

NEWS SERVICES: Lingling Wei – Mortgage Finance

To the Judges of the Gerald Loeb Awards:

2006 will be remembered as the year in which the four-year housing boom ground to a halt, bringing with it an end to the kind of instant wealth individuals and companies haven't seen since the stock market bubble burst in early 2000. The impact was far-reaching: the housing slowdown hurt the economy, it dented overall consumer confidence and sent some companies out of business.

Nowhere was the pain of the eroding housing market felt so acutely than among those borrowers with poor credit and the companies that underwrote their mortgages – the subprime lending market, a sector that accounts for nearly 20% of all home-buying loans. Dow Jones Newswires Special Writer Lingling Wei covered the meltdown in the subprime business with doggedness and originality that took readers well beyond the routine reporting of monthly housing numbers to divulge long before others the cracks that would make the entire business vulnerable. Her articles uncovered industry developments that later led to the closing of several subprime lenders and kicked off an industry consolidation.

Many mortgage lenders make money from origination fees by underwriting the loans and selling them to third-party investors. The more loans you create, the more fees you take in. But if you cut corners, you introduce huge risks to your business. Lingling interviewed regulators and consumer advocates who raised concerns about a disturbing trend of reduced documentation designed to speed up the loan process. In particular, more companies were offering “stated-income” mortgages, a loan in which an applicant discloses annual income but it is never verified. Many of these loans led to another trend Lingling uncovered – a sharp rise in defaults by borrowers who couldn't even make their *first* monthly payments. Ultimately, when loans default, the borrowers lose their homes and the companies and investors who hold the mortgages lose money. Lingling wrote how some investors were forcing mortgage underwriters to take back the bad loans, an unprecedented move that cost these companies millions of dollars.

As the number of bad loans mounted, Lingling found that homeowners and lenders had an unlikely ally in preventing foreclosures – community groups. She also found that scam artists had set their sights on a new group of needy and unsuspecting victims – people in need foreclosure rescue.

We are pleased to nominate Lingling Wei for the Gerald Loeb Award for News Services.

Best regards,

Rick Stine
Senior Editor, Americas
Dow Jones Newswires

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Stated Income Loans Pose Risks; Call For 'Suitability', Aug. 14

By Lingling Wei
Of DOW JONES NEWSWIRES

Martha Aikens was on the verge of losing her home in early 2004. The culprit: a "stated income" loan that she had been induced to take out one-and-a-half years earlier but was never able to make a single payment on.

Aikens, a widow in her seventies, sought to refinance the mortgage on her home in Evanston, Ill., near Chicago, in May 2002. However, to qualify her for a higher-rate loan and get the commission, the mortgage broker she came to rely on grossly inflated her income and falsified her employment information to make the overstated income look plausible, according to a complaint later filed against the broker.

Her application then went through as a stated income loan - one that discloses income but doesn't require verification.

The case points to a growing concern among consumer advocates and regulators over the home-lending industry's increasing reliance on reduced documentation, particularly unverified income, to speed up the loan approval process amid the ever-intensifying competition.

"It's just too easy to cheat," says Tom Miller, Iowa's attorney general. He says fraud related to stated income loans often is initiated by lenders and brokers in pursuit of profits, leaving unsuspecting consumers in the dark.

In a recent multi-state investigation led by Iowa, Ameriquest Mortgage Co. was alleged of engaging in a variety of improper lending practices including encouraging borrowers to exaggerate their income to qualify for loans. The subprime lender, a unit of closely held ACC Capital Holdings Corp. in Orange, Calif., in January settled those charges by agreeing to pay \$325 million and making sweeping changes to its lending practices.

Trading Risk For Convenience

Loans requiring no income check have been around for many years, with the initial intention of offering convenience, time savings and financial privacy to self-employed borrowers with high credit quality and large down payments. A qualifying borrower may only need to submit his or her business license, a signed letter from his or her accountant confirming a two-year history of the business, and an IRS form verifying the income source - not the amount.

But greater competition and the desire to simplify and quicken the loan origination process has led more lenders to extend stated income loans to borrowers with lower credit scores, higher loan-to-value and debt-to-income ratios than traditionally allowed.

"The industry is trading risk for convenience," says Larry Goldstone, president and chief operating officer at Thornburg Mortgage Inc. (TMA) in Santa Fe, N.M. "That may be mistaken at some point in the future." Goldstone says the company's underwriting guidelines discourage borrowers with FICO scores less than 700 from applying for stated income loans.

In addition, as noted by banking regulators, lenders are increasingly relying on unverified income to qualify borrowers for "non-traditional mortgage loans." Those products, such as pay-option adjustable-rate mortgages and interest-only loans, allow borrowers to defer payment of principal and sometimes, interest. Many analysts see such a combination of non-traditional products and non-traditional underwriting processes as presenting another "layer of risk" to those who could

be hurt by defaults, including consumers, shareholders in mortgage lenders, and investors in securities backed by mortgage loans.

Industry experts say loans with reduced documentation now account for about 40% of the entire mortgage pool. In some cases, to compensate for the increased credit risk, lenders would charge more for stated income loans, with their rates typically an eighth- to a quarter-point higher than those on a loan with full underwriting requirements.

Little Historical Appreciation

Suzanne Mistretta, senior director of residential mortgage at Fitch Ratings, says "there is more risk with a loan that is not fully documented compared to a fully documented loan because borrowers can overestimate their income to obtain a larger loan they otherwise might not have qualified for under a fully documented program where the income or assets are verified."

