Subprime fallout will claim more lenders: lawyer

By John Spence, MarketWatch
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BOSTON (MarketWatch) -- The subprime contagion has already forced several of the nation's largest home lenders into bankruptcy, but a banking attorney specializing in the mortgage industry says the carnage is far from over.

"This isn't the last of it," said Kal Das, head of the global bank and institutional finance and restructuring practice group at law firm Seward & Kissel, in a telephone interview. "Many more mortgage lenders will go down in the coming months."

American Home Mortgage and New Century Financial were among those that filed for Chapter 11 as a result of rising defaults, and questions are swirling around the nation's largest mortgage lender, Countrywide Financial Corp. (CFC

Countrywide Financial Corp

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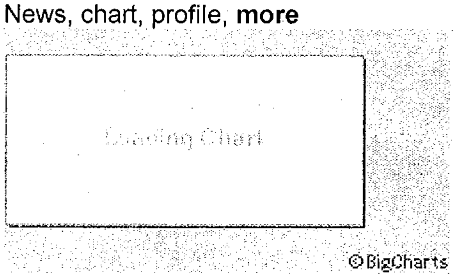

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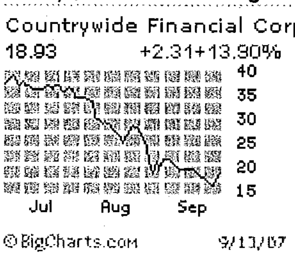
CFC) , which is cutting thousands of employees.



The pain has spread well beyond subprime and so-called Alt-A mortgages, Das said.

The commercial-paper market on which companies rely for short-term funding needs "is nonexistent right now," he said.

Also, the grief is spilling beyond residential and into the market for commercial real estate, such as office and apartment buildings.

"Lenders are getting jittery and people are thinking twice before lending money" as they demand more documentation and covenants, which is stalling commercial real estate deals, Das said.

Conduits in trouble

Meanwhile, banks are feeling the mortgage pinch in off-balance-sheet "conduits" and structured investment vehicles, or SIVs. These vehicles issue commercial paper which is backed by various types of investments such as mortgages, credit cards and auto loans.

Investors have balked at buying the commercial paper because they're uncertain if it's backed by risky mortgages. The banks may be exposed to losses because they support the conduits through backup lines of credit. An unattractive alternative would be to sell the assets into a battered market.

"No one wants to liquidate collateral in the asset-backed market because of the huge losses they would face," Das said.

"The collateral isn't always bad, but when you use mark-to-market, it gets hit," he added, referring to the accounting practice in which companies value assets purchased previously at current market rates. If the assets were bought on margin, marking down the value may trigger margin calls from lenders for payment or more collateral.

With many banks exposed to SIVs, investors are waiting for the corporate earnings season for disclosure of any losses. Since banks don't release a lot of financial information on conduits, "we don't know what the fallout will be yet," Das said.

Help on the way?

Investors are hoping the Federal Reserve will provide relief at an upcoming meeting by cutting the federal funds rate, the rate banks charge each other on overnight loans. The rate currently stands at 5.25%. Das said he's "hoping" for a 50-basis point cut, but that he "expects" a 25-basis-point reduction. (A basis point is a hundredth of a percentage point, or 0.01%.)

Additionally, allowing Fannie Mae (FNM

Fannie Mae

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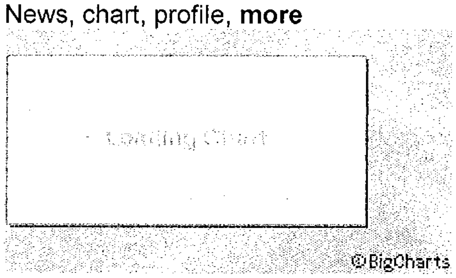

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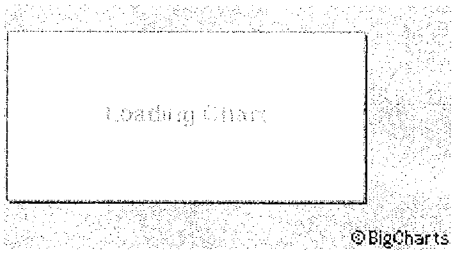

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FRE) to buy more loans would help pump liquidity into the mortgage market, he said.

"I'm not sure it will happen in the near term because both companies have other problems, but it would be a boost," Das said. "To sum it up, we need liquidity in the mortgage market, because it has dried up."

He said the turmoil in the mortgage and credit markets will continue to play out and further weaken the residential housing market and possibly push the economy into recession.

"It's not going away anytime soon," Das said. "From all indications, home prices are going to fall next year because of the lag time between the economy and housing prices," he said, estimating that major metropolitan areas will see residential prices drop 5% to 10% next year.

John Spence is a reporter for MarketWatch in Boston.