



Feeling the Sub-Prime Pinch

What's the local situation?

By Angela Mihm Nigro

Watching the news, the sub-prime mortgage crisis becomes all too real. Analysis of dropping property values and sky-high foreclosure rates is enough to give you heartburn. In March, CNN Money reported that “2.2 million sub-prime borrowers are at risk of defaulting on their loans and losing their homes.” What does it all mean for Dane County?

Nationwide, about 12 percent of mortgages were sub-prime as of December 2006, reports First American Loan Performance and Census Bureau as compiled by the Wall Street Journal Online. Of those, about 12 percent were delinquent 60 days or more. Madison matches up, with 11.83 percent of our sub-prime mortgages being delinquent as well. The big difference is this: Only about four percent of area mortgages were sub-prime to start. The lower number of overall sub-prime mortgages is a positive factor in keeping the housing market strong, says **Stephan Malpezzi**, chair of the Department of Real Estate and Urban Land Economics/Lorin and Marjorie Tiefenthaler Distinguished Chair in Real Estate at the **UW-Madison**, **James A. Graaskamp Center for Real Estate**.



Stephan Malpezzi
UW-Madison

Examining a market

When examining a housing market for high default risk factors, Malpezzi looks at three indicators.

“The first question to ask is, ‘Do we have

housing prices that have gotten, out of alignment with fundamentals?’” he explains. Malpezzi says that if Madison’s housing prices are “a little rich,” they are not terribly out of line. The second factor “is that our lenders have not made a huge number of sub-prime loans,” thus minimizing the risk.

Finally, “our economy is solid.” Malpezzi quickly points out that while Madison is “at much less risk than other markets,” a general assessment cannot address the pain and hardship individuals face because of foreclosure.

The human face of foreclosure is something Realtor **Paula Dollard** at **Keller Williams**, Madison, knows too well. In the past 12 months she has seen a “definite spike” in sellers involved in the foreclosure process. Presently, foreclosures comprise 30 percent of her listings, a number much higher than in years past. Even more frightening, all of these homeowners purchased within the past two years.



Paula Dollard
Keller Williams

“Clients who had two-year ARMs and planned to refinance before the rate adjusted higher were hit with a pre-penalty fee that they were unaware of,” she says. In other cases, clients attempted to refinance and were shocked to get a home appraisal lower than what it was two years ago. Foreclosure looms as homeowners struggle to keep up with their payments and refinancing options run dry.

How did we get here?

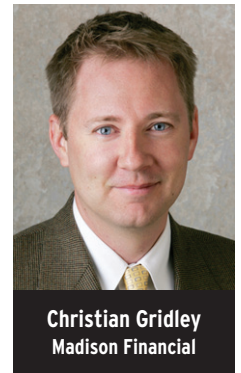
“On a grand policies scale, sub-prime

mortgages get more people into the housing market and if done right, it expands opportunity,” Malpezzi explains.

An example is the “stated income” loan where an individual has the income to afford the mortgage and an acceptable credit score but does not meet traditional underwriting standards

“Sub-primes started as a good program for the self-employed and individuals with non-traditional incomes,” says **Christian Gridley**, president, **Madison Financial**. The problem arises when either through lack of consumer education, loose underwriting or even fraud, consumers accept loans they do not understand and cannot fulfill, he continues.

“Buyers see the maximum they can borrow [on the pre-approval paperwork] and do not fully understand what the mortgage payment would mean to the rest of



Christian Gridley
Madison Financial

MADISON BY THE NUMBERS

- 4.71: Percentage of all loans made that are sub-prime
- 11.83: Percentage of sub-prime loans that are delinquent (as of December 2006)
- 5.09: Percentage-point increase in same number from year previous

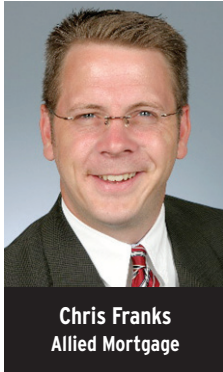
Source: Wall Street Journal Online, March 29, 2007

—Compiled by Pat Minczeski and Brett Taylor

their lifestyle,” says Dollard. Consumers quickly begin to sink with mortgage payments that are out of reach or they float along until the “introductory rate” on the ARM expires, ticks upward and payments skyrocket.

What does it mean?

While a glut of new housing may be contributing to longer days on the market, foreclosures also play a part because as that number rises, so does the number of available houses. Dollard says that the local May MLS shows seven sellers for every one qualified buyer reflecting the now familiar slowdown. Houses in foreclosure also can have a “ripple effect” on neighborhoods, with buyers feeling uneasy about unkempt homes and lawns. “Foreclosures in an area make it tougher for neighbors to sell,” she continues.



Chris Franks, branch manager of Sun Prairie’s **Allied Mortgage**, worries about abuse of “a good idea” and the freeze-out of first-time homebuyers.

“The National Association of Realtors estimates 250,000 first-time homebuyers can’t get a loan due to a tightening of standards. That means that someone wanting to sell their first home won’t have a buyer. In the meantime, he can’t buy his next, bigger home and so on up the line.” Fortunately for Dane County, Franks continues, it is the fastest-growing county in Wisconsin and that helps to drive the housing market.

Malpezzi offers that the sub-prime crisis is “a complex story that we will watch unwind over time. The lending pendulum has swung from one extreme to the other,” he says. The right response, in his mind, “is to reign in the abuses through tightening of standards and to educate consumers on the risk. Everyone should understand how a mortgage works and what it means to him or her.” ■

Consumer Education

If you want to help clients, employees or others improve their financial literacy, consider these local resources:

- UW Extension, www.uwex.edu/ces/flp/famecon/index.cfm, offers a variety of classes on general financial management, including the home-buying process
- Asset Builders of America, www.assessbuilders.org, winner of the Wisconsin Governor’s Financial Literacy Award, offers programs to educate families and communities about monetary issues.
- Madison Financial, www.madisonfinancial.net, provides free mortgage consultation, seminars on the home-buying process and links to additional resources.
- The Home Buyers Round Table of Dane County, www.homebuyers-roundtable.org, offers education classes on the buying process including financing options.