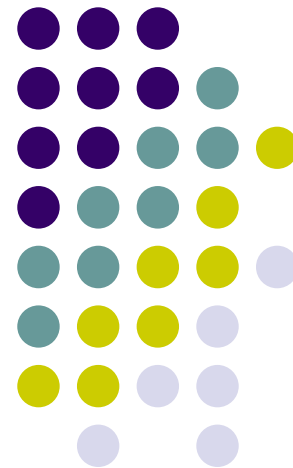


Delinquency and Foreclosure: A National Framework

Federal Reserve Bank of New York
2 November 2006

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The Promise:



- **Benefits** of owning a home
 - Financial
 - Social - especially for children
- **Neighborhood** effects
 - Property upkeep, crime, schools
- **Asset building** potential
 - Provides a stake in society
 - Leverages private sector resources
 - Lower-income households have few financial assets



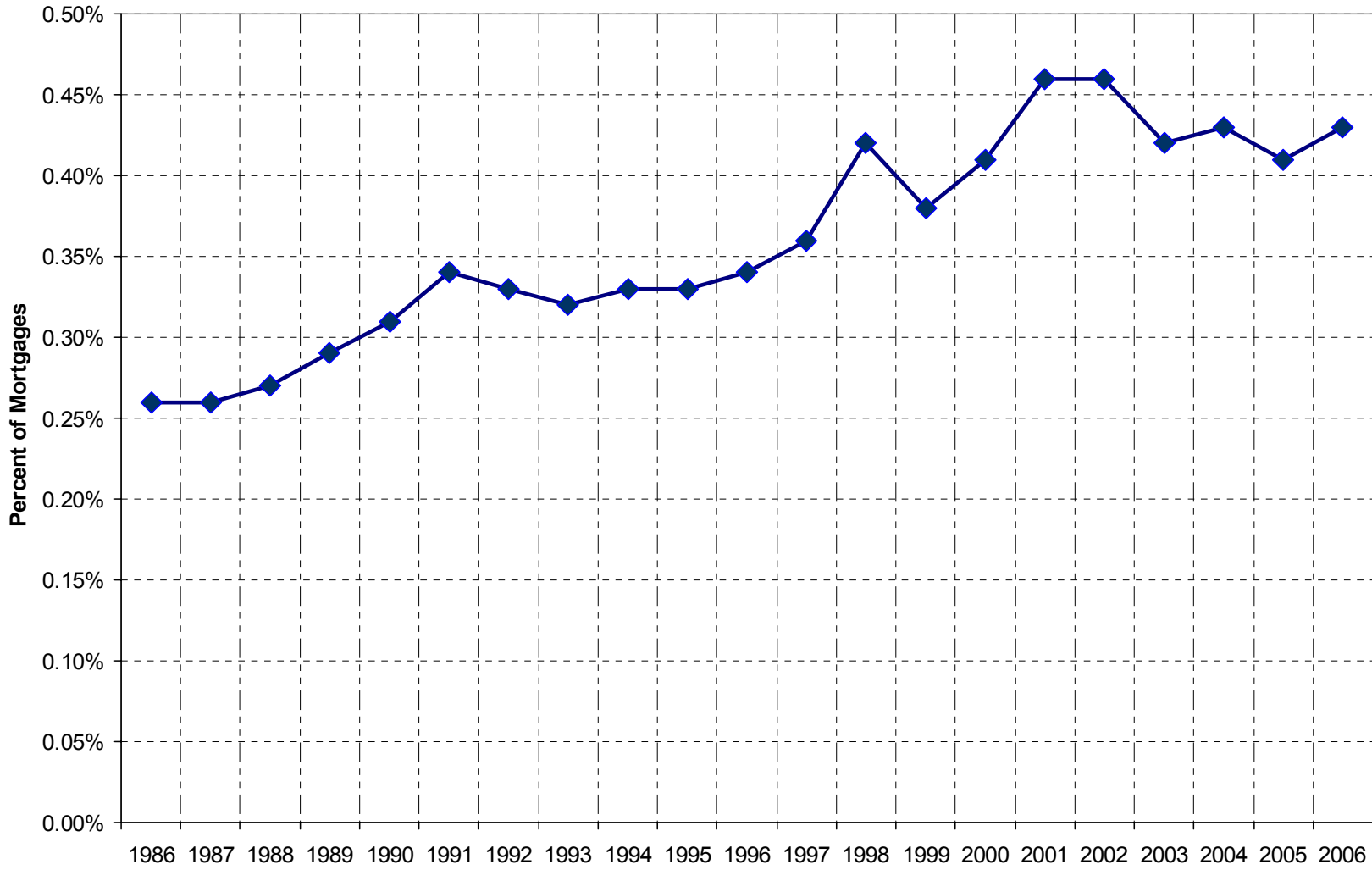
The Pitfalls



- Delinquency
 - Payment is “past due”
- Default
 - Violation of mortgage contract; often = “seriously delinquent”
- Foreclosure
 - A legal filing to take a property
- REO
 - “Real Estate Owned” – lender’s inventory of foreclosed assets



Foreclosures Started 1986-2006



Source: National Delinquency Survey, Mortgage Bankers Association, (2006 as of 2q)

The Marketplace Has Changed



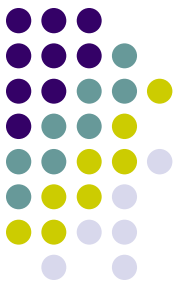
The Risk Distribution has Shifted

- Decrease in government-backed loans
- Adjustable rate loans versus fixed payment loans
- Borrowers with more credit problems in the market

