



Rita Gillam, 85, pauses to remember some good times in her home. She is the original owner and has lived there since 1957. She is losing the house to foreclosure.

JEBB HARRIS, THE ORANGE COUNTY REGISTER

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Video



Widow, 85, is one of foreclosure's faces Rita Gillam of Orange may lose her home in August. Video by Steve Zylius, The Orange County Register.

Monday, June 15, 2009

Second mortgages: Lines of danger?

A study finds homeowners tapped all their equity before facing foreclosure.

By **MATHEW PADILLA**

THE ORANGE COUNTY REGISTER

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Record foreclosures hitting Orange County involve more than just newbie buyers who got in over their heads.

Some housing watchers say evidence is mounting that even veteran homeowners got caught up in housing euphoria and now are paying for it.

The latest argument comes from Michael LaCour-Little, a finance professor at Cal State Fullerton. He is lead author of a new study, which found that during the housing boom some long-time owners borrowed against all their property's equity gain, or paper profits. They treated their houses like cash machines.

People who owe their bank as much or more than their home is worth are most vulnerable to foreclosure. When they suffer a job loss or other drop in income, they can't sell, because the sale price won't cover the debt.

It's long been assumed that homebuyers who purchased at housing's peak with little money down are among the most likely to face foreclosure. They owed more than their property was worth once prices tanked.

But the study concludes 'cashing-out' is about as predictive of foreclosure for the same reason: negative equity.

LaCour-Little admits the data he used isn't perfect. Still, he said his findings cast light on how borrower behavior may be impacting many foreclosures.

The trend has implications for government policy, he said.

"The conventional view is that housing appreciation is good because it reduces (default) risk," LaCour-Little said. "Not according to my theory, which is housing appreciation is bad. It encourages junior-lien borrowing. When appreciation stops, somebody is going to be left in a bad position."

Tapped out

One homeowner who cashed-out her equity is Rita Gillam, an 85-year-old widow in Orange.

Gillam said she has owned hair salons and baby supply stores for decades. When her baby store hit a rough patch, she borrowed money to keep it going, culminating in a \$556,000 loan from Fremont Investment & Loan in 2006.

And not expecting to live so long, she spent some money on non-necessities, including a vacation to Las Vegas, Gillam said.

The \$556,000 is gone and so is her business, Gillam said.

"I am broke," she said.

Loan servicer HomEq Servicing is putting her home, which she has owned since 1957, up for auction on Aug. 4. The company and its parent, Barclays Bank, declined to comment on Gillam's case, citing privacy concerns.

The big question is whether Gillam is the exception, or are most borrowers facing foreclosure also people who extracted all their equity.

Professor LaCour-Little tracked all houses and condos set for foreclosure auctions, known as trustee's sales, in the first two weeks of November 2006, 2007 and 2008 in Orange, Los Angeles, Riverside, San Bernardino and San Diego counties. Earlier this month he presented his study at the mid-year conference in Washington, D.C. of the American Real Estate and Urban Economics Association.

For the early November 2008 data sample, he tracked 2,358 properties and found 79 percent of borrowers had at least a second mortgage. Some also had third and fourth liens. (During housing's heyday, some people bought homes with a first loan and simultaneous second mortgage totaling 100 percent of the price.)

The 2008 foreclosures were purchased in "median" year 2004, meaning half the purchases were before and half after. That suggests more than half the purchases were before housing's peak in 2005 and 2006.

Total debt on the 2008 properties averaged \$551,000 at time of foreclosure, or roughly 170 percent of their average value at the time based on a computer model and double the average price the bank later received from buyers.

That suggests owners borrowed against all the gains in their property's value by refinancing or taking out second loans. When prices dropped, they owed much more than the houses were worth.

LaCour-Little said he was surprised by the results.

"I expected a much higher concentration of (home purchases in) peak years of 2005 and 2006," he said.

But there are limits to the county records used in his study, LaCour-Little said. For example, he assumed that borrowers with home equity lines of credit had drawn down the entire line before foreclosure. But public filings don't show how much is actually used. (Home credit lines function somewhat like credit cards, with credit limits that may never be reached.)

The professor argued a borrower in trouble would use the money from a home credit line to keep making payments on the first mortgage until the line's limit is reached.

Interest on home equity lines, as with other home loans, is tax deductible. LaCour-Little said that encourages owners to borrow against their homes, possibly putting them at risk, as opposed to using credit cards or other debt, such as auto loans.

USA to the rescue?

If the study is indicative of a larger trend of homeowners being in trouble because of junior mortgages, that poses a challenge to politicians who want to prevent foreclosures, LaCour-Little said.

"It is hard to see a solution that addresses this problem," he said. "The one beauty of foreclosure – if you can find beauty in it – is it does clean up title to a property. Foreclosure is a well defined system for who is going to lose money."

The Obama administration on April 28 released details of a loan-aid program targeted to second mortgages. Treasury would share with banks or investors the cost of modifying or eliminating such loans to help borrowers avoid foreclosure.

Kevin Stein, associate director of San Francisco-based consumer group the California Reinvestment Coalition, said so far his group hasn't seen the Obama plan impacting loan modifications. Too few are being done, same as before, he said.

In any case, the President's plan is likely to fail because it "does not in any way emphasize principal reduction, which is what would keep people in their homes in Orange County and California," Stein said.

