

**THE TICKING TIME BOMB:
Adjustable Rate Mortgages
and
Depreciating Home Values
in New Subdivisions**

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The Alliance for Homebuyer Justice,
a Project of the
Laborers International Union of North America

LIUNA!

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THIS REPORT EXAMINES the mortgages made in 2005 and 2006 in Maricopa County, Arizona by the lending subsidiaries of three of the nation's largest home builders: Richmond American, Lennar, and KB Home.

We found that **more than one third of all the mortgages were Adjustable Rate Mortgages (ARMs) that will reset in 2010 and 2011.**

Homebuilders and their lending subsidiaries made these five-year ARM's assuming that homeowners would refinance before the rate resets. However, as the report shows, many of these homeowners will be trapped into their loans and not able to refinance due to their high loan amounts and their decreasing home values.

- Half of the mortgages made were 80/20 loan combinations, in which there is a first mortgage for 80% of the sale price and a second mortgage, also known as a piggy-back loan, for 20% of the price of the home.
- Home values have declined an average of more than \$50,000 just in the last year (Lennar homes decreased an average of \$61,600, KB Homes decreased by \$55,600, and Richmond American homes decreased by \$49,500.)

While these problems are not limited to new subdivisions, the concentration of homeowners who face this situation threatens entire communities. The report looks specifically at one such community, the Santarra subdivision in Buckeye which was developed by KB Homes. In the Santarra development in Buckeye, AZ:

- Fifty-five percent of the mortgages are five year ARM's
- Sixty-three percent of the purchases had a first and second mortgage
- Home values have decreased \$78,800 just in the last year

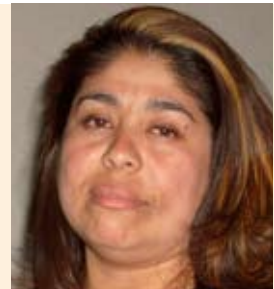
Many new subdivisions already have an unhealthy number of vacant homes due to foreclosures and speculators who purchased homes intending to resell them. This glut of homes has been exerting a downward pressure on home values, and each new foreclosure brings home values down even further. In May 2008, 1 out of 150 homes in Maricopa County were in foreclosure.¹ As shown in this report, the housing downturn and soaring foreclosure rates so far may just be a preview of the real catastrophe in 2010 and 2011 when the largest number of home loan interest rates will reset.

ROSA GARCIA IS A SINGLE MOTHER. She sold her home in Phoenix because she wanted to move to a safer area. She bought a KB home in Buckeye for \$231,900 in 2006. She put down \$23,300, 10% of the purchase price, and received a first and second mortgage from Countrywide KB for the remaining \$208,600.

The first mortgage is an interest-only loan at 7.5%. The second mortgage is at a variable rate which changes monthly, and has been over 10%.

Ms. Garcia's mortgage problems began when Ms. Garcia had to pay Countrywide over \$300 more a month for her property tax escrow, due to the reassessment of her property value as normally happens with new construction.

Now Ms. Garcia is behind on her mortgages and facing foreclosure. Her home has gone down drastically in value. Maricopa County lowered the assessed value from \$213,000 to \$145,800 in just one year. So not only has she lost the \$23,300 she put down, but the \$208,000 she owes on her mortgages are much more than her house is worth.



Homeowners in new developments have been especially hard hit by the current housing crisis, and the worst is yet to come. New subdivisions are in a unique situation because unlike older existing neighborhoods where there is a mix of homeowners with recent mortgage and those who have had their mortgages for a longer period of time, new developments have a concentration of homeowners who purchased their homes within a year or two of each other.

Most large home builders have their own mortgage subsidiaries to which they steer the vast majority of their homebuyers. At the height of the housing boom in 2005 and 2006, homebuilders were increasingly relying on predatory and risky mortgage products such as those with negative amortization, loans requiring only stated income, or piggy-back loans with high-cost second mortgages, in order to qualify customers for houses which were sold at what are now clearly inflated prices.

As a result, there is a convergence in new subdivisions of three factors:

1. Many of the homeowners borrowed the full, or close to full, price of their home
2. A large number of homeowners have Adjustable Rate Mortgages (ARMs)
3. Home values have plummeted dramatically.

While each of these is significant by itself, together the three are a dangerous combination. It means that a significant percentage of the homeowners in new subdivisions are trapped and cannot refinance to avoid their resetting ARM.

Although this problem is not limited to new subdivisions, the concentration of homeowners who face this situation threatens to destroy entire communities.

Many new subdivisions already have an unhealthy number of vacant homes due to foreclosures and speculators who purchased homes intending to flip them. This glut of homes has been exerting a downward pressure on home values, and each new foreclosure brings values down even further.

Nationally, public attention has been focused mostly on two-year ARMs whose rates have already reset or will soon. The homebuilders' mortgage operations made some two-year ARMs, but the majority of their ARMs have fixed interest rates for the first five years.

Given the large number of new homes sold, and new loans originated, by homebuilders in 2005 and 2006, and the inability of homeowners to refinance these loans due to the dramatic decrease in home values, the stage is set for an explosion of resetting ARMS in 2010 and 2011.

This report examines the mortgage lending of three of the largest builders in the country, Lennar, Richmond American, and KB Homes, in 2005 and 2006 in Maricopa County, Arizona. Maricopa County exemplifies the housing boom, bubble, and bust that has occurred in the last eight years. According to the U.S. Census Bureau, Maricopa County had the largest population growth in the country every year this decade, with almost a million new residents moving there since 2000.

Part I

Current Outlook: Residential Construction in the United States

BETWEEN 2003 AND 2006, 6.27 million new single-family homes were built, peaking with 1.68 million homes in 2005 as homebuilders raced not only to feed consumer demand, but also the demand of speculators who were betting on ever rising housing costs, and the demands of Wall Street, which rewarded ever-increasing sales and as has now come to light, irresponsible lending. These factors helped create and reinforce an artificial, weak and inflated market.²

With the nation's for-sale housing inventory now at almost 5.5 million homes and new homes constituting about 11 percent of that amount, housing starts have decreased 25.2 percent from 2006 and 33.5 percent from 2005. New home sales have decreased by similar percentages during this time.^{3,4}

Forty percent of the new homes built in the last two years were constructed by the largest corporate home builders, with each adding tens of thousands of homes each year. Despite their contribution to the market crash, builders reaped enormous profits. In 2006, the top 10 builders alone made \$16 billion in profits on \$100 billion in revenues.

