

SUBPRIME MORTGAGE CRISIS AFFECTS ON THE DALLAS-FORT WORTH RESIDENTIAL MARKETS

Macro-View

The increasing subprime mortgage defaults over the past quarter have had a rippling effect throughout the US financial markets. Foreclosure activity has seen significant increases exacerbated by defaults in the second mortgage and ARM markets. The percentage of mortgages in default rose to an all-time high in 1Q/07. According to the Mortgage Bankers Association (MBA), 0.65% of all loans on 1-4 unit residential properties entered foreclosure (a new record). The impact on residential real estate values across the nation is a hotly debated topic with up to 50% price declines projected.

The genesis of this crisis started with the influx of the so-called exotic mortgages and the resulting real estate price bubbles seen throughout the nation (mostly on both coasts). Approximately 40% of mortgages in 2006 were exotic mortgages including ARM's, seconds and subprime. This has allowed the not-so qualified mortgagee to participate in the housing bubble, thus increasing demand levels. The subprime buyer has virtually no disposable income and no savings, making any rise in interest rates a precursor to further trouble. The subprime loans have reportedly accounted for half of the foreclosure activity during the past 12 months. Typically, the subprime loan will come into default after 2 or 3 years when monthly payments start to rise. Subprime mortgages made up 20% of all mortgage loan activity in 2006, up from 5% in 2001. In the 2Q/07, subprime mortgages outstanding numbered 5.9 million, up from 1.2 million in 2Q/02.

The burst of the housing bubble has caused record levels of listing activity, foreclosures and price declines. Housing prices are projected to fall back to levels where buyers using traditional fixed rate mortgages can afford to purchase them. Price and supply stabilization is not anticipated to occur for 12-18 months.

Micro-View (D/FW)

According to Residential Strategies, Inc. (RSI), the annual housing closing rate declined to 43,341 units, only 7% off its 3Q/06 peak. The finished vacant housing inventory (the desired barometer of supply) dropped 8% from 1Q/06 levels. This equates to a 3 month supply. Annual closings are 4,600 units above new starts, indicating steady base demand levels and restraint in builder activity. The vacant lot supply remained constant at 97,000 developed lots which equated to a 29.4 month supply in Dallas and a 31.4 month supply in Fort Worth (24 months in optimal).

There are 30,000 lots currently near completion which will add to the oversupply conditions. Builders, who recently pulled back in the number of starts to sell off inventory, will have to increase construction starts if the lot supply is to dwindle. This will not be likely if job growth numbers recede or if interest rates rise. The latter causes a decrease in effective demand levels as less buyers can qualify for a loan.

SUBPRIME MORTGAGE CRISIS – CONTINUED

The subprime crisis has hit the local market in rising the “real” cost of owning a home through higher interest rates and lower appreciation. The D/FW area did not see the double digit appreciation rates that the coastal U.S. areas experienced. This was primarily due to the low entry barriers to development, an ample supply of vacant land without any natural barriers (mountains, oceans) and available builder capacity to construct homes. Demand levels increased with the job growth, but new construction starts kept pace, stifling any significant appreciation in prices.

The national credit crunch has affected payroll numbers and the Gross Domestic Product for 1Q/07 was revised downward. A greater number of economists are predicting a national recession, which could have a trickle down affect on the D/FW area. Economists are also split on whether the Federal Reserve will reduce rates, which would increase the number of qualified buyers. Either way, the local excess capacity levels are not likely to decrease without the high levels of pent-up demand that were present during the 2003 - 2006 growth period.

To counter the declining pent-up demand levels, naturally builders have recently exited from less profitable subdivisions and have concentrated on projects with healthy absorption velocities. The lots in the slower moving subdivisions are being sold at under market price levels to various local builders. These builders are projecting greater profit margins due to their lower land costs. This “flight to quality” by the larger home builders will increase their profitability or at least keep them in business.

Overall, the D/FW market has been spared from the brutal housing price collapse which occurred throughout the nation. However, both the new construction and re-sale markets are currently in the buyer’s corner. Developers will likely delay commencement of any new lot development, unless a strong credit builder is secured. This should alleviate the oversupply of developed lots caused by elevated demand levels (which were artificially inflated by the massive sub-prime lending). With local job growth levels remaining strong and housing prices actually increasing, the D/FW market is anticipated to have a soft landing in the remainder of 2007.