July 30, 2009

Federal Trade Commission
Office of the Secretary
Room H-135 (Annex T)
600 Pennsylvania Avenue NW
Washington, DC 20580

Submitted online at https://secure.commentworks.com/ftcmortgageactsandpractices

Re: Mortgage Acts and Practices Rulemaking, Rule No. R911004

Thank you for the opportunity to share our opinion with the Federal Trade Commission (FTC) (FHFA) regarding unfair and deceptive mortgage acts and practices that should be prohibited or restricted.

We would like to call the FTC's attention to the fraudulent lending practices of home builders and their affiliated lenders.

The abusive and deceptive practices described here are not limited to one company but are an industry wide problem. There are striking similarities among the homebuyers' experiences, demonstrating that these are standard practices in the industry.

Together, the individual cases also highlight the role that homebuilders played in the boom, bubble, and bust that brought on the current crisis. They kept building, kept buying land, and kept pushing mortgages even though there were clear signs the housing market was not sustainable and that homebuyers were financially over their heads. In the process, they misled homebuyers about the deals they were getting and pushed them into mortgages that were unfair and deceptive.

There is a fundamental conflict of interest in builders originating their buyers' mortgage. 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 height of the housing boom in 2005 and 2006 builders were only able to sell homes at such inflated prices because of the collaboration with their mortgage subsidiaries and affiliated appraisal companies

Homeowners in new developments have been especially hard hit by the current housing crisis and their subdivisions are in a unique situation. Unlike older existing neighborhoods where there is a mix of when homeowners received their mortgages and how much equity they have, new subdivisions have concentrations of homeowners who purchased their homes within a year or two of each other.

Steering

Most large builders have their own mortgage subsidiaries which provide the financing for the vast majority 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.

Builders offer incentives, such as paying a buyer's closing costs, that are only available to homebuyers who use the builders' affiliated mortgage lender. Homebuyers automatically assume that this savings on closing costs is the best deal available, which deters comparison shopping with other mortgage companies that might be able to offer a better rate or type of loan.

However, we have seen a number of transactions in which the builder offered to pay a large amount of money, such as $20,000 to $25,000, and then in order to make it seem as if the builder were actually paying that amount, the bulk of the money went towards discount points to give the buyer a lower rate, but the buyer did not actually get a lower rate than they would have otherwise.

> Teresa Sandoval bought a home from Lennar in Indio, CA in October 2006. She received financing through Lennar's lending subsidiary Universal American Mortgage and Lennar paid $15,000 for closing costs. The bulk of this went for discount points paid to Universal American -- $7,486 on the first mortgage and $1,660 on the second mortgage. However, it is difficult to see what discount Ms. Sandoval received. At the time of her loan, the average rate on a 30 year fixed rate mortgage was 6.4%, and Ms. Sandoval's rate was 6.75% on the first and 12.125% on the second.

> Jesus Beltran purchased a home from KB in Coachella, CA in May 2007 with financing from Countrywide KB Home Loans. KB paid $10,000 for his closing costs, all of it went towards paying the $12,698 of discount points on the first and second mortgage.
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> It is unclear how much of a discount Mr. Beltran actually got for the 3.75 points on his first mortgage. At the time of his loan the average rate for a fixed 30 year mortgage according to Freddie Mac was 6.18%. Mr. Beltran received an adjustable rate loan with a prepayment penalty that started at 5.5% but could go as high a 10.5% and had an APR of 6.88%.
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> It does not appear that Countrywide KB informed Mr. Beltran of how much the discount points would be until very late in the process. Although the discount points are disclosed on the Good Faith Estimate which is dated two weeks before the closing, a document titled "Closing Cost Estimate" and dated three months before closing shows the closing costs and prepaids totaling less than $5,000, which were all the fees except the discount points which are not disclosed at all on this form.

In other cases, the promised benefits are more than made up for by inflated appraisals, unfavorable mortgage terms, or other fees.