Top 10 Home Builders 2006⁵

Rank	Company	Total Closings 2006	Total Revenue 2006 (\$ millions)
1	D.R. Horton	53,410	15,016
2	Lennar Corp	49,568	16,267
3	Pulte Homes	41,487	14,274
4	Centex Corp	37,539	14,400
5	KB Home	31,124	11,004
6	Hovananian Enterprises	20,201	7,016
7	Beazer Homes USA	17,500	5,159
8	The Ryland Group	15,392	4,757
9	NVR/Ryan Homes	15,139	6,134
10	MDC/Richmond American	13,123	4,802

Homebuilders and the Housing Crisis

Most large builders have their own mortgage subsidiaries which provide the financing for up to 90% of their homebuyers. Builders steer homebuyers to their in-house mortgage units in order to control the buying process and ensure that they are able to sell their homes at a higher price than might be the case if there were the involvement of third party lenders.

The homebuilders' mortgage lending was a key factor in how the builders contributed to the current housing and foreclosure crisis.

The exponential increase in homebuilders' origination of subprime and exotic loans enabled builders to continue to sell homes even after markets were overbuilt. The chief lobbying organization for corporate builders, the National Association of Home Builders, acknowledges that builders continued to flood the market with new construction, even when it became clear that demand for new homes was slowing down.

*"Economists were starting to say this is a cyclical business and we are going to get into a downturn. But some guys were chasing the gold and pursuing the brass ring, and they didn't heed the market warnings as quickly as they should have."*⁶

Subprime Mortgages

Nationally, big home builders became increasingly reliant on the use of higher cost subprime mortgages in order to sell their homes. In 2006 subprime loans made up a much greater percentage of the total loans originated by the builders than in 2005.⁷

Percentage of Home Purchase Mortgages That Are High Cost/Subprime*

Lender/Builder	2005	2006	% Change
DHI Mortgage (DR Horton)	16.2%	21.6%	33.3%
HomeAmerican (Richmond American/MDC)	7.3%	18.5%	153.6%
Hovnanian	14.8%	20.0%	35.2%
KB/Countrywide KB	18.1%	27.7%	52.8%
NVR (Ryan)	5.4%	11.2%	108.8%
Pulte	6.8%	10.4%	51.9%
Ryland	12.8%	16.3%	27.1%
Universal American (Lennar)	9.6%	22.7%	136.1%

* First and second lien mortgages

In fact, from 2005 to 2006 the largest home builders had a much greater percentage increase in the number of subprime loans they issued than prime loans. For instance, the number of subprime mortgages originated by homebuilder giants Lennar, Richmond American, and Ryan more than doubled from 2005 to 2006 while their prime mortgage originations remained the same or decreased.

Home Purchase Mortgages*

Lender/Builder	Prime Loans			Subprime Loans		
	2005	2006	% Change	2005	2006	% Change
DHI Mortgage (DR Horton)	34,339	38,632	12.5%	6,651	10,644	60.0%
HomeAmerican (Richmond American/MDC)	9,465	9,809	3.6%	746	2,233	199.3%
Hovnanian	5,098	6,830	34.0%	885	1,706	92.8%
KB/Country-wide KB	5,309	15,500	230.6%	1,175	5,934	405.0%
NVR (Ryan)	6,832	7,417	8.6%	387	935	141.6%
Pulte	27,539	27,784	1.0%	2,016	3,212	59.3%
Ryland	10,939	9,942	-9.1%	1,604	1,930	20.3%
Universal American (Lennar)	21,843	20,368	-6.75%	2,321	5,978	157.6%

* First and second lien mortgages

Piggyback Mortgages

Between a third and a half of the mortgages made by most of the big builders in 2006 also had a second mortgage. These were almost always done as 80/20 loan combinations, in which the builder gave the homebuyer a first mortgage for 80% off the home's value and a second mortgage for 20% of the value, also known as piggyback mortgages.

Percentage of Mortgages with a Piggyback, 2006

DHI Mortgage (DR Horton)	48.1%
HomeAmerican (Richmond American/MDC)	58.8%
Hovnanian	38.8%
KB/Country-wide KB	37.5%
NVR (Ryan)	19.3%
Pulte	29.4%
Ryland	44.3%
Universal American (Lennar)	34.6%

The large number of homebuyers who were given a first and second mortgage is significant not only because it means these homebuyers are in a negative equity situation, but also because the majority of second mortgages made by these builders were subprime loans with high interest rates. Even many homebuyers with prime first mortgages received second mortgages with subprime rates.

Percentage of Second Lien Purchase Mortgages that are Subprime, 2006

DHI Mortgage (DR Horton)	44.6%
HomeAmerican (RichmondAmerican/MDC)	40.8%
Hovnanian	35.9%
KB/Country-wide KB	44.0%
NVR (Ryan)	44.2%
Pulte	36.2%
Ryland	38.3%
Universal American (Lennar)	61.4%

Builders also did little to curtail speculative investors.

The massive amount of speculative purchasing raised overall housing prices, resulting in greater profits for builders and greater reliance on subprime and risky mortgages—as well as rising costs for buyers. “We now find out in hindsight [the speculative building] played an important role and a very dangerous role,” the NAHB said regarding speculators. “For the first time that I can remember, you saw investors coming into the housing market and trying to play it almost like a day stock.”⁸

In major markets like Phoenix, Fort Lauderdale, and Las Vegas, almost one in six houses were purchased by investors.⁹ From late 2003 to the first part of 2005, speculators drove up Las Vegas new home prices by 40 to 50 percent, and in some communities nearly half of sales went to speculators.¹⁰

Top 5 Markets with the Most Speculative Activity¹¹

Phoenix-Mesa, Arizona	17.1%
Fort Lauderdale, Florida	17.0%
Sacramento, California	16.4%
Las Vegas, Nevada	16.0%
Miami, Florida	15.3%

The result of investors being given free reign would later be that entire communities of homeowners—who played no part in creating the current crisis other than seeking their American Dream—are suffering the consequences.

