# REAL TROUBLE LIES IN RISING DEFAULT RATES

*Foreclosures only tell part of story; more New Yorkers quietly fall into arrears*

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Washington politicians and editorial writers throughout the country are bashing banks for foreclosing on hapless homeowners. And, indeed, foreclosures are on the rise.

However, an even larger wave of foreclosures is coming to New York City, say experts who base their predictions on rising default rates, combined with the difficulty of refinancing underwater homes.

The increasing numbers of distressed properties, they say, portend a substantial decline in property values throughout the city.

"If you are looking at the statistics, it cannot possibly have hit bottom," says Joshua Stein, a partner in the real estate practice group of Latham & Watkins, and chair of the education committee of the Mortgage Bankers Association of New York.

About 11.6 percent of mortgage borrowers in the New York City area are underwater, according to data from Deutsche Bank.

But a new report from the bank claims among its dire predications that 77 percent of borrowers with outstanding mortgages in the New York City area will be underwater by the first quarter of 2011, well above the bank's projected national average of 43 percent.

According to NYU's Furman Center for Real Estate and Urban Policy, in the first two quarters of this year, there were more than 9,000 lis pendens or pre-foreclosure filings in New York City for all property types. While that still represents a small portion of all households in the city, that's on pace to be the worst year for foreclosures since the mortgage meltdown began, and the figures are only expected to go up.

With many New Yorkers overleveraged on their homes, prices only have to drop a little further here to have

devastating effects, experts say.

The median price for a single-family home in the New York area declined by about 19 percent in the first quarter of 2009 from its peak in the second quarter of 2007. And in another recent Deutsche Bank report on housing prices, the bank is predicting prices to fall further, for a total of 52 percent from the 2007 peak by the first quarter of 2011.

"Most people, even if they are borrowers with good credit and [are] very conservative, they go for about 80 percent [loan-to-value ratio]," says Ying Shen, director of non-agency mortgage research and mortgage modeling at Deutsche Bank Securities.

"A loss of 30 percent and you basically wipe out a lot of people."

Further, although the Deutsche Bank report on housing prices looked at single-family houses, which are mostly in the outer boroughs, researchers are also expecting condos to depreciate significantly.

"[Condos] had more appreciation during the good years, and then they have a lag when they decline," says Shen.

Some borrowers will be able to refinance under federally backed programs, but the programs are just getting off the ground so it is unclear how successful they'll be. Plus, many high-income homeowners in pricey areas such as Manhattan do not qualify for them.

According to Brian Meier, a senior vice president at Prudential Douglas Elliman, struggling New Yorkers who took out mortgages of more than $729,000 could be in serious trouble.

"Nobody I can find is doing refinances on jumbo loans over 50 percent [loan to value]," he says.

Meanwhile, it's clear that many New Yorkers are having trouble paying their mortgages. Mortgages that are more than 90 days in arrears, the time at which a bank generally can file a foreclosure notice, are rising at significantly faster rates throughout the city than are actual foreclosures, according to statistics provided by First American CoreLogic, a real estate data-tracking firm.

That may be because banks are not automatically foreclosing on defaulting borrowers the way that they did in the past, says Frank Cammarata, president of Cammarata Associates, a New Jersey-based company that does audits for the mortgage banking industry. He says the industry is taking time to evaluate borrowers for loan modifications.

"What was an automated process is now a manual process," says Cammarata. "Everyone recognizes that this is now a touch and feel operation."

In June 2009, 0.9 percent of all mortgages in Manhattan were 90 days or more past due, double the rate of

0.4 percent in June 2008. The rate of increase for foreclosures in Manhattan was, on the other hand, significantly smaller, at 0.3 percent in June 2009, up from 0.2 percent in June 2008.

The same pattern of defaults jumping at a faster rate than foreclosures was also found elsewhere in the city. In the Bronx, the number of mortgages more than 90 days in arrears shot up to 8.4 percent in June 2009, from 4.5 percent in June 2008. Yet the increase in the Bronx's foreclosure rate only rose to 3.5 percent from 2.5 percent during the same time.

In Brooklyn, meanwhile, the number of mortgages in arrears jumped to 7.6 percent from 4.4 percent, while foreclosure rates there only rose to 3.7 percent from 2.8 percent. In Queens, the number of mortgages more than 90 days in arrears rose to 8 percent from 4.3 percent, while the foreclosure rate only rose to 3.1 percent from 2.4 percent.

Prior to the bursting of the real estate bubble, foreclosure rates generally rose in tandem with over 90-day default rates, says Cammarata.

There is no definitive research on what's happening to the defaulting homeowners, says Josiah Madar, a research fellow at the Furman Center, which is about to embark on such a study.

"We will be able to at least get some descriptive data about all of the people who went into default at a certain date: What percentage of them actually went into foreclosure, versus refinancing, versus modifying?"

He said that will get to the heart of the question: "Why is the delinquency rate jumping so much, without a corresponding spike in foreclosures?"

Some observers speculate that it's because of the slowdown by banks. "Some people use the term 'extend and pretend,'" says Brad Hunter, chief economist at Metrostudy, a real estate consulting company, noting that banks are delaying moving defaulting homeowners into the foreclosure pile. The same delay tactic is being used on the commercial side as well (see *The Real Deal's* July issue).

There are a variety of reasons why banks are slowing down on foreclosing. For one, federal bailouts have made it easier to carry the non-performing debt of defaulted mortgages. In addition, there have been a slew of government programs designed to slow the foreclosure crisis.

Although government action is helping to prop up housing prices to a certain extent, the prospect of foreclosure is already having a profound effect on an increasing number of well-heeled New Yorkers who are underwater, and cannot meet their monthly payments without depleting their savings accounts or selling assets, says Meier.

"There are a lot of people who are living in fear of foreclosure right now — people who cannot sell for the amount they owe, but they know that the banks won't do a short sale with them because they can still pay their note."

Many affluent buyers took out adjustable-rate mortgages and now they face the prospect of their mortgages resetting at the very time their property values are falling and their incomes are declining.

Even in cases where residential properties actually are in foreclosure, many New Yorkers have not lost their homes yet, especially in higher-end neighborhoods.

"You can sit and milk the process for a long time, especially if you have a lawyer," says Meier, adding that he knows an attorney who is handling about 50 foreclosure cases, none of which have gone through to a foreclosure auction.