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Mortgage Woes Pass By New York, for Now

By ELIOT BROWN, Special to the Sun | March 15, 2007

A DRIVING FORCE BEHIND THE RECENT COLLAPSE OF A SECTION OF THE NATIONAL MORTGAGE industry appears to have skipped over New York City, for now, due to the strength of its housing market. However, should the local real estate market stagnate, experts warn, the city could easily see a big spike in foreclosures that may hurt the local economy.

In the five counties that compose the city, foreclosures actually fell 5.3% between the fourth quarter of 2005 and the fourth quarter of 2006, in stark contrast to a 47.5% increase in foreclosures nationwide, according to numbers provided by the foreclosure tracking company, RealtyTrac.

In 2006, foreclosures were up 14.8% in the city over 2005, with the counties encompassing Staten Island, Brooklyn, and the Bronx experiencing increases of over 20%.

The market for subprime mortgages, which are aimed at borrowers with credit histories too poor to qualify for traditional prime loans, has crashed in recent weeks, due in part to the rise in foreclosures. For years, subprime lenders issued mortgages to borrowers who had little capital outside the value of their homes, and when the national housing market stagnated, refinancing brought in less cash and borrowers often had few options other than to default.

The crash has bankrupted numerous subprime lenders, leaving many to speculate that a greater instability in the housing market could be triggered by a tightening on credit markets. At a breakfast forum Tuesday, the CEO of the Related Companies, Stephen Ross, said he was concerned by the possibility that the collapse could lead to a real estate slowdown. Today, Senator Clinton is expected to announce an initiative aimed the issue of the subprime collapse.

Analysts are now pointing to the foolish lending practices of the subprime lenders, which would frequently issue loans without even checking an applicant's income.

As the housing market in New York City continues to be strong, defying national trends, borrowers of subprime mortgages are still able to count on their homes rising in price, paying off unanticipated expenses by refinancing and capturing the greater home value.

Housing and lending experts warn, however, that these same unstable lending practices that were employed throughout the country, were also applied in New York. If and when the local housing market eventually stagnates or cools, the city, and particularly the boroughs outside Manhattan, could see soaring numbers of foreclosures, a force that could add to the troubles of the national housing market and on Wall Street.

"New York is in some ways very much at risk of suffering from the problems in the subprime market because so many low income borrowers have used subprime lenders in order to bridge the gap" between income and housing costs, a research fellow at NYU's Furman Center, Solomon Greene, said. "Home buyers tend to be much more overextended than buyers in other parts of the country."

The lending industry has comprised an increasingly larger portion of subprime mortgages in New York City in recent years, according to figures provided by the Furman Center. In 2002, 6.5% of home purchasing loans citywide were considered to be subprime, compared to 22.9% in 2005.

A professor at Brooklyn Law School, David Reiss, said that a slower real estate market or a hike in interest rates could create a "perfect storm" for housing in the city, particularly in the boroughs outside Manhattan, where subprime loans are more prevalent.

The increase in subprime loans comes in part from the rise of predatory lenders who employ illegal tactics to issue loans to borrowers who will likely be unable to pay them off, Mr. Reiss, who studies subprime lending, said.

While the state and City Council have passed regulatory laws aimed at curbing predatory lending, Mr. Reiss said the measures were like "a finger in a dike instead of a new dam." Others have criticized the laws for shifting too much liability to lenders.

With the instability of the subprime system now revealed in full color, lenders say they are backing away from issuing the riskier loans. That could mean fewer New Yorkers would be eligible to secure the financing to buy a house. That could slow down the booming local housing market, or initiate a belt tightening that could lead to fewer mortgage defaults, analysts say.