How Mortgage Subsidiaries Helped Home Builders

There are two specific ways that builders were able to sell their homes. The first is the process by which the homebuyer is steered to the builder's mortgage company, and the second is the appraisal process that the builders' mortgage company uses to be able to make the loan.

Steering/Capture rate

Builders steer homebuyers to their in-house mortgage units in order to control the buying process and ensure that they are able to sell their homes at a higher price than might be the case if there were the involvement of third party lenders. Builders measure their success in this through their "capture rate"—the percentage of their homebuyers who obtain financing through the builder's mortgage subsidiary.

Homebuilder Mortgage Capture Rate, 2006

D.R. Horton ¹²	68%
KB/Countrywide KB ¹³	57%
Lennar ¹⁴	66%
Pulte ¹⁵	91%
Richmond American ¹⁶	76%

The high capture rates show that builders have figured out how to get the large majority of their customers to use their own mortgages services. Many homebuyers choose the builder's mortgage company without a comparison of costs. Builders steer their customers to their mortgage company through a combination of the carrot and stick.

Builders commonly offer incentives that are only available to homebuyers using their services. One of the most common incentives is that the builder will pay the closing costs if the buyer uses the builder's mortgage company.

The effect is that many homebuyers automatically think that the savings on closing costs is the best deal they could get so they don't bother to comparison shop with other mortgage companies who might be able to offer a better rate or type of loan.

One homebuyer's experience presents a vivid example. Here, the buyers report that the builder steered them away from much better mortgage products towards a more costly product.

Troy Monson was in the Air Force. When he and his wife Jennifer went to purchase their home from Lennar in Arizona, they wanted to use his Veterans Administration certificate. However, the Lennar salesperson convinced them to get a loan through Lennar's mortgage company instead.



According to the Monsons, the salesperson lied and told them they could only use their VA certificate one time and that they should save it for the future. The salesperson also said that if they got financing through Lennar's mortgage company, Universal Mortgage, that Lennar would pay the closing costs.

With a VA loan the borrower can get 100% financing. The Monsons had excellent credit and should have qualified for the market rate, which at the time they got their loans in July 2006 was under 6%. Instead however, Universal gave them a first mortgage for \$169,000, which is an interest-only ARM that starts at 7.25% and can go as high as 12.25%, and a second mortgage for \$42,400 with a variable rate that started at 8.625%.

Appraisals

A lawsuit filed in 2007 in California alleged that KB Homes and Countrywide KB Home Loans—a joint venture between Countrywide and KB—conspired with appraisers to inflate home prices.

And the buyers' report below, from Buckeye, Arizona, is another example of inflated appraisals.

Mr. and Mrs. Johnson wanted to buy a KB home that was priced at about \$394,000.

They applied for a loan through their Credit Union, which denied the loan because their appraisal said the house was worth only \$351,000. The Credit Union's appraisers refused to use two of the sales that KB had submitted as comparables because the properties had gross living area more than twenty percent higher than the subject property. The appraiser noted that "[T]he inclusion of either or both of these sales...would be inappropriate and may give the impression that the appraisal's purpose was to target a predetermined value range."

KB Home Sales referred the couple to Countrywide which came back with an appraised value of \$394,000. The Countrywide appraisal used three different sales from the credit union. One of the sales was the property that the credit union appraiser had refused to use. Another of the sales was 3.75 miles from the Johnson's property (all of the credit union's properties were less than 0.75 miles from the Johnsons).

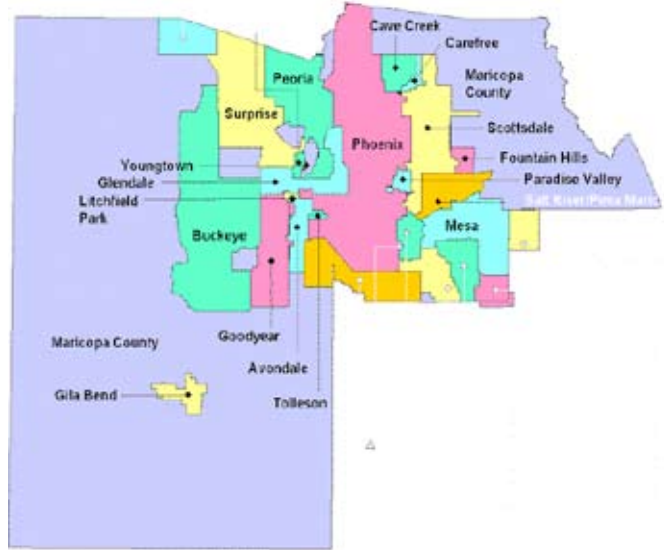
Countrywide gave Mr. and Mrs. Johnson a first mortgage for \$315,000 and a second mortgage for \$78,000.

Now the couple owes significantly more than their home is worth. Maricopa County recently lowered the home's assessed value from \$269,000 to \$187,200.

Part II

Closer Look: Welcome to Maricopa County, Arizona

MARICOPA COUNTY IS HOME to over 3.7 million people, more than half of the state of Arizona's population.¹⁷ The County is made up of 27 cities, including the state capital Phoenix, Mesa, Glendale, Scottsdale, Tempe, Chandler, Peoria, Gilbert, and Sun City.



Maricopa County consistently led the nation in the number of new housing units built, averaging about 47,000 new homes a year from June 30, 2003 to July 1, 2006.¹⁸

It would seem from the outside that the growth in housing units was the result of the population increase, but those closer to the scene saw other factors at play. A report from the Arizona Real Estate Center at Arizona State University noted:

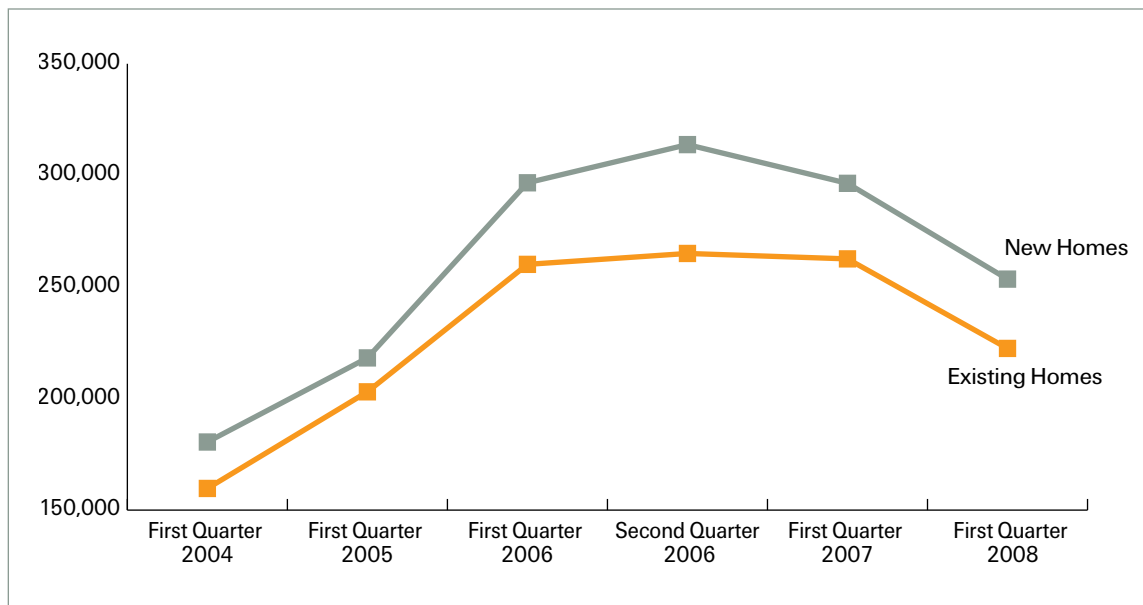
Although some of the growth can be attributed to people moving to the area and new households being formed, much of the hyperactivity of 2003-2005 was driven by people seeking investment opportunities through rentals and/or flipping. As prices accelerated over those years, it drew in more and more people who did not want to be left out of the booming housing market whether they were occupants or investors.¹⁹

Home prices in Maricopa County soared. The median sale price for existing homes rose 66% in just two years from \$159,705 in the first quarter of 2004 to \$265,000 in the second quarter of 2006. The median sale price of new homes rose even faster, increasing 74% from \$180,510 to \$313,775 during this same period. Those median prices have since crumbled, falling to \$222,450 for existing homes and to \$253,505 for new homes.²⁰

Maricopa County Median Home Prices

Period	Existing Homes	New Homes
First Quarter 2004	\$159,705	\$180,510
First Quarter 2005	\$203,000	\$218,195
First Quarter 2006	\$260,115	\$296,665
Second Quarter 2006	\$265,000	\$313,775
First Quarter 2007	\$262,570	\$296,425
First Quarter 2008	\$222,450	\$253,505

Maricopa County Median Home Prices



Along with the rest of the country, Maricopa County has been beset by a foreclosure crisis that is worsening. According to the most recent information from RealtyTrac, Arizona has the third highest foreclosure rate in the country in the first quarter of 2008, behind Nevada and California. The number of foreclosure filings in the state increased 45% from the previous quarter and 245% compared to the first quarter of 2007.

In the first quarter 2007, Maricopa County had the 24th highest foreclosure rate out of all metropolitan areas in the country. A year later, Maricopa County had a 294% increase in its foreclosure rate, giving it the seventh highest rate in the country.²¹

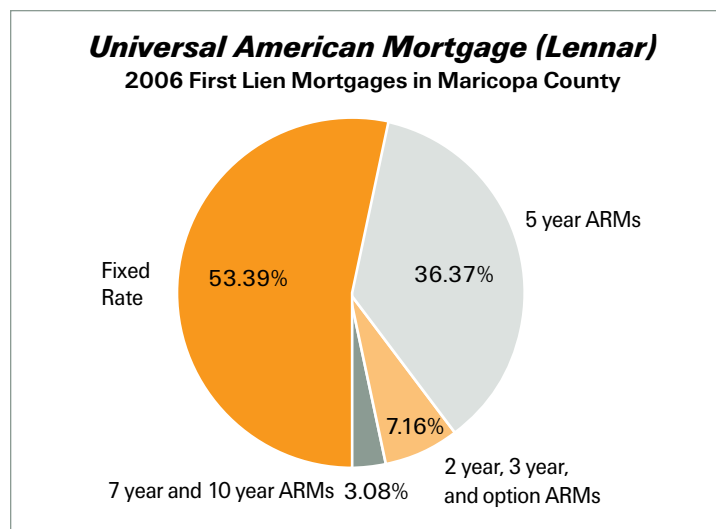
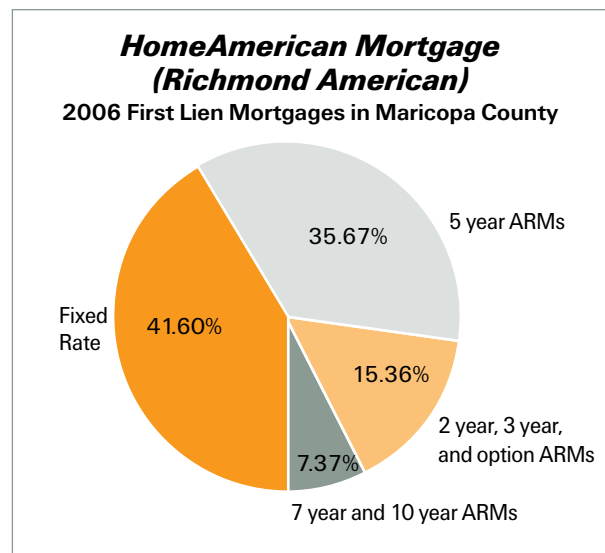
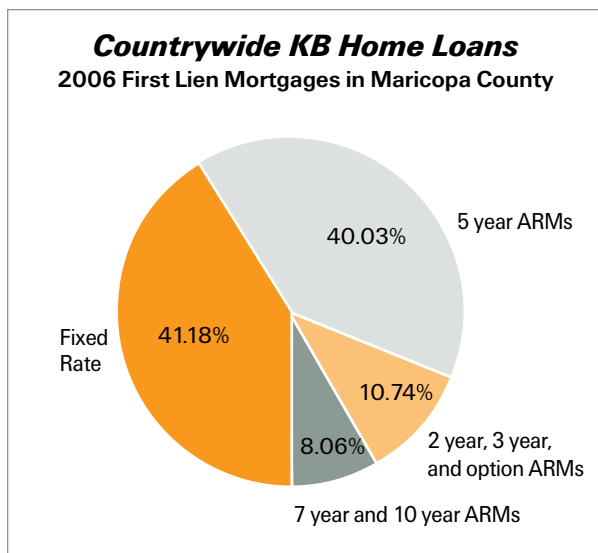
Maricopa County Findings

ARMs

An examination of mortgage data from the Maricopa County Recorder's office reveals that half of the purchase mortgages made by Lennar, Richmond American, and KB Homes in 2006 were Adjustable Rate Mortgages (ARMs). Over a third of the mortgages made by the builders in 2006 were 5 year ARMs that will reset in 2011.