When Bob Berres purchased his home in Arizona from Lennar, Lennar offered to give him a $90,000 reduction in the price of the home from $587,000 to $497,000 if he used Lennar's mortgage company Universal American. However, the home was not worth $587,000. The appraisal valued it at just $502,000.

Buyers who became wary of the terms of the mortgages were threatened with losing their deposits if they walked away from the mortgage. The misleading and high pressure sales tactics explain the homebuilders' very high rates of persuading their buyers to use their mortgage affiliate.

The chart below shows the percentage of a builder's customers who used the builder's affiliated mortgage lender to purchase their home. The industry collectively refers to this as a "capture" rate, reflecting how they view the process

Homebuilder Mortgage Capture Rate 2006

Builder	**2006 Capture Rate**
D.R. Horton[i]	68%
KB/ Countrywide KB[ii]	57%
Lennar[iii]	66%
Pulte[iv]	91%

Builders have not been content to just use incentives to steer buyers to the affiliated mortgage company. Builders have resorted to what can only be termed "scare tactics" – frightening buyers with the dangers of using an outside lender and the financial harm that can result to the buyer. These scare tactics are evident in the purchase agreements of several of the largest home builders.

<u>DR Horton</u>

Buyer <u>must</u> apply for financing through DR Horton's affiliated mortgage lender, DHI Mortgage within five days after entering into a purchase agreement. The buyer may apply to another lender in addition to, but not instead of, DHI Mortgage.

The buyer is considered in default of the purchase contract if the buyer uses an outside lender and is not able to close by the closing date. In which case DR Horton has the right to cancel the purchase agreement and keep the buyer's deposit, which is often $5,000 or more. DR Horton may, in its sole discretion, choose to extend the closing date and charge the buyer $300 per day until closing.

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<u>KB Home</u>

The "financing agreement" that is part of the KB Home purchase agreement states that KB will not accept any government finance programs such as FHA, VA, or state programs from an outside lender.

The "financing Agreement" imposes several penalties on buyers if they use an outside lender and the outside lender doesn't meet KB's timeline for closing. There is a $500 late charge if the loan documents are not at the title company 14 days before closing and there is a penalty of $300 per day if the deal does not close by the seller's estimated closing date.

<u>Lennar</u>

Buyer must apply for financing with Lennar's affiliated mortgage lender, Universal American Mortgage Corporation within five days of entering into a purchase agreement. The buyer may apply to another lender in addition, but not instead of applying through Universal American.

If the buyer decides to finance the purchase through an outside lender and does not close by the closing date, Lennar may cancel the purchase contract and keep the buyer's deposit.

The purchase agreements and process used by the builders seem designed to limit the choices of their homebuyers. There are many cases in which homebuyers are steered to the builder's own mortgage company and offered incentives or discounts, but are actually charged higher rates or fees.

<u>Mortgage Terms</u>

Most of the homebuyers report having very high credit scores and putting down large down payments but say that they received mortgages with terms that were not what they wanted or what they thought they were getting, such as interest-only, adjustable rate loans and piggyback and disguised second mortgages with high interest rates and balloon payments. These transactions bear many of the hallmarks of predatory lending, according to HUD criteria.[1]

Some found out about these terms at closing, but by then it was too late. Others found out about the terms after they were in the home.

In some of the cases, the buyers were Spanish speakers who generally did not read or write English. The sales and loan representatives conducted the transactions primarily in Spanish, but

[1] According to HUD, predatory lending is indicated by the presence of the following factors, along with a few others: (1) sell properties for more than they are worth using false appraisals; (2) encourage borrowers to lie about their income, expenses or available cash; (3) knowingly lend more money than a borrower can afford to repay; and (4) pressure borrowers to accept higher-risk loans, such as balloon loans, interest only payments, and steep pre-payment penalties. HUD, Don't be a Victim of Loan Fraud, at http://www.hud.gov/offices/hsg/sfh/loanfraud.cfm.

mortgage documents were provided only in English, making it even less likely that buyers would understand or reject the mortgage terms.

