REAL ESTATE ROULETTE

How the national foreclosure crisis is playing out locally – where it stops, nobody knows

ERIC SMITH The Memphis News

In Memphis, like most urban settings, the word "foreclosure" conjures images of boarded-up homes and blighted communities, dreary streetscapes and depressed neighborhoods. For many it's a problem that afflicts only low- to moderate-income homeowners in places like Frayser and Raleigh, where predatory lenders lurk in the shadows and lure minority borrowers into risky loans.

But foreclosure's reach knows no bounds, no race, no limit on home value, no restriction on loan product. Its reputation as being constrained to only the poorest parts of town dissipated long ago, and while it's true that foreclosures historically have occurred in marginal neighborhoods where minority borrowers were targets of bad mortgages, foreclosure is happening frequently and with ferocity in suburbs such as Cordova, Arlington and Collierville.

Such communities are registering huge upswings across Shelby County as the trend sweeps east into places once considered insulated from the ills of foreclosure.

EXPECT THE UNEXPECTED

The city has long ranked near the top of nationwide statistics for foreclosure, and the recent housing crisis exacerbated the problem. When subprime lending got out of control, and numerous homeowners found themselves upside down on their homes with no means to retain ownership, Memphis suffered dramatically.

In the first half of 2008, Shelby County saw 3,412 foreclosures, up 13.4 percent from the 3,008 in the first half of 2007, according to data from real estate information company Chandler Reports, www.chandlerreports.com. The increase doesn't seem drastic until looking at a more historical comparison. Between 2005 and 2007, foreclosures jumped 54 percent in Shelby County, from 3,800 (2005) to 5,250 (2006) to 5,850 (2007).

The problem, however, goes much deeper than just foreclosure sales. From January through June of this year, the city notched 6,522 foreclosure notices, up 13.9 percent from 5,724 notices in the same period of 2007.

Clearly, the top areas historically for foreclosure have been Frayser and Raleigh, two neighborhoods of North Memphis where a high percentage of black homeowners were exposed to bad loans, primarily subprime adjustable-rate mortgages (ARMs) that become problematic when the rates reset after two years. The combination of predatory lending, first-time homeowner naïveté and declining home values has been a recipe for disaster that first surfaced last year and has lasted well into 2008.

From Jan. 1 to June 30, Frayser's 38127 led all area ZIP codes with 309 foreclosures and Raleigh's 38128 came in second with 264. They ranked first and third, respectively, for foreclosures in 2007, with Westwood's 38109 taking second.

But each of those communities also experienced month-over-month declines during the first half of 2008, a sign that things are not only evening out but declining slightly, noted Steve Lockwood, executive director of the Frayser

PHOTO BY ERIC SMITH

DERELICT: Foreclosures remain high in Frayser, where this home sits idle and overgrown, but the crisis has gone beyond the traditional at-risk communities and into the suburbs. No matter which neighborhood it strikes, however, foreclosure takes a toll by leaving empty homes with diminished values.

Community Development Corp. Chalk it up to more outreach or the simple theory that what goes up must come down. No matter the reason, Lockwood likes the trend.

"The neighborhood can't stay at a fevered pitch of foreclosure forever; it's just not possible," he said. "While the nation has jumped a large percentage from the same time last year, we're basically holding steady. That's not good, but it also tells you the increases are absolutely east of here. And they're not just Raleigh, which they are, but they're far east of here. They're pieces of Germantown and Collierville."

A FAILED GAMBLE

Indeed, Shelby County's eastern suburbs have seen a rise in foreclosure rates. Arlington's 38002 led Shelby in the increase with a 122 percent rise in foreclosures between 2005 and 2007. Among the other top ZIP codes were Cordova North's 38016 (119 percent); Collierville's 38017 (78 percent); Cordova South's 38018 (67 percent); Hickory Hill South's 38141 (64 percent); Southeast Shelby County's 38125 (62 percent); and Bartlett's 38135 (58 percent).

Dr. Phyllis Betts, director of the Center for Community Building and Neighborhood Action, said the problem in the suburbs is different from other neighborhoods in that it stems from homebuyers getting into too much home for their incomes, taking the American Dream a step too far and trying to keep up with the Joneses, so to speak.

