000 -- would show up in a borrower's bank account just before closing, Blackwell said.

"No underwriting was done to determine where that \$5,000 came from. ... They were fronting the monies needed for the deposit," she said.

"That would've been a very tell-tale sign that they were not going to be able to make those payments."

Such dubious practices largely reflected the unregulated nature of the mortgage-brokerage industry, LaBarreare said.

"You could broker a mortgage out of the trunk of your car," she said.

But that's changing. Tennessee's legislature last year approved a bill calling for criminal background checks for people seeking broker's licenses. This year, the state is expected to adopt additional measures mandated by Congress to tighten standards for mortgage-brokers and loan-originators, said Cullen Earnest, spokesman for the Tennessee Department of Financial Institutions.

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BEHIND THE FORECLOSURES

The banks and mortgage companies initiating loans that went into foreclosure usually were not the ones actually foreclosing on the property.

The institutions that originated the most loans that went into foreclosure during the first 10 months of 2008 are as follows:

- First Franklin Financial, 233 loans
- Community Mortgage Loans, 211
- Long Beach Mortgage Co., 172
- Union Planters National Bank, 123
- Wells Fargo, 117.

The top five financial institutions that actually foreclosed on loans during 2007 and 2008 are as follows:

- Deutsche Bank National Trust Co., 758 foreclosures
- Housing and Urban Development (HUD), 718
- Federal National Mortgage Association, 647
- U.S. Bank National Association, 531
- Wells Fargo National Association, 216.

Source: Chandler Reports



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