About half of U.S. mortgages seen underwater by 2011

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By Al Yoon

NEW YORK (Reuters) - The percentage of U.S. homeowners who owe more than their house is worth will nearly double to 48 percent in 2011 from 26 percent at the end of March, portending another blow to the housing market, Deutsche Bank said on Wednesday.

Home price declines will have their biggest impact on prime "conforming" loans that meet underwriting and size guidelines of Fannie Mae and Freddie Mac, the bank said in a report. Prime conforming loans make up two-thirds of mortgages, and are typically less risky because of stringent requirements.

"We project the next phase of the housing decline will have a far greater impact on prime borrowers," Deutsche analysts Karen Weaver and Ying Shen said in the report.

Of prime conforming loans, 41 percent will be "underwater" by the first quarter of 2011, up from 16 percent at the end of the first quarter 2009, it said. Forty-six percent of prime jumbo loans will be larger than their properties' value, up from 29 percent, it said.

"The impact of this is significant given that these markets have the largest share of the total mortgage market outstanding," the analysts said. Prime jumbo loans make up 13 percent of the total market.

Deutsche's dire assessment comes amid a bolt of evidence in recent months that point to stabilization in the U.S. housing market after three years of price drops. This week, the National Association of Realtors said pending home sales rose for a fifth straight month in June. A widely watched index released in July showed home prices in May rose for the first time since 2006.

Covering 100 U.S. metropolitan areas, Deutsche Bank in June forecast home prices would fall 14 percent through the first quarter of 2011, for a total drop of 41.7 percent.

The drop in home prices is fueling a vicious cycle of foreclosures as it eliminates homeowner equity and gives borrowers an incentive to walk away from their mortgages. The more severe the negative equity, the more likely are defaults, since many borrowers believe prices will not recover enough.

Homeowners with the riskiest mortgages taken out during the housing boom have seen the greatest erosion in equity, in part because they were "affordability products" originated at the housing peak, Deutsche said. They include subprime loans, of which 69 percent will be underwater in 2011, up from 50 percent in March, Deutsche said,

Of option adjustable-rate mortgages -- which cut payments by allowing principal balances to rise -- 89 percent will be underwater in 2011, up from 77 percent, the report said.

Regions suffering the worst negative equity are areas in California, Florida, Arizona, Nevada, Ohio, Michigan, Illinois, Wisconsin, Massachusetts and West Virginia. Las Vegas and parts of Florida and California will see 90 percent or more of their loans underwater by 2011, it added.

"For many, the home has morphed from piggy bank to albatross," the analysts said.

(Editing by Dan Grebler)

http://www.reuters.com/article/GCA-Housing/idUSTRE5745JP20090805