"You've got what we call 'pushing the envelope' type of foreclosures in the eastern suburbs, where people could have been successful homeowners had they bought somewhat less house," Betts said. "With the teaser rates and that kind of thing, you had people buying as much house as they possibly could. And that was consistent with the idea that a house is an investment."

The phenomenon that made matters worse was the perception that home values would escalate wildly. Memphis, of course, has never matched the highs (or lows) of other markets, Betts said, but that didn't dissuade some buyers from overextending on their ARMs with the hopes of huge gains in value and the chance to refinance to a fixed rate once the loans reset – something that never happened.

"When the bottom dropped out, they couldn't refinance," Betts said.

Beanie Self, executive director of the Southeast Memphis Community Development Corp., agreed that the problem in places like Southeast Shelby County, Hickory Hill and other nearby communities exploded from the ease of ARMs, which typically didn't require income verification. When the time came for ARM borrowers to refinance – for those who didn't have restrictions in their mortgages preventing that – homeowners found their properties not only didn't increase, but actually declined in value. Their lack of equity prevented refinancing and proved disastrous.

"They were under the impression that their homes would escalate in value," Self said. "With the soft market, that is not happening at all. That's pretty significant."

Lockwood also noted the growing number of "upside down" suburban homeowners as a symptom of the much larger eastward trend.

"These are people who were financially sound and they should have bought a house for $230,000 and they bought one for $400,000 instead," he said. "Those folks also start losing equity, and if they had an adjustable-rate that they thought they could refinance out of, they have turned out to be wrong. Without any equity, you can't get refinancing even if your credit's still good."

COMPOUND FRACTURES

The scenario not surprisingly became more intense where home values were higher. It's almost as if the severity of the housing crisis compounds with each mile traveled away from the city's core.

"I don't see any doubt from a financial analysis standpoint that the stakes really go up as you head east," Lockwood said.

Perhaps nowhere is the foreclosure rate more troublesome than Cordova. One of the most populous areas in town, both of Cordova's ZIP codes saw staggering increases in foreclosures over the past three years. The 38016 ZIP code of Cordova North notched a 119 percent gain (from 113 foreclosures in 2005 to 248 in 2007) while the 38018 ZIP code of Cordova South went up 67 percent (84 to 140).

What's more, the area has no housing counseling presence. Although the foreclosure rate there is above average, the community's higher-income population prohibits CDCs from opening there as those organizations are reserved for needier neighborhoods, noted Emily Trenholm, executive director of the Community Development Council of Greater Memphis.

"Cordova is not a neighborhood where you'd think we need a CDC because it's considered a nice place to live," Trenholm said. "We don't have any traditional community revitalization organizations or counseling agencies out there. As a result, a lot of people probably didn't get homebuyer counseling. Unless they got it from their bank or from a workshop at their church, those services aren't necessarily delivered in suburban locations the way they could be. That's hurt."

The pain continues in Cordova. Both ZIP codes rank in the top 10 for foreclosure in 2008, giving people a glimpse of what might become of the suburb if things aren't kept in check.

"You don't want another situation like Hickory Hill, which has gone

Roots of a Crisis

How did things get so bad? Many analysts have likened the current housing crisis to a "perfect storm," in which a number of factors blended together and wreaked havoc much the same way various patterns create a hurricane.

Start with subprime lending, in which borrowers with subpar credit are loaned money for more home than they can afford (sometimes the fault of a predatory lender, sometimes the fault of a real estate professional, sometimes the fault of a borrower). Stated-income applications are the norm, meaning the borrowers aren't required to show proof they can actually afford a home.

In this scenario – rampant in the mid 2000s – the borrower is given an adjustable-rate mortgage with a low introductory interest rate. When that loan resets to a much higher rate, the monthly payment becomes too much and the homeowner is overextended.

Often, the borrowers ignored the warning signs from their lenders that a reset was coming, and then they failed to acknowledge the numerous delinquency notices that began appearing in the mail. They got behind as other bills piled up.

