The Mortgage Corner

RISING FORECLOSURE RATE CAUSE FOR ALARM?

The delinquency rate for mortgage loans on one-to-four-unit residential properties is rising. What does it mean for the real estate market, particularly sub-prime and first time home-buyers? Delinquencies stood at 4.95 percent of all loans outstanding in the fourth quarter of 2006 on a seasonally adjusted (SA) basis, up 28 basis points from the third quarter, and up 25 basis points from one year ago, according to Mortgage Bankers Association's National Delinquency Survey.

The increase was driven by increases in delinquencies for all major loan types, most notably for subprime and FHA loans. Delinquency rates for prime, subprime, FHA, and VA loans increased on a seasonally adjusted basis relative to the third quarter. The delinquency rate for FHA loans reached a new record in the fourth quarter.

The percentage of loans in the foreclosure process was 1.19 percent of all loans outstanding at the end of the fourth quarter, an increase of 14 basis points from the third quarter of 2006, while the SA rate of loans entering the foreclosure process was 0.54 percent, eight basis points higher than the previous quarter and a record high. Compared with the fourth quarter of 2005, the percentage of loans in the foreclosure process was up 20 basis points while the percentage of loans entering the foreclosure process was up 12 basis points.

"Although the U.S. economy and job market remain solid, the housing market continued to decelerate in the fourth quarter of 2006. Nationally, house prices increased at a slower rate and the pace of sales and construction activity continued to slow," said Doug Duncan, MBA's Chief Economist.

"The market is working, culling over-capacity from the industry, as price signals from the capital markets lead to changes in product mix from originators, and directly and immediately impact the rates that mortgage lenders can offer to borrowers. Far from being a problem, these clear and effective market signals and actions will help the market to more efficiently regain its equilibrium.

One result of the worsening sub-prime problem is that federal regulators are calling for stricter qualification standards that must assess a borrower’s ability to repay their loan. This can be achieved with either higher credit score minimums, income and/or asset verification.

Also, the Federal Reserve, the Office of the Comptroller of the Currency and other regulators have cautioned banks about predatory lending practices including concealing the true nature of a mortgage loan. This will definitely put a crimp in sub-prime lending, although it is too early to assess its extent.

The National Association of Realtors doesn’t believe the delinquencies will impact the prime lending market. "Lending problems in our nation's sub-prime marketplace are building, which could inhibit future housing activity and further dampen our forecast," said NAR chief economist David Lereah in his latest update. "Even so, these problems are likely to be contained and not spill over into the prime mortgage market."

There will be "some additional pain" in the new-home market, though existing-home sales are expected to "slowly improve" from a cyclical low last fall, Lereah said. NAR now forecasts new-home sales at 950,000 in 2007, followed by 981,000 next year. A total of 1.06 million new homes were sold in 2006.

Although it's difficult to gauge home builders' direct exposure to the imploding market for sub-prime loans, none are likely to be immune to the ripple effects resulting from tighter mortgage lending standards whether they sell to first-time buyers or the high-end luxury market.

After the housing market's peak, home builders are struggling with a glut of unsold homes on the market with many speculative investors who flipped homes for a profit finally throwing in the towel. Buyers nervous about purchasing a home that may be cheaper in a few months are backing out of contracts, resulting in a spike in cancellation rates at the home builders.

The Seasonally Adjusted (SA) delinquency rate increased during the fourth quarter for all loan types. The delinquency rate increased 13 basis points for prime loans (from 2.44 percent to 2.57 percent), 77 basis points for sub-prime loans (from 12.56 percent to 13.33 percent), 66 basis points for FHA loans (from 12.80 percent to 13.46 percent), and 24 basis points for VA loans (from 6.58 percent to 6.82 percent).

At the regional level, the Northeast region had an overall SA delinquency rate of 4.58 percent, the North Central region had a delinquency rate of 5.68 percent, the South had a delinquency rate of 5.71 percent, and the West had a delinquency rate of 3.18 percent, compared to the national rate of 4.95 percent. For the unadjusted foreclosure inventory rate, the Northeast region had a rate of 1.16 percent, the North Central region had a rate of 2.02 percent, the South had a rate of 1.08 percent, and the West had a rate of 0.63 percent, compared to the national rate of 1.19 percent.

"Given our macroeconomic forecast of below trend economic growth and a slowly recovering housing market, we would expect delinquency and foreclosure rates to level off as the housing market regains its footing towards the end of 2007," said Duncan.