



ALL BUSINESS: Sapping the American Dream



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NEW YORK (AP) - It's not just subprime borrowers who are defaulting on their mortgages these days.

Bank executives and credit-rating agencies are warning that an increasing number of homeowners who are current on their credit cards, car leases and other debts are walking away intentionally because the size of their mortgage debt exceeds the value of their homes.

What's going on undermines the idea of home ownership as the American dream, where people do whatever they can to own and keep their homes. The stigma that used to exist when you lost your house apparently is fading; more homeowners are deciding against the economics of an underwater mortgage as home prices fall around the country.

Wachovia Corp.'s chief risk officer Don Truslow told analysts last month that one of his bank's challenges was dealing with the "acceleration" in people who should be paying but aren't because "they've lost equity, value in their properties."

Fitch Ratings echoed that when it announced on Feb. 1 that it was considering cutting its rating on \$139 billion in mortgage debt because it assumes more people who borrowed money to buy homes in the last two years are going to default.

"The apparent willingness of borrowers to 'walk away' from mortgage debt has contributed to extraordinarily high levels of early default," the credit-rating agency said.

There are even businesses popping up to help homeowners navigate the default process. One, YouWalkAway.com based in Carlsbad, Calif., offers professional advice on how to repair credit and says it can assist its clients in understanding their legal rights when it comes to default. The company declined to give specifics on the size of its customer base.

Banks and financial institutions can only blame themselves for this mess. To start, they encouraged borrowers to load up on debt during the housing boom, often by fully financing their home purchases, and offered all sorts of adjustable-rate and interest-only mortgages.

Long gone was the old "80/20" rule, which used to require home-loan borrowers to put 20 percent down in cash while 80 percent of their purchase was financed. In recent years, that shifted to 80 percent borrowed in the primary mortgage and then 20 percent in a secondary loan.

Homeowners were drawn to those mortgages because they allowed them to buy more expensive homes and keep their payments low, at least for the short term. Lenders benefited, too, from all the mortgage-related fees.

Now the party is over—for everyone. Nationwide, home prices have tumbled 5 percent since the market peak since early 2006, and some estimates say another 5- to 10-percent decline is still to come. The pullback has been more pronounced in some parts of the country, like southern California, where prices are off more than 15 percent since the downturn began.

That has already led to surging defaults among risky subprime borrowers who could barely afford their mortgage payments even before they got hit with the double whammy of falling home values and rising adjustable rate loans.

Seemingly creditworthy homeowners are bailing out now, too. They aren't following the predictable script of the past, which meant stopping payment on credit card and other debt just to keep up their mortgage obligations.

"If you go into a new home purchase with no skin in the game, with just your credit score but no money down, then you really don't have much to lose from walking away," said Alex Stenback, a mortgage banker in Minneapolis who writes the blog "Behind the Mortgage."

Lenders also failed to recognize the likelihood of creditworthy borrowers defaulting. The rules of mortgage lending had changed, which meant default rates could, too. But most financial institutions didn't pick up on that because they used historical data as their basis for future estimates.

"Were they modeling risk right? No, since they were showing very low expected losses. They were blinded by the immediate opportunity" of bringing in bigger profits through such lending, said Christopher Whalen, managing director at the consulting firm Institutional Risk Analytics.

Whalen thinks that the performance of Wachovia's mortgage unit could be a litmus test for how the situation with non-subprime borrowers plays out. The Charlotte, N.C.-based bank bought Golden West Financial at the height of the housing boom in 2006.

Golden West was known for its stringent underwriting standards, but it also specialized in option adjustable rate mortgages and negative amortization loans. Most of its loan originations were in California.

The good news is that so far that portfolio hasn't cracked. There have been around 2 basis points in charge offs—which represent actual cash losses—in the last two quarters versus 20 basis points for the mortgage specialization peer group, Whalen said.

What's key is where those losses go next. If they jump higher in the coming months, that would be very telling about the trend of homeowners walking away. No one should want to see that.

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