In another scenario, homeowners tried to refinance to a fixed-rate mortgage only to find out their lenders stipulated against it, or they had become "upside down" on their homes, meaning the value had declined so much they didn't have enough equity to refinance.

When people realized they could no longer afford the home, they simply abandoned it, their credit rating shot. Meanwhile, the credit markets began drying up, home values plummeted and consumer confidence waned. Those who wanted to buy a new home found they lacked the minimum credit score. And those who could buy sat on the proverbial fence.

Sales declined, homebuilders pulled back on starts, lenders laid off mortgage personnel. It quickly became the housing market's own Hurricane Katrina. ■

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>
> *Executive director of the Frayser Community Development Corp.*

Is Help on the Way?

At the end of July, Congress passed and President George W. Bush signed into law the Housing and Economic Recovery Act of 2008. The landmark bill, dubbed "rescue" or "bailout" legislation by many, is designed to prevent further foreclosures while strengthening the Federal Housing Administration, Fannie Mae and Freddie Mac.

Among other measures, the bill gives $300 billion in lending authority to the Federal Housing Administration to provide affordable, fixed-rate mortgages to an estimated 400,000 at-risk homeowners. It also prevents the collapse of Fannie Mae and Freddie Mac by giving the U.S. Treasury Department temporary authority to lend each agency money until Dec. 31, 2009.

The bill gives a tax credit of $7,500 for first-time homebuyers, and it grants $3.9 billion to communities hardest hit by the housing crisis; the monies allow for buying and fixing up foreclosed properties.

Of course, how much it helps Memphis and Memphians remains to be seen. More than one person used the phrase, "The devil is going to be in the details" when asked for their assessment of the bill, meaning they need to see how well the government makes this legislation a reality.

"The one thing that stands out is the part of the housing bill that contains the $300 billion for FHA to refinance high-cost loans," said Webb Brewer of Memphis Area Legal Services. "One of the criteria is that the new loan can't be more than 90 percent of the appraised value of the property. On a whole lot of loans, the lender would have to write off or write down a fair amount of the current amount of debt to get it down to that 90 percent criteria. I'm anxious to see how they react to that. That's going to be the most obvious question in determining how effective the housing bill is at bailing people out."

Emily Trenholm, executive director of Community Development Council of Greater Memphis, said she is "guardedly optimistic" that Memphis – certainly one of the hardest-hit cities by foreclosure – will receive a fair share of neighborhood stabilization funds. As for other components, the bill could be hit or miss.

"It will help some people. I don't know how many, and I guess it will depend on whether or not the lenders are going to be willing to write down the mortgages," Trenholm said. "There's a lot of people who aren't going to qualify for those mortgages here in Memphis because they've got bad credit or they got behind. If that works it's ideal."

Steve Lockwood, executive director of the Frayser Community Development Corp., said one of the housing market's biggest problems right now is tightened credit. Simply put, many people in Memphis couldn't qualify for a home loan under current standards, and the bill will need to address that adequately.

"Having a very rigid system that only lends to someone with a 620 credit score or above is too rigid," he said. "We only want to make safe, affordable, ethical, loans to people, but sometimes the criteria are just too stiff. The swing is too far in the other direction. If they want to make loans, it will have to (swing back to center). How long it will take to swing back, that's the question." ■

really fast," Trenholm said.

Corky Neale, research and innovation specialist for the RISE Foundation, said the level of loans that have gone bad in Cordova as well as places like Hickory Hill and Southeast Memphis is the prevalence of first-time homebuyers who bought in 2005 and 2006. Those were two of the best sales years in history, likely because lending was the laxest it's ever been.

"Those loans were written in 2005, which was pretty much the peak in the market, so those loans have now reset maybe once, maybe twice, and we're beginning to get that kind of situation," Neale said. "That's a real issue, and I think it's really going to play havoc with the market for some time to come."

DAMAGE THAT DIES HARD

The havoc it wreaks has numerous layers, each one debilitating in its own way. First, there's the personal toll foreclosure takes on an individual family forced out of their home and into a rental. The homeowner's credit is shot and it might take years to recover.

