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Unwary borrowers snared in U.S. housing "bloodbath"

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By Emily Kaiser

CHICAGO (Reuters) - Renae Gorney sees the human side of the slumping U.S. housing market, the people whose homes are part of the $1 trillion worth of unconventional mortgages that are about to get more expensive.

Gorney, director of loss mitigation at Freedom Foreclosure Prevention Services in Mesa, Arizona, receives more than 300 applications a month from people facing foreclosure, and has little faith in forecasters who say the worst of the housing market downturn is over.

"It's going to be a bloodbath this year," she said.

Many of her clients -- homeowners who come for help renegotiating mortgage terms or to work out deals to avoid foreclosure -- have adjustable-rate mortgages that initially carried lower interest rates but will soon spike up.

The Mortgage Bankers Association estimates that between $1 trillion and $1.5 trillion in adjustable-rate mortgages face an interest rate reset this year.

As the housing market cools and homeowners have trouble refinancing or selling, more people are falling behind on mortgage payments. The delinquency rate for all types of mortgages rose to 4.67 percent in the third quarter of 2006 from 4.39 percent in the prior three months, a gain of 6 percent, according to the Mortgage Bankers Association.

Foreclosures last year were up 42 percent from 2005 levels, and will likely rise another 20 percent to 25 percent this year, real estate information service RealtyTrac Inc. says.

NEW CENTURY, NEW PAIN

A jittery Wall Street has focused on the subprime mortgage sector, which lends money to people with poor credit histories. One such mortgage company, New Century Financial Corp., has said its lenders plan to halt the financing it may need to fund its operations, as bad loans keep piling up.

While subprime mortgages have spread credit more widely and helped more people buy their own homes, critics contend a hot real estate market encouraged lenders to get more aggressive and offer increasingly complicated terms that borrowers did not always fully understand.

Housing has always been an integral part of the U.S. economy, but it has taken on greater significance in recent years as many consumers took out home equity loans and ramped up their spending.

Some economists worry that as house prices fall and lenders tighten credit terms, consumers will curb spending and drag down the U.S. economy.

Christopher Cagan, director of research and analytics at First American CoreLogic, estimates that adjustable-rate mortgage resets will trigger some 1.1 million foreclosures over the next 5 or 6 years, wiping out $110 billion in equity.

That may sound like a lot, but Cagan does not believe the fallout will tank the $13 trillion U.S. economy or even the mortgage industry.

"It's less than we spend on alcoholic beverages," he said.

Bill Rayburn, chairman and chief executive of FNC Inc., which provides collateral data to banks, said lenders are increasingly eager for information to help them value homes for both loans and foreclosures.

"Our phones are ringing off the hook," he said.

Rayburn, whose firm takes data from home appraisers to help banks process information for some 400,000 loans a month, said bankers "are in bunker mentality" as the housing market slumps, and desperate for details such as whether they can quickly resell a foreclosed home.

SIGN, SIGN, SIGN

Lack of information is a big part of the problem for borrowers, said Freedom Foreclosure Prevention's Gorney. She says "99.99 percent of people just sign, sign, sign" without fully understanding mortgage terms.

Some of her clients had borrowed 100 percent of the purchase price on homes that are now worth less than the mortgage. She has referred a few to attorneys general to investigate whether they fell victim to fraudulent lenders.

"They've been sold the American dream and now there is no way to go forward," she said.

She talks of clients who signed blank loan documents and later discovered that they had agreed to interest rates as high as 10 percent. Others learned of high rates when it was too late to do much about it -- their belongings were on a moving truck in the parking lot while they signed the documents to close on a new house.

Malachi Cade, one of Gorney's clients in Monroe, Louisiana, said he didn't realize that he was late on his mortgage payment until the bank mailed back his check. When he called to find out why, they told him he was four or five months behind and they had started foreclosure procedures.

He's still not exactly sure what happened.

As the number of homeowners in financial distress soars, Gorney said banks are increasingly willing to consider alternatives that may be cheaper and faster than foreclosure.

Some troubled homeowners are turning over deeds in exchange for banks ripping up mortgages, a practice called "deed in lieu" of foreclosure. It damages credit ratings, but not as severely as a foreclosure would.

Even with those tools available, Gorney rejects nearly half of the applications she receives from homeowners looking for a way to avoid foreclosure because there is simply nothing she can do to help them.

Despite such problems, Rick Sharga at RealtyTrac said subprime mortgages aren't bad. It was more a matter of bad timing.

"We wouldn't be having this discussion if the real estate market was still booming," he said.