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Shadow inventory threatens housing recovery

There is a growing glut of foreclosed homes threatening to hit the market over the next couple of years, potentially delaying any recovery.

There were 1.7 million homes either owned by lenders or in some stage of foreclosure at the end of the third quarter of 2010 and it would take 44 months, at the current rate of sales, to sell them off; that's a 25% increase from the beginning of 2010. And that does not count home loans backed by Fannie Mae and Freddie Mac.

This so-called "shadow inventory" may depress home values even more and delay the housing market recovery.   Shadow inventory refers to properties whose borrowers are (or recently were) 90 days or more delinquent on their mortgage payments, ones currently or recently in foreclosure or that are back in the hands of the lenders.

All these properties coming down the pipeline are nearly certain to hit the market, creating a negative for the supply-demand equation, Data through last Sept. 30 suggests there are more than 2 million Americans seriously delinquent on their mortgages and another 2 million lender-owned homes. In addition, it was reported recently last week that a million homes were repossessed in 2010.

The biggest contributor to the longer shadow inventory is that banks are taking far longer to foreclose on homes than they once did. There are several reasons for that. One is that banks have struggled to keep up with the sheer volume. Last year there were nearly 2.9 million homes that received some kind of foreclosure notice.

Many foreclosures have also been delayed as lenders make greater efforts to save homes by modifying mortgages. Gathering all the paperwork and working out a deal with all the parties takes time. Lenders have gotten better at this, with modified loans less likely to re-default. In early 2008, 80% to 85% of these loans re-defaulted. By the third quarter of 2009, that had dropped to a 50% to 55% rate.

Just as an example of how shadow inventory is affecting specific markets, in the nine month period between Dec. 2009 and Sept. 2010, shadow inventory in Minneapolis rose to a 35 month backlog from 21 months, in Las Vegas it went up from a 21 month to a 30 month supply and in nearby Portland it jumped from 31 to 45 months.

Thanks in part to Les Christie, staff writer for CNNMoney