"When you have people go from homeowners to homeless people, that puts an enormous strain on local governments and everyone else to say nothing of what effect it has on families," said Webb Brewer, a Memphis Area Legal Services lawyer who represents homeowners in overcoming mortgage-related problems. "I think it's a huge problem."

Then there's loss of property value on homes surrounding a foreclosure. It's estimated that a single foreclosure can have a negative impact of 1.3 percent of the value of every home within 1/8 of a mile. An already precarious housing market doesn't need something else to decline home values.

Also, banks and mortgage companies are taking big losses because of foreclosure, and to prevent further loss they often discount foreclosed homes and sell them to investors at a fraction of that home's most recent sales price. In spring 2008, the top 10 residential sellers sold homes at an average rate of 38 percent off the appraised value.

"That's a huge amount of value that's out there that's not in anybody's portfolio except the bank-owned properties at this point. And they don't want it," Neale said. "So let's suppose that they mark it down. In order to clear the market, they're going to have to mark it down another 30 percent or so. If we've got a concentration of those in a neighborhood or ZIP code where we've got lots of foreclosures, we've tainted that market. People who may well be in perfect shape on their mortgages have lost probably 30 percent, maybe more, of the stored value in their home."

> "You don't want another situation like Hickory Hill, which has gone down really fast."
>
> **– Emily Trenholm**
>
> *Executive director of Community Development Council of Greater Memphis*

How much the rash of foreclosures in Shelby County impacts next year's reappraisal remains to be seen, but Brewer estimates the cost to local government at $20,000 per foreclosure, which could result in a loss in millions of dollars in local tax revenue.

"That's something else that's looming out there that's a cause for real concern," Brewer said.

A NIP, NOT A CHOMP

Yet another problem is emerging from this housing debacle, one that has the potential to be more damaging. Much has been made of a second "wave" of foreclosures resulting from Alt-A loans. These are credit-score-driven loans and carry higher interest rates, somewhere between prime (issued to borrowers with good credit) and subprime (issued to borrowers with spotty or less established credit).

Some have argued that this second, more ferocious wave will take further hold in the suburbs and bring additional ruin to traditionally strong neighborhoods and their high-dollar home values.

Chris Bowers, mortgage loan officer at Bank of America and president of the Memphis Mortgage Bankers Association, said Alt-A loans resetting in the coming months could definitely have an impact on the market and some of the higher-value homes where this product was more common.

"There potentially will be some rising delinquencies and potentially some additional foreclosures in that category and maybe some in the prime loans when you've got folks who were selling, say, an interest-only loan to someone and that was all they could afford," Bowers said. "They pushed what they could afford on an interest-only loan. When that loan becomes a principal/interest loan, then their payments will go up."

Fortunately, local analysts argue that Alt-A isn't as prevalent in Memphis and Shelby County as it is elsewhere. California, Florida and New York were notorious for rash Alt-A lending because of their excessive home values, so Memphis' slow and steady real estate market could be a blessing in this case.

"There's a fair number here," Betts said. "But the whole thing was designed for the really hot markets."

Bowers agreed that the Alt-A presence in Memphis isn't overwhelming. And now, with the tightened credit, they have all but vanished because of their higher pricing and more stringent underwriting. But there's plenty of issues ahead for these products.

"If their income didn't go up in the five years that it was interest only, they're going to be in a little bit of trouble," Bowers said. "You're going to see some of that, but I don't think by and large you'll see a significant rise in that. You will see a little bit of a rise, but not near the scale as you would in other areas."

NO END IN SIGHT

For a problem that's still redefining itself each month, the overall scale is hard to gauge. It's even more difficult to fathom a comprehensive solution to the foreclosure fiasco, although plenty of stopgaps exist for homeowners at risk – even those in the 'burbs – starting with the Memphis Housing Counseling Network. The network's intake line of 725-8361 will direct callers to an appropriate CDC, even if it's not in their neighborhood.

One problem that's arisen of late, however, is the advent of counseling centers that charge for their services. Organizations that are part of the Memphis Housing Counseling Network are free (except for small fees for pulling credit reports), and when homeowners end up at a center that charges, they often spend a lot of time and money before ultimately being referred to a CDC after all.