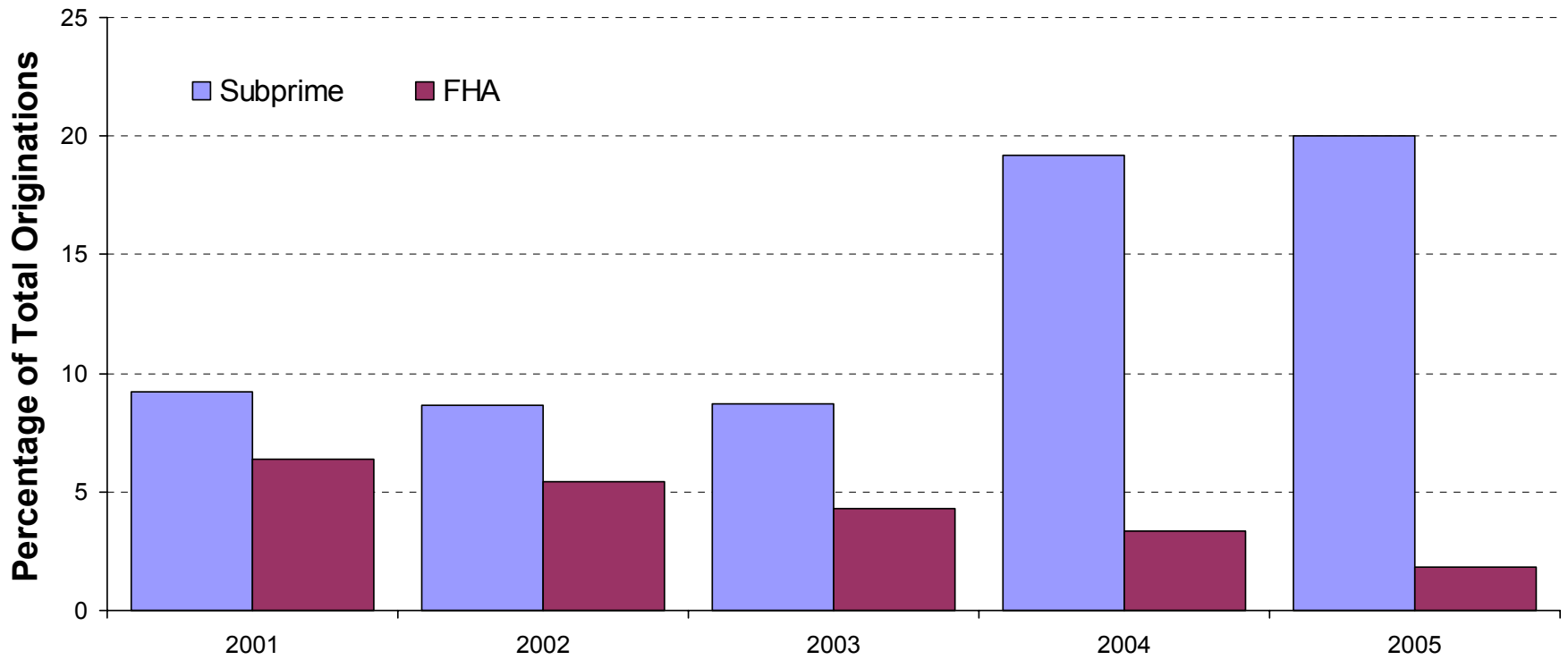
More Risk: Delinquency rates will generally rise

- Growth in adjustable loans (ARMs) & “exotics”
 - 1 out of 3 mortgages in 2005 was an *Interest Only* or *Option ARM*
- Investor-Owners
- Payment Pressures
- Housing values finally peaked

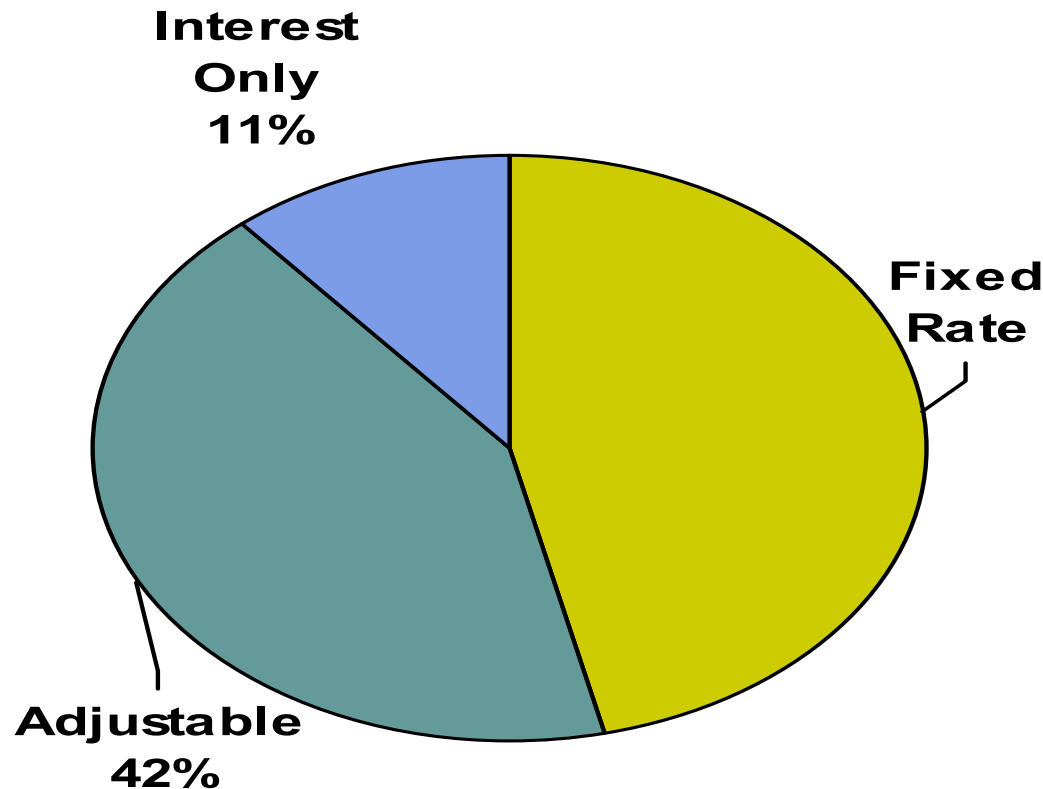
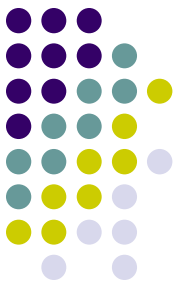
More Risk in the Marketplace: 1 in 5 Mortgages are Subprime



Nonprime Loan Volumes 2001-2005



Traditional Fixed Rate Mortgages No Longer Majority of Loans



Hybrid-ARM Resets:

2005: \$100 billion

2006: \$375 billion

2007: \$1 trillion

Total value of ARMs with payment resets in year.^

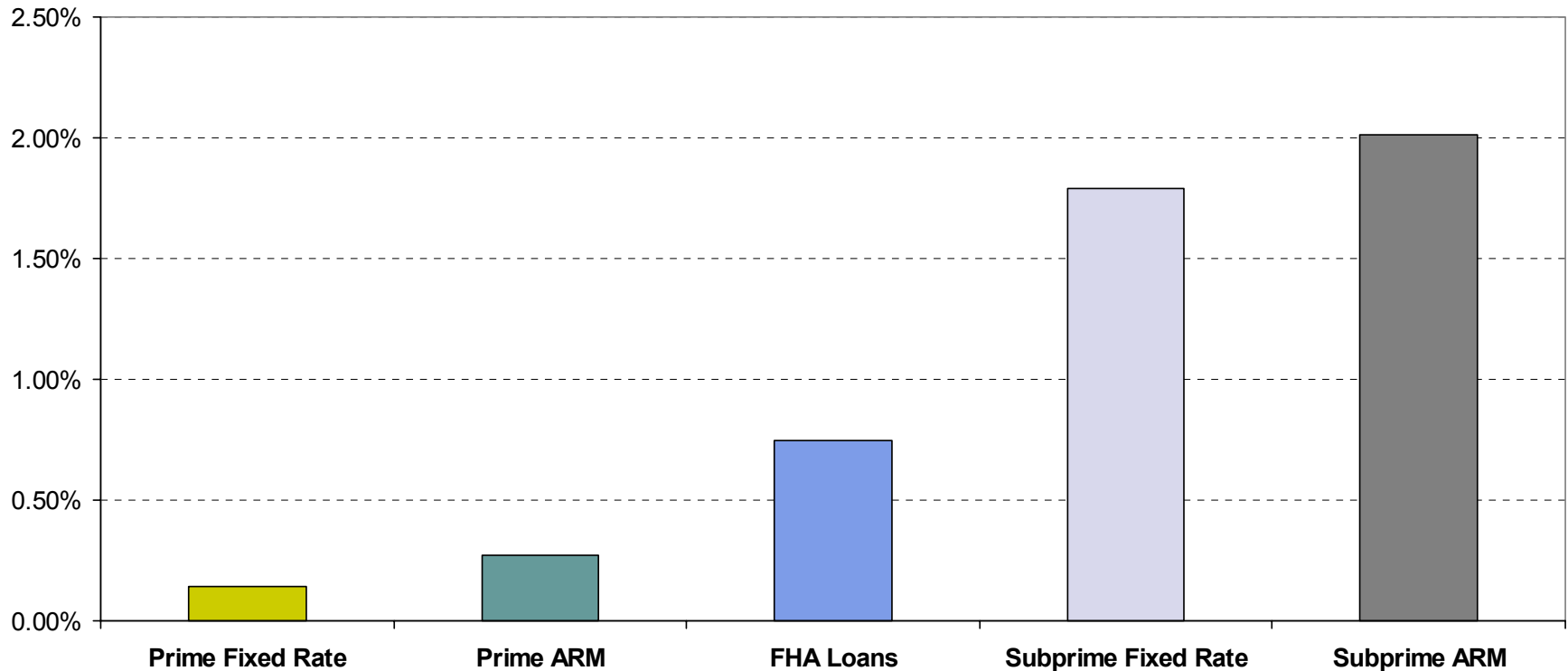
Sources: Single Family Mortgage Activity Survey, Mortgage Bankers Association, 2005

^ DB Global Markets Survey, as cited by Mortgage Bankers Association, 2006

Incidence of Foreclosure Varies by Loan Type



2006 Foreclosure Starts by Type of Loan
(Seasonally Adjusted, 2Q2006)

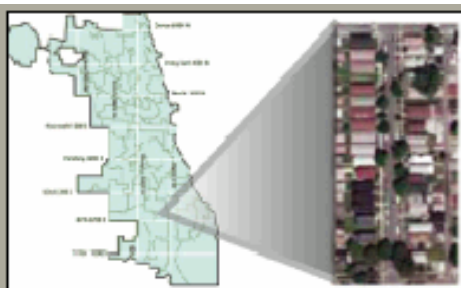


Source: National Delinquency Survey, Mortgage Bankers Association, n = 45 million loans serviced (22.6m, 5.9m, 3.2m, 2.0m, 2.9m)

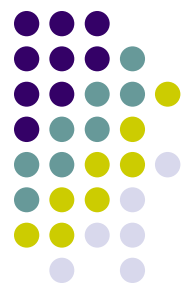
Special Concern: Underserved Borrowers



- **Consumers** may lack knowledge
 - Lack of education and counseling; Poor disclosure
 - Mistrust of traditional banks; reliance on brokers
- **Property** instability
 - Property condition and location
- Less ability to manage **payment shocks**
 - More likely to experience
- More likely to have **trigger events**
 - Job loss, death in the family, disability
 - Inability to recover post-foreclosure
- **Neighborhood Concentrations** – hotspots
 - Destabilize low-income communities



Case Study of Foreclosure Impact: The 8300 Block of S. Morgan St. Auburn/Gresham, Chicago, Illinois



Foreclosures



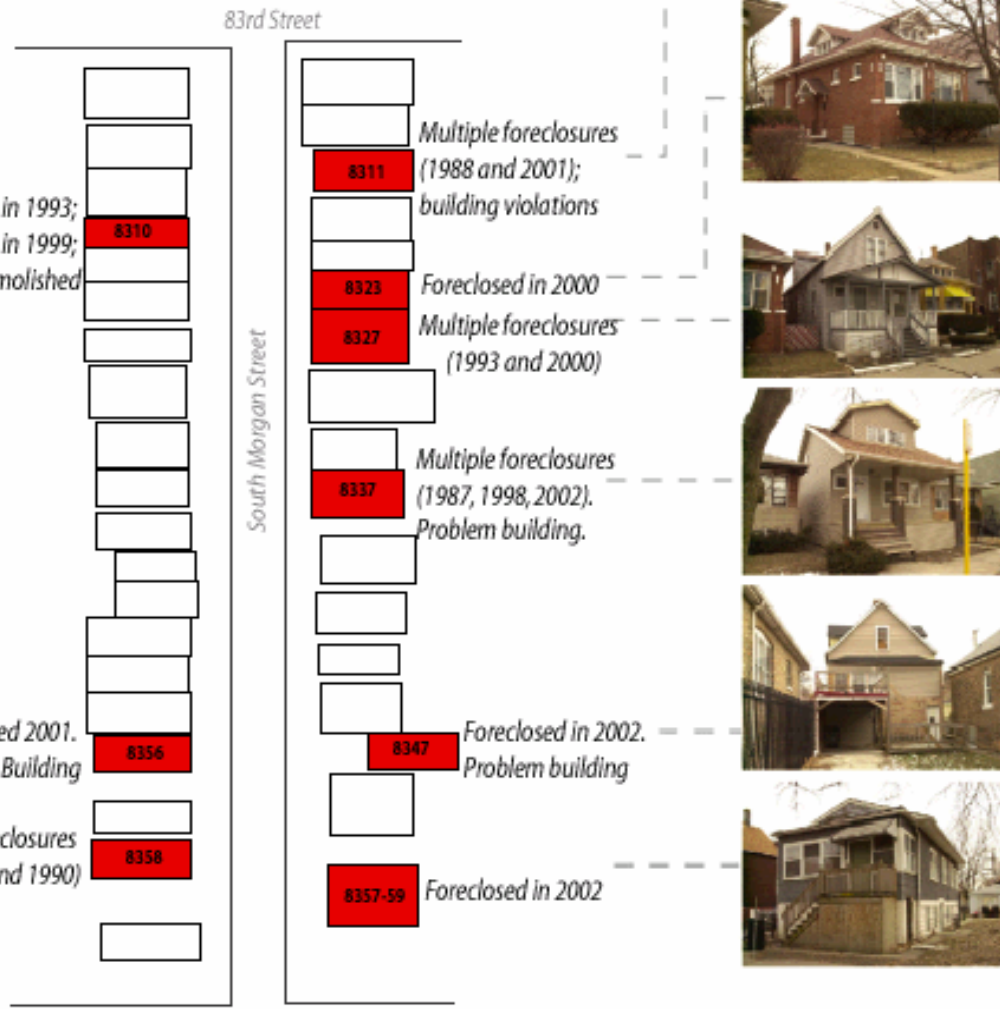
Foreclosed in 1993;
sold for unpaid taxes in 1999;
property demolished



