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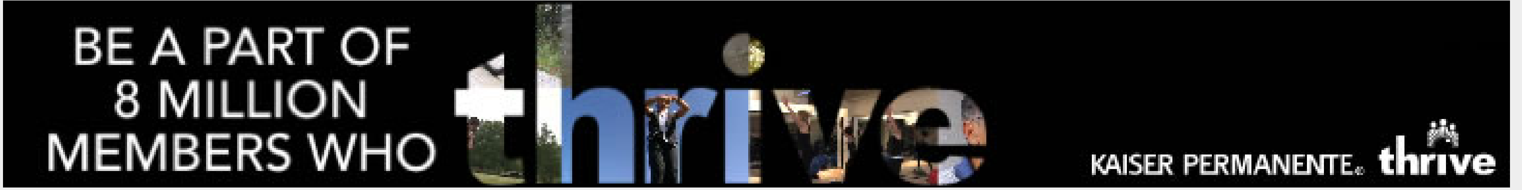

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- Metro | Latest News
- North County
- Temecula/Riverside
- Tijuana/Border
- California
- Nation
- Mexico
- World
- Obituaries
- Today's Paper
- AP Headlines

Business
- Technology
- Biotech
- Markets

In Depth
- In Iraq
- War on Terror
- Pension Crisis
- Special Reports
- Multimedia
- Photo Galleries

Topics
- Politics
- Military
- Science
- Education
- Health | Fitness
- Features
- Solutions
- Travel

Opinion
- Columnists
- Steve Breen
- Forums
- Weblogs

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Lending rules 2 years late, a few billion dollars short

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December 23, 2007

After more than a year of watching the real estate bubble pop and spatter over the economy, the Federal Reserve finally decided to pull the reins in on the mortgage industry.

Under new guidelines set forth last week, borrowers will have to prove they're making money before they can get a loan. What a radical concept! Lenders will be barred from making loans without first considering whether borrowers have enough money to pay them back. Amazing!

The Fed has finally started telling lenders to restrain themselves and stick to making loans that actually make financial sense.

And get this: Lenders will also have to tell the truth about loans. Under the Fed's new rules, you can't advertise ultra-low “teaser rates” for mortgages or issue loan documents for adjustable rates without clearly warning borrowers how high their interest payments might pop.

Why didn't anyone think of that before?

If the Fed had enacted those rules three or four years ago, many of our current problems could have been avoided. Tighter regulation by the Fed could have kept unqualified borrowers out of the market, which could have prevented real estate prices from skyrocketing to untenable heights.

These rules are about three years too late to do much good in fixing the current mortgage crisis. And in today's lending environment, they seem hopelessly retro.

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The rules make it seem as if the Fed is still trying to solve the problems of 2005, when lenders were doling out billions of dollars of subprime loans to borrowers with spotty credit histories. News flash: It's nearly 2008, and the lending environment has changed dramatically in the past three years.

Spooked by losses in the mortgage market, most reputable lenders have shied away from the practices the Fed seeks to ban. In fact, they are now tightening their loan standards so much that they threaten to strangle the most ironclad borrowers.

And the tighter lending standards are making it harder for troubled borrowers to sell or refinance their homes, leading to more defaults and foreclosures.

In San Diego County alone, 28,854 homeowners went into default or foreclosure between January and November, compared with 10,945 who experienced similar difficulties during the same period of 2006, according to RealtyTrac, a firm in Irvine that monitors real estate trends. Mortgage lenders expect these numbers to worsen next year.

“In San Diego, I think this will hit a bottom in 2008, but maybe not until the end of the year,” said Craig Bramlett, president of CalPacific Mortgage Consultants.

Christopher Thornberg, an economist with Beacon Economics in Los Angeles, sees the mortgage troubles in the state and county continuing through 2009.

If there's a silver lining to all of this, it's that the decline in housing prices will make San Diego and other high-priced places nationwide a bit more affordable for first-time buyers. But the wave of defaults and foreclosures, which are predicted to total about 2 million nationwide by the time the dust clears, means there's a growing class of one-time homeowners whose money has vanished, meaning they will lack the financial wherewithal to get back into the market.

So far, the Fed, the Bush administration and Capitol Hill have taken relatively few steps to help homeowners who have gone into default. Congress came closest last week when it passed a measure to prevent the ever-kindly Internal Revenue Service from taxing people for taking

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a loss on their homes.

Currently, if a homeowner were forced to sell at a $50,000 loss and the lender forgave that part of their mortgage, the IRS would treat the $50,000 as income. Taxpayers in a 28 percent bracket would end up paying $14,000 in taxes for the pleasure of watching their dreams of homeownership go down the tubes.

As soon as the law is enacted, that sordid practice will at long last be stopped, as long as you actually live in the home (sorry, speculators) and the debt forgiveness is less than $2 million (sorry, millionaires).

But that bill's not going to help anybody keep their homes. It will just help them move out a little less painfully.

Most measures that are currently being promulgated as fixes for the mortgage problem are aimed at borrowers who still have their credit history intact, not those going into default. And even those measures seem like stop-gap measures that will prevent relatively few home buyers from falling off a cliff.

Gov. Arnold Schwarzenegger and President Bush made some headlines last month by getting lenders to agree to help qualified borrowers – people who have not missed payments – renegotiate the terms of their loans. And they've been touting a toll-free consumer help-line – (888) 995-HOPE – which puts troubled homeowners in touch with loan counselors.

But at a town hall meeting last week in Stockton – the epicenter of California's foreclosure crisis – Schwarzenegger and Treasury Secretary Henry Paulson heard plenty of complaints that the HOPE line doesn't provide much hope.

“I work every day. I've never been late until this situation happened,” Stockton homeowner Trudy Crawford said. “But the mortgage company is not trying to help me. I've called the HOPE line. They tell me to put my house up for a quick sale. That's not help.”

Another home buyer complained that he's now facing an $8,000-a-month mortgage payment from his adjustable-rate loan, but his lender told him it was powerless to renegotiate the loan. “We're sorry, but your loan has been securitized, and we can't modify your loan,” he said the lender told him. “And oh, by the way, even if we would modify your loan, you have to first be three months late before we'll even let you talk to loss mitigation.”

John Shields, a troubled homeowner that Schwarzenegger had brought along to tout the benefits of the help line, was lukewarm about its effectiveness.

“It took like two months” to get in touch with his lender, Shields said. “We kept calling them over and over and over, trying to get some sort of feedback and some help.”

Shields got a loan modification package, but he hasn't heard back from

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Weddings
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Catering
Casino
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the lender. All he can say is he hopes that his "mortgage company will go ahead and be able to work with us."

Paulson tried to smooth things over by mentioning all the great stuff the Fed was doing, notably its requirement for clearer disclosures on loan documents. "That's not going to help you today," Paulson conceded. "You know, that may help your grandchildren or your children."

Which is a good thing, for our children and grandchildren. But it will do nothing for the people currently going into default. Their train long ago left the station and is now barreling past the "Bridge Out" sign at Gruesome Gulch.

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