"By then, sometimes it's too late," Trenholm said. "It's difficult to compete in that environment. We get a lot of publicity and do some marketing, but it's hard to get the word out to people."

Legislation is another avenue. The Tennessee Home Loan Protection Act, which took effect in 2007, is helping organizations like Memphis Area Legal Services go after predatory lenders. And Housing and Economic Recovery Act of 2008 (see sidebar) brings a wide range of assistance to nearly all parties involved in foreclosure – from the borrowers to the banks to the local governments and neighborhoods that have been affected.

But measures from the national housing bill could take months, even years, to make a dent in the local foreclosure problem, to bring a close to the fallout that seems to evolve with each passing month.

"I don't know if we've hit the zenith in terms of the fallout from irresponsible lending or not," Brewer said. "I think it may not come for a while. Regardless, it's going to take a long time for those bad loans to come through the pipeline. This high incidence of foreclosure is going to be with us for a while." ■

PHOTO BY ERIC SMITH

KEEP OUT: Signs like these continue popping up on front doors of area homes. The foreclosure rate has exploded in the city during the past few years as a result of the subprime fallout. The rate increased 54 percent in Shelby County between 2005 and 2007. And it doesn't show any indication of slowing down this year.

MORTGAGE MELTDOWN

WHAT'S SO BAD ABOUT PUTTING PEOPLE IN HOMES?

By JOHN E. GNUSCHKE Special to The Memphis News

Gnuschke is the director of the Sparks Bureau of Business and Economic Research at the University of Memphis.

Consider the nation's efforts to make affordable housing available to everyone and how the process has changed. The post-2000 gold rush in housing disguised a broader pattern of using private-sector mortgage loans to create single-family housing opportunities for low- and modest-income families.

Before, mortgage loans for marginally qualified households were only available if subsidized by the government. Lenders were encouraged to broaden the base of mortgage opportunities via Community Reinvestment Act requirements that extended credit opportunities beyond traditional market mechanisms. In the past, Section 8 and multi-family housing programs that The U.S. Department of Housing and Urban Development promoted were primary public efforts to support housing.

But public efforts have changed with the destruction of many older public housing projects and their replacement with more tightly controlled mixed-income properties. The new models created a demand for new housing products to serve low-income families.

Record low interest rates provided incentives necessary to address the market gap through new mortgage loan opportunities.

The post-2000, market-driven model was the financial industry's attempt to make home loans available to a vast market of low- to moderate-income families. These households typically rented houses or apartments because they could not qualify for home loans under mortgage requirements then. The entrepreneurial private mortgage market found a new market for home loans. This was supported by negative real interest rates promoted by the Federal Reserve.

Non-traditional sub-prime and low/no documentation mortgage loans, requiring little proof of ability to maintain payments in the face of financial problems, were created to accommodate new participants. Also, new mortgage instruments allowed more traditional borrowers and market speculators to become overextended in housing-related debt and investments.

Without due concern for conditions in the market or economy, lenders made home mortgage loans available for a group of borrowers that had little ability to sustain payments if faced with personal setbacks.

Those loans have experienced higher than expected failure rates. But many loans have failed that were not related to low-income borrowers. Those failed because of the belief that homes wouldn't decline in value. Market speculators and many homeowners were investing in real estate in the belief that the positive market price trends in housing would continue. They were overextended or caught with an illiquid investment that was losing value.

The outcome expanded housing credit has not been completely negative. Millions were able to become homeowners and most marginal borrowers still pay mortgages on time. Home ownership rates increased and some positive civic and economic consequences result from that.

Few analysts want to review the dramatic home price increases that occurred during the years of double-digit growth in home prices and compare those increases with the decline in prices since the downturn. Except for home buyers at the peak, most homeowners are better off having invested in housing than they would have been investing in some other things.

Home ownership, even if temporary, was an experience many could not have expected and one that may not occur again with today's tighter credit.

