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THE SUBPRIME MORTGAGE CRISIS: ITS IMPACT ON THE LONG ISLAND HOUSING MARKET

America is facing its worst housing crisis since the Great Depression. With the collapse of the recent housing bubble, almost 8.8 million homeowners, 10.3 percent of the total, are in trouble. About 24 percent of all "subprime" mortgage loans outstanding are either delinquent or in foreclosure. Moreover, falling home prices mean that significant numbers of homeowners are experiencing "negative equity" in that their homes are worth less than their mortgages. Home foreclosures and mortgage delinquencies are a particular problem on Long Island. This article discusses the dimensions of today's subprime mortgage crisis and analyzes the size of the subprime mortgage problem on Long Island.



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The Dimensions of the Housing Crisis

Home debt is currently at its highest level since World War II. Moreover, significant numbers of recent homebuyers currently owe more on their homes than they are actually worth. Those with "negative equity" have become "trapped" in their homes, unable to move or accept a job in another location because they cannot cover the shortfall between the current selling price of their home and the size of their mortgage.

Although the housing crisis started in the market for subprime mortgages, many of those currently facing default are actually prime borrowers. Recent prime loans also

incorporated low teaser rates that ultimately reset to higher interest rates. These resets were not a problem as long as home prices were rising because homeowners could refinance their loans or sell their homes to pay off the mortgage. However, falling home prices have put even homeowners with solid credit under the same financial pressures as subprime borrowers. Tightening lending standards have made the problem even worse.

Credit problems in the housing market are part of a broadly based process of "deleveraging" that is occurring throughout the economy. Much of the nation's recent prosperi-

ty was predicated on debt. Low interest rates and an expanding money supply motivated households and businesses to borrow more than they could reasonably repay. The resulting credit bubble has since collapsed and assets are now being repriced to more realistic levels. Defaults on mortgage loans are only part of the problem. The contagion has spread to home equity lines of credit, auto loans, credit card debt, student loans and securities backed by commercial mortgages. Credit card issuers have tightened lending standards. Private student loans are becoming more expensive.

Nevertheless, residential mortgage defaults pose the greatest threat to the economy. The rising tide of mortgage delinquencies and foreclosures is placing an unprecedented burden on the U.S. financial system. Until lenders can ascertain the full extent of their losses on residential mortgages, they will be forced to protect their capital and will be less willing to make new loans, even to each other. This could lead to a period of excessively tight credit and to a longer and deeper recession than any in the

The Dimensions of the Subprime Mortgage Crisis on Long Island, October 2007

	Nassau County	Suffolk County	Total
Number of Subprime Mortgages	16,508	24,480	40,988
Number in Foreclosure	1,648	2,877	4,525
Percent of Total	10.0	11.8	11.0
Number Delinquent	3,232	5,250	8,482
Percent of Total	19.6	21.4	20.7
Number in Foreclosure or Delinquent	4,880	8,127	13,007
Percent of Total	29.6	33.2	31.7

Source: Federal Reserve Bank of New York

recent past.

Homebuilders have responded to the crisis by reducing new home construction to 1991 levels. In many areas, median home prices have fallen to their level of three years ago. Some analysts anticipate that average home prices will decline by 20 to 25 percent in the next two or three years before the balance between supply and demand in the housing market is restored. A price decline of this magnitude would eliminate \$5 trillion in household wealth. It would leave an estimated two-thirds of those who bought homes in the past 18 months with negative equity.

The Need to Rescue Homeowners

A growing number of analysts have come to the conclusion that the best way to avoid a deep and prolonged U.S. recession is to rescue financially troubled homeowners. Several rescue plans are already in place. Project Hope, aimed at subprime borrowers, freezes mortgage interest rates, giving

lenders and borrowers time to develop more affordable repayment plans. A newer initiative, Project Lifeline, is aimed at all at-risk borrowers. Under this initiative, a group of some of the nation's largest lenders will voluntarily contact homeowners whose payments are overdue by 90 days or more. Foreclosure procedures will be halted for 30 days as more affordable mortgage terms are negotiated.

These initiatives have made some headway in reducing foreclosures. A recent report from the Hope Now Alliance, the group coordinating the mortgage industry's response to the foreclosure crisis, said its members had worked out 1.04 million mortgage loans between July 2, 2007 and January 31, 2008. Three-quarters of these workouts allowed borrowers to catch up on missed payments or applied missed payments to the balance of their loan. The remaining workouts involved loan modifications such as interest rate reductions. An estimated 43 percent of the loan work-

outs by the Hope Now Alliance involved loans by prime borrowers, confirming fears that the mortgage crisis has spread well beyond the market for subprime loans.

Thus far, lenders have borne the principal responsibility for easing the mortgage crisis. However, modifying mortgage terms doesn't solve the underlying problem, which is that many Americans now own homes that are worth less than their mortgages. Federal Reserve Chairman Ben Bernanke recently called upon lenders to voluntarily reduce the mortgage principal for some struggling homeowners as a means of eliminating negative equity. It is hoped that this will discourage homeowners from "walking away" from their homes. Others want bankruptcy judges to unilaterally modify the terms of some mortgage loans. However, this would interfere with the contractual relationship between lender and borrower.