The vulnerability of stated income loans to fraud is illustrated in a recent report by the Mortgage Asset Research Institute to Mortgage Bankers Association: after reviewing a sample of 100 stated income loans and the accompanying IRS forms, an undisclosed lender recently discovered that almost 60% of the stated incomes were inflated by more than 50%, while 90% of the stated amounts were exaggerated by 5% or more.

"It appears that many members of the industry have little historical appreciation for the havoc created by (low-documentation or no-documentation) products that were the rage in the early 1990s," the report says. "Those loans produced hundreds of millions of dollars in losses for their users."

On the other hand, industry leader Countrywide Financial Corp. (CFC) and subprime lenders like Long Beach Mortgage, a unit of Washington Mutual (WM), maintain that they have proper controls and safeguards in place to adequately manage risks of loans with reduced documentation. For instance, the lenders say, they always attempt to gauge the validity of the stated income based on the applicant's occupation and assets including savings and investments.

"If the income amount seems reasonable, we then use it to help assess (the borrowers') overall qualifications," Countrywide said in a statement. "Otherwise, we will verify the income provided." The Calabasas, Calif., company also said "we have not found a significant enough difference in performance between fully documented loans and stated income loans to cause us concern."

Call for 'Suitability' Standard

Still, consumer advocacy groups are urging regulators to install more safeguards to protect consumers from abusive lending practices related to stated income loans and other non-traditional products. In a letter to the Federal Reserve Board, more than 50 organizations in California, including California Reinvestment Coalition and Housing and Economic Rights Advocates, voiced support of the creation of "a suitability standard for home loans" similar to the one that governs how stockbrokers should sell stocks, bonds or other investment products to investors.

"Where unsuitable loans are sold, as is rampant today, borrowers must have meaningful redress," the letter says.

In the case of the borrower Aikens, at the time she went to the broker, 1st Metropolitan Mortgage, to refinance her home so as to be able give money to her granddaughter, she had a monthly income of about \$1,400, including \$800 from Social Security and \$600 from working part-time as a housekeeper for a couple down the street. However, her loan application, prepared

by the broker, said she made \$7,225 a month as a housekeeping supervisor for a large institutional employer, according to the complaint filed on May 16, 2005, against the broker in the Circuit Court of Cook County, Ill.

A month later, through the broker, Aikens received a loan of \$149,000 with a monthly tab of roughly \$1,029 - almost three-quarters of her entire monthly income. She was never able to make a single payment, says Daniel Lindsey, a supervisory attorney with the Legal Assistance Foundation of Metropolitan Chicago that represented Aikens in her case. Her lender, Countrywide, filed a foreclosure action against her in January 2004.

Earlier this year, a settlement was reached with both the broker and the lender that Lindsey says "saved her a substantial amount of debt, defeated the foreclosure action and kept her in the home." The broker, 1st Metropolitan Mortgage, was dissolved in August 2003. Its two principals named in the complaint couldn't be reached for comment. Countrywide wouldn't comment on cases involving individual customers.

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Subprime Mortgage Lenders Seeing Early Payment Defaults, Aug. 29

By Lingling Wei
Of DOW JONES NEWSWIRE

NEW YORK (Dow Jones)--More subprime borrowers are defaulting in the early months of their home loans, a trend that has led to greater fear among investors and lenders of rising delinquencies and losses.

For more than a year, shareholders in mortgage lenders and investors in mortgage-backed securities have worried that the end of the housing boom, along with higher interest rates, would cause more borrowers to default on their home loans, leading to more bank and investment losses. But credit quality industrywide has generally held firm, thanks to a still-strong economy and a robust job market. However, in recent months, an increasing number of lenders catering to borrowers with weak credit have reported a sharp rise in delinquencies that had occurred as soon as six months after origination.

Nationwide, about three and a half subprime loans out of every 10,000 originated between January and June had a delinquency on their first monthly payment, according to LoanPerformance, a subsidiary of First American Real Estate Solutions. By comparison, only one out of every 10,000 subprime loans granted last year had experienced missed payment in their first month. LoanPerformance's data also show that so far this year, there has been a 14% increase in the number of nonprime mortgages with at least one missed payment in the first three months after origination.

"If those borrowers are finding themselves in trouble very early on, it may give lenders an indication that the underwriting criteria or quality control are not sufficiently tight," says Damien Weldon, director of collateral risk analytics at LoanPerformance. Based on the year-to-date data, Weldon says early payment defaults on subprime mortgages are expected to increase this year.

Those early defaults have forced lenders such as NetBank Inc. (NTBK), Fremont General Corp. (FMT) and H&R Block Inc. (HRB) to buy back loans already sold to whole-loan acquirers, particularly Wall Street investment banks that pool and package those loans into asset-backed securities and then sell them to large investors like insurance companies and hedge funds. The

buybacks, in turn, have led lenders to incur losses and set aside more money in their reserve funds for potential loan repurchases in the future.

For instance, as recently as a week ago, H&R Block told investors that it expects to take a \$102.1 million pre-tax charge, or \$61.3 million after-tax, for losses related to rising delinquencies by its subprime mortgage borrowers. The Kansas City, Mo., tax-services firm, which has expanded into mortgage and other financial services, said "an increase in early payment delinquencies" and the resulting "higher level of repurchase requests from loan buyers" led it to increase its loan reserves. The company, which is to release its first-quarter earnings Thursday, didn't specify the reasons for those early defaults in the press release.