While foreclosures are at a high, only part of these are associated with loans to poor people. Strong growth markets where market speculation was terminated by the recent market price declines are illustrative. High foreclosure rates in those areas were often an outcome of market speculation and economic performance.

Foreclosures are also occurring in moderate- and high-income neighborhoods where families have become overextended. Housing is not the only thing that has increased in price. It is the overall budget that affects an ability to pay for housing.

The correlation between unemployment, illness and foreclosures shows the double-digit unemployment rates for minority families, and concentrations of bad health in low-income households have caused part of the problem.

In Memphis, neighborhoods and the community have been transformed by the availability of mortgage credit. Also, the dramatic growth of suburbs in Shelby, Fayette, Tipton and Desoto counties are affected. Existing homeowners sold their homes to the new group of market participants and bought homes in other suburbs.

While the financial industry struggles to address market weaknesses, other positive things occurred as part of credit availability. The housing market was the only high-growth segment for the first five years since 2000. That drove the economy forward and homeowners prospered with increased home-based wealth.

New homeowners took advantage of rising home prices to move into more expensive housing or increase expenditures for other items. Market speculators became wealthy by trading in housing and financial institutions and generated profits. Millions of families were placed in new and improved housing that might never have happened in the absence of easy credit. The opportunity to own a home grew to a reality for more low- to moderate-income families.

See Page 30 for more views about the national and local housing meltdown.

Borrowers Must Take Action to Turn Things Around, Counselors Say

ERIC SMITH The Memphis News

Verna Yates had lived in her Whitehaven home less than three years when the warnings from her mortgage company started arriving in the mail. The interest rate on her adjustable-rate mortgage would soon adjust, the notices read, and she should prepare for a huge spike in her monthly mortgage premium.

At first, Yates didn't know what to do. When the payment did rise – about 50 percent higher than her original bill – she honored the increase while wondering how this could have happened. She didn't remember signing on for that product when she bought her home.

"They told me it was going to be at a fixed rate and it wouldn't go up," she said. "But it did."

Yates claimed she was tricked into signing a bad loan, but instead of merely accepting the higher payment, as many do, she began inquiring about what could be done about it.

Yates attended a foreclosure conference sponsored by U.S. Rep. Steve Cohen where she discovered a housing counseling service called The Works Inc. and one of its counselors, Rhonda Rucker. That meeting changed everything.

"It was just a blessing," Yates said.

BE NOT AFRAID

A blessing because Rucker began working with Yates' lender to reduce and freeze the interest on her mortgage, something that many homeowners facing foreclosure aren't aware is a possibility. Too often, they sit idle, go into default and ultimately are foreclosed.

PHOTO BY ERIC SMITH

BACK ON TRACK: Verna Yates, left, needed help from housing counselor Rhonda Rucker of The Works Inc. to avoid foreclosure on her Whitehaven home. Yates, who called her introduction to Rucker a "blessing," had the interest rate on her adjustable-rate mortgage reduced and frozen. That's happening more and more around town as at-risk homeowners take action.

But housing counselors around Memphis are charged with preventing that. In the past year alone they have been busier than ever, logging countless hours for their clients as the subprime fallout reached a critical mass.

As more recipients of ARMs found themselves overstretched on their payments, only to find their lenders had sold their mortgages to an unsympathetic and unwilling servicer, CDCs have come to the rescue. The counselors often become tireless advocates for their clients – but only if the homeowners step forward and admit they are in trouble can the problem be resolved.

"You are a victim to a certain degree, but you have to know that you've got to get up and speak and make a change and do things differently," Rucker said.

Fortunately, that process of speaking up is happening more often. Rucker and plenty of other counselors around town have noticed a heightened awareness from those at risk.

"They're understanding the seriousness of it now because it's happening to so many of them," Rucker said. "A lot of them are saying they didn't realize they had ARMs – I've had a lot of that. I say, 'How do you go to a closing and not know you have an ARM?' But they see the light. They say, 'OK, now I know I have to pay attention and educate myself and know exactly what I'm signing.'"

Thanks to Rucker's patience and persistence with the lender, Yates' payments are back to normal – and so is her life as a homeowner and mother.

