Housing slump into 2008 likely, study finds

by Emmet Pierce

The implosion of the subprime mortgage market is likely to prolong the national housing slump, Harvard University researchers said recently in their annual report on the state of the nation's housing.

"At a minimum it will slow any recovery," said Nicolas P. Retsinas, director of Harvard's Joint Center for Housing Studies, which issued the report. "Add to that the overbuilding and the inventory correction and you can see why it appears, particularly for the new-home market, that this slump will last well into 2008."

Housing-industry analysts say the riskiest subprime adjustable-rate loans were made in 2005 and 2006. As they reset at higher interest rates through 2008, they are likely to fuel the current surge in foreclosures.

REAL ESTATE INVESTMENT - Things may be slowing down still for the real estate investment sector. Here is a chart about real estate investment in the San Diego area. Because of rising defaults, investors everywhere have lost their appetite for securities backed by subprime mortgages, experts say. CNS Graphic.
As lenders move to tighten loose credit standards and prevent defaults, it will become harder and harder for subprime borrowers to refinance into more affordable loans, Retsinas said.

"One of the aftermaths of the subprime implosion was a tightening of credit," he said.

Retsinas said problems in the housing industry go beyond lending and foreclosures. Even as prices ease somewhat, affordability remains an issue in many areas.

As home prices increased in many areas between 2000 and 2005, they far outpaced middle-wage incomes. With job expansion concentrated in the low-paying service sectors, the Harvard report foresaw no quick improvement in housing affordability.

When housing is prohibitively expensive, the economy suffers, Retsinas said.

"The danger is ... you're going to lose skilled workers who will move to a part of the country where they can get a job and afford a place to live."

According to Harvard's "The State of the Nation's Housing 2007" report, everyone who attempted to profit during the nation's housing boom - buyers, sellers, builders and investors - played a role in the market's decline.

" ... This housing downturn has been driven largely by the market's own excesses," the report said.

Troubles from risky subprime loans are evident in U.S. markets where home prices soared during the first half of the decade.

Doug Duncan, chief economist for the Mortgage Bankers Association, said subprime loans had done far more good than harm to the economy. Such loans have opened the door to homeownership to millions of Americans in pricey markets, Duncan said.

Of all outstanding U.S. home loans, about 14 percent are subprime, he said. Of those, about 19 percent are delinquent or in the process of being foreclosed on. Duncan expects less than one-third of those will actually be lost to foreclosure.

Among causes of the nation's housing slump, subprime lending "was a contributing factor, but it was not the driving issue," Duncan said.

Consumer advocates and credit counselors hold that many borrowers don't understand the risks associated with subprime loans. Designed for people with low credit scores, they are more profitable for lenders and mortgage brokers than prime loans.

Subprime loans allow borrowers to qualify for credit on low, introductory "teaser" interest rates that adjust upward after several years. They carry higher fees because of the greater risk of default.

When teaser rates end in expensive markets, monthly mortgage payments can increase by hundreds of dollars, said Paul Leonard, director of the California office of the Center for Responsible Lending.

To avoid defaults, consumers should be educated about the importance of shopping around for the best mortgages, said Melinda Opperman, vice president for community outreach for Springboard, a nonprofit consumer credit management organization.

"I do feel that the worst is yet to come," as more subprime loans move into default, Opperman said.

Some analysts blame Wall Street for the subprime crisis. Because of rising defaults, investors have lost their appetite for securities backed by subprime mortgages, said economist Edward Leamer, director of the UCLA Anderson Forecast. That means the subprime market "isn't going to come back anytime soon," Leamer said.

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