Credit crunch: Home equity lending evaporates

Hock the house? Home equity lending evaporates as real estate values fall, banks get stingy

By Adrian Sainz, AP Real Estate Writer, On Friday December 25, 2009, 11:37 am

Hocking the house for quick cash is a lot harder than it used to be, and it's causing headaches for homeowners, banks and the economy.

During the housing boom, millions of people borrowed against the value of their homes to remodel kitchens, finish basements, pay off credit cards, buy TVs or cars, and finance educations. Banks encouraged the borrowing, touting in ads how easy it is to unlock the cash in their homes to "live richly" and "seize your someday."

Now, the days of tapping your house for easy money have gone the way of soaring home prices. A quarter of all homeowners are ineligible for home equity loans because they owe more on their mortgage than what the house is worth. Those who have equity in their homes are finding banks far more stingy. Many with home-equity loans are seeing their credit limits reduced dramatically.

The sharp pullback is dragging on the economy, household budgets and banks' books. And it's another sign that the consumer spending binge that powered the economy through most of the decade is unlikely to return anytime soon.

At the peak of the housing boom in 2006, banks made $430 billion in home equity loans and lines of credit, according to the trade publication Inside Mortgage Finance. From 2002 to 2006, such lending was equal to 2.8 percent of the nation's economic activity, according to a study by finance professors Atif Mian and Amir Sufi of the University of Chicago.

For the first nine months of 2009, only $40 billion in new home equity loans were made. The impact on the economy: close to zero.

"The home as ATM is yesterday," says Keith Gumbinger, vice president of HSH Associates Financial Publishers, which publishes consumer loan information.

Millions of homeowners borrowed from the house to improve their standard of living. Now, unable to count on rising home values to absorb more borrowing, indebted homeowners are feeling anything but wealthy.

Holly Scribner, 34, and her husband took out a $20,000 home equity loan in mid-2007 -- just as the housing market began its swoon. They used the money to replace sinks and faucets, paint, buy a snow blower and make other improvements to their home in Nashua, N.H.

The $200 monthly payment was easy until property taxes jumped $200 a month, the basement flooded (causing $20,000 in damage) and the family ran into other financial difficulties as the recession took hold. Their home's value fell from $279,000 to $180,000. They could no longer afford to make payments on either their first $200,000 mortgage or the home equity loan.

Scribner, who is a stay-at-home mom with three children, avoided foreclosure by striking a deal with the first mortgage lender, HSBC, which agreed to modify their loan and reduce payments from $1,900 a month to $1,100 a month. The home equity lender, Ditech, refused to negotiate. Scribner's husband, Scott, works at an auto loan financing company but is looking for a second job to supplement the family's income.

The family is still having trouble making regular payments on the home-equity loan. The latest was for $100 in November.

"It was a huge mess. I ruined my credit," Holly Scribner says. "We did everything right, we thought, and we ended up in a bad situation."

It's a mess for the banking industry, too.

Home equity lending gained popularity after 1986, the year Congress eliminated the tax deduction for interest on credit card debt but preserved deductions on interest for home equity loans and lines of credit. Homeowners realized it was easier or cheaper to tap their home equity for cash than to use money taken from savings accounts, mutual funds or personal loans to fund home improvements.

Banks made plenty of money issuing these loans. Home equity borrowers pay many of the costs associated with buying a home. They also may have to pay annual membership fees, account maintenance fees and transaction fees each time a credit line is tapped.

In 1990, the overall outstanding balance on home equity loans was $215 billion. In 2007, it peaked at $1.13 trillion. For the first nine months of 2009, it's at $1.05 trillion, the Federal Reserve said. Today, there are more than 20 million outstanding home equity loans and lines of credit, according to First American CoreLogic.

But delinquencies are rising, hitting record highs in the second quarter. About 4 percent of home equity loans were delinquent, and nearly 2 percent of credit lines were 30 days or more overdue, according to the most recent data available from the American Bankers Association.

A rise in home-equity defaults can be particularly painful for a bank. That's because the primary mortgage lender is first in line to get repaid after the home is sold through foreclosure. Often, the home-equity lender is left with little or nothing.

Banks are applying the brakes.

Bank of America, for example made about $10.4 billion in home equity loans in the first nine months of the year -- down 70 percent from the same period last year, spokesman Rick Simon says. The also started sending letters freezing or cutting lines of credit last year, and will disqualify borrowers in areas where home prices are declining.

"This was just solid risk management," he says.

Jeffrey Yellin is in the middle of remodeling his kitchen, dining room, living room and garage at his home in Oak Park, Calif. He planned to pay for the project with his $200,000 home equity line of credit, which he took out in January 2007 when his house was valued at $750,000.

In October, his lender, Wells Fargo, sent a letter informing him that his credit line was being cut to $110,000 because his home's value had fallen by $168,000, according to the bank.

He is suing the bank, alleging it used unfair standards to justify its reduction, incorrectly assessed the property value, failed to inform customers promptly and used an appeals process that is "oppressive." Jay Edelson, a lawyer in Chicago who is representing Yellin, says homeowners are increasingly challenging such letters in court. He says he's received 500 calls from upset borrowers.

Wells Fargo declined to comment on Yellin's lawsuit but said it reviews of customers' home equity lines of credit to make sure that account limits are in line with the borrowers' ability to repay and the value of their homes.

"We do sometimes change our decisions when the customer provides sufficient additional information," Wells Fargo spokeswoman Mary Berg said in a statement e-mailed to The Associated Press.

Work has stopped at the Yellin's home. The backyard, used as a staging area for the remodeling job, is packed with materials and equipment.

"Now, I've got a backyard that looks like 'Sanford and Son' almost," he says.

http://finance.yahoo.com/news/Credit-crunch-Home-equity-apf-1280606101.html?x=0&sec=topStories&pos=main&asset=&ccode=