Foreclosed 2001.
Problem Building



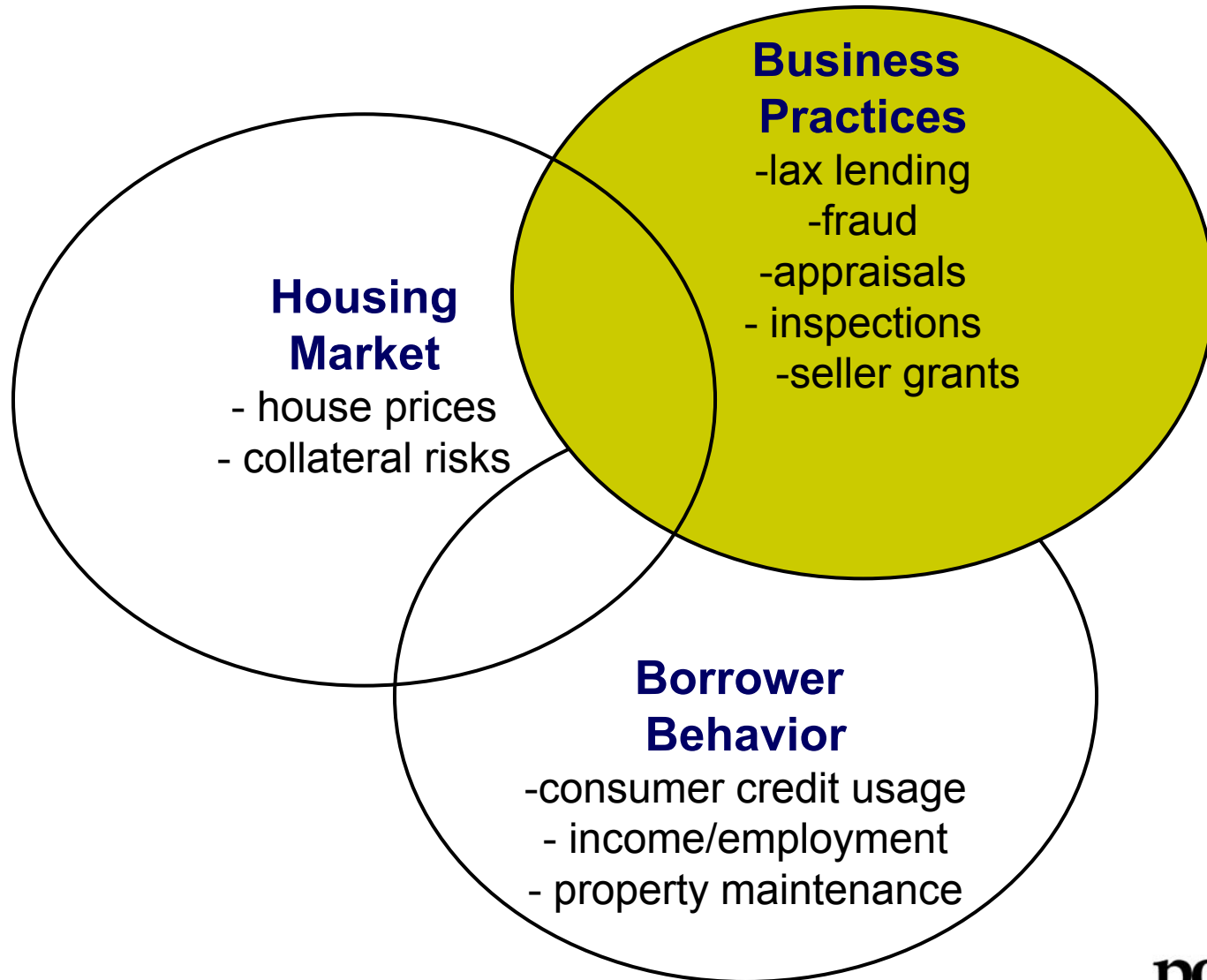
Multiple foreclosures
(1988 and 1990)



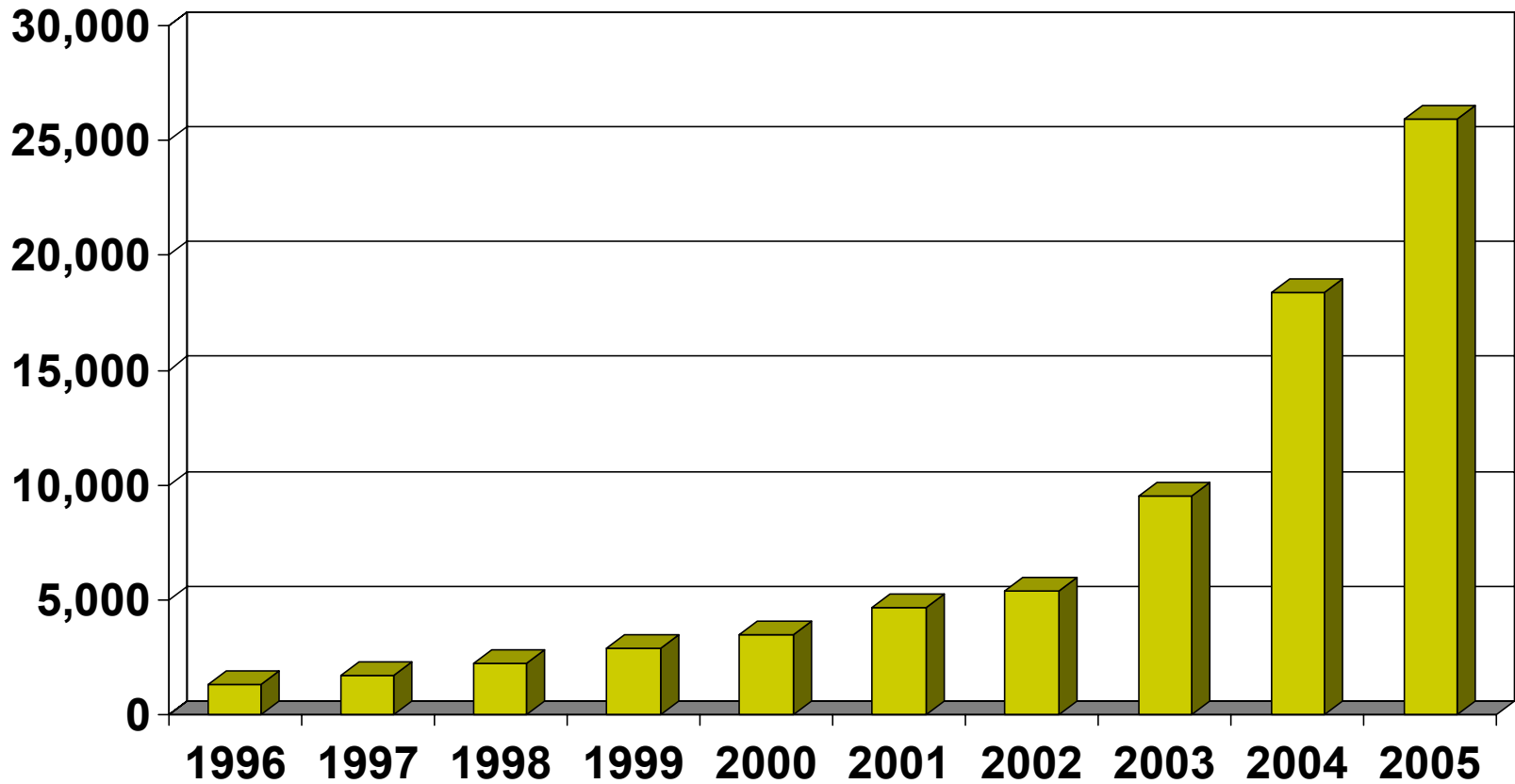
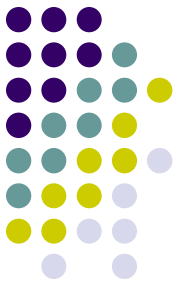
“I was born and raised here. I just didn’t see property boarded up like it is now. It’s scary.

