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**The Mortgage Corner**

## Builders Downgrade Construction Starts

The National Association of Home Builders' chief economist lowered his forecasts for new construction as the market has weakened further on subprime-mortgage problems and tighter lending standards, even though June housing starts rose 2.3 percent to 1.5 million annualized units.

"It's fair to say the performance of the housing market during the first half [of 2007] and the outlook for the second half and next year are a lot weaker than six months ago," said David Seiders, referring to his last semi-year forecast.

One reason for Seiders' downgrade is that sales of new homes in the U.S. declined more than expected in June, falling 6.6 percent to a seasonally adjusted annual rate of 834,000, the Commerce Department estimated Thursday.  Sales are down 22.3 percent compared with June 2006.  The sales pace in June was the lowest since March's 830,000 and is the second lowest since 1999.

His outlook for 2007 single-family housing starts is now 9 percent lower than it was at the beginning of the year, while his 2008 forecast has been slashed by 15 percent, Seiders said on a conference call. His forecast is for housing starts of 1.42 million this year and 1.45 million in 2008.

The key reason is the "unanticipated and sudden turmoil in the subprime-mortgage sector" which has resulted in more stringent lending requirements for home buyers, and also spread into other higher-quality loans.  This is because the Federal Reserve had raised short-term rates 17 consecutive times June 2004 to June 2006, even though it has kept rates unchanged since then.  This resulted in ARM interest rates (and payments) surging to above 8 percent, beyond the capacity of many borrowers' incomes.

Another reason for the slowdown in housing starts is surging inventories in both new and existing-homes, up to 7.8 and 8.8 months' inventories, respectively.  Combined new and existing home sales fell 4.2 percent to 6.58 million annualized, the lowest since September 2002.

Consequently, delinquencies and foreclosures are rising and the market is "still dealing with problems and that creates massive uncertainty over where we're going," Seiders said.   "Financial markets are clearly correcting dramatically as it becomes clear what loans were made earlier and their performance."

He said the repricing of mortgage-backed securities and collateralized debt obligations represent "strong signals from the securities markets."  Meanwhile, financial regulators "are now in the game" and establishing stricter lending standards. Also, major ratings agencies, which he said were "behind the curve," are "finally in the game in earnest" and "downgrading securities all over the place."

The economist said the housing downturn was the result of the unsustainable boom when home prices and sales rocketed higher. The euphoria was also driven by "overly aggressive monetary policy" and new types of loans. At the same time, there was an unprecedented level of buying by investors and speculators who flipped homes for profit, while the correction was unique in that it wasn't caused by higher interest rates or a weakening economy.

His prediction is that single-family housing starts will fall 23 percent this year, but recover next year and rise 2 percent. He thinks a "reasonable" rate is 1.5 million housing starts, which the market is now well below. Seiders said it will be "a slow climb out of this hole" with no expected surge in job growth or lower interest rates, so it make take several years to reach the 1.5 million level.

Further home-price declines are needed to "get markets back in balance" and make houses more affordable for buyers. However, one risk of price erosion is that buyers might wait on the sidelines to see if prices drop further, according to Seiders, which tends to make it a self-fulfilling prophecy.