

Subprime mortgage lenders take beating from bad news

by Mike Freeman

Shares of subprime mortgage lenders nose-dived Monday as investors reacted to a stream of bad news pouring out of companies that make home loans to buyers with weak credit.

New Century Financial of Irvine, which announced late Friday that it faced a federal criminal probe over its handling of securities prior to its earnings restatement last month, sparked the sell-off. Its shares lost 69 percent of their value Monday, closing at \$4.56. Some analysts speculated that the nation's second-largest subprime lender was headed for bankruptcy.

San Diego's Accredited Home Lenders was swept into the downward vapor trail. Its shares shed 26 percent of their value to close at \$16.06.

The problems in subprime, which have crescendoed in recent weeks, could have broader implications for the overall housing market. Lenders spooked by subprime's troubles may tighten their standards for borrowers with better credit.

For the most part, that hasn't happened so far. A host of mortgage options remain available to buyers with good credit or those with equity in their homes, industry experts said.

But in the subprime industry, the upheaval stemming from a surge in deadbeat loans has created a "crisis in confidence" that is putting mounting pressure on lenders, Chris Brendler, an analyst with Stifel Nicolaus, said in a research report released Monday.

Fremont General of Santa Monica saw its shares drop 32 percent to \$5.89 after announcing Friday that it received a cease-and-desist order from the Federal Deposit Insurance Corp., which noted violations in some company transactions. Fremont said it may sell its subprime business.

And NovaStar of Kansas City, Mo., slipped 41 percent to \$4.28. New Century, NovaStar and Accredited were downgraded to a "sell" recommendation Monday by Brendler.

"We see increasing evidence that this industry is now in a downward spiral whereby each negative development fuels additional deterioration in key fundamentals," he wrote in a research note to clients.

Accredited doesn't comment on moves in its stock, company spokesman Rick Howe said.

Although problems at New Century and Fremont were expected to depress Accredited's share price, the extent of the sell-off surprised Wall Street analysts.

"I'm trying to figure out right now whether it's collateral damage, in which case it's severely overdone, or is there something I don't know?" said Richard Eckert, an analyst with Roth Capital Partners.

Subprime lenders have been reeling from a surge in defaults, where borrowers fail to make mortgage payments. Most of the problems stem from loans made in the past two years, when easy credit standards led to a surge in loans.

Lenders usually bundle their loans and sell them to investors in the secondary market. But as defaults have risen, investor appetite for subprime loans has evaporated.

"They all got caught up in this insanity of throwing all standards out the window," said David Olson of Mortgage Access, a mortgage research company based in Maryland. "They just handed out money thinking any loan would sell to Wall Street."

The result is that the amount investors are willing to pay for certain mortgage pools is less than it costs lenders such as Accredited and New Century to originate loans.

"Finally, Wall Street is saying no more. These loans aren't performing," Olson said.

There's another strain for subprime lenders. If a loan defaults early in its life, secondary buyers often require the lender to buy it back, with penalties and interest.

The top fear analysts have, however, is that investment banks that provide warehouse lines of credit to lenders will pull back. Most of these credit lines have covenants that say the lender can't post two straight quarters of losses. Subprime lenders must obtain waivers to these covenants to remain in business. Accredited, which lost \$37.8 million last quarter, has received waivers from the eight banks that provide its warehouse lines, said Howe, the company spokesman.

Accredited is stronger than some of its subprime rivals, analysts said. It has been among the more conservative subprime lenders. Accredited had more than \$500 million in cash or short term investments - some of which is restricted - at the end of the third quarter, according to filings with federal regulators.

Still, Accredited faces a tough road given industry upheaval, analysts said.

"If there's widespread panic in the capital markets - if New Century's warehouse lenders get nervous and start pulling their lines, and the warehouse lenders up and down the street start pulling their lines - that's the thing that scares me," Eckert said.

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