Sometimes it’s three or four houses on one block boarded up. What is wrong? What’s going on?”

Multiple Underlying Causes of Foreclosure



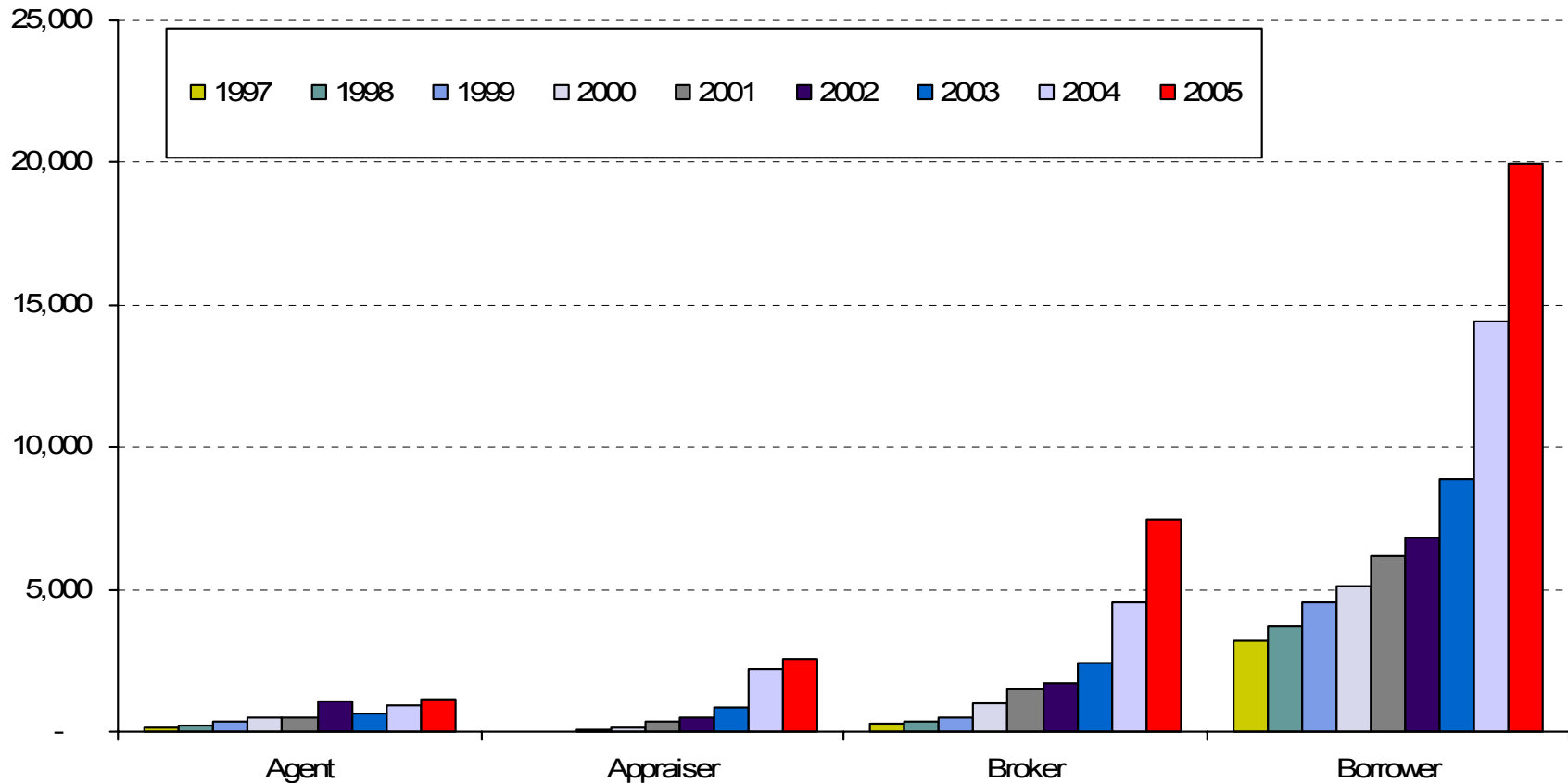
Growth in Mortgage Fraud



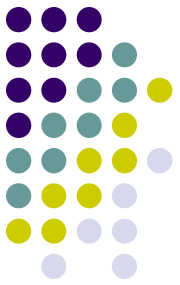
Most Reported Scams Involve Borrower or Broker Fraud



SARS Fraud Reports: Lending-Related Categories



Why Did Borrower Take Out This Loan?



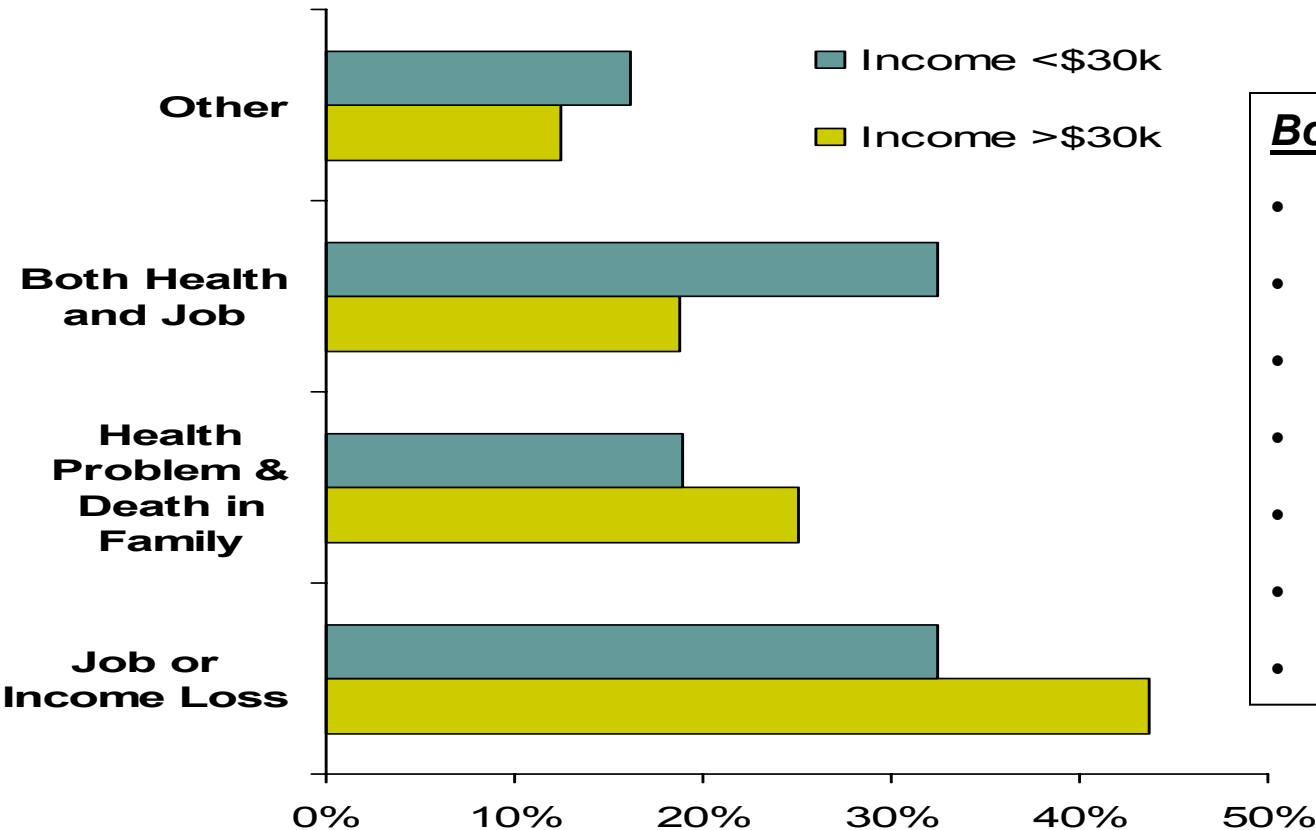
**72% of
Defaulted
Loans
Are
Refinances**

