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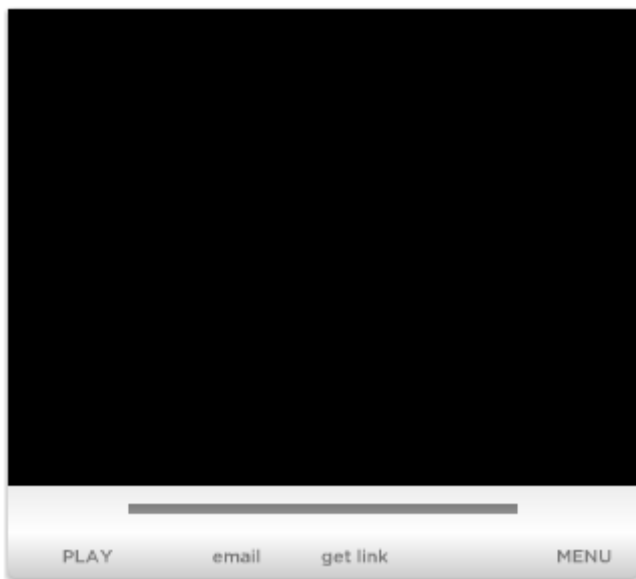
Decline in Home Prices Accelerates

Fed's Efforts Have Only Muted Effect On Mortgage Rates

 By **KELLY EVANS, SERENA NG and RUTH SIMON**
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The decline in U.S. home prices accelerated in the fourth quarter, according to two leading barometers, compounding two of the biggest threats facing the nation's economy: faltering consumer spending and tight credit markets.

The S&P/Case-Shiller national home-price index for the fourth quarter fell 8.9% from a year earlier, the largest drop in its 20 years of data. And the Office of Federal Housing Enterprise Oversight's index -- which tracks only homes purchased with mortgages guaranteed by home-loan giants Fannie Mae or Freddie Mac -- was down 0.3%, the first year-to-year decline in the measure's 16 years.




Bank of America Chief Economist Mickey Levy analyzes this week's economic reports on housing prices, consumer confidence and wholesale prices. He predicts there will be another half year of falling home prices.

biased in favor of more interest-rate cuts. "It appears that the correction in the housing market has

Lower home prices threaten the economy's growth by making consumers feel less wealthy and thus less willing to spend. They also curtail homeowners' ability to borrow against the value of their homes to finance other purchases. In addition, lower housing prices erode the value of banks' collateral, prompting them to tighten their lending standards, which further damps economic growth.

A top Federal Reserve official indicated the housing slump and its broadening impact on the economy probably would keep the central bank

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further to go," Fed Vice Chairman Donald Kohn said yesterday in a speech in North Carolina. Mr. Kohn said that the downturn, after being "contained" for nearly two years, "appears to have spread to other sectors of the economy." He added that if the housing market deteriorates more than expected, "lenders might further reduce credit availability."

The Fed's efforts so far to soften the blow of the housing slump with lower interest rates appear to be having a muted effect. Since September, the Fed has reduced its target for short-term interest rates by 2.25 percentage points to 3%. But some mortgage rates are actually rising, and those that are falling haven't fallen that much.

The average interest rate on a standard 30-year fixed-rate mortgage was 6.38% yesterday, little changed from September but up from 5.61% in late January, according to HSH Associates, a mortgage-data publisher in Pompton Plains, N.J. Interest rates on so-called jumbo mortgages -- those larger than \$417,000 -- were at 7.35%, also close to their September levels.

Rates on adjustable mortgages have come down, but not by as much as the Fed has cut the rates it influences. A three-year ARM, for instance, carried a 5.43% interest rate yesterday, down from 6.29% in mid-September. Still, lower short-term rates should help millions of homeowners who took out ARMs with low teaser rates that are set to jump higher.

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There are two reasons mortgage rates haven't responded more to the Fed's rate cuts. One is that long-term Treasury yields, which are the benchmark for most mortgage rates, have risen recently, perhaps because of increased concern about inflation as the prices of oil and other commodities soar. The other is that the spread between mortgage rates and Treasury rates has widened as investors and banks become increasingly reluctant to make home loans.

Hoping to Refinance

William Zempsky, a pediatrician who lives in West Hartford, Conn., was hoping to refinance his adjustable-rate mortgage before the rate -- which had been fixed at 4.5% for five years -- jumps to 6% or so in March. "I started to put my stuff together to refinance, but before we could pull the trigger, rates bounced up again," Mr. Zempsky said. "It seemed that with the Fed dropping rates that things would stay low, but they haven't."

If Mr. Zempsky doesn't refinance, his monthly payments will jump by about \$275 a month, says his mortgage banker, Michael Menatian, president of Sanborn Mortgage Corp.

