

THE PROPERTY REPORT

Speculators May Have Accelerated Housing Downturn

Rising Number of Defaults Also Could Complicate Effort to Help Homeowners

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As lenders pore over their defaulted mortgages, they are learning that the number of people who bought homes as investments is much greater than previously believed.

Such borrowers turn up frequently in analyses of loans that defaulted within months after origination. In many cases, these speculators lied on loan applications, saying they intended to live in the homes in order to obtain more favorable loan terms or failed to provide the requested information.

Roughly 20% of mortgage fraud involved "occupancy fraud," or borrowers falsely claiming they intended to live in a property, according to an analysis by BasePoint Analytics, a provider of fraud-detection solutions in Carlsbad, Calif. Another study, by Fitch Ratings, looked at 45 subprime loans that defaulted within the first 12 months even though the borrowers had good credit scores. In two-thirds of the cases, borrowers said they intended to live in the property but never moved in.

Some home builders have come to similar conclusions: They now believe that as many as one in four home buy-

ers in some markets were investors during the boom, up from their earlier estimates of one in 10 buyers.

The high number of hidden speculators helps explain some of the problems roiling the housing and mortgage markets. The loans backing these speculator purchases turned out to be riskier than ratings agencies and investors who bought mortgage-backed securities once thought. Investors tend to be more likely than borrowers who live in the homes to walk away from their purchases when home prices fall. "We couldn't understand what was driving so many borrowers to default so early in the life of their mortgage," said Glenn Costello, a managing director at Fitch.

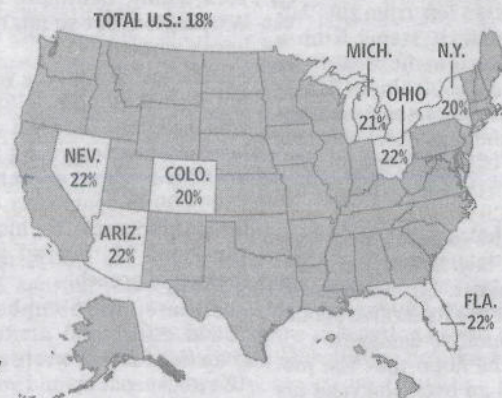
Much of the occupancy fraud was concentrated in markets such as Florida, Nevada and Arizona, where prices were appreciating by double-digit percentages annually, said Kevin Kanouff, president of Denver-based Clayton Fixed-Income Services, a unit of Clayton Holdings Inc. that reviews about seven million loans a month on behalf of investors.

In Las Vegas, as many as 60% of the foreclosures last year involved non-owner-occupied homes, according to Applied Analysis, a real-estate-research firm. The Las Vegas firm compared the addresses of the borrowers with the locations of their homes. Where the addresses didn't match likely indicated a speculator.

The temptation to lie can be sub-

Hidden Speculators

The increase in the number of people buying houses as investments helped to worsen the mortgage crisis in some areas. States with the highest share of non-owner-occupied foreclosures*, as a percentage of all loans, based on the number of loans:



*Started during the third quarter of 2007
Source: Mortgage Bankers Association

stantial and may have been encouraged, or at least tolerated, by mortgage brokers and real-estate agents eager to close a home sale. Standards tend to be tougher for borrowers purchasing investment properties, since these loans are considered riskier.

Lenders typically allowed investors to finance no more than 90% of a home's value, but if borrowers said they planned to live in the property, they could buy a home with no money down, even if they had scuffed credit and didn't document their income, said Pete Ogilvie, a mortgage broker in Santa Cruz, Calif., and president of the California Association of Mortgage Brokers.

In the early years of the housing boom, demand for homes rose be-

cause of strong economic fundamentals and low interest rates, which made it more affordable for a large swath of Americans to buy homes. But as home prices began to soar, hordes of investors jumped in.

Once there was a whiff that prices could no longer rise, this speculative demand evaporated, sending prices falling in some markets. The housing boom would eventually have cooled, anyway, but investors amplified the boom and bust.

Rising defaults among speculators may complicate government efforts to assist home buyers. The Bush administration has said it wants to help only homeowners facing foreclosure, not speculators. But foreclosures of investor-owned properties can create rip-

ple effects in neighborhoods, pushing down prices and making it tougher for people who live in those communities to refinance or sell their homes if they can't make their mortgage payments.

Lenders and builders said they tried to weed out speculators during the boom. To discourage flipping, some builders put clauses into contracts stating that investors who resold their homes soon after they bought had to give up some of their profits.

"We had people at the end signing four-page documents, 'I am not an investor. I am not an investor. I am not an investor,'" Robert Toll, chief executive of luxury builder Toll Brothers Inc., said at a UBS AG conference in 2006. And the person "turned out to be an investor, of course."

While it is true that occupancy fraud can sometimes be difficult to detect, fraud experts said lenders and builders could have vetted their borrowers more closely. Pulling a borrower's credit report, for instance, may reveal multiple mortgages. In other cases, appraisal reports will sometimes indicate that a tenant lives in the property, and Internet searches can also turn up indications that a borrower owns multiple homes.

"There's a lot of telltale signs," said Frank McKenna, chief fraud strategist for BasePoint, which develops computerized fraud-detection tools. But "the industry was very focused on volume," he said.