Use of Loan Proceeds	
Home Improvement/Repair	35%
Bill Consolidation	24%
Taxes	6%
Investments	5%
Medical Costs	5%
Appliances	5%
Education	4%
Other	7%

Causes of Borrower Falling Behind



Initial Cause of Delinquency



Borrowers in Default:

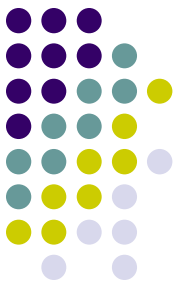
- 32% are in bankruptcy
- 69% 1st time buyers
- 55% 1st time refinance
- Average of 2.1 refinances
- 11.6 years in home
- 22% retired seniors
- Unpaid mortgage: \$91,213

Understanding Borrowers in Default



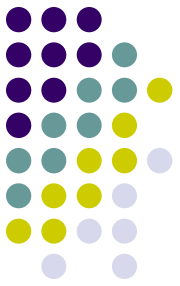
- **The majority of borrowers (historically) will self-cure**
- **Lenders/Servicers have wide array of tools**
 - Budgeting, loss mitigation, workouts, loan modifications, pre-foreclosure sales, etc
- **But...Right-party contact rates are low**
 - In some market segments, lenders make pre-foreclosure contact with the borrower less than 30% of the time
 - About half of borrowers in default have no contact with their lender
- **...Borrowers don't trust their lender**
 - And confident they can solve own problems
- **...Borrowers are under great stress**
 - Financial, health, employment, family effects

Borrower Voices

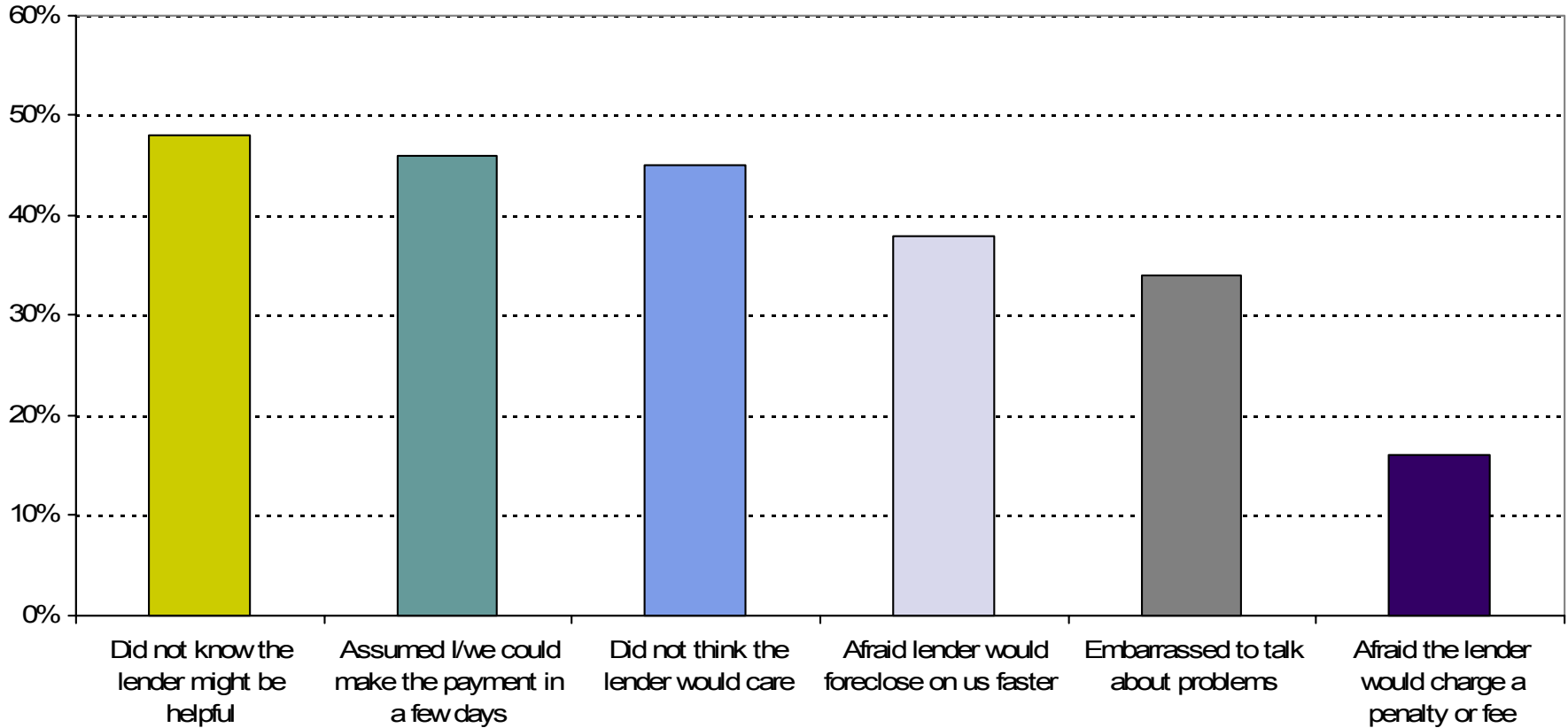


- **Borrowers are under a great deal of stress, leading them to avoid help.**
 - “I was always week to week. I get paid, I pay my bills. I get paid, I pay my bills. Then it’s not there. Then you’re in trouble. **I didn’t know which way to turn.** I didn’t know there was help out there.”
- **Borrowers feel little sympathy from their lender** (although borrowers dealing with loss mitigation staff were more favorable)
 - “They make you feel like a **deadbeat**...the way they **interrogate** you, they seem like they want to **catch you in a lie** because the questions are repetitious...the only thing I’m going to say is blah, blah, blah. I’m not lying. I need help.”
 - They want us to lose our homes. **They don’t care.”**

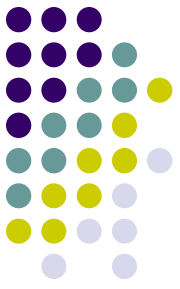
Why Did You Not Contact Your Lender?



