

“Lenders Tighten Credit for Real Estate at Worst Time!”

by John V. Kamin

Who is having trouble borrowing, as lenders tighten requirements, due to the existing sub-prime loan mess? The list mainly includes recent homebuyers, new homebuyers, many young adults without much money, and people who took on Adjustable Rate Loans; low-down payment and no-down payment loans; people who took on interest only loans, and other loans, new homebuyers and the poor.

These are the very folks who are being squeezed out by the tougher, tighter lending standards imposed upon borrowers late 2007, say, compared to 2006 and 2005. Recent years have resulted in a cornucopia of weird loans (compared to traditional loans) as lenders, awash with liquid money, wanted to lend it out to any warm body who might repay in a climate of low interest rates.

But the Federal Reserve Board (Central Bank) has been busy, as you know, the last couple of years, raising interest rates 17 times. Record foreclosures are now rising visibly, but not on folks who put 20% down or more, the traditional down payment. Bankers tightening lending at the wrong time have often been blamed for the 1929-1939 Depression.

There’s another phenomenon at work. Most of the new borrowers buy brand new homes, and most of the new borrowers are first-time buyers and first-time mortgage borrowers. From whom are the foreclosures coming? First-time buyers and first-time mortgage borrowers! Do you think it’s a coincidence?

21st Century Societal Change. Age Switch Among Buyers

Used to be, young marrieds, other young adults needing a car and a home started out with a cheaper used car, something they could afford, and a used home, which was almost always much cheaper than a brand new one.

That’s changed in the last several years. Now, after the \$50,000 wedding, they want a new home, not a used one. Chances are they’re driving a relatively new car, or a couple of new cars, rather than a 2001 or earlier model, that they could buy for cash and easily afford. Look around you on your drive home today, please estimate the average age of the new car drivers. I think you’ll get a surprise at how many 20-somethings are driving new “iron”.

Take another spot check next time you visit a development of latest new homes. Who’s looking? The 20-somethings.

This is the very group about which lenders say, “Whoops, we’ve got a sub-prime mess as well, too many home loans are 30 to 90 days delinquent on payments. Let’s tighten lending standards!”

Refis Tougher. Shock Treatment

What about the delinquent borrowers? They’re saying to each other, “Let’s refinance. Let’s trade in our Adjustable Rate Mortgage for a new Fixed Rate Mortgage. Let’s raise the loan amount, so we can pay off some of our accumulated bills and \$9,000 (average) on credit cards!” Then borrowers get a shock when they run into newly-reluctant mortgage lenders.

When I survey recent college grads, I find another surprising thing. Many have piled up \$80,000, \$100,000, \$150,000 or more in student loans, debt. So, why are these the very people who are driving new cars and insisting on new homes instead of used? A lot of them feel they deserve it, many more don't even ask the final price of the car loan, they just ask, "How much is the monthly payment?" Wrong question. It's their folks driving the clunkers and living in the 40-year-old homes!

When you ask young adults if they have a budget, or how they're going to pay back their rising debts, they may look at you as though you are some prehistoric accounting dinosaur. They're addicted to fast credit for most everything they want.

Lending Conflicts. Greenspan Warned

At the same time that banks, insurance companies, loan brokers, and others, are tightening up their lending standards (after several years of making some stupid loans that never should have been made in the first place), that's when the new borrowers and refinanciers and debt-uppers are growing just a bit more desperate to get bigger loans, better payments, lock in fixed rates, so future house payments won't rise! Bad timing. Dr. Alan Greenspan during 2004 told bankers attending a meeting in Texas, "Bad loans are made in good times". Greenspan's warning went unheeded.

Who's going to win in this monetary tug-of-war? Will it be the lenders, the people with the money to lend out? Will they, as in the past, become less cautious? Or, is the marketplace changing so fast that lenders are becoming more risk-averse, which makes lenders likely to tighten credit approvals even further at the precise time more borrowers badly need loans?

Prediction: Will the number of foreclosures rise, especially on low-equity and no-equity deals? Probably, 80% certainty.

Builders Hustle to Downsize

Major USA builders admit that they sell mostly to first-time buyers. Builders are desperately trying to cut back on inventories of unsold new homes. But it's a race against time before contractors' own loans become troubled and many cannot be rescued.

Déjà vu - you saw similar loan acrobatics during the late 1980s and early 1990s, when many S&Ls failed, when the FSLIC had to be folded into the FDIC.

Surviving lenders, S&Ls, and banks took back so many collateralized bad loans (mostly homes and land) that the RTC (Resolution Trust Corporation) had to be formed, and then RTC auctioned off huge numbers of homes for whatever they would bring (average 59% of low appraised values on homes) just to get those delinquent loans off the banks' balance sheets. After all, the banks and lenders are in the banking and lending businesses, not in the vacant home-owning business. Bank auditors don't like to see too many repossessed homes and bad loans on their balance sheets.

Long time homeowners have been through this same kind of business cycle before. Real estate cycles do fluctuate, often last seven to 10 years.

Prediction: It's going to take some time to work off this glut of new homes, unsold builder inventories, excess listings, and troubled loans.

Prediction: Work-out won't happen by the end of 2007, maybe not even by the end of 2008.

Prices may fall (as they already have in many parts of the nation) 5% to 15% or more.

What happens when you have a foreclosed home that didn't have any equity build-up, say, on no money down or 5% or less down, virtually no equity left after paying commissions? Those prices are going to have to come down to attract borrowers. And even if you're buying a foreclosure, if there's no equity there (to profit), it's usually not attractive to a new buyer, a first-time buyer, and is even unattractive to a speculator who usually needs a minimum of 20% equity even to consider risking his money amidst a house glut.

Forecast: The foreclosed homes with equity build-up are more likely to move out of inventory first. But those homes that were overpriced to begin with, where there is no equity, and where prices are falling 3%, 5%, 8%, those are going to hang around for a while, continuing the glut, until larger concessions are made on price and terms.

Strategy:

- A. It's going to take some time to work out this situation. Build your cashform assets. Build your credit score.
- B. Resales (used homes) are holding up better than new homes, a more fertile shopping area for profits (and more equity) ahead.
- C. Interest rates could stay high or move higher for a year or two or three. Those who are providing liquid money, to illiquid markets, want to get some equity premium for taking on illiquid risks as their reward. Or they can just let their money sit and earn 5% or so risk-free in bank accounts, CDs, and T-bills, until the market settles.
- D. If you're shopping and prospecting, I suggest you look for NTS (Need-To-Sell) deals.
- E. Once you find an NTS deal, you'll have to do some negotiating to get the best terms and price.

More predictions and forecasts in upcoming reports, to help you make some chunks, big money. Don't miss.

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