The Real Minefield: Sub Prime Loans

Contributed by Administrator
Saturday, 23 December 2006
Last Updated Wednesday, 27 December 2006

The Real Minefield: Sub Prime Loans

It's becoming increasingly clear that the greatest vulnerability to foreclosure lies in the sub-prime sector of the mortgage market. According to a recent article in the New York Sun, 62% of sub-prime loans made in 2005 were made with little or no income verification. In addition, 52% of those loans were interest only or had negative amortization.

The Real Minefield: Sub Prime Loans

by Alan Smith

It's becoming increasingly clear that the greatest vulnerability to foreclosure lies in the sub-prime sector of the mortgage market. According to a recent article in the New York Sun, 62% of sub-prime loans made in 2005 were made with little or no income verification. In addition, 52% of those loans were interest only or had negative amortization.

{quotes align=right} Did bankers lose their minds during the heady years of record price appreciation? Apparently so. {/quotes} In response to this disturbing situation, the Comptroller of the Currency office issued new guidelines in September that will require higher reserves against non-traditional loans and require fuller disclosure to lenders by borrowers.

Comptroller of the Currency John Dugan, at a recent convention of community lenders, acknowledged that the federal guidelines only apply to federally chartered banks, and the bankers are complaining that the new guidelines put them at a competitive disadvantage with local non-traditional mortgage lenders. Dugan said that he understood the problem, and urged that the states must also follow the federal guidelines as well.

There is evidence that this is happening, but is it too late to prevent financial distress to thousands of homeowners?

New Century, a California sub-prime lender recently said that they were tightening their underwriting standards and that 88% of their outstanding loans were sub-prime, 42% were made on stated income, and that 17% were interest only loans.

Now they're upgrading their underwriting? Talk about locking the barn door after the horse is gone! Foreclosure activity is rising across the nation.

What will be the impact of the current situation on the foreclosure market?

While non-traditional mortgages make up an alarming percentage of outstanding home loans, there are other factors that are going to put homeowners in a bind. For example, in 2005, according to the U.S. Census Bureau, 47 million people or 16% of the U.S. population were without health insurance. Uninsured homeowners that develop health problems will experience costs that could put their homes in jeopardy.

And then there is the rise in short-term consumer debt. According to the Federal Reserve, credit card debt more than doubled in the first six months of 2006. Over the last two years, non-mortgage debt has increased nationally year over year about 12.5 % to an average of $11,669 early in 2006. Non-mortgage debt could force households that are overextended into foreclosure.

As we’ve said, in past columns, too many homeowners have been using their property as ATM machines. With home price appreciation going flat in most metro markets, and declining slightly in the previously overheated coastal markets, they can’t do that anymore.

Gary Gordon of Annaly Capital Management, a firm that deals in mortgage backed securities feels that further declines in sales volume and in prices could actually lead to a recession in 2007.

Jim Glassman at JP Morgan Chase disagrees with the recession prediction.. He says consumer spending is driven by job and income growth, the stock market, as well as by the housing market. In so saying, he acknowledges that we are in a consumer economy, and consumer confidence remains at healthy levels.

Gordon points out that the housing market is much more broadly based than the stock market and that there is a constant marketing drive for home equity loans even as the housing markets cool down. “When was the last time you got a flyer in your mailbox asking you to borrow against your stock portfolio?” he says.

Edward Leamer of the Anderson school of business at UCLA has said more than once that falling sales volume in any market is a harbinger of price correction in that market. Once a bubble alarmist, he now sees a gradual return to normalcy rather than a price crash. Sales peaked in mid 2005 at an annualized pace of 7.2 million units. Currently sales are off 12% from that peak.

So, what do we do with all these opinions?

The bottom line for us as investors is that we have thousands of homeowners out there that have used non-traditional mortgages to purchase homes in inflamed markets. Many were not fully informed by their lenders, or by the brokers with whom the dealt, of the future risk of severe payment shock. As a result, many have bought homes they could not, in the long run, afford.

Now, remember what we have said for the last four years: THERE IS NO NATIONAL HOUSING MARKET!! Housing markets are regional. There are hundreds, if not thousands, of micro-markets around the country.

Chicago never had a price boom, but the market there is cooling and prices have gone flat and foreclosures are on the upswing. Still, there are buyers for homes there, as well as sellers who MUST sell.

San Diego Calif. had a price boom that dazzled the real estate world, and now that's over. Prices have fallen about 4% there this year, and foreclosures are up, for the foregoing reasons. But people are still growing up, moving in, and buying homes.

This time around, the increase in foreclosures can happen in a normal, healthy housing market. The feeding frenzy of the last five years was NOT normal. In fact, this is the first time in history that housing has slowed in the absence of economic weakness.

There are thousands of homeowners out there with equity to protect as they find themselves faced with sharply higher payments that they can't handle. People who bought in 2003 and 2004 with exotic mortgages – they can't refinance, and they don't have time to sell at full market value.

And, they can no longer run into court and stall foreclosure with a bankruptcy filing at the drop of a hat. The new law makes it a lot tougher to seek shelter there.

2007 will see an incredible flood of buying opportunities for foreclosure investors, both in helping troubled homeowners, and in buying properties at deep discounts from lenders swamped with REO. This is your chance to make a fortune for yourself and your family. DO NOT MISS OUT!!!

- All Past "Nationwide News" Columns

- As a Successful Foreclosure Investor

Give your Family the Gift of Your TIME

Details on Wednesday November 8th, 2006 6pm PDT

- I Create Successful Real Estate Entepreneurs...

One at a Time (the Honest and Ethical Way)

- Foreclosure Profits are BOOMING

Search over 1,537,714 Foreclosures natinwide and Growing!

- Foreclosure Buying Season is upon Us...

Copyright © 2006 Foreclosures.com.

This article is available for free distribution under the following terms:

a) You may not edit, delete or add any content to this article.

b) You must maintain all links to Foreclosures.com.

c) This article must be distributed free of charge.

d) This Resource Box must stay intact.