Technology Lacking Experience

In the first quarter of this year, consumer debt grew at its fastest pace in four years, raising at an annual rate of 11.2 percent. It was just shy of the rapid pace of 11.4 in the fourth quarter of 1995. Meanwhile, consumer spending grew at the fastest pace in 17 years and personal savings rates are at all time lows. All this points to an impending crisis that our technological tools are ill equipped to plan for.

My biggest concern is that most of the technology that's been developed to approve borrowers was developed during a dramatic growth period. The 1990's saw ever increasing economic improvements without any significant downturn. During this same period, virtually all of the automated underwriting systems were designed, developed and implemented. These systems make approvals primarily based upon the experiences of the past decade. Further, these systems couldn't have factored in the historical records of high consumer debt and low savings rate. I fear record loan default rates that haven't been seen since the 1930's.

Mortgage originators continue to love the ever-increasing variety and availability of high LTV loans. Except for the 90's, such high LTV loans were unavailable. Common sense says that at some point, 100% LTV loans are going to come back and bite the lenders that hold the paper. The recent slowdown in the refi business has seemed to make this even more gregarious as lenders try to beat the odds and find new loan programs to prop up their declining loan volume.

Once again, the new technology based models that make these decisions may be hampered by lack of long term experiences. In the last decade, we have seen some large increases in the value of homes throughout the country during a time when inflation rates are very low. Thus, the *real* increases in property value in the last decade could very well cause a nation of overvalued homes. Certainly this is more pronounced in some regions versus others. Silicon Valley has seen housing values jump in multiples of their 1990 prices. To believe a correction isn't coming is like believing that Internet stocks won't ever fall. What happens to all those consumers with high debt levels sitting on houses that have loans significantly higher than what they can be sold for? The answer is as simple as walking out of the house and the loan obligations. At some point, hundreds of thousands might decide it's a prudent financial option (or perhaps their only option).

Further evidence comes from the comments of Allen Greenspan who has hinted that banks in general are becoming overly aggressive in their lending decisions. Much like the practices that led to the last economic recession banks are making loans based upon today's good economic times. Seems to me, we are just setting ourselves up again for the same fall.

Yet another sign is stock trading on margins. We've already seen significant corrections in the stock market with many consumers being forced out of their stock holdings from margins calls and lack of personal liquidity. It's likely that more of these are to come. We've never seen such a significant number of consumers trading stocks. Today, 50% of all households now own stock. Once again, today's technological advancements like the Internet might be setting us up for a fall. Most people credit the Internet for allowing consumers to so easily trade stocks and thus, the rapid increase in the number of stock traders. The stock market is also more volatile than ever before – primarily because of this increased consumer activity.

What's really concerning to me is the confluence of all these factors coming together at the same time. High consumer debt, low savings rates, high real estate values, high LTV's, aggressive banking decisions, volatile stock assets and new underwitting systems, seems to create a perfect recipe for putting a lot of borrowers under. Normally, technology brings about wonderful things. However, we must not be blind of potential side effects.

With all this in mind, our industry should be doing more at advising consumers of the pitfalls of over leveraging themselves. Mortgage originators should be especially cautious with their clients and evaluate their overall asset structure. Sometimes, this might mean walking away from a potential loan because it really isn't in the best long-term interest of the consumer. In the interest of ethics, loan originators should be more concerned then ever about consumers that over-spend and set themselves us for a "personal liquidity crises". I believe the demand for credit councilors will skyrocket over the next 18 months. Perhaps you should be increasingly recommending the use of them to some of your clients.