Some investors and analysts view the early hiccups as a sign of weakening mortgage credit. Alan Fournier, who runs Pennant Capital Management LLC, a Chatham, N.J., hedge fund with more than \$1 billion under management, says although the housing market has already softened, as shown in a growing inventory of unsold homes and slowing home-price appreciation, "the credit cycle is just starting" to turn for the worse.

The secondary market, where lenders sell the new loans they create to manage risk as well as to have more funds available for making mortgages, could also see more pressure from rising delinquencies. Merrill Lynch analyst Kenneth Bruce wrote in a recent report commenting on H&R Block's announcement that "if the fixed-income market anticipates further losses, it could begin to pressure spreads on lower rated bonds, thus undermining whole-loan pricing." A potential decline in whole-loan pricing would eat into lenders' mortgage gain-on-sale income.

The subprime mortgage market has grown substantially in recent years, with total subprime loans outstanding representing about 13% of total mortgage loans outstanding. Subprime borrowers, who pay higher rates than prime borrowers due to their weak FICO scores (typically lower than 640) or a lack of documentation such as no income proof, tend to take on more debt and have less disposable income. A typical subprime mortgage represents 80% of the house value.

Such highly leveraged borrowers also have a greater tendency to refinance and take cash out when home prices rise. However, when home prices decline, as is now happening in many parts of the country, those borrowers may have fewer choices to tap into their homes' wealth to pay down debt, leading to more defaults on their home loans.

Analysts at UBS Investment Research noted in an August report that they suspect "the squeeze high [debt-to-income] homeowners are facing" due to slower home-price appreciation and higher loan rates accounts for "a good portion of the higher delinquency and foreclosure rates on the 2006 subprime deals."

The analysts doubted whether worse underwriting or servicing standards could have accounted for the sharp rise in foreclosures, noting that "every subprime issuer we speak with has greatly expanded their loss mitigation efforts, and they will keep homeowners out of foreclosure if at all possible."

Mike Frantantoni, senior economist for the Mortgage Bankers Association, says strong economic growth has so far kept delinquencies in check. He predicts that delinquencies "are likely to increase modestly" over the next several quarters but will remain historically low.

To reduce early delinquencies and protect themselves against future buybacks, some lenders including NetBank in Atlanta and Fremont General in Santa Monica, Calif., have backed away from offering loans featuring higher loan-to-value ratios and lower credit scores.

Some subprime lenders have also raised the bar for qualifying borrowers for loans requiring only limited paperwork and implemented more stringent procedures to fend off fraud, another oft-cited cause for early defaults. Though some of the tightening measures might make it harder for some borrowers to swing a loan, they could prevent lenders from issuing loans they shouldn't make in the first place.

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Some Lenders Cut Riskier Mortgages Due To Street Pressure, Aug. 21

By Lingling Wei
Of DOW JONES NEWSWIREs

NEW YORK (Dow Jones)--Some mortgage lenders are feeling the heat from Wall Street to tighten their lending standards and cut their exposure to some of the riskier loans.

The force at work is the increasing demand from investment banks for lenders to buy back the loans already sold to them due to borrowers' failure to make their first few payments on those loans. Such "early payment defaults" so far have largely been limited to nonprime mortgages made to borrowers who pay higher rates than those qualifying for standard loans due to their weak credit or inadequate documentation.

Buybacks of defaulted loans demanded by whole-loan acquirers, particularly Wall Street firms, have in recent quarters led some lenders to incur losses and set aside more money in their reserve funds for potential loan repurchases in the future. An increase in those reserves then cut into their profits. To shield themselves from future buybacks, some lenders including NetBank Inc. (NTBK) and Fremont General Corp. (FMT) have backed away from offering loans that have seen greater delinquencies, such as those featuring higher loan amount relative to the property value and lower credit scores.

Some subprime lenders have also raised the bar for qualifying borrowers for loans requiring only limited paperwork and implemented more stringent procedures to fend off fraud, a common cause for early delinquencies. Though some of the tightening measures might make it harder for some borrowers to swing a loan, they could prevent lenders from issuing loans they shouldn't make in the first place.

"You'll continue to see us change policies, products and processes to ensure that we achieve the correct returns for our shareholders and minimize repurchase activities," says Jerry McCoy, chief capital markets executive at NetBank. Due to a spike in the buybacks of loans previously sold to investors, the Atlanta bank added \$13.2 million to its provision expense in the second quarter, which in turn ate into its mortgage gain-on-sale income.

At subprime lender Fremont General, the amount of home loans repurchased and re-priced reached \$238.4 million in the second quarter, up from \$67.7 million in the year-ago quarter and \$107.7 million in the first quarter of this year. The Santa Monica, Calif., company said it had cut back on "certain higher loan-to-value products and lower FICO" loans during the second quarter to reduce early payment defaults and thereby loan repurchases from investors.

In its fiscal year ended April 30, H&R Block Inc. (HRB) increased its loss reserves \$11.6 million above its normal loss accrual, also blaming loan buybacks triggered by early payment defaults. "The mortgage industry has seen an increase in early payment defaults over the past few months, and we have taken steps in reaction to our loss exposure," the Kansas City company said in its annual report.