In other cases the homebuilders sales representatives discouraged homebuyers away from better loans, including credit union and Veterans Administration loans, misrepresenting the availability or terms of those loans and promising more favorable terms, such as in the following case:

> *Troy Monson is in the Air Force. When he and his wife Jennifer went to purchase their home from Lennar in Arizona, they wanted to use his VA certificate. However, the Lennar salesperson convinced them to get a loan through Lennar's company Universal American instead.*
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> *According to Mr. Monson, the salesperson said they could only use their VA certificate one time (which is not true) and that they should save it for the future. The salesperson also said that Lennar would pay the closing costs if they got financing through Universal American.*
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> *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 Lennar gave them an interest-only ARM that starts at 7.25% and can go as high as 12.25%, and a second mortgage with a variable rate that started at 8.625%.*

Appraisal Fraud

We have been conducting reviews of appraisals that were done by Countrywide KB Home Loans on homes that were being sold in Arizona by KB Home. The reviews have found a number of irregularities, such as that the appraisers overlooked sales that were more similar in size and closer geographically in favor of sales of homes of dissimilar sizes that were much farther away (10 miles in one case).

> *In a particularly egregious case, Nathan Johnson sought to purchase a home from KB Home for $394,000. He tried to get a mortgagee through the Navy Federal Credit Union. However the Navy Federal appraiser valued the home at just $351,000.*
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> *Rather than lower the price, KB Home tried to get the Navy Federal appraiser to increase the value. When this failed, Countrywide did its own appraisal which found that the house was worth $394,000, and Countrywide KB agreed to make a first and second mortgage for the full amount. Mr. Johnson and his wife had just relocated from California and were expecting a baby soon and so felt they had to go ahead with the purchase.*

The homeowners whose appraisals we reviewed are now the plaintiffs in a $2.8 billion class action lawsuit filed against Countrywide KB and its appraisal firm Landsafe. We believe that similar claims may exist against the other homebuilders. An independent review of a Pulte appraisal found that:

- *"The original appraiser traveled two miles for one of the comparable sales when sales were available closer to the subject"* and

- *"The appraiser used a sale that had 442 square feet difference of gross living area than the subject. Using a sale with this big difference tends to over/under state the value conclusion due the adjusted amount. The reviewer found sales the appraiser could have used with GLA within 50 square feet of the subject."*

<u>Disguised second mortgages</u>

Many homebuyers report not knowing that they received a second mortgage until they closed on their new homes. These second mortgages were described as home equity lines of credit (HELOCs). However, the HELOCs were in fact second mortgages: they were for the balance of the purchase price and were fully drawn down at closing. Homebuyers weren't told the monthly payment, as is required for closed-end second mortgages under the Truth in Lending Act (though open-ended HELOCs are exempt). These seconds also have adjustable interest rates that change monthly and could go up to 18% and have interest only payments.

Contrary to what the builders and lenders may say, these HELOCs are not intended to be drawn on later by the homebuyer. With the HELOCs at Countrrywide KB, the entire credit limit is lent out at closing. The loan documents state that the homebuyer's minimum payments due will not reduce the principal balance at all during the first five years after the loan. The loan documents also state that the only time the borrower may draw on the HELOC is during the first five years, a period which may be extended only by the decision of the lender.

We believe that through their loan originations home builders played a large role in creating the current housing crisis. If builders' sales and lending practices continue unabated, it will lead to more problems in the future for individual homeowners and entire communities.

Thank you again for the opportunity to comment on this important matter. Please contact us if you have any questions regarding this letter.

Sincerely,

Terence M. O'Sullivan
General President
Laborers International Union of North America

[i] D.R. Horton, Fourth Quarter Earnings Call, November 14, 2006
[ii] KB Home 2007 10-K, February 13, 2007. KB's lower capture rate than the other builders may be due to their mortgage operation being a joint venture with Countrywide and not a wholly owned subsidiary of the company.
[iii] Lennar 2007 Annual Report
[iv] Pulte 2007 10-K, February 25, 2008