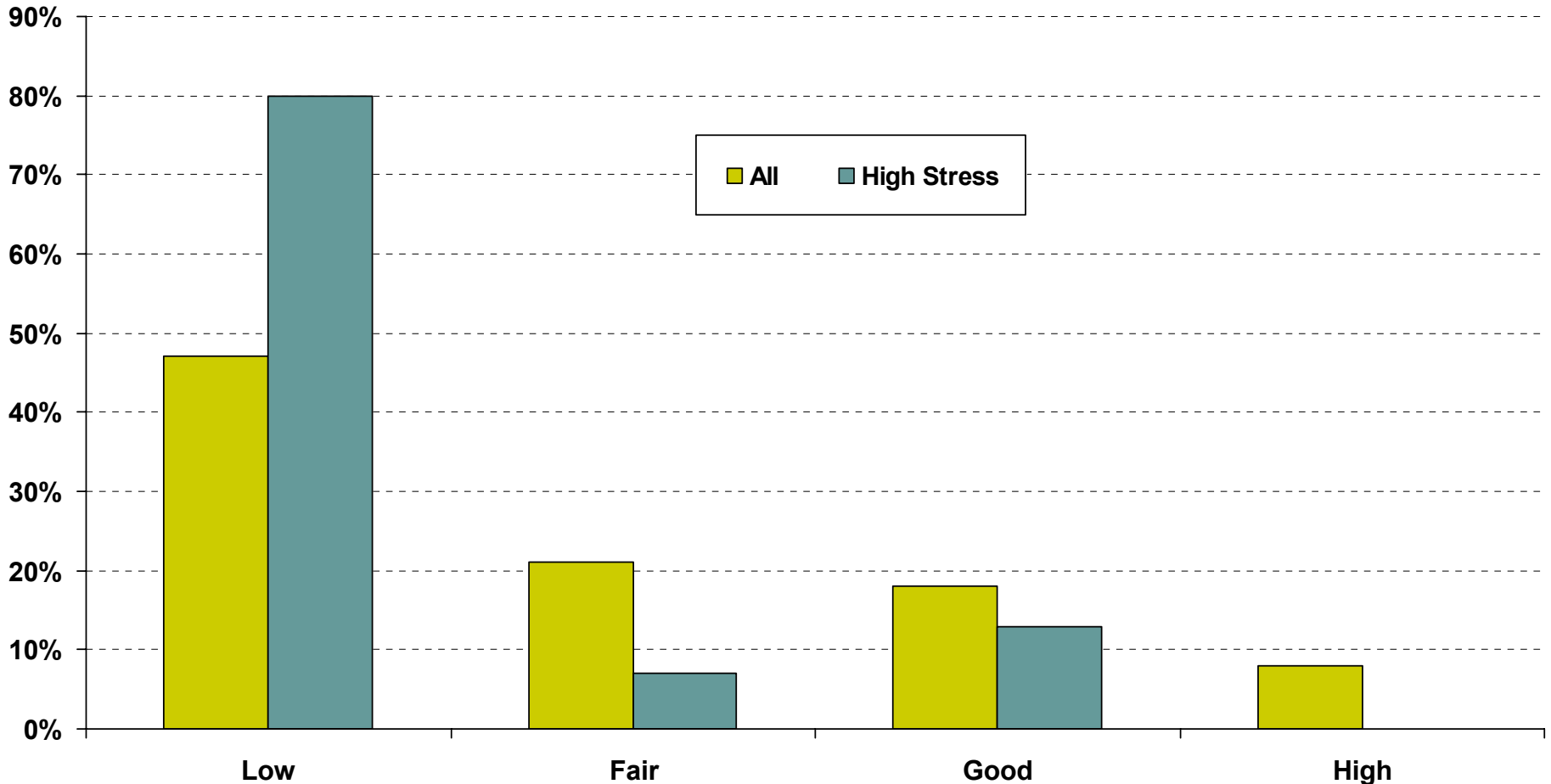
Why did you not contact your lender/servicer?



Most Have Low Opinion of Lender's Willingness to Help, Especially those Under Stress



Rate lender's willingness to help (if contacted)