A spokesman at the tax-preparation firm, which has been expanding into mortgage banking and other financial services, declined to comment on the specific steps it has taken to cut its loss exposure, citing the quiet period ahead of its earnings release.

As a way to manage risk as well as to have more funds available for making mortgages, more lenders are opting to sell the new loans they create in the secondary market rather than keep them on their books. Buyers of those mortgages, such as Wall Street investment banks, pool and package the loans into mortgage-backed securities and then sell them to investors. When inking those loan purchase deals, industry experts say, Wall Street buyers increasingly ask to retain the right to request the seller to take back the loans in event of an early default, which typically occurs within the first three months.

"Whole-loan buyers are a little more stringent in exercising their rights under that (loan purchase) contract," says Patti Dodge, New Century Financial Corp.'s (NEW) chief financial officer. The Irvine, Calif., subprime lender allows only "limited window of opportunity" for loan buyers to request repurchases by generally limiting the warranty-like protection for the investors to the first payment, she says.

Some buyers of loans in the secondary market have taken their cases to court. Bear Stearns Cos.' (BSC) EMC Mortgage Corp., for instance, sued MortgageIT Holdings Inc. (MHL) in February, seeking to force the New York lender to buy back about \$70.5 million in subprime mortgages due to alleged early payment defaults on those loans and alleged breaches of representations and warranties. MortgageIT, which is being acquired by Deutsche Bank AG (DB), has said it intends to vigorously defend itself.

Escalating housing prices and low interest rates in the past few years have prompted home buyers to take on bigger mortgages than they might have historically, resulting in a surge in subprime loans. Now, however, with the appreciation in home prices slowing down, mortgages sporting higher loan-to-value ratios or poor creditworthiness could pose greater risks for default as borrowers may have fewer choices to tap into their homes' wealth to pay down debt.

As a sign of concern over the subprime sector, the Federal Reserve's latest quarterly survey of senior loan officers nationwide shows that about one-third of the respondents expect the performance of their subprime loans mortgage portfolio to "deteriorate somewhat" within the next year.

Eric Fitzwater, a senior analyst at SNL Financial, says the recent increases in early payment defaults as experienced by some subprime lenders represent "the initial shakeout" in a correction cycle. Shareholders in those lenders "want to hear that the business they are slowing down is the riskier business," he says.

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Foreclosure-Rescue Scams On the Rise Amid Higher Defaults, Nov. 21

By Lingling Wei
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Having tried for months to refinance their home and take it out of foreclosure, Alejandro and Martha Balderas thought they finally found their white knight: a mortgage and real-estate investment company that offers "foreclosure rescue services."

The company, Platinum Investment Group, promised the Chicago couple a loan against their house so that they could pay off their mortgage and stay in their home. The Balderas, in their early 40s, signed on in April 2005 - only to find out soon afterwards that they had signed over their home to Platinum, which then sold it. Unable to keep paying "rent" to the company, they are now threatened with eviction. A lawyer representing Platinum didn't return requests for comment.

"It's a nightmare and we're reliving it every day," says Martha Balderas, who along with her husband have joined a growing number of homeowners to bring to state or federal authorities their complaints of fraud and deception by companies that engage in lending to financially distressed borrowers to avoid foreclosure.

Those complaints center on "foreclosure rescue" companies which target homeowners who are behind on their mortgage payments through newspaper ads or flyers claiming services such as "fast cash," "equity funding" and "no credit check." According to some recent cases filed by consumers and regulators, those companies misled borrowers into believing they can save their homes from foreclosure in exchange for a transfer of the title to their property for about a year or two.

At the same time, those companies promised the borrowers that they can stay in their homes by paying rent during that time. The pitch is to give them time to catch up financially until they can buy back their property. But in fact, often unknown to the borrowers, those companies sold their homes to outside investors, stripping out the home equity and leaving the borrowers on the verge of eviction.

"The number of complaints (about foreclosure fraud) is more than what we ever had before," says Thomas James, senior assistant attorney general in the Illinois Attorney General's consumer fraud bureau.

Adds Arizona Attorney General, Terry Goddard: "more and more, we're seeing some real sharks, pretending to be the homeowner's best friend, but what they are after is the equity in the house."

'More Targets' For Scams

Foreclosure fraud, involving dishonest businesses trying to take advantage of already vulnerable homeowners, has existed for a long time. But in recent years, experts and law enforcement officials say, those schemes have grown increasingly complex, with scam artists often eying the chunks of equity homeowners across the country amassed in their homes during the rapid housing-price appreciation from 2000 to 2005.

Even in places, notably the Midwest rust belt, where the growth in housing wealth hasn't been as strong as in areas such as Arizona, California and New York, there are still homeowners who have built up substantial equity in their homes by paying down their mortgages for years, making them also attractive targets for equity skimmers.

Now, the housing boom is fading and the number of past-due mortgage loans and foreclosures are climbing, in part because many borrowers are finding themselves struggling to pay off high-priced loans lenders churned out during the boom time. Online foreclosure-data service RealtyTrac, of Irvine, Calif., says more than one million borrowers have seen their properties put in foreclosure so far this year, up 27% from the same time last year.

"Because (American consumers) are stressed now more than ever before because of the debt load" associated with rising costs for housing, health care and education, "there are more targets (for foreclosure scams) than ever before," says Elizabeth Renuart, a staff attorney at the National

Consumer Law Center in Boston, who co-authored a report last year entitled Dreams Foreclosed: The Rampant Theft of Americans' Homes Through Equity-Stripping Foreclosure "Rescue" Scams.