The plan emphasizes interest-rate reductions. However, it does offer to reimburse mortgage holders a few pennies on each dollar of principal balance if they simply erase second mortgages. That may not sound like much, but seconds can be worthless if a property goes to foreclosure.

In Stein's view, there is no question Orange County as a whole would benefit if the government did more to halt foreclosures.

"Preventing foreclosures helps maintain community stability, keeps blight at bay, supports local tax revenue and the local economy," Stein said.

Other experts debate if there is any economic benefit to stopping foreclosures.

Christopher Thornberg, a principal with **Beacon Economics** in Los Angeles, said, people who stop paying an "over-sized mortgage" and instead rent an apartment or house, may "have a lot more money to spend on things like iPods and clothes."

"So in a sense all these foreclosures are probably one of the things stabilizing consumer spending," he said. "That's far more important to the economy than whether people pay off their mortgages."

On the flipside, Bill Gross of Newport Beach-based **Pimco** has long argued government helping homeowners will benefit everyone.

"The ultimate support of housing prices is an important link in any eventual economic recovery," Gross said. "Keeping homeowners in their homes, as opposed to putting them out on the street, irrefutably keeps prices higher than they would be otherwise. Viewed in this way, foreclosure relief is a winning proposition for Americans of any political persuasion."

LaCour-Little said foreclosure prevention could help the economy, but current programs merely delay the process.

A better idea might be for banks to foreclose and then rent the property to the former owner, he said. That would keep foreclosures from flooding the market and depressing property values.

Some investors are already doing that in some markets. But banks don't do it because of stiff capital requirements from regulators and because they are not set up to manage properties.

LaCour-Little said government could ease capital restrictions and banks could hire property managers. "Gee, that would create jobs," he said.

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charleswillett wrote:

Check out <http://obamamortgage2009.blogspot.com> or obamamortgage2009.blogspot.com
There needs to be a program for the elderly but not quite to retirement age for mortgage modification when they have lost their job during this particular recession. I made a decent wage because I put my time into a company and now have no job. I am looking at \$10 - to \$12 hr jobs after working all my life. You can't make a mortgage payment on that kind of money. I will eventually lose my home.

6/16/2009 2:07:14 AM

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quigley wrote:

Obama's foreclosure prevention plan falls flat when it comes to folks with a second mortgage. Whether it's a HELOC or a piggyback, the program doesn't account for the write-downs banks have to take to make it work under those circumstances. And even if the banks can rewrite it totally, the "homeowner" ends up with the first mortgage refinanced to a lower rate, but the second is still at 9-13%. And of course, they're still severely underwater on the loan. So the "homeowner" does some fairly easy math and just walks away.
Happening every day folks!

6/15/2009 10:57:14 PM

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fcprop wrote:

This story is being played out over and over again! My friend foreclosed, he started his own business. Instead of trying to be successful at the business, he put his feet-up and lived off the equity in his house. Guess What? He foreclosed.

6/15/2009 9:13:36 AM

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ocmomin wrote:

This wave of foreclosures is coming to South and Coastal OC as well because of greed. Folks took out amazing amounts of equity on their primary homes in order to buy 10 or more investment homes. Now they are losing the investment homes and their primary residence while playing on the sympathy of friends. I don't think it is sad except for the people in the 10 different neighborhoods where the homes that were foreclosed dragged down the value. These folks are greedy fools and should spend sometime in debtors prison.

6/14/2009 9:19:27 PM

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frombackeast wrote:

How interesting that the OCR uses this woman as a face for line of credit lending, as if trying to elicit sympathy for an old woman who was wronged. Apparently someone is trying to elicit charity from a reader.

Bob's comment was spot on that houses are not to be used as ATM machines. The fact is this woman was irresponsible and (regardless of age) should have been prepared for retirement. I can't believe that someone of her generation (The Great Depression, WWII, rationing) chose instant gratification (she took trip to Vegas with proceeds) instead of saving for a rainy day. A reverse mortgage would have been better than this. Forgive me for being blunt, but no wonder this woman lost her business; she couldn't plan for the future.

6/14/2009 4:41:53 PM

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gouscoc wrote:

Most LOC were killed over a year ago.

6/14/2009 3:09:32 PM

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frombackeast wrote:

She had a baby clothes store? Was it in Santa Ana? Probably the best place for baby clothes; unless it's high end clothes.

6/14/2009 1:37:15 PM

Recommend(2)

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frombackeast wrote:

newportbob wrote:

Simple Rule: Your house is not an ATM machine.

BRAVO Brother! Well said!

Definition of a recession...

When your neighbor loses his job

Definition of a depression...

When you lose yours (I'm in a depression)

Definition of a recovery...

When Obama, Reid and Pelosi lose theirs!

6/14/2009 1:04:23 PM

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leftca wrote:

In a nutshell, these people legally stole from the banks and spent the money on goods and services. The least they can do is give the undervalued house back so the banks can recoup some of the money. Why we would bail out these folks is beyond me.

6/14/2009 12:49:50 PM

Recommend(5)

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unreal55 wrote:

How do you lose a home you've owned since 1957? Ridiculous! Sad sorry, but no one to blame but yourself.

6/14/2009 12:22:59 PM

Recommend(3)

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