"I didn't want to be one of those people, a statistic. I didn't want to be that," Yates said. "I wanted to be somebody who was able to tell people, 'Don't be afraid to do it.'"

'DON'T GIVE UP'

Yates is by no means the only local victor in the fight against foreclosure. Glenda Dunham found herself in the same predicament earlier this year when she began receiving notices about her ARM. She was shocked, also claiming the

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THE MEMPHIS NEWS OPINION

Troubled Economic Times Likely Herald Troubled Future

A year into the national mortgage and foreclosure meltdown and the links between the real estate industry and the overall economy are unmistakable.

As severe as this scenario has become across all sectors, it's been pelted even more with higher gas prices, the U.S. dollar's declining value, rising unemployment, lackluster sales by American automakers and about 40 other economic indicators that make it clear all is far from well.

Sometimes, it's difficult to separate the economic indicators from the economic causes.

Focusing just on the real estate sector, though, the picture is a hurtful one. Chat for a moment with any Realtor you know and they will tell you how times are. The same goes for most any homebuilder.

Foreclosures are at almost unprecedented levels. Houses stay on the market perhaps three times as long as they did just three or four years ago. Invariably, listing prices are ratcheted down and down as the buyer's market has a heyday and the seller's market gets clobbered.

Usually the purveyor of sensibility when describing the nation's temperature, even the Federal Reserve is talking in sobering tones. Just last month, Fed Chairman Ben Bernanke said the U.S. economy not only is in poor condition, but the financial crisis is probably broadening. Dual forces are at work that Keynesian economists did not always see as dancing partners: a recession and inflation.

It has happened before in what was termed stagflation. Usually, when there is a recession (with a dip in demand), prices go down, not up. That's because consumers aren't able to make discretionary purchases. Bernanke did say inflation will moderate this year and next, but at the end of the day, that is uncertain.

A little background: Subprime lending practices that ran rampant around 2005 have come home to roost in all U.S. cities, although other players are involved. The excesses of Wall Street "ingenuity" fed the recent national housing valuation boom.

It created specialized investment packages bundled and sold on secondary markets with a variety of products with differing credit quality. This practice also made it virtually impossible to properly evaluate the value of the investments.

Clever investment bankers who developed sophisticated computer models projecting risks and outcomes that satisfied ratings agencies only fed the problem.

Bernanke now is recommending that regulators work on ways to assess the health of the entire financial system, rather than the condition of individual banks, Wall Street investment firms or other financial companies. That might not be a bad idea as long as it isn't taken too far. If so, it might prove costly for the regulators and those they supervise. But then it might prove costly if nothing is done.

No one can reach into the future and predict what comes next. However, we do know this: Regular homeowners, speculators and the foreclosed upon will continue to have an uphill struggle trying to get out of loans they can't afford or properties worth less than the value of their mortgages. Many owe more on their homes than they are worth.

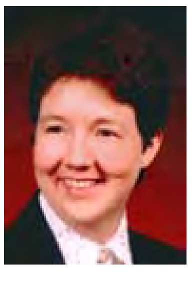
Inflation has worsened as the Fed has slashed interest rates several times in recent months. Some wonder whether the Fed made money too cheap, something that could feed into other bubbles in the future.

One thing is clear: The mess isn't going away anytime soon. ■

An Insider's View: The Mortgage Environment's Ripple Effects

Garner is a loan officer for First Tennessee Home Loans.

BY JO GARNER



Like the ripple and roll of the Mississippi River, the rainstorms upriver churn their way downstream to Memphis. The result is that it changes the way we navigate river traffic and affects other peripheral businesses beyond the riverbank.

The mortgage storm and subsequent credit crunch have washed into various business sectors, some of which are not considered to be associated with the mortgage industry. Economists are still trying to determine the severity of the problem and what to about it.

Dan Reid, a commercial banker for First Tennessee Bank, speaks from experience when he says, "Memphis is a conservative economy as opposed to Nashville and other cities, which tend to peak and fall more severely."