Statistics on the exact number of foreclosure-fraud cases filed are hard to come by as they are usually broadly referred to as mortgage fraud - including defrauding of lenders as well as borrowers. The Federal Bureau of Investigation says that of the 818 pending mortgage-fraud cases as of September 30, 2006, about 37% involve individuals. Of those cases, more than half involve estimated losses in excess of \$1 million.

Using Suspicious Activity Reports filed with the Financial Criminal Enforcement Network, the FBI estimated that mortgage fraud in general led to over \$1 billion in losses in 2005, up from \$429 million a year earlier. "We're increasing our focus on mortgage fraud," says Bill Stern, a supervisory special agent and mortgage-fraud coordinator at FBI.

New Legislation

In response to the recent spike in foreclosure scams, some states have recently passed or are contemplating new laws to give homeowners more protection. Today, a total of 10 states have legislation in place to deter foreclosure-rescue fraud, including California, Georgia, Missouri, Minnesota, Maryland, Colorado, Rhode Island, New York, Ohio and Illinois, according to Creola Johnson, an associate law professor at Ohio State University. She also notes that because those statutes differ state by state, their effectiveness may differ, too.

A common feature among those laws is that they give homeowners the right to cancel the "rescue" transaction days before the closing. In addition, for instance, under the legislation passed in Illinois this year, if a company acquires any financial interest in a property in foreclosure and simultaneously leases it back to the homeowner and gives the owner the option to buy it back at a later date, the acquirer, in certain cases, must pay the homeowner at least 82% of the property's fair-market value at the closing of the purchase.

The goal of the payout requirements under the Illinois law, which goes into effect Jan. 1, is to ensure that distressed homeowners will receive a substantial and fair amount of home equity when entering into those lease-back transactions, while giving legitimate foreclosure purchasers a reasonable chance to profit.

The new legislation also covers so-called "foreclosure consultants." Another common type of consumer complaint involves those consultants - for an upfront fee - promising borrowers to negotiate with their lenders to postpone or avoid foreclosures but in fact failing to offer any meaningful help. Illinois and several other states forbid foreclosure consultants from charging an upfront fee before performing the agreed-upon services.

Tough Fight

Homeowners who find themselves duped into foreclosure scams often have a hard time recovering their losses, consumer lawyers say. For example, "state law may not protect consumers if their houses are sold to third parties" who claim unawareness of any alleged fraud, notes the National Consumer Law Center report on foreclosure fraud.

But an equity-skimming case filed by the Arizona attorney general's office could offer some hope to those fighting foreclosure-rescue fraud cases in court. At issue in its suit against Virtual Realty Funding Company, filed in June 2005, in Maricopa County Superior Court, are the "reverse sale" transactions characterized by the Chandler, Az., company and several other defendants.

In deals conducted between 2003 and last year, Virtual Realty provided funds to about 60 homeowners to bring their mortgages current. In return, they deeded their houses over to the company and rented them back for a period of 18 to 24 months, paying rent equal to their original mortgage payments plus an additional "monthly margin." The homeowners also had an option to regain their property title prior to the termination date - if they met all the conditions set by Virtual Realty.

But in some cases, those homeowners ended up missing their payments to Virtual Realty, therefore losing their right to repurchase the property and facing eviction as a renter, according to Bob Zumoff, the assistant attorney general handling the case.

"The 'reverse sale' transactions were in fact mortgage loans" and as a result, the homeowners who had entered into those deals should have been given more rights and protections than renters who fail to make rental payments, says Zumoff. The lawyer representing Virtual Realty didn't respond to a request for comment.

The judge in the case, Barry C. Schneider, in July ruled in favor of the government, saying the "defendants violated the consumer fraud act and the banking statutes." The attorney general's office is now in the process of identifying households defrauded by Virtual Realty to determine how much restitution to ask for.

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Community Groups Play Key Role In Preventing Foreclosures, Oct. 23

By Lingling Wei
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Mortgage lenders are finding themselves a strong ally in preventing foreclosures: community groups.

Consider East Side Organizing Project, a neighborhood organization founded in Cleveland more than a decade ago to focus on improving local schools. J. White, among hundreds of other local residents, also credits the group for preserving homeownership in the community by serving as a liaison between financially strained borrowers with their mortgage lenders.

White, 57 years old, turned to East Side a year ago as he was seeking help with negotiating with his lender about modifying the terms of an adjustable-rate loan that White says he and his wife were duped into by a mortgage broker. The Whites accepted the loan in 2003 out of the desire to lower their monthly payment and pay off other bills that had piled up since White lost his job a year earlier due to the shutdown of the commercial printing company for which he then worked.

Two years after the refinancing, however, the couple saw their mortgage payment almost double to \$2,035 a month. "We did a stupid thing by refinancing with the people we refinanced with and not recognizing the fact that we had an option to just get out of the chair and not take the loan," White says.

Facing the prospect of turning their house over to the lender, White and his wife contacted the Department of Housing and Urban Department, the local United Way, and then East Side. "They are very good at working out deals with lenders," White says of the neighborhood group. Under an agreement brokered by East Side recently, another lender came through for the couple, agreeing to loan them \$147,000 to pay off their existing \$167,000 mortgage, and the original lender agreed to waive the \$20,000 difference. The Whites got to keep their home.