2006 Single Family Home Purchases

Lender/Builder	Fixed Rate	5 year ARMs	2 year, 3 year, and option ARMs	7 year and 10 year ARMs
KB/Countrywide KB	41.08%	40.03%	10.74%	8.06%
HomeAmerican (Richmond American)	41.60%	35.67%	15.36%	7.37%
Universal American (Lennar)	53.93%	36.37%	7.16%	3.08%



Change in ARMs from 2005 to 2006

There were large increases from 2005 to 2006 in the percentage of KB/Countrywide KB and HomeAmerican loans that were ARMs, while there was a small decrease with Universal American's loans.

At all three lenders, there was an increase in the percentage of their loans that were five-year ARMs. At KB/Countrywide KB and Universal American, there was a decrease in the percentage of loans that were ARMs which reset in fewer than five years.

Lender/Builder	Percentage of Loans that were ARMs		Percentage of Loans that were 5-year ARMs		Percentage of Loans that are 2-year, 3-year, or option ARMs	
	2005	2006	2005	2006	2005	2006
KB/Countrywide KB	40.15%	58.82%	22.63%	40.03%	13.63%	10.74%
Richmond American (HomeAmerican)	43.76%	58.40%	30.60%	35.67%	10.07%	15.36%
Lennar (Universal American)	52.29%	46.07%	32.70%	36.37%	17.44%	7.16%

Just as with two and three year and option ARMS, lenders made five-year ARMs based on the assumption that homeowners would refinance before the rate resets. As with two year and three year option ARMs, the interest rate of a five-year ARM can typically increase to a maximum rate of six percentage points higher than the starting rate.

This means that for many homeowners who are not dealing with resetting ARMs this year, tragedy has not been averted, but merely postponed.

Subprime Loans

In Maricopa County home builders became increasingly reliant on the use of higher cost subprime mortgages in order to sell their homes. An analysis of data provided under the Home Mortgage Disclosure Act (HMDA) shows that subprime loans made up a much greater percentage of the total loans originated by the builders in 2006 than in 2005.

Percentage of Home Purchase Mortgages That Are High Cost/Subprime

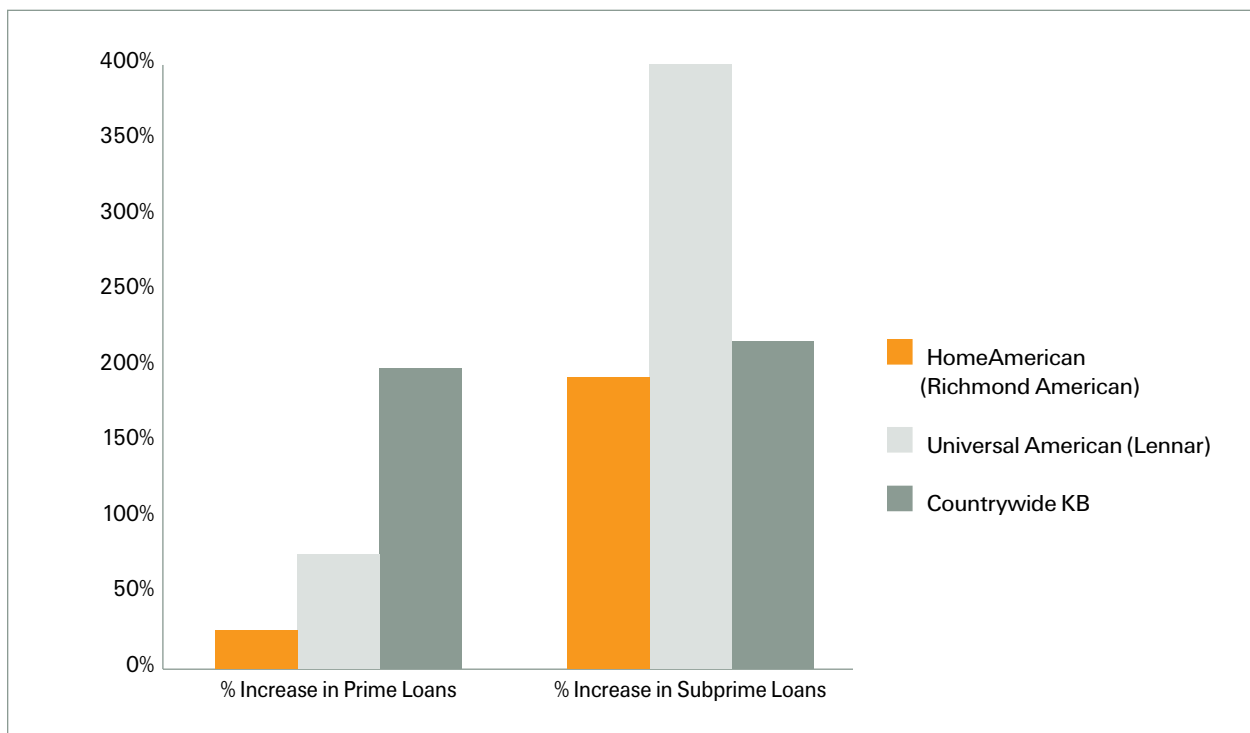
Lender	2005	2006	% Change
HomeAmerican (Richmond American)	9.3%	19.4%	107.3%
KB/Countrywide KB Home Loans	29.9%	31.1%	4.2%
Universal American (Lennar)	16.7%	36.3%	117.1%

A review of HMDA data also shows that the number of subprime loans originated by homebuilders increased at a greater rate than builder-originated prime loans.²²

Home Purchase Mortgages in Maricopa County

Lender	Prime Loans			Subprime Loans		
	2005	2006	% Increase	2005	2006	% Increase
HomeAmerican (Richmond American)	1,371	1,720	25.5%	141	413	192.9%
KB/Countrywide KB	249	744	198.8%	230	336	217.0%
Universal American (Lennar)	806	1,419	76.1%	162	810	400.0%

Increase in Prime vs. Subprime Loans, 2005-2006



Piggy-back Mortgages

Approximately half of the mortgages made by Lennar, Richmond American, and KB Home in Maricopa County in 2006 also had a second mortgage. These were almost always done as 80/20 loan combinations, in which the builder gave the homebuyer a first mortgage for 80% off the home’s value and a second mortgage for 20% of the value, also known as piggyback mortgages.

