07/30/2007

Subprime Market Takes its Lead From Wall Street

The big issue of the day for the mortgage market seems to be the foreclosure crisis in the subprime sector. For many months, default and foreclosure rates among subprime, or poor credit, homeowners have been rising. It is assumed that this rise is a product of the many risky adjustable rate loans made to these borrowers in more robust market conditions. Now that the market has turned colder, these homeowners are seeing their mortgage payments increase with resetting interest rates. With little or no equity to tap, some are forced into foreclosure. The larger market effect is that lenders are becoming wary of such exotic loan products and credit for bad credit borrowers is drying up.

Cries have gone up to Washington, with lawmakers and interested parties calling on the Federal Reserve to better regulate the mortgage industry. The Federal Reserve has reluctantly complied, coming out with new guidelines asking lenders to provide consumers with more complete information about certain loans and to make sure borrowers qualify at higher standards. The trouble is, these new guidelines have little bite; they are not actual mortgage laws, but more like strong suggestions.

It seems the real decision maker in terms of mortgage practices is Wall Street, or in other words, the investors. Most mortgage loans bundled up with others from the same lender and then sold on the secondary market. These mortgage bonds are then rated by the company Standard and Poor’s according to the loans’ payment histories and other factors. Lenders then cater their loan offerings based on what type of mortgage bonds investors are willing to buy. The market has reacted faster to the dangers of current subprime loans than the government has as investors slowed in buying subprime loans since early spring of this year.

“The market has been way ahead of the Fed,” said David Wyss, chief economist for Standard and Poor’s as stated in a recent CNN.com interview. “If anything, it has overreacted.”

And according to Mortgage Bankers Association chief economist Doug Duncan, that overcorrection has included several significant lending changes. First, whereas no-down payment loans were popular for subprime borrowers during the housing market boom, they are almost non-existent now. With current market conditions, they are just too risky for lenders and investors. Lenders almost always require some money down for poor credit borrowers these days. Second, lenders are requiring better proof of their income and assets to further reduce risk. Lastly, lenders are simply not lending as often to those with really poor credit.

If you have found yourself in the category of “bad credit,” it may be wise to take note of these changes before you start searching for a home loan. Be prepared to bring down payment money to the bargaining table and plenty of proof that you can actually afford a mortgage. And if your credit is really that bad, you may just have to wait and work on improving it by being more consistent with timely payments and lowering your debt, before you will be able to qualify for a mortgage loan.

Copyright © 1999-2008 Homeloanbasics.com, Etrafficers, Inc., or its affiliates