Fannie Mae and Freddie Mac, the two government-chartered buyers of U.S. home mortgages, were recently permitted to increase the size of their portfolios, allowing them to purchase mortgages that other investors have shunned. These agencies have lower borrowing costs than private banks because of their presumed government backing. The recently passed fiscal stimulus legislation will allow Fannie Mae and Freddie Mac to purchase mortgage loans of up to \$729,750 as compared with the current \$417,000 limit. The stimulus legislation also allows the Federal Housing Administration (FHA) to insure home loans of up to \$725,000 as

Home Foreclosures and Mortgage Delinquencies in Nassau Communities With 300 or More Subprime Loans, October 2007

Zip Code	Nassau Communities	Subprime Loans	% In Foreclosure	% 30-59 Days Late	% 60-89 Days Late	% 90+ Days Late	% Late or In Foreclosure
11003	Elmont	1,151	11.6	11.2	4.8	7.0	34.6
11510	Baldwin	793	11.7	11.2	5.9	6.8	35.6
11520	Freeport	1,094	15.4	12.8	4.5	5.4	38.1
11550	Hempstead	1,334	13.9	9.9	6.3	5.5	35.6
11552	West Hempstead	453	13.5	9.3	6.6	4.0	33.4
11553	Uniondale	795	10.1	9.6	4.8	5.4	29.9
11554	East Meadow	365	7.7	6.0	4.9	5.2	23.8
11561	Long Beach	337	6.5	11.9	5.3	4.2	27.9
11572	Oceanside	349	5.4	10.0	4.3	3.4	23.1
11575	Roosevelt	715	13.6	9.1	4.1	6.6	33.4
11580	Valley Stream	796	10.4	8.9	5.8	6.4	31.5
11590	Westbury	802	9.7	10.8	6.6	6.2	33.3
11710	Bellmore	367	10.1	8.4	3.5	4.4	26.4
11735	Farmingdale	350	10.9	8.3	5.4	7.4	32.0
11793	Wantagh	305	6.2	7.9	4.9	3.9	22.9
11801	Hicksville	445	7.2	8.3	3.8	5.2	24.5
11756	Levittown	687	9.6	8.9	4.2	5.1	27.8
11758	Massapequa	596	8.1	9.7	2.9	5.7	26.4

Source: Federal Reserve Bank of New York

compared with the current ceiling of \$362,000.

Despite these efforts, the crisis is worsening and there are calls for a Federal government bailout of financially troubled homeowners and lenders. Some have called for a federally funded organization to buy mortgages that are in or near default and refinance them on more affordable terms. It is anticipated that such an agency might have to refinance as many as 2 million mortgages. Others want the Federal government to fund state and local governments, which could buy foreclosed homes and rent them out until the housing crisis subsides. Economist Martin Feldstein has proposed a program of federal mortgage-paydown loans to individuals, secured by future income rather than by a formal mortgage.

The argument against a tax-funded Federal bailout of homeowners and lenders is that it would create a "moral hazard". That is, by rewarding imprudent borrowing and lending decisions, it would encourage such behavior in the future. The rationale for federal involvement is that it could prevent more serious damage to the broader economy. There is a real possibility that the housing market could collapse if too many foreclosed homes are thrown on the market. This in turn could precipitate a financial crisis. Moreover, there are precedents for federal involvement in housing markets. During the depression, the federal government created the Home Owners' Loan Corporation, which helped

refinance a million mortgage loans and at the end of the day actually made a profit. Some analysts believe that today's housing crisis is as bad or worse than that during the depression and that the viability of the entire financial sector could be at stake.

Home Foreclosures and Mortgage Delinquencies on Long Island

Home foreclosures and mortgage delinquencies have become a significant problem on Long Island. The Federal Reserve Bank of New York recently released home foreclosure and delinquency data for owner-occupied homes on Long Island. These data were shown by individual zip code. As of October 2007 there were almost 41,000 subprime mortgages on

Long Island: 16,508 in Nassau and 24,480 in Suffolk. The higher number of subprime loans in Suffolk reflects the presence of more first-time homebuyers in Suffolk. Often, a subprime mortgage loan was the only way such buyers could afford to buy a home.

Approximately 10 percent of all subprime mortgages outstanding in Nassau County were in foreclosure and almost 20 percent were delinquent by at least 30 days as of last October. In Suffolk, almost 12 percent of all subprime mortgages were in foreclosure and more than 21 percent were delinquent by 30 days or more. In effect, almost 30 percent of subprime loans in Nassau and more than one-third of those in Suffolk were either delinquent or in foreclosure. This means that the

Home Foreclosures and Mortgage Delinquencies in Suffolk Communities With 300 or More Subprime Loans, October 2007