Amid rising mortgage delinquencies and defaults, community groups like East Side, together with some nonprofit housing counselors, are becoming increasingly valuable to financially stressed homeowners to battle against foreclosure. A powerful tool in their arsenal, says Mark Seifert, executive director at East Side, is the fact that "contrary to the common myth, the lender loses, too, when someone goes to foreclosure."

A Federal Reserve study estimates that foreclosure can cost a lender anywhere between 30% and 60% of the outstanding loan balance due to legal fees, foregone interest and property expenses. Mike Fratantoni, a senior economist at the Mortgage Bankers Association, states: "Every party to a foreclosure loses - the borrower, the immediate community, the servicer, mortgage insurer and investor."

According to the industry group's analysis, three out of four borrowers who enter the foreclosure process leave it through something other than a forced foreclosure sale - whereby a lender repossess a borrower's house and sells it. It means that through lenders' "loss mitigation" efforts, they either pay off the arrears through agreed-upon payment plans with their lenders or sell their homes to avoid foreclosure and protect their credit ratings and their ability to borrow again.

But foreclosure prevention has proved challenging for both borrowers and lenders. To start with, delinquent borrowers may feel too tired of creditors to reach out to them, while lenders often find borrowers hard to reach. That's where community groups and nonprofit housing counselors come into play.

For instance, the East Side group, among a dozen other neighborhood organizations affiliated with the National Training and Information Center - known as NTIC - is able to help homeowners negotiate with lenders such as Citigroup Inc.'s (C) CitiFinancial, JPMorgan Chase & Co. (JPM), and Ocwen Financial Corp. (OCN) by tapping into the partnerships they have formed over the years with them. The partnerships call on the lenders to be committed to combating both predatory lending and foreclosure.

The forming of those pacts, however, has come a long way. "It's not in the corporate mindset to work with community groups," says David Rose, a director at the Chicago-based nonprofit community network NTIC. But more and more, he notes, lenders "see us as a bridge to reach out to their troubled customers as early as possible." When a lender calls a homeowner about a delinquent loan, Rose says, the homeowner may not call the lender back. "Borrowers don't see lenders as partner, but as somebody only trying to get money out of them."

That may explain why borrowers never contact their lenders in more than half of all foreclosure cases. A study conducted last year by Freddie Mac (FRE) and Roper Public Affairs and Media also found that nearly two-thirds of delinquent borrowers surveyed were not aware of lenders' "workout options" designed to avoid foreclosure. Among the common options are forbearance - which temporarily delays or reduces payments, and loan modifications - which means changing the payment terms for a fixed period.

If the borrowers knew about those options, "they would be more willing to work with servicers," says Bill Merrill, director of default asset management at Freddie Mac. Other reasons cited by troubled borrowers for not contacting lenders included "embarrassment," "fear" or "not knowing whom to call."

The survey results, mortgage-industry executives say, serve as a reminder to lenders of the need to strengthen their borrower outreach and education programs - especially at a time when national delinquency and foreclosure rates, though still historically low, are creeping up from their year-ago levels.

"We're working to move that contact much earlier," Donna Sheline, head of JPMorgan Chase's homeownership preservation office, says of the contact between lenders and delinquent borrowers. "The earlier the detection," she says, "the easier the prevention" of foreclosures.

A recent report by RealtyTrac, an Irvine, Calif., company that tracks foreclosure properties, showed that nationwide, there was one new foreclosure filing for every 1,030 households in September. It projected that more than one million borrowers would see their properties put in foreclosure by the end of the year. The Midwest rust belt, in particular, boasts the highest foreclosure rates due to the loss of manufacturing jobs in recent years.

In addition to partnering with community groups, a growing number of mortgage lenders are also embracing the idea of appointing a senior executive as an "ombudsman," whose job is to listen to customers' complaints and make recommendations to senior management as to how to resolve the disputes. Furthermore, more mortgage companies such as Freddie Mac and GMAC's residential-mortgage arm, ResCap, are sponsoring outside housing counselors to offer free foreclosure-prevention and financial counseling to borrowers.

Latisha Carlisle, an Oakland, Calif.-based housing counselor at NID-HCA, a community-based counselor network, says lenders have become "more receptive" in terms of working with housing counselors. "They realized that we're not trying to get into a blame game for why the borrower enters foreclosure," she says. "We are able to realistically discuss the potential workout solutions for the borrower."

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TALES OF THE TAPE: Subprime Mortgage Lenders A Hard Sell, Dec. 4

By Lingling Wei
A Dow Jones Newswires Column

NEW YORK (Dow Jones)--More subprime mortgage lenders are putting themselves up for sale, but those on the prowl for acquisitions are becoming increasingly selective.

In recent months, higher funding costs, weakening loan demand and rising delinquencies have driven a steady stream of lenders to look for the exit. At the same time, acquirers are becoming more vigilant in what they are taking on. That has led some lenders to sell their operations in pieces rather than as a whole, and others - especially the smaller ones - to opt to close shop without a buyer.

"When you have a period of consolidation, where a lot of companies are exploring opportunities to sell, what the buyers are particularly interested in are niche, scale, or a proven management team or business model and not every company is going to be able to offer that," says Jeffrey M. Levine, a managing director at Milestone Advisors LLC., a leading merger-and-acquisition adviser for mortgage-finance companies. He declines to comment on any specific transactions or clients the firm advises.

