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REAL ESTATE:

Mortgages Made in 2007 Go Bad at Rapid Clip Delinquencies Worse Than 2006 Vintage; New Stress on Banks

By RUTH SIMON

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Mortgages issued in the first part of 2007 are going bad at a pace that far outstrips the 2006 vintage, suggesting that the blow to the financial system from U.S. housing woes will be deeper than many people earlier estimated.

An analysis prepared for The Wall Street Journal by the Federal Deposit Insurance Corp. shows that 0.91% of prime mortgages from 2007 were seriously delinquent after 12 months, meaning they were in foreclosure or at least 90 days past due. The equivalent figure for 2006 prime mortgages was just 0.33% after 12 months. The data reflect delinquencies as of April 30.

Evidence that lax lending standards were leading to higher mortgage delinquencies first emerged in late 2006. The first major casualty of the subprime credit crisis, New Century Financial Corp., imploded in early 2007. Yet the data from the FDIC and others suggest that lenders didn't substantially tighten standards until at least July or August 2007, when credit jitters hit Wall Street and financial stocks began to swoon.

The FDIC's analysis was based on mortgage data provided by LoanPerformance, a unit of FirstAmerican CoreLogic Inc. LoanPerformance says it tracks more than 95% of mortgages that were bundled into securities by financial institutions, not including those securitized by government-sponsored mortgage giants Fannie Mae and Freddie Mac.

Data on other classes of mortgages suggest the same trend. Freddie Mac reported Wednesday that 1.38% of the 2007-vintage loans it purchased were seriously delinquent after 18 months compared with 0.38% of 2006 loans at the same point in their life. Freddie Mac generally purchases loans made to creditworthy borrowers.

Last month, [J.P. Morgan Chase](#) & Co. said it expects losses on prime mortgages that weren't securitized and remain on its books to triple from current levels. The increase in bad loans is driven mostly by jumbo mortgages originated in the second half of 2007, a company spokesman said.

Until these bad loans are fully digested, "foreclosures will remain at record highs, the financial system will be under severe stress and the broader economy will sputter," said Mark Zandi, chief economist of Moody's Economy.com. One piece of good news, he

said, is that loans originated in the fourth quarter of 2007 and early 2008 appear to be performing better.

Economists and industry officials say several factors may account for the dismal performance of the class of 2007. Home prices were falling sharply in much of the country by 2007, meaning many borrowers who took out loans in that year for nearly the full price of the home now owe more than the home is worth. These borrowers are particularly vulnerable to a weakening economy, and have difficulty selling or refinancing if they lose their job.

Questionable business practices may have played a role, too. Some of the 2007 loans "were knowingly originated as really bad loans," says Chris Mayer, a professor of real estate at Columbia University's business school. Mortgage originators who profited handsomely from the housing boom "realized the game was completely over" and pushed mortgages out the door, says Mr. Mayer.

As credit began to tighten last year, some mortgage brokers and borrowers tried to circumvent tougher restrictions by inflating borrowers' credit scores and appraisal values, says Jay Brinkmann, vice president of research and economics for the Mortgage Bankers Association.

At [Washington Mutual Inc.](#), 27.2% of subprime mortgages originated in 2007 were at least 30 days past due at the end of the second quarter, compared with 24.3% of such loans originated in 2006. National City Corp. said recently that 2007 loans are driving delinquencies in its home-equity portfolio.

Some 65% of subprime loans originated in 2007 will end up in default compared with about 45% of those originated in 2006, according to estimates by UBS AG, which looked at loans packaged into securities.

To be sure, lenders did take some steps to cut their losses. The Federal Reserve Board's quarterly survey of bank loan officers indicates that lenders began to tighten underwriting standards in late 2006. And loan volume declined 18.5% last year, according to the trade publication Inside Mortgage Finance.

Still, it's now evident they didn't pull back far enough, at least in the first half of the year. The average credit score of borrowers who took out Alt-A adjustable-rate mortgages edged upwards in 2007, according to UBS, but the portion of such borrowers who fully documented their income and assets dipped. Alt-A is a class between prime and subprime.

The share of borrowers with prime jumbo loans who took out a "piggyback" second mortgage -- which allowed borrowers to finance more than 80% of their home's value without private mortgage insurance -- climbed to a record 33% in 2007, according to the UBS analysis. In other words, many people buying expensive homes were putting little of their own money down.

"The more conservative lenders were scaling back in 2007, but the more aggressive lenders were expanding," says Frederick Cannon, an analyst with Keefe, Bruyette & Woods.

The sharpest pullback in lending didn't begin until the second half of the year, when investor demand for mortgage-backed securities waned. Wells Fargo & Co. reduced the maximum amount borrowers could finance in the fourth quarter of 2007 and again in the first quarter of 2008, according to a recent analyst presentation. J.P. Morgan Chase, meanwhile, tightened lending standards twice by August 2007, but was still making some loans that didn't require full documentation of borrowers' income and assets. [Wachovia Corp.](#) made its most drastic changes in loan standards earlier this year.

The changes that lenders did make often took 60 to 90 days to implement because companies need to clean out their pipelines and change their systems, says Michael Zimmerman, senior vice president for investor relations at mortgage insurer MGIC Corp.

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