# U.S. Housing Market Must Stabilize Before Recovery Can Occur



Last Friday, the Commerce Department reported that personal spending fell 0.3% in September marking the biggest decline since June of 2004. These numbers followed flat readings in both July and August which contributed to the worst quarterly performance for consumer spending in 28 years. This spending accounts for approximately 2/3 of total economic activity in the United States and the September numbers were slightly worse than expected. **Last Thursday, the Government reported that gross domestic product, which is the broadest measure of economic health, declined at an annual rate of 0.3% in the third quarter.** Current reports are demonstrating that the financial crisis has driven consumer confidence to a record low and economists believe that the fourth quarter will be no different. We have been feeling like we have been in a recession for quite some time but given the expected fourth quarter economic performance, the economy will meet the standard definition of a recession by the end of the year.

Much of the consumer spending that has occurred over the last few years has been stimulated by the massive amounts of mortgage equity withdrawal taken by homeowners who have, essentially, used their homes as ATM machines. Additionally, the wealth effect of feeling as if they had massive equity in their homes created spending habits which fueled the economy. As these dynamics no longer exist, it is important for the housing market to bottom out in order for our economy to turn around. This is also vitally important because the value of mortgage backed securities and derivative products based on these securities cannot be accurately valued unless there is a high level of confidence in the value of our housing stock. A big concern about the implementation of the TARP is what the government will pay for these toxic securities. If we know what houses are worth, it will be easier to determine fair market value of the securities.

**While there is clearly no easy solution to the foreclosure crisis, recently J.P. Morgan and Bank of America have implemented mortgage modification programs which could cover approximately 800,000 borrowers.** These plans come amid intense national focus on the root cause of global financial turmoil, rising home foreclosures, and what the role of the banks and the government should be in helping struggling home owners. **Approximately 1.5 million homes were in foreclosure at the end of June and economists expect several million more may default in the coming year as housing prices erode and job losses rise.** The political pressure the banking industry is under to address the foreclosure problem is immense.

This article, and all other Commentaries by Bob Knakal, can be found on The Massey Knakal Reel – a blog for breaking sales, listing and neighborhood real estate news – at www.masseyknakal.com/blog

The TARP has enhanced liquidity in the banking system but now the focus on borrowers, who are in default or delinquent, is coming to the forefront. Recently, FDIC Chairman Sheila Bair floated a plan that could help 3,000,000 troubled borrowers which the White House is considering. You will recall that the FDIC is presently in control of IndyMac Federal Bank and is assisting strapped borrowers who had mortgages with that bank. Thus far, the agency has been able to help 40,000 of the 60,000 delinquent IndyMac borrowers. These moves by major banks and the FDIC are

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*Please give a call if you have questions about your property or the market in general.*

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addressing one of the last elements of the global and financial upheaval as yet untouched by major Federal programs.

**The economy and financial markets will have trouble beginning a reversal until there is a halt to the decline in housing prices, a phenomenon that is worsened by foreclosures.** Banks are willing to recast troubled mortgages because they are realizing that they can improve the value of their loan portfolios through mass modifications rather than foreclosures which tend to produce larger losses. **A clear consensus is emerging that broad based and systematic loan modifications are the best way to maximize the value of mortgages while preserving homeownership.** This should ultimately help stabilize home prices and the broader economy.

Last week's announcement by J.P. Morgan increases pressure on other mortgage companies to respond with relief programs for distressed borrowers. The bank will open 24 counseling centers and hire 300 employees to work with borrowers and will suspend foreclosures on loans it owns for 90 days as it puts new policies into place. Nationwide 7.3 million American homeowners are expected to default on mortgages between 2008 and 2010, about triple the usual rate. Approximately 4.3 million of these borrowers are expected to lose their homes. The focus of J.P. Morgan and Bank of America is specifically aimed at option adjustable rate mortgages or option ARMs. These mortgages allow borrowers to make minimum payments that may not even cover the interest due resulting in increasing principal loan balances. While an extremely cumbersome process, mortgages which are owned completely by a bank can be modified. There is a question as to whether mortgages which serve as collateral for mortgage backed securities can be modified. Investors in these mortgage securities may be more willing to foreclose to try to recoup their investment than to allow a servicer to renegotiate underlining mortgages.

The need to slow down the foreclosure rate is important because as more properties are taken by lenders, they are placed on the market which adds to the already bloated available inventory. This additional supply exerts downward pressure on value which serves to exacerbate the downward spiral the market is experiencing. It is positive that these issues are now being addressed by those who can do something about it. **Mortgage recasts are difficult, particularly on the scale which is necessary, but this could be a way to help the housing market stabilize and when this happens it will be a sign that we are on our way out of the crisis.**

Have a great week,