Zip Code	Suffolk Communities	Subprime Loans	% In Foreclosure	% 30-59 Days Late	% 60-89 Days Late	% 90+ Days Late	% Late or In Foreclosure
11701	Amityville	633	15.5	10.9	6.2	5.5	38.1
11703	North Babylon	373	12.3	11.5	5.4	4.6	33.8
11704	West Babylon	680	11.2	11.2	5.6	5.9	33.9
11706	Bay Shore	1484	13.4	10.6	6.3	5.1	35.4
11717	Brentwood	1782	12.5	11.0	4.8	6.7	35.0
11720	Centereach	582	12.2	11.7	4.8	6.5	35.2
11722	Central Islip	1145	16.3	10.0	5.4	6.1	37.8
11726	Copiague	417	12.9	11.0	4.3	3.8	32.0
11727	Coram	551	15.1	8.5	6.4	6.7	36.7
11729	Deer Park	560	13.0	10.0	5.5	5.2	33.7
11741	Holbrook	362	6.1	11.0	2.8	5.0	24.9
11743	Huntington	414	10.9	9.7	3.6	3.1	27.3
11746	Huntington Sta.	843	12.2	8.1	3.6	3.6	27.5
11757	Lindenhurst	715	9.4	9.8	5.2	4.8	29.2
11763	Medford	706	12.0	11.3	3.4	6.2	32.9
11772	Patchogue	781	11.1	9.1	5.0	7.3	32.5
11716	Pt. Jefferson Sta.	392	11.0	11.7	4.8	6.1	33.6
11779	Ronkonkoma	675	9.6	12.1	4.3	5.5	31.5
11784	Selden	553	11.8	10.5	7.4	6.5	36.2
11787	Smithtown	324	7.7	8.0	3.4	5.9	25.0
11795	West Islip	319	10.7	11.0	4.4	4.1	30.2
11798	Wyandanch	581	14.5	12.6	8.1	8.3	43.5
11901	Riverhead	332	10.2	9.0	3.3	4.5	27.0
11950	Mastic	557	13.5	12.7	5.4	6.8	38.4
11951	Mastic Beach	532	15.4	13.2	6.6	7.9	43.1
11967	Shirley	813	15.0	11.6	5.8	6.0	38.4

Source: Federal Reserve Bank of New York

subprime problem is significantly worse on Long Island than in the nation as a whole.

County-level statistics fail to capture the pain being caused by the subprime mortgage crisis within individual Long Island communities. Subprime mortgage loans are concentrated in some of Long Island's lowest-income communities, including Westbury, Elmont, Freeport, Hempstead, Roosevelt, Brentwood, Bay Shore, Central Islip, Huntington Station and Shirley. More than one-third of the subprime mortgage loans outstanding in Elmont, Baldwin, Freeport, Hempstead, West Hempstead, Roosevelt and Westbury were either in foreclosure or delinquent by at least 30 days. More than 38 percent of those in Amityville, Mastic and Shirley and more than 43 percent of those in Wyandanch and Mastic Beach were delinquent or in foreclosure.

Conclusions

The subprime mortgage crisis is a symptom of the "irrational exuberance" that permeated the nation's housing markets during the past several years. A prolonged period of excessively low interest rates coupled

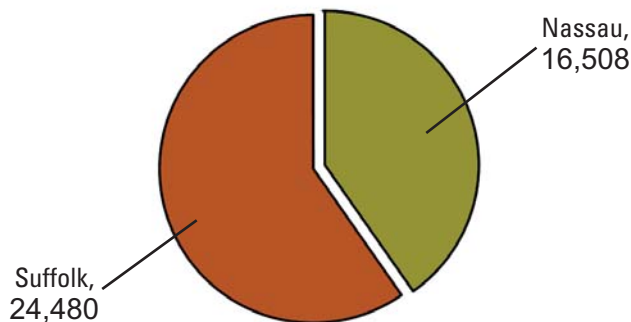
with relatively loose lending standards encouraged excessive borrowing for all purposes. This in turn helped to inflate asset prices, particularly housing prices. With more and more buyers priced out of the housing market, innovative financing mechanisms, including so-called subprime mortgages, came to the rescue.

The widespread securitization of mortgage debt made subprime mortgages possible. Lenders were less concerned about the potential risk of

default by borrowers with less than perfect credit because in many cases they "sold off" the risk to investors eager for higher returns. The prevailing theory was that by spreading the risk so broadly, no individual investor would be seriously hurt in the event of a default. Today, the credit bubble has burst and much of the leverage that became embedded in the economy over the past several years is being squeezed out. The process has resulted in huge financial losses for investors, lenders and borrowers.

Given the heavy burden of subprime mortgage debt on Long Island, the foreclosure problem is likely to worsen before it improves. As foreclosures increase and foreclosed homes return to market, the downward pressure on Long Island home prices will intensify. Higher inflation and falling home prices are bound to have a negative impact on consumer spending, which has held up relatively well to date. Troubled homeowners continue to look to the Federal government for policies that will stem the tide of foreclosures and allow more Long Islanders to remain in their homes. This offers the best hope for mitigating the current economic downturn.

Number of Subprime Mortgages in Nassau-Suffolk, October 2007



Subprime Mortgages in Foreclosure or Delinquent, Nassau-Suffolk, October 2007

