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The Ever More Graspable, and Risky, American Dream

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ANAHEIM, Calif. - For years, Ray and Shahrazad Daneshi sought to buy a home, only to be told that they did not earn enough to qualify for a mortgage. But they recently managed to buy a small house in the shadow of Disneyland for $360,000 - six times their annual income - thanks to a lender who allowed them to borrow the entire value of the home, with no down payment.

"We will not be going to any movies or eating out at restaurants," said Mr. Daneshi, a self-employed wedding photographer who came here from Iran in 1988. "But in two years, the house will be worth a lot more and we will have something to show for it."

The Daneshis' purchase underscores the new, ever-optimistic economics of home buying. A kaleidoscopic array of mortgages for people with little cash or overstretched budgets has enabled families of modest income to take on debt that once would have been beyond their reach. As long as new home buyers could count on rock-bottom interest rates and housing values were going nowhere but up, this seemed to be a virtuous circle.

But now, with the Federal Reserve expected to embark on a series of interest rate increases starting with its meeting on June 30, some experts worry that recent first-time buyers could find easy home ownership a lot harder on their wallets, possibly causing housing prices to wobble in some high-price markets.

With the Daneshis, for example, rising interest rates on the two adjustable-rate mortgages they took out to buy their house would mean that their monthly payment of $2,500 - already more half their monthly income - could go up substantially in two years. Mr. Daneshi realizes that, but is unconcerned.

"Why worry?" he said, adding that he believes rising home prices will help him obtain a better loan deal by then.

With interest rates going up, that may be wishful thinking. Most analysts agree that there is no nationwide housing bubble because housing prices have climbed only slowly in the Midwest and the South, even as they have soared on the East and West Coasts. Still, if rising interest rates cause housing prices to drop, even slightly, industry officials warn that some new buyers will have no equity in their homes and could choose to walk away from their loans if they run into trouble with payments.

"A lot of these loans are dangerous," said Allen Jackson, manager of Bristol Home Loan in Bellflower, Calif., a mortgage broker who specializes in so-called subprime loans, which charge higher interest rates to people unable to qualify for traditional mortgages. "If you have any dip in values, people can just say the heck with it because they don't have any of their own money in the house."

Lenders have aggressively encouraged home buyers to stretch in ways that would have been unimaginable a decade ago. In the new world of flexible mortgage lending, it is possible to buy a $600,000 house with no down payment, and to pay only interest and nothing on the principal for years.

"The financing has changed everything," said Humid Karat, a manager of Tarbell Realty's office in Anaheim. "Ten years ago, if I offered to buy your house with a 100 percent loan, you would have called it 'creative financing' and thought I was crooked. Today, everybody wants a 100 percent loan."

The volume of subprime mortgages, primarily for people with poor credit ratings, has risen sharply, as indicated by securities backed by the mortgages. Such securities soared to a total of $195 billion in 2003 from $17 billion in 1995, according to Inside Mortgage Finance, an industry research firm in Bethesda, Md. Securities backed by unconventional mortgages, like no-money-down loans, climbed to nearly $80 billion from less than $1 billion.

"Underwriting standards have loosened to almost historic levels," said Bill Dallas, a pioneer in no-money-down loans and a board member of the California Mortgage Bankers Association. "Nobody is heeding the yield signs."

Experts say these novel techniques have democratized the access to credit and home ownership. The overall rate of ownership climbed to nearly 69 percent in 2003 from 64 percent in 1994. Home ownership among blacks rose to 48 percent from 42.2 percent. Among Hispanics, it was up to 46.4 percent from 41.1 percent.

But the experts worry that problems may be just over the horizon, especially in markets where housing prices have risen far faster than personal income. Here in Orange County, one of the frothiest markets of all, the median price of a single-family home is $572,000, up 28 percent in the last year alone.

In the New York area, the median home price - half were less expensive, half more expensive - rose 88 percent from 1998 to 2003, to $353,000 from $188,100; in Miami, prices jumped to $226,800 from $121,500. The median home price for the Washington area increased to $286,200 from $172,100.

Signs that the frenzy has not yet reached a peak abound in Southern California. In Ladera Ranch, a planned community in the southern part of Orange County, more than 1,000 people are on a waiting list for the chance to buy one of 27 unbuilt three-bedroom houses at prices starting in "the low $400,000's." In San Bernardino County, where some commute as long as two hours a day to jobs in Los Angeles and elsewhere, a five-bedroom tract house that sold for $378,000 a year ago is on the market again for $609,000.

Mark Zandi, chief economist at the research firm Economy.com, estimates that about a third of the nation's housing is now overpriced and poised for at least a mild drop in values as the Fed begins to push up rates.

And there is a risk that the situation could turn into something a lot worse. "If there is a fissure in the economic system, it's in housing," Mr. Zandi said. "This is a big, rapidly growing market that has not been tested by higher interest rates. Many people got into their houses by the skin of their teeth."

Southern California is at the leading edge. People with poor credit ratings or low incomes can take out subprime mortgages at high interest rates. Those with good credit but erratic earnings can get what are called no-document loans, in which they do not have to prove their incomes.

By any measure, such innovations have vastly expanded the availability of credit over the last decade, making it possible for people previously shut out of the market to share in the dream of home ownership.

"Thanks to God for finding me a mortgage program that let me buy my own house," Mr. Daneshi said.

He and his wife, a seamstress at Disneyland, had lived for years in a cramped apartment with their autistic son. They took out two mortgages this month, one for $280,000 at 6 percent and the second mortgage for $80,000 at 10.25 percent. Both are adjustable after two years, and the payments are virtually certain to rise, meaning that their budget will be further pinched unless their income rises, too.

And they are hardly alone in stretching.

Mark Christian, 33, a controller at a stock brokerage firm, is buying a four-bedroom house for $620,000. Mr. Christian, who earns $160,000 a year, is also borrowing the entire purchase price. To keep his monthly payments down to $3,700, he is taking out an interest-only loan.

Mr. Christian is already bracing for higher monthly payments. His mortgage will adjust to prevailing interest rates after three years, which he expects will be higher. "I'm figuring that my income will have climbed by then as well," he said.

House prices have climbed so rapidly in the last few months that banks are refusing to appraise some properties as high as their selling prices.

Jennifer Tracy, a graphic designer, recently agreed to buy a condominium in Los Angeles for $235,000. But the same property had exchanged hands less than a year before for $114,000, and no appraiser would value it at more than $195,000. Ms. Tracy bought the condo anyway, but only after coming up with the extra cash to bridge the gap.

The big question is whether prices will remain so high once the Fed begins raising interest rates.

Real estate agents and many homeowners here vividly remember that Southern California housing prices soared in the 1980's and then fell in the early 90's - the bubble ruptured by a combination of rising rates and a severe contraction in the region's aerospace and armaments industries.

Today, interest rates are clearly heading up, but employment is climbing and economic growth appears strong. As a result, the Fed is widely expected to start raising rates at the end of this month, and some analysts worry that it may have to raise rates more sharply than originally planned to keep inflation under control.

Mr. Zandi, of Economy.com, said that in overheated markets like Southern California, housing prices could easily drop at least 5 percent.

Mortgage brokers who help people qualify for bigger loans, acknowledge that they are nervous. But for the moment, they are pressing ahead.

"What can I do?" asked Mr. Jackson, the manager of Bristol Home Loan, the subprime loan specialist. "My job is to help people realize the American dream."