Even though the mortgage lending industry is intricately entwined through other business sectors, Memphis rests behind strong buffers such as the distribution businesses, manufacturing and a well-grounded medical presence. The areas that are feeling the biggest waves from the mortgage storm are construction contractors and their suppliers, Realtors and real estate service vendors.

Don Berge, president of Market Graphics of Memphis, has pointed out that new-home closings were down 35 percent in Shelby County compared to last year. Fayette County reported a drop of 10.9 percent, DeSoto County dropped 27 percent, Tipton County 34.9 percent and Crittenden County came in lower than last year by 26 percent.

"The good news when analyzing the number of new home closings with the number of housing starts over the last year," Berge explained, "is that the level of inventory is diminishing, bringing the Memphis housing market toward an equilibrium."

The recent Housing Recovery Bill of 2008 with a provision prohibiting the popular FHA seller-funded down payment assistance program will take effect Oct.1.

Memphis homebuyers are heavy users of this program, which allows buyers to buy a home with little or no money down. Other third-party assistance programs still will be available but with more restrictions.

Clint Smith, director of the U.S. Small Business Administration District Office in Tennessee, has reported that the volume on SBA loans has fallen 15 percent over the last year.

"One reason for the decline in small-business loan requests is due to the shrinking equity in homes. Small-business entrepreneurs often use an equity line of credit on a home for 'seed money.' Smith continues in his analysis: "Another reason for the decline in small-business loan volume is the uncertainty in the market and the tightening of credit standards."

Robert Staub, founder and leader of the Memphis Small Business Chamber, echoes the words of Dan Reid of First Tennessee: "The Memphis real estate market is relatively stable as compared to other areas of the country. We just don't have the value swings like other areas. The doom and gloom perception perpetuated in the national media is driving the buyer's decision."

So while Memphians aren't in great shape right now, they will overcome. ■

Loan Creativity Creates REO Boom

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BY MARY KATE BRANDON

In 2005, some lenders were extending what is often called creative financing to borrowers. Although there was a big push to get many of these borrowers into new homes, the push also affected homeowners' refinancing their existing mortgages.

Making a wide variety of creative financing programs available to a largely uneducated market of borrowers laid a strong foundation for the current focus of real estate – real estate owned by the bank (REO). Providing three-year, interest-only loans or a 30-year loan amortized over 45 years gave many Memphians the accurate though short-sighted perception that they could own a home. Own, yes, but only for two or three years.

It takes three years for the loan to switch from interest-only to principal and interest (PI) or to switch from a fixed rate to an unafforable adjustable rate. During those three years, borrowers learned that if you can't escrow your taxes when you borrow the money to buy your home, then you actually can't afford the home.

By the time these borrowers were two years into their loans, the market prices had fallen because of the change in lending practices, the glut of new construction and the decline of market values from excessive seller contributions.

The scenario continues and now it's two years too late for borrowers to get out of the hole. Some people are recognizing the problem and getting out, even if it means buying their way out when they sell the house. Others are thinking short-sell, deed-in-lieu-of-foreclosure and bankruptcy.

Meanwhile, the REO companies have jumped in to help banks deal with their excess home inventory. REO companies have realized that with the glut of housing in the banks' inventories, they are virtually indispensable. Gone is the ability to negotiate a contract.

In essence: "Accept our terms or move on. Close with our company, use our title search, take our policy." Oh, the REO company will pay for these things as long as they are providing them. It sounds great, that the REO company will pay for part of the closing costs.

Don't be fooled. As the provider of the settlement services, the REO company will disclose or not disclose liens on title, deaths of foreclosed borrowers and other matters deemed relevant. Those that are not disclosed will be insured over by their title policy. The title policy just prepares the foundation for the next wave in the housing market – curing title and litigation for people wrongfully foreclosed out of their homes.

The government bailout in Congress is supposed to be the saving grace. It will save borrowers who have been able to stay afloat while their mortgage payments adjusted.

Memphis will continue to see foreclosures and thriving REO business into 2010 while the creative loans come of age. Memphians will continue to lose their homes. Investors from California will continue to buy up housing only to lease it back to Memphians.

But some of those lenders made quite a bit and now it's the REO companies' turn to make the profit. ■