Source: Chicago Mortgage Default Counseling Survey, 2005

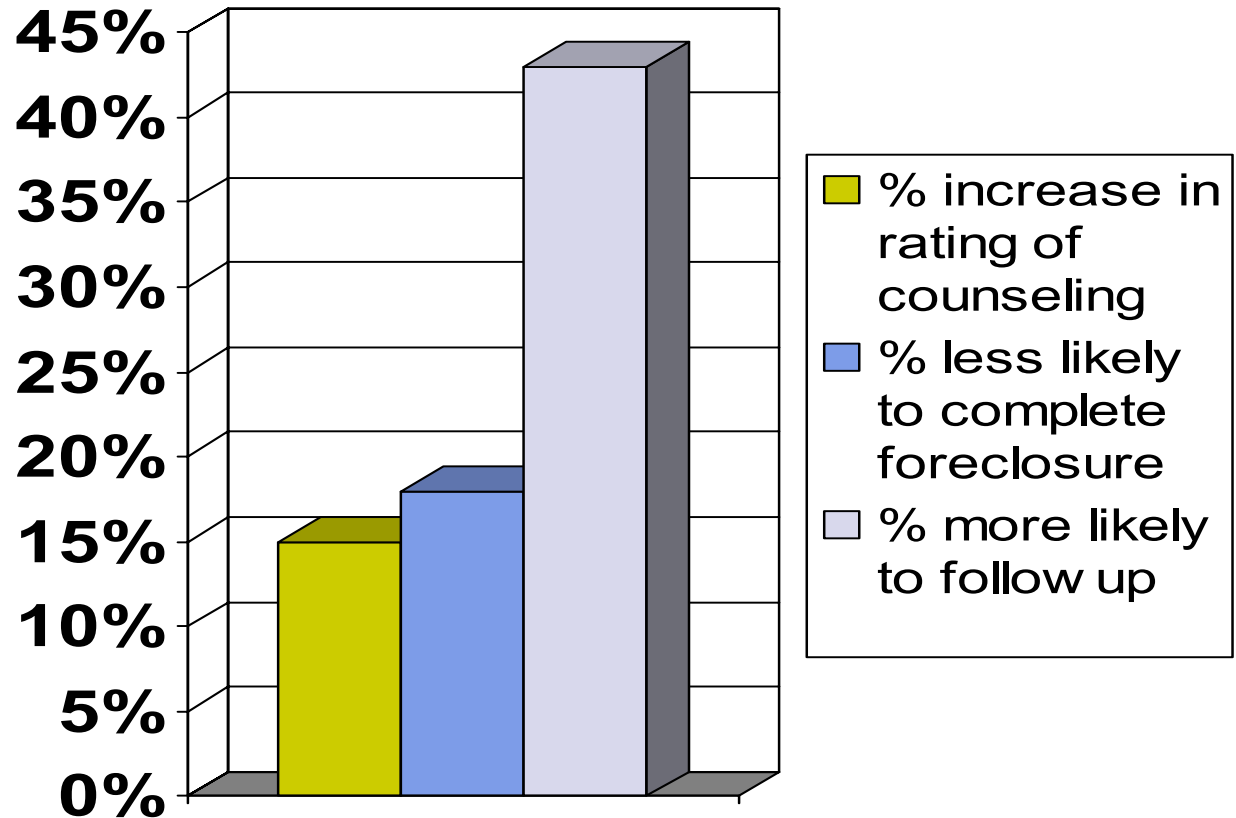
Nonprofit Counseling Can Help



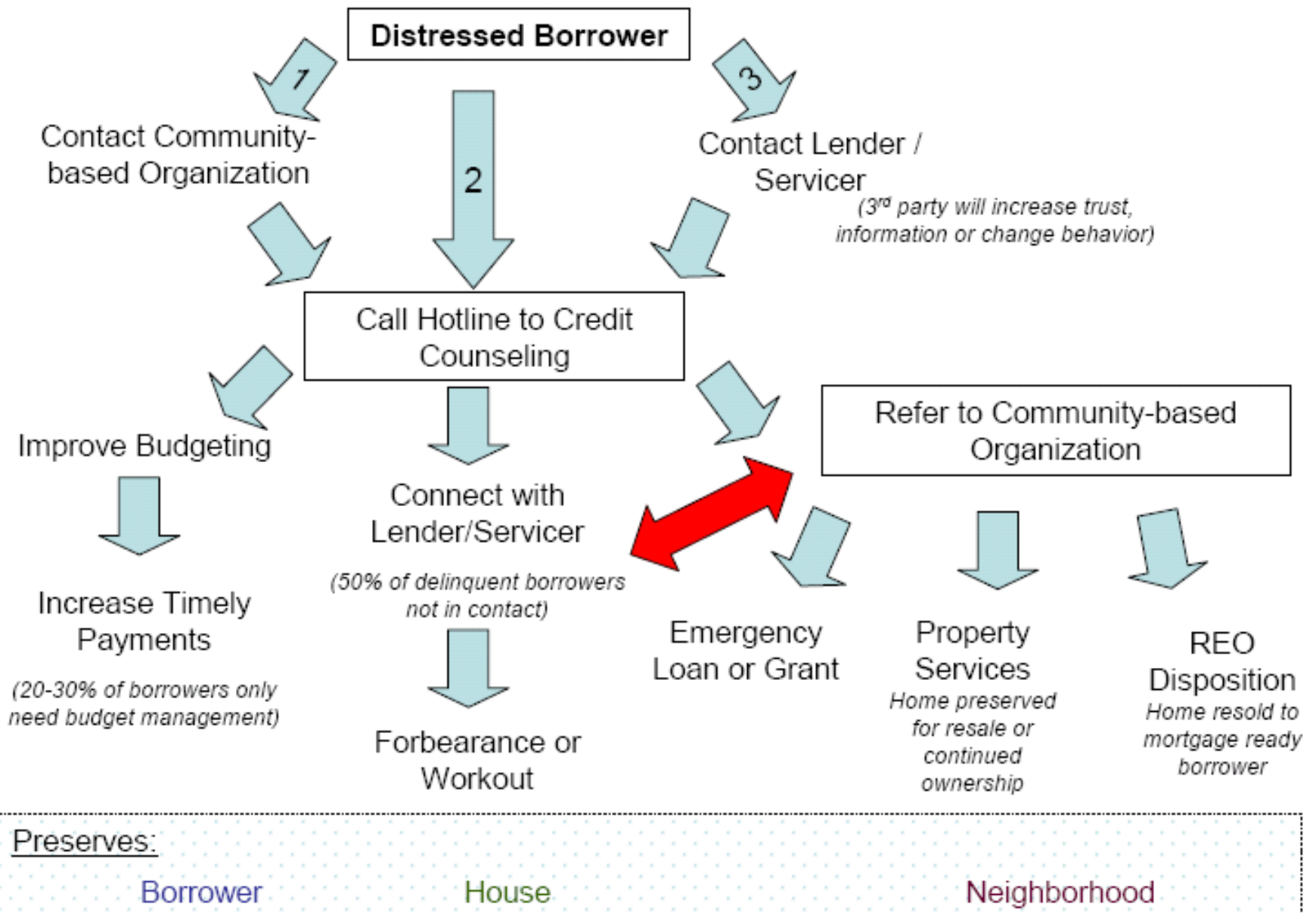
Typical Borrower Counseling:

- 2.2 counseling sessions
- 1.9 hours total time
- Phone 1.3 hours
- Face-to-face 2.2 hours
- Health and death in family take longer - 2.7 hours

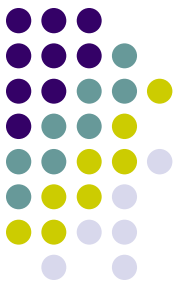
Impact of an Additional Hour of Counseling



Connecting Distressed Borrowers to Services



Finding Solutions Benefits Families, Lenders & Communities



- Neither lenders nor investors “make money” on foreclosures.
 - Losses range from 20 cents to 60 cents on the dollar
 - One estimate: lender’s cost of a foreclosure averages **\$58,800** ^
 - Servicers incur expense pursuing problem loans
 - Legal costs and costs of securing/maintaining properties
- Vacant properties can attract crime and reduce neighborhood property values.
 - One estimate: each foreclosure associated with a 0.9% decrease in values of properties within 1/8th mile (**\$139,000** on average per foreclosure in Chicago) ^^
 - Municipal costs estimated as high as **\$34,199** for worst properties *
 - Estimate average municipal cost of **\$6,937** per foreclosure. *

Sources:

^ Crews Cutts et al, Freddie Mac working paper, 2005

^^ Immergluck et al, “There Goes the Neighborhood,” Woodstock Institute, 2005.

* William Apgar et al “Collateral Damage” Homeownership Preservation Foundation, 2005

The Challenge



The “front-end” of the mortgage market adapted to meet the needs of underserved borrowers; can the “back-end” do the same?

- Potential for payment shocks in next 2-3 years
- Housing values flattening, although today’s owners may hang onto properties despite negative debt ratios
- Exotic mortgages push limits

Can you promote homeownership, but ignore issues of default?

- Neighborhood effects are compelling
- Consumers need to take risks, but often face problems beyond their control and that could not have been predicted
- Consumers need help – we are still learning how to provide it
- Problems are probably going to get worse; need to be ready