

Jumbo Mortgages May be Next in Line to Default

Do you have a big mortgage and good credit scores but not much equity — maybe you're even underwater? Do you see little chance that your home's market value will improve much during the coming three to seven years?

If you answered yes to both questions — and thousands of homeowners across the country could do so — new research suggests that you are in a category that lenders need to worry about most: prime jumbo borrowers who once were thought to be among the safest bets but who now are the most likely to opt for a strategic default and walk away from their homes.

In a study released Oct. 31, the ratings agency Moody's said that based on its analysis of mortgage-backed bond portfolios, homeowners with jumbos now constitute "greater strategic default risk" than any other type of borrowers, including subprime. That's because an exceptionally high number of jumbo owners — many in high-cost markets hit by real estate deflation over the past several years — are stuck with persistent negative equity. More than half of the jumbos analyzed by Moody's where owners are still making payments have home market values lower than their outstanding loan balances.

Jumbo Loans are those that exceed the conventional limits of Fannie Mae and Freddie Mac. Nationally, that ceiling is \$417,000, but in high-cost areas such as Washington, conventional limits ranged as high as \$729,750 until this year. The maximum in those high-cost areas is now \$625,500.

Meanwhile, FICO (formerly known as Fair Isaac Corp.), developer of the ubiquitous FICO credit score, says strategic defaults — in which owners who can afford to keep paying their loans but see no economic rationale for doing so and stop making payments — continue to be a "growing problem." The estimated number of mortgages underwater is at least 12 million, and 30 percent of all defaults on loans are strategic, according to Joanne M. Gaskin, FICO's predictive analytics director.

FICO recently created a type of score designed solely to spot potential strategic defaulters before they hand back the house keys. At least four of the 10 largest lenders and servicers are already using it, contacting high-risk borrowers and offering financial solutions plus information about the costs associated with strategic walkaways. The company claims its score can spot the riskiest homeowners, some of whom show characteristics that make them as much as 110 times as likely to walk away as the least-risky borrowers. Although FICO has not disclosed the specific risk combinations in the mathematical models supporting its proprietary score, the company confirms that among them are good credit scores and payment performance on debts; low balances of outstanding revolving credit; and a relatively short period of ownership of their current homes.

In an interview, Gaskin lifted the lid on the FICO black box a smidgen more. Using a wide variety of data — including property values and historical valuation trends along with standard FICO scores and other information in credit bureau files — the strategic default score essentially tries to get inside homeowners' heads to predict their behavior.

"We're trying to understand [the situation] from the consumer's perspective," she said. "How much have I lost on the value of my home? What is the velocity of change?" That is, how fast have I lost market value, and is my situation getting worse? And how long will it take to recapture what I've lost?

When the answers are grim and the prospects for equity recovery distant, the probability that the owners will plot a strategic departure — often characterized by halting mortgage payments while staying current on credit cards and car payments — goes up sharply.

“Most consumers have a pretty good idea of what the market is doing” in their local neighborhoods,” Gaskin said. What they often don’t know, however, are the penalties they face for walking away. These include triple-digit drops in their credit scores — which will hamper their ability to rent a house or obtain credit for years — plus the possibility that lenders will find a way to seek recovery of whatever they owe after foreclosure proceedings. About a dozen states, including California, restrict “deficiency” recoveries. But in most states, lenders are free to pursue whatever assets they can locate, and often do so if the amount of unrecovered debt is large enough to justify the legal expenses.

Ultimately, strategic default for many owners boils down to a calculation: Are the costs, financial and otherwise, worth the relief from an albatross house and mortgage? If the Moody’s study is accurate, thousands of jumbo borrowers are struggling with that very calculation right now, and a lot of them are likely to bail.

Kenneth Harvey, Washington Post Real Estate, published Nov 11, 2011

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http://www.washingtonpost.com/realestate/jumbo-mortgages-may-be-next-in-line-to-default/2011/11/08/gIQAoLK9BN_story.html