Business

Mortgage Crisis Spreads Past Subprime Loans

Isaac Brekken for the New York Times

Brenda Harris is pictured at her home in North Las Vegas on Feb. 6.

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By VIKAS BAJAJ and LOUISE STORY

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The credit crisis is no longer just a subprime mortgage problem.

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As home prices fall and banks tighten lending standards, people with good, or prime, credit histories are falling behind on their payments for home loans, auto loans and credit cards at a quickening pace, according to industry data and economists.

The rise in prime delinquencies, while less severe than the one in the subprime market, nonetheless poses a threat to the battered housing market and weakening economy, which some specialists say is in a recession or headed for one.

Until recently, people with good credit, who tend to pay their bills on time and manage their finances well, were viewed as a bulwark against the economic strains posed by rising defaults among borrowers with blemished, or subprime, credit.

“This collapse in housing value is sucking in all borrowers,” said Mark Zandi, chief economist at Moody’s Economy.com.

Like subprime mortgages, many prime loans made in recent years allowed borrowers to pay less initially and face higher adjustable payments a few years later. As long as home prices were rising, these borrowers could refinance their loans or sell their properties to pay off their mortgages. But now, with prices falling and lenders clamping down, homeowners with solid credit are starting to come under the same financial stress as those with subprime credit.

“Subprime was a symptom of the problem,” said James F. Keegan, a bond portfolio manager at American Century Investments, a mutual fund company. “The problem was we had a debt or credit bubble.”

The bursting of that bubble has led to steep losses across the financial industry. American International Group said on Monday that auditors found it may have understated losses on complex financial instruments linked to mortgages and corporate loans.

The running turmoil is also stirring fears that some hedge funds may run into trouble. At the end of September, nearly 4 percent of prime mortgages were past due or in foreclosure, according to the Mortgage Bankers Association.

That was the highest rate since the group started tracking prime and subprime mortgages separately in 1998. The delinquency and foreclosure rate for all mortgages, 7.3 percent, is higher than at any time since the group started tracking that data in 1979, largely as a result of the surge in subprime lending during the last few years.

An example of the spreading credit crisis is seen in Don Doyle, a computer engineer at Lockheed Martin who makes a six-figure income and had a stellar credit score in 2004, when he refinanced his home in Northern California to take cash out to pay for his daughter’s college tuition.

Mr. Doyle, 52, is now worried that he will have to file for bankruptcy, because he cannot afford to make the higher variable payments on his mortgage, and he cannot sell his home for more than his $740,000 mortgage.

"The whole plan was to get out" before his rate reset, he said. "Now I am caught. I can't sell my house. I'm having a hard time refinancing. I've avoided bankruptcy for months trying to pull this out of my savings."

The default rate for prime mortgages is still far lower than for subprime loans, about 24 percent of which are delinquent or in foreclosure. Some economists note that slightly more than a third of American homeowners have paid off their mortgages completely. This group is generally more affluent and contributes more to consumer spending and the economy relative to its size.

Unlike subprime borrowers, who tend to have lower incomes and fewer assets, prime borrowers have greater means to restructure their debt if they lose jobs or encounter other financial challenges. The recent reductions in short term interest rates by the Federal Reserve should also help by reducing the reset rate for adjustable loans.

Still, economists say the rate cuts and the $168 billion fiscal stimulus package are unlikely to make a significant dent in the large debts weighing on many Americans, because banks have tightened lending standards and expected rebates from the government will not cover most house payments.

The problems are most acute in areas that experienced a big boom in housing — California, the Southwest, Florida and other coastal markets — and in the Midwest, which is suffering from job losses in the manufacturing sector.

And it is not just first-mortgage default rates that are rising. About 5.7 percent of home equity lines of credit were delinquent or in default at the end of last year, up from 4.5 percent a year earlier, according to Moody's Economy.com and Equifax, the credit bureau.

About 7.1 percent of auto loans were in trouble, up from 6.1 percent. Personal bankruptcy filings, which fell significantly after a 2005 federal law made it harder to wipe out debts in bankruptcy, are starting to inch up.

- 1
- 2

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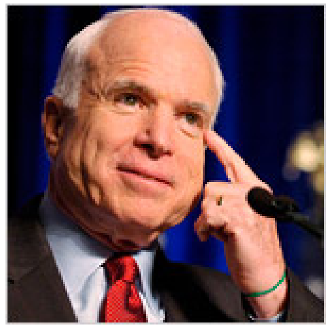

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