

US Housing Market Update

For both mortgage providers and borrowers alike there may be trouble ahead!

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One of the largest providers of mortgages to borrowers with marginal credit abruptly closed its doors earlier this week. Moreover, derivatives based on the lowest tier of sub-prime mortgage securities have been plummeting in price in recent days, sending the cost of insuring against these loans' default sharply higher.

At the same time, more and more mortgages are becoming more and more dangerous to the people who pay them.

As recently as three years ago, only eight out of every 1,000 Californians who took out a mortgage chose a 'pay option' model. By 2005, one of every five new mortgages was of the 'pay option' variety. More recently, the number has risen to one of every three.

The genius of the 'pay option' mortgage is that it allows a homebuyer the option of not really buying his house. Instead, the 'pay option' gives the buyer the option of not paying, which means that the interest he should have paid is added to the principal. Or, another way to look at it is that the money he should have paid is subtracted from his equity. So every day that the buyer fails to bring his interest payments up to par...he owns less of his own house.

In other words, the 'pay option' gives the new homeowner the option to short his own house.

Why would buyers do such a thing? Unless his house goes up in value faster than he can spend the money he's taking out - his equity goes down. Finally, he is living in a house in which he has no equity at all - or even a mortgage greater than the house value itself.

Few US house buyers have any experience with a bear market in housing. Imagine their surprise when the home they expected to make them rich actually drags them to the poorhouse

RIO has long predicted the collapse of the US housing market.

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