Those looking to sell include H&R Block Inc. (HRB), which announced in November its decision to explore a sale of its subprime unit, Option One Mortgage Corp. And ACC Capital Holdings Corp., a privately-held company in Orange, Calif., has hired investment bankers to solicit bids for its subprime unit, Ameriquest Mortgage Co., according to a person familiar with the matter.

Wall Street firms like Morgan Stanley (MS), Merrill Lynch & Co. (MER) and Bear Stearns Cos. (BSC) have so far led the charge in snapping up subprime lenders. The investment banks have made a lucrative business out of packaging pools of mortgage loans into bonds and selling them to investors. But it has become harder for them to access those loans as higher interest rates have damped new borrowing and shrunk loan supplies. As a result, many firms have turned to buying lenders so they can generate their own mortgages to feed their securitization business.

Buyers Cherry-Picking

Despite the strong interest from Wall Street, some industry experts say, potential buyers, also including private-equity firms, are getting careful not to inherit from the subprime sellers the costly obligation of having to buy back the loans already sold in the secondary market due to borrowers' failure to make their first few payments on those loans.

As the housing boom fades, more mortgage loans are defaulting early due to reasons including lax underwriting standards and more instances of loans obtained through fraud. And a recent outburst in the repurchases of defaulted loans forced by whole-loan acquirers have led some lenders to incur big losses and set aside more money in their reserve funds for potential loan buybacks in the future.

Brenda White, head of Deloitte & Touche USA's financial-services investment banking practice, says "the buyers are trying to figure out how to structure the deals in a way that they can avoid the liabilities they may encounter in the future due to (loan) repurchase requests and regulatory issues."

For instance, to beef up its mortgage business, Bear Stearns agreed in October to acquire for \$26 million certain operating assets from ECC Capital Corp.'s (ECR) wholesale subprime mortgage unit, including its property and customer lists. Under the agreement, ECC, an Irvine, Calif., real-estate investment trust that makes and buys residential mortgages, will retain, among others, "loan repurchase obligations" arising from the subprime unit. Upon the completion of the transaction, expected to close by year end, ECC will exit the business of lending to subprime borrowers through mortgage brokers.

The company "is continuing to explore strategic alternatives" including the sale of its remaining assets "to provide additional distributions to stockholders and satisfy its remaining liabilities," President and Co-Chief Executive Shabi Asghar said in a press release announcing the deal with Bear Stearns.

Falling Price-to-Book

Meanwhile, Midwest bank KeyCorp (KEY) also announced that it is disposing of its subprime lending unit, Champion Mortgage, in pieces rather than as a whole. The Cleveland-based bank said on Friday it sold the division's roughly \$2.5 billion worth of loan portfolio to HSBC Finance Corp., the U.S. consumer-finance arm of HSBC Holdings PLC (HBC).

Separately, KeyCorp is selling the unit's mortgage-origination infrastructure to a unit of hedge fund Fortress Investment Group LLC. The companies didn't disclose the terms of either transaction.

KeyCorp acquired Champion in 1997 for about \$200 million. Analysts at Friedman Billings Ramsey put the price on the unit's origination platform at \$130 million, "far below" the \$200 million to \$250 million they had expected. A KeyCorp spokeswoman said "the deals generated the best price for both the portfolio and the platform."

Among other recent deals involving Wall Street firms acquiring subprime lenders: Morgan Stanley agreed to buy Saxon Capital Inc. for \$706 million; Merrill Lynch agreed to purchase National City Corp.'s subprime lending unit for \$1.3 billion. Steve Duong, associate director of research firm SNL Financial's financial institutions group, estimates that the median deal value this year represents about 120% of book value, down from last year's median price-to-book value of about 440%.

Dress Up For Sale

Industry executives and investors also note that some subprime lenders are making loans at rates that are intended to attract volumes in order to dress up for sale. "Credit has suffered because of this," says Alan Fournier, who runs Pennant Capital Management LLC, a Chatham, N.J., hedge fund with more than \$1 billion under management. Driven by the deteriorating credit quality and rising losses, he says, "everybody is for sale at the right price today."

But not everybody on the block has the luck to find an acquirer. NetBank Inc., for example, recently shut down its subprime mortgage division without a buyer. For the first three quarters of this year, the unit posted on average \$5 million in operating losses each quarter. The Atlanta company reached a "personnel placement" deal with another mortgage lender under which the lender, Lime Financial Services in Portland, Oregon, agreed to take over the majority of NetBank's subprime mortgage sales force and other employees at the unit.

NetBank, which is refocusing on banking and prime mortgages, didn't receive any material financial or other considerations under the agreement. "Rather than continue to lose money while looking for a buyer (for the subprime unit), it makes more sense for us to exit the business," a NetBank spokesman said.

(Lingling Wei covers mortgage-finance companies for Dow Jones Newswires.)

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TALES OF THE TAPE: WaMu's New Strategy Ups Credit Risk, Sept. 28

By Lingling Wei
Of DOW JONES NEWSWIREs

NEW YORK (Dow Jones)--Washington Mutual Inc.'s (WM) efforts to spice up its home-loan business raise the question of whether the company is trading interest-rate risk for too much credit risk.

In recent months, the nation's largest thrift has moved further away from making government-insured and fixed-rate home loans while focusing more on what it calls "higher-margin" products - such as option adjustable-rate mortgages, home-equity loans and subprime mortgages.