Percentage of Mortgages with a Piggyback, 2006

Richmond American (HomeAmerican)	49.9%
Lennar (Universal American)	41.8%
Countrywide KB	55.5%

The large number of homebuyers who were given a first and second mortgage is significant not only because it means these homebuyers are in a negative equity situation, but also because the majority of second mortgages made by these builders were subprime loans with high interest rates.

Even many homebuyers with prime first mortgages received second mortgages with subprime rates. The lenders told them not to worry because they would be able to refinance in a few years and combine the first and second into one lower rate loan.

Percentage of Second Lien Purchase Mortgages that are Subprime, 2006

Richmond American (HomeAmerican)	43%
Lennar (Universal American)	79%
Countrywide KB	71%

Home Value Depreciation Leads to Disaster!

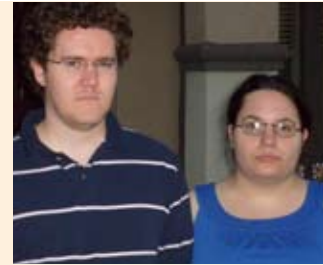
Homebuyers in new subdivisions built by Lennar, Richmond American, and KB Homes have seen their home values decline dramatically just since last year. Because of the decline in home values, many homebuyers are trapped and cannot refinance since lenders will not loan more than the house is worth.

Maricopa County Home Values Have Declined Dramatically²³

Builder/Lender	Average Assessed Value for 2008 Taxes	Average Assessed Value for 2009 Taxes	Average Decline	Average Percentage Decline
Richmond American (HomeAmerican)	\$264,210	\$214,692	\$49,518	18.7%
Lennar (Universal American)	\$298,345	\$236,735	\$61,609	20.7%
Countrywide KB Home Loans	\$227,826	\$172,204	\$55,622	24.4%

Spotlight on Buckeye, Arizona

Carl Reniker closed on his KB home in Buckeye in January 2006, purchasing it for \$195,900. Countrywide KB Home Loans gave him a first mortgage for \$156,720 and a second mortgage for \$39,180. The first mortgage is an interest only ARM that starts at 6.875% and can go as high as 11.875%. The second mortgage has an interest rate of 9.625%.



He says there was no discussion about his mortgage options or whether he wanted a fixed or adjustable rate.

Maricopa County lowered the assessed value of the property from \$177,500 to \$124,200 just since last year. He owes a total of \$196,000 between the two mortgages and is not able to refinance because his home has gone down so much in value.

Mr. Reniker is just one of several hundred homeowners in the Santarra subdivision in Buckeye, Arizona. Buckeye is a “once sleepy agricultural town” located 35 miles west of Phoenix. As other areas in Maricopa County were becoming almost fully built out, developers turned their attention farther west to towns such as Buckeye.

Buckeye Growth

Year	Single Family Building Permits Issued in Buckeye ²⁴	New Homes Sold in Buckeye ²⁵
2002	213	N/A
2003	1,009	N/A
2004	3,056	1,370
2005	4,549	3,305
2006	2,583	3,845
2007	2,888	2,015

With over 600 square miles of available land in Buckeye, there seemed no limit to the amount of new housing that could be built. The town approved 22 new master planned communities which would have over 300,000 new housing units.²⁶

Buckeye was excited for its future and proclaimed on its website that it would be “The Next Great World-Class Town of the Southwest.”²⁷

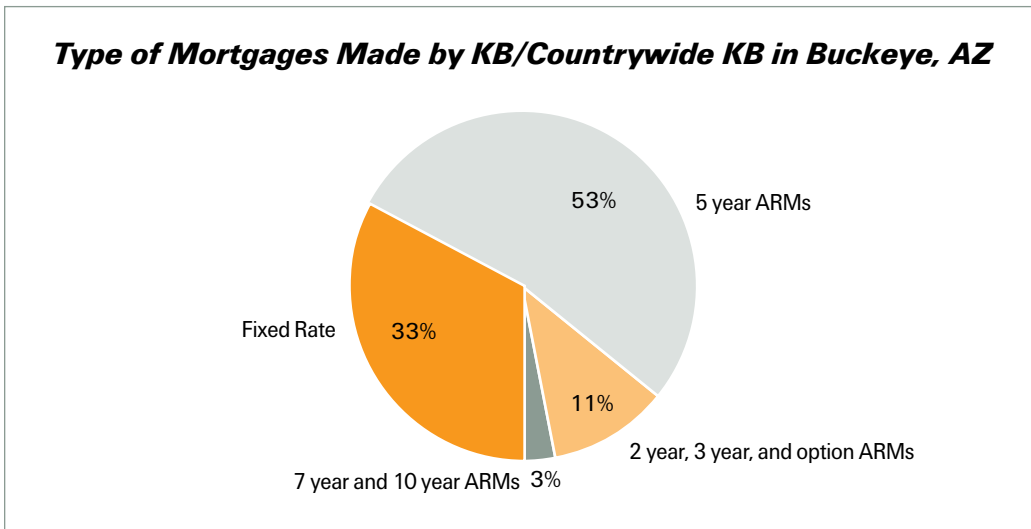
Buckeye was the second fastest growing suburb in the country with a 191.9% increase in population from 2000 to 2006.²⁸ This prompted the town to declare itself “America’s biggest ‘small town.’”²⁹

The town’s population is currently at about 40,000, and had been projected to hit 100,000 by 2010.³⁰ Whether or not the town hits that population mark, it’s likely that 2010 will be marked by a much less positive development—an explosion of resetting interest rates on mortgages that homeowners could not refinance because their home values have declined so dramatically.