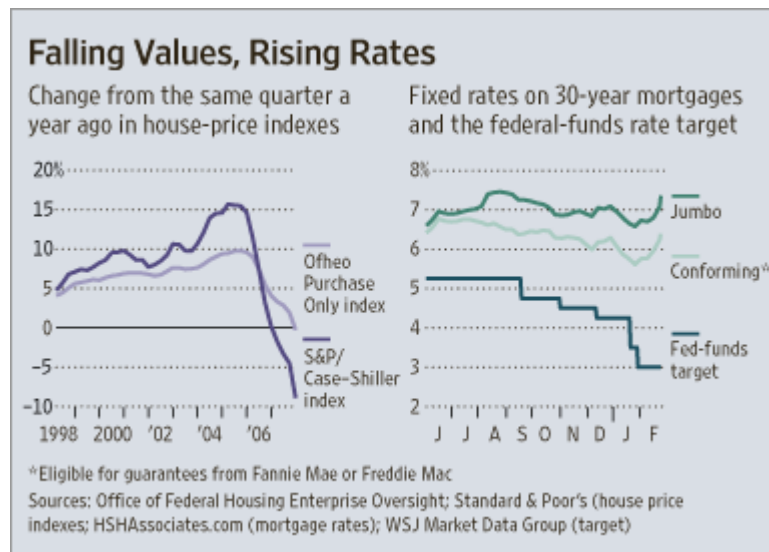
The housing-market slump also is taking its toll on consumer sentiment, which could lead to further pullbacks in spending, depressing the economy. The Conference Board, a New York-based business-research group, said yesterday that its index of consumer confidence fell sharply to 75.0 in February from 87.3 in January. The index is closely watched because consumer spending drives much of the U.S. economy.

"Consumer spending is going to take a hit," said Patrick Newport, an economist at Global Insight in Waltham, Mass. "The hit will be bigger the more home prices drop."

A growing glut of homes for sale suggests buyers have little interest in snapping up houses at

current prices. Buyers "are waiting for the bottom to be there," said Vicki Nellis, a real-estate agent at Re/Max Allegiance in Burke, Va. She said this is the worst market she has seen in her 25 years in the business.

Goldman Sachs Group Inc. estimates home prices ultimately will fall by 20% to 25% from the peak of the housing boom, while Merrill Lynch chief economist Dave Rosenberg says they could fall even further. According to the S&P/Case-Shiller national home-price index, prices have fallen 10.2% from their highs in the summer of 2006. In some areas, the declines have been much steeper. Prices in the Miami area were 17.5% lower in December than they were a year earlier, and prices in Las Vegas, Phoenix and San Diego have fallen by 15% or more.



There may be light at the end of the tunnel. As prices fall, potential buyers may be tempted off the sidelines. Economists agree the key to stabilizing prices is working off the huge inventory of unsold homes. Supply is shrinking: New-home construction has plunged dramatically. But demand has fallen just as much, leaving inventories high. Sales are now far below normal trends, and on Monday, an industry trade group reported a 0.5% increase in single-family home sales in January, the first in 11 months.

The S&P/Case-Shiller and Ofheo indices have important differences. The Ofheo index is less volatile because it only tracks the prices of homes purchased with mortgages guaranteed by government-backed agencies. That excludes jumbo mortgages, subprime mortgages and other riskier mortgage products.

One reason home prices are falling: Builders are trying to unload their unsold houses. Stuart Kaye, founder of Kaye Homes Inc. in Naples, Fla., has been offering discounts, including price cuts and other incentives, of 20% to 30% on about 50 homes in his inventory. He has sold 18 of them in recent months. "We want to be out from underneath this inventory, and we have made a commitment we will be through it in a 90-day period," he said.

But the interest-rate environment has brought a near halt to refinancing activity. P.H. Naffah, a musician in Goodyear, Ariz., has a roughly \$415,000, 30-year mortgage with a fixed rate of 6.25%. He figures he could cut his mortgage costs by around \$250 a month by refinancing into a loan with a 5.5% rate. "I'm waiting for the interest rates to go down," said Mr. Naffah, who added the savings "would be significant" because his monthly income as a musician fluctuates.

Other borrowers have been hamstrung by tighter credit standards as lenders eliminate programs and set tighter requirements, particularly in markets where home prices are falling. Steve Walsh, a mortgage broker in Scottsdale, Ariz., says his firm is originating about 300 loans a month, but closing only about 65. Mr. Walsh says that about 100 applications fell apart because of problems with appraisals. Another 100 loans didn't close because of rising mortgage rates.

In addition to inflation concerns, rates are rising because the market for mortgage-backed securities is in upheaval, thanks to rising mortgage delinquencies and the collapse of the high-risk subprime corner of the mortgage business.

Upward Pressure

Investors are demanding higher risk premiums for securities they buy with mortgages attached to them. And that is putting upward pressure on the rates charged to individuals. Even bonds backed by government-sponsored enterprises Fannie Mae and Freddie Mac -- which are considered safe triple-A-rated institutions -- have declined in value, pushing mortgage rates higher.

The difference between yields on some Fannie-backed mortgage bonds and yields on Treasury notes hit around 2.46 percentage points this week. This gap -- also known as the "spread" -- gets larger when investors become more risk averse and seek safety in Treasury bonds. It is up from 2.06 percentage points two weeks ago and has reached levels last seen during the 1980s savings-and-loan crisis, according to Bear Stearns.

Of course, mortgage rates would likely be even higher if the Fed hadn't moved aggressively in the past few months. But Fed officials seem mindful of their own limits. "Financing costs have risen, on balance, for riskier credits, and almost all borrowers are dealing with more cautious lenders who have adopted more stringent standards," Mr. Kohn said in his speech yesterday.

--Michael Corkery and Sara Murray contributed to this article.

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