WaMu's cutback on the low-yielding conventional mortgages, notably its recent sale to Wells Fargo & Co. (WFC) a large chunk of assets associated with servicing those loans, can help reduce its exposure to market-rate fluctuations. The alternative products it is now committed to promise greater profit opportunities - but at the same time, they also pose a bigger risk of loss stemming from potential borrower defaults.

The rejigging of product-mix comes as industry competition has squeezed much of the opportunity to make money on traditional 30-year, fixed-rate mortgages. Meanwhile, with a cooling housing market and a decline in home-loan demand, lenders like WaMu can't count on

the volume to make up for the low margin, making such commoditized products even less appealing to a lender in pursuit of earnings growth.

WaMu's restructuring of its home-loan group, which also involved job cuts, is part of its overall strategy aimed at achieving a return on equity in the "high teens" and "double-digit" earnings-per-share growth for the period from 2005-2009. So far, it has realized its target for earnings growth but fallen short of its return-on-equity goal.

The company has in general reduced its reliance on the home-lending business. It has bulked up its retail-banking operations, which now account for about two-thirds of its profit, and ventured into credit-card services with its \$6 billion acquisition in October of credit-card issuer Provident Financial Corp. And as it is becoming more like a diversified bank than a thrift, WaMu has drawn executives from firms like General Electric Co.'s (GE) GE Capital, JPMorgan Chase & Co. (JPM) and Citigroup Inc.'s (C) CitiMortgage to lead its management team.

Diversification Raises Concerns

With the reorganization of the home-loan unit, home-equity loans now represent about 15% of its total assets, compared with 5% at the end of 1999. Those loans, which consumers often take out to fund their children's education or home remodeling, are expected to reach as much as 20% of the total assets in the future. Subprime mortgages now make up 6%, up from 2%, and would grow further to account for 10% of the assets. In the meantime, the share of prime single-family mortgages and mortgage-backed securities has dropped to 44% from 76%, and would decline even more to represent as low as 25% of the assets.

However, the move by WaMu - the third-largest U.S. mortgage lender after Countrywide Financial Corp. (CFC) and Wells Fargo - toward the dicier type of home loan also comes amid a growing sense of uneasiness about the economy and consumer stress, leading to concerns over its ability to handle the heightened credit risk related to those higher-margin products.

To be sure, like any of the top banks the thrift desires to be, WaMu can manage such a risk through the use of funds to reserve for potential loan losses. Recognizing its shift in risk profile - namely greater credit risk associated with higher-yielding loans - as well as its outlook for the economy and the housing market, WaMu recently forecasted that its overall provision for loan and credit-card losses next year would reach between \$850 million and \$950 million, up from \$650 million to \$750 million projected for this year.

Risk Strategy

However, it has yet to convince Wall Street that the strategy will work if consumers face greater financial distress over the next 12 to 18 months, as believed by many economists and analysts. Shares in the Seattle company, having been battered in the past by interest-rate shocks, have barely budged so far this year. The stock closed Wednesday at \$43.40 in the New York Stock Exchange composite trading. By comparison, the index of 174 thrifts in the U.S., compiled by research firm SNL Financial, has been up 6.84% year-to-date.

According to John McCune, director of SNL's financial institution group, WaMu is trading at 10.7 times its estimated earnings for the next 12 months, while its peers - mainly the large thrifts on the West Coast - are trading at an average of 11.6 times forward 12-month earnings.

"The mortgage products being emphasized by WaMu have untested risks that must be qualified before the stock can be bought," notes analyst Dick Bove at Punk, Ziegel & Co., adding: "if they

are right, meaning they go through the credit cycle without major losses, I'm going to buy the stock hand over fist."

The biggest worries involve option ARMs, which allow borrowers to lower their monthly tabs in the early years of the loan but can lead to a rising loan balance. Option ARMs accounted for about 26% of WaMu's home-loan volume in the second quarter. As many of those loans issued in previous years will start to be reset soon, there is a growing fear that some borrowers - especially those who haven't had a chance to build up equity in their homes - may not be able to afford higher payments, resulting in credit losses for the lender.

In a presentation early this month to investors, WaMu executives sought to calm the fears by highlighting the company's more than two decades of experience with option ARMs, its underwriting criteria and proactive programs aimed at educating borrowers on the risks of the complex loans. WaMu doesn't make option ARMs to borrowers with poor credit.

In addition, they pointed out that instead of keeping those loans on its own book and assuming the associated risk, WaMu has sold in the secondary market 71% - or \$59.5 billion - of its option-ARM production since last year, thanks to the strong demand for such loans from yield-hunting institutional investors. So far, the credit performance of the company's option-ARM portfolio has been "in line with expectations," Chief Executive Kerry Killinger said in an interview following the presentation.

An external factor that would work in favor of lenders like WaMu is a potential full halt by the Federal Reserve in interest-rate hikes after its two-year rate-raising campaign to contain inflation.

If rates stabilize as expected, WaMu will be able to see "a nice (net interest) margin expansion" on its adjustable-rate home loans, which adjust to current market rates more slowly than the lender's funding sources, says Chad Yonker, chairman and chief investment officer at hedge fund Litchfield Capital Management. "The margin expansion can offset" the potential credit losses on those higher-yielding loans, he says.

The Litchfield, Conn., fund, which mainly invests in financial-services firms, currently doesn't own WaMu stock. "We're looking at it," Yonker says. "It's pretty cheap."

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