The Santarra Development in Buckeye

The Santarra community is a subdivision in Buckeye that was developed by KB Homes and that is especially threatened by the factors described in this report.

- Fifty-five percent of the first lien mortgages made by KB/Countrywide KB in the Santarra development in Buckeye are five year ARMs that will reset in 2010 or 2011.** Based on our review, it appears that many of Countrywide KB’s ARMs are also interest-only, which means that these homeowners are not paying down any of their principal.



- Sixty-three percent of the purchase mortgages made in the Santarra development by KB/ Countrywide KB also had a piggyback second mortgage.** This means that almost two-thirds of the homeowners in Santarra had 100% or close to 100% financing.

As noted in the previous section, over seventy percent of the second mortgages made in Maricopa County in 2006 by Countrywide KB were subprime.

- The properties which were built by KB and for which KB/ Countrywide KB also provided the mortgage to buy the home, have lost an average of \$78,800 per home, more than 32% of the home’s value the previous year.** The average value of the KB homes in Santarra according to Maricopa County was \$243,797 last year but just \$164,996 this year.

What will happen to homeowners in Santarra come 2010 and 2011 when they can't refinance and their ARMs reset? What will happen to homeowners such as Joni Lynn described below?

Joni Lynn moved from Texas to Arizona. Her realtor found her a KB Home in the Santarra subdivision in Buckeye, AZ. Joni said she told the realtor that she just wanted a plain old conventional mortgage with a fixed rate, that she didn't want any "bells and whistles" with it.

Joni closed on her home in November 2006. Countrywide KB gave her two mortgages. Although she is retired and her income is just from social security and a pension, the first mortgage is an interest only ARM which starts at 6.5% and can go as high as 11.5%.

Joni now owes about \$204,000 between the first and second mortgages. The Maricopa County tax assessor has lowered the value of Joni's house from \$210,000 to \$148,800 just since last year.

Unfortunately, Santarra is not a unique situation. There may be thousands, if not tens of thousands, of communities throughout the U.S. that will be facing a similar crisis due to the greedy practices of home builders who pursued profits without regard to the well being of homeowners or communities.

Not at Your Service—Countrywide and Homeowners

IN ORDER TO AVOID CATASTROPHE, the problems described in this report will require a high level of attention and involvement from the mortgage servicer, which, unfortunately, for many of the loans in question is Countrywide. Countrywide was the largest mortgage servicer, administering \$1.5 trillion in mortgages made both by itself and other companies, including many of the homebuilders' mortgage subsidiaries.³¹

Despite numerous public pronouncements that they are attempting to help as many people avoid foreclosure as possible, Countrywide appears to have been ill-equipped to handle the massive number of delinquent loans they were faced with. Homeowners report their frustration even with the most basic first step of finding the right person to talk to. They must navigate automated phone systems, endure multiple transfers, suffer through numerous holds, only to have to redial after being disconnected.³²

We have also found that when homeowners finally manage to talk to a Countrywide representative, the situation is not much better, and many homeowners are not offered a loan modification that would allow them to stay in their home with an affordable payment.

In the introduction, we described how Rosa Garcia, a Buckeye resident, fell behind on her mortgage and how her home value has fallen drastically—Maricopa County lowered the assessed value from \$213,000 to \$145,800 in just one year. Ms. Garcia's two mortgages with Countrywide total \$208,000.

Clearly this is a case in which it is in Countrywide's financial interest to avoid foreclosure and have Ms. Garcia stay in the home. However, Ms. Garcia has been trying to work out the situation since the beginning of the year, and there is still no resolution.

Countrywide originally offered to lower her payment by just \$100/month. When Ms. Garcia responded that this would still be unaffordable, Countrywide told her that in order for them to even consider a loan modification, she would have to come up with 30% of the arrears. Ms. Garcia could not come up with the amount needed, so Countrywide told her that the best they could offer her is an additional loan to bring her current, which she would need to begin paying back after six months, on top of her regular mortgage payments. When Ms. Garcia told them that this would not help her, Countrywide reminded her that they can foreclose at any time.

Homeowners who will have an increase in their payment due to a resetting ARM and who contact Countrywide often face a double-edged sword of disappointment. If they are not yet behind on their mortgages Countrywide will usually inform them there is nothing they can do until they are behind, other than refinancing their loan. However, in many cases, such as those within Santarra, home values have dropped so much that Countrywide is unwilling to refinance their mortgage.

Felipe Torres purchased his KB home in Buckeye, AZ in July 2006 for \$281,000. He made a \$60,000 down payment and received a mortgage for the remainder. The interest rate, which started at a 7.44% interest rate, will adjust in September 2008, and the payment is projected to increase by over \$500/month. When Mr. Torres first contacted Countrywide about this, he was told to callback within 90 days of the reset date. Mr. Torres got back in touch with Countrywide within the 90 days. Countrywide began the process to refinance the loan but then told Mr. Torres that they could not make a loan because his home value had gone down so much. (The assessed value, according to the County, fell from \$235,500 to \$162,100 just in the last year). Mr. Torres has now submitted a hardship letter and is waiting for Countrywide's response.

Homebuilders and Questionable Activity

THERE HAVE BEEN WIDESPREAD REPORTS across the whole mortgage industry of illegal and unethical practices to market subprime and non-traditional loans, downplaying the risks to lenders, denying traditional, fixed rate loans to buyers who would have qualified, and outright selling loans to borrowers who didn't understand the product or loan structure or escalating payments they would be obligated to. Unfortunately, a number of events have shown that many homebuilders have also been active participants in these types of fraudulent and illegal practices in their mortgage origination and financial services activities.

- Beazer Homes has said it would restate financials for a three-year period after an internal probe found employees in its mortgage origination unit violated federal lending rules. Among other mortgage-related issues, Beazer said it was subpoenaed by the United States Attorney's office seeking documents related to the mortgage service, and the SEC launched a formal investigation of Beazer to determine whether any person or entity related to the company violated federal securities laws. In early February, Beazer Homes exited the mortgage origination business and announced its intention to pull out of various markets in North Carolina, Ohio, South Carolina and Kentucky where roughly 5 percent of the company's homebuilding assets were invested.
- Through 2006 and 2007, the U.S. Department of Housing and Urban Development reached millions of dollars in settlements with homebuilders and mortgage lenders over allegations that they "engaged in illegal business practices" involving captive title reinsurance and accepted illegal kickbacks from title insurers in the form of payments in exchange for referrals. The arrangements were essentially ways for home builders and mortgage lenders to accept kickbacks for referring a high volume of business to a preferred title insurer. Any payments in exchange for referrals violate RESPA, the real estate settlement procedures act. In addition to the settlement payments, the companies agreed not to enter into any new captive title arrangements and to cease writing new captive title reinsurance business. Richmond American, Shea, Pulte, KB, Meritage, and Beazer Homes were among the companies involved in the settlements.
- In 2005, KB Home paid a record \$3.2 million settlement over HUD allegations that KB's mortgage unit was responsible for a number of poor underwriting practices such as approving loans to borrowers who were not eligible; approving loans based on overstated or incorrect income; failing to include all of borrowers' debts; failing to properly verify sources of funds; and, failing to ensure gift letters met HUD requirements.³³ KB subsidiary KB Countrywide has been hit with a number of lawsuits recently, including claims that it schemed with real estate appraisers by falsifying sales data and manipulated appraisals to inflate prices paid for homes as the housing market

began to tank.³⁴ Another KB Countrywide lawsuit includes a former regional vice president and manager claiming wrongful termination after he reported fraudulent lending practices to superiors and refused to approve mortgages for unqualified applicants. Among other things, he alleges “being strongly encouraged to inflate homes’ appraised values by as much as 6 percent” resulting in buyers owing more than their home was worth.³⁵

- This past March, Ryland Homes agreed to a settlement with the North Carolina Banking Commissioner who had accused Ryland Mortgage of charging excessive fees to recoup the costs of the incentives that were given to homebuyers to use the mortgage company. The company will refund the fees to almost 1,000 homebuyers.³⁶

What Needs to Be Done

Restricting Mortgage Originations by Home Builders

There is a fundamental conflict of interest in builders originating their own mortgages. Builders have an incentive to sell their inventory at the highest possible price, and their in-house mortgage units provide the financing to make it possible. There is evidence that during the housing boom in 2004-2006 builders were only able to sell homes at such inflated prices because of the collaboration with their mortgage subsidiaries and affiliated appraisal companies. These practices played a large part in creating the current housing crisis.

- The U.S. Department of Housing and Urban Development has proposed a change to the Real Estate Settlement Procedures Act (RESPA) that would make it a potential RESPA violation when a builder uses economic incentives or disincentives that have the effect of steering homebuyers to the builder's mortgage company. Although this is a step in the right direction, **HUD should completely repeal the 1983 amendments to RESPA that allowed builders and other businesses to make referrals to affiliated businesses.**
- Countrywide was the single largest source of financing for home builders' mortgage operations. Countrywide had servicing, marketing, and secondary market relationships with the nation's largest home builders including KB Homes, Toll Brothers, NVR, Ryland Homes, Beazer Homes, and Lennar. **Bank of America, which acquired Countrywide, should discontinue the lending relationships that Countrywide had with builders' mortgage operations.**

Curbing the foreclosure crisis

We need to take major steps to prevent foreclosures which lead to an increased housing inventory and a decline in home values.

- **Congress should pass the Emergency Home Ownership and Mortgage Equity Protection Act, HR 3609** by Rep. Brad Miller (D-NC) and Rep. Linda Sanchez (D-CA) and "Helping Families Save Their Homes in Bankruptcy Act of 2007," S. 2136, Senator Dodd and Senator Richard Durbin (D-IL). This legislation would allow bankruptcy judges to modify harmful mortgages (such as by reducing the principal to the actual value of the home or changing an ARM to a fixed rate) and would help more than 600,000 families stay in their homes.
- **Rather than merely paying lip service to preventing foreclosures, as Countrywide did, Bank of America must start actually doing it.** Although Countrywide made numerous public statements about its willingness to work with delinquent borrowers and its reluctance to foreclose, this did not match the experience of many of its customers. In too many cases Countrywide has refused to do loan modifications, such as converting adjustable rates to a fixed rate or reducing the principal, and instead pursued foreclosure even when it resulted in a greater loss to the company.

The Alliance for Homebuyer Justice and LiUNA

THE LABORERS' INTERNATIONAL UNION OF NORTH AMERICA (LiUNA) has over 500,000 members, most of whom are construction workers. Our members do the hard, dangerous, and often dirty work of building our communities. Now they are facing a “triple threat” due to the current downturn in the residential market. Our members have lost jobs. They have lost their homes, and they have seen a portion of their retirement security evaporate over the past two years.

LiUNA recently became a founding member of the Alliance for Homebuyer Justice, which is made up of labor, community, and religious organizations working together against deceptive and abusive practices in the homebuilding and mortgage industry.

Homebuilders are supposed to be in the business of making dreams a reality—developing the neighborhoods of the future and laying the foundation for families and communities to grow. However, through our work, we have found that homebuilders are too often homewreckers, creating problems that tear families apart and devastate neighborhoods.

Their greed has led builders to skimp on labor and material costs, resulting in construction defects and a workforce that is barely able to make a living. In their quest for ever larger profits, homebuilders rapidly increased their prices for these poorly built houses, and then resorted to shady loan practices to sell them. In short, experience shows that many large homebuilders don't care about their workers, their homebuyers, or their communities.

Our goals are that:

- Residential construction workers should be paid a living wage and treated with respect, and that workers should have the right to organize a union free of intimidation or harassment.
- Residential construction workers should receive better training to ensure quality work and that builders must pay more than lip service to producing quality homes. This includes being willing to make repairs when construction defects are found and honoring the terms of their warranties.
- Homebuyers should have access to affordable and sustainable mortgages from independent sources; this is a necessary component of a healthy construction industry.
- Home sale prices should be targeted to what the community can afford, not to the price that brings the maximum profit to the builder.

LiUNA was instrumental this year in stopping corporate homebuilders from receiving billions of dollars in unfair tax breaks under a provision that Congress was considering as part of the Foreclosure Prevention Act. LiUNA helped expose the role that homebuilders had played in creating the current housing crisis and successfully persuaded Congress to scrap the provision.

Endnotes

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