



*Scam and Eggs:  
A Consumer-Protection Seminar*

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**Foreclosure-Crisis Update:  
Is the End in Sight?  
(Full-length version)**

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## *Foreclosure-Crisis Update: Is the End in Sight?*

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- **Federal foreclosure-prevention initiatives**
  - **US Government.**
  - **Federal banking supervisors.**
- **Recent research on foreclosures**
  - **Factors that do *not* explain the foreclosure surge.**
  - **Primary causes of foreclosures.**
  - **Why are modifications rare and ineffective?**
- **Foreclosures nationwide and in St. Louis**
  - **The foreclosure crisis to date.**
  - **The outlook: When will the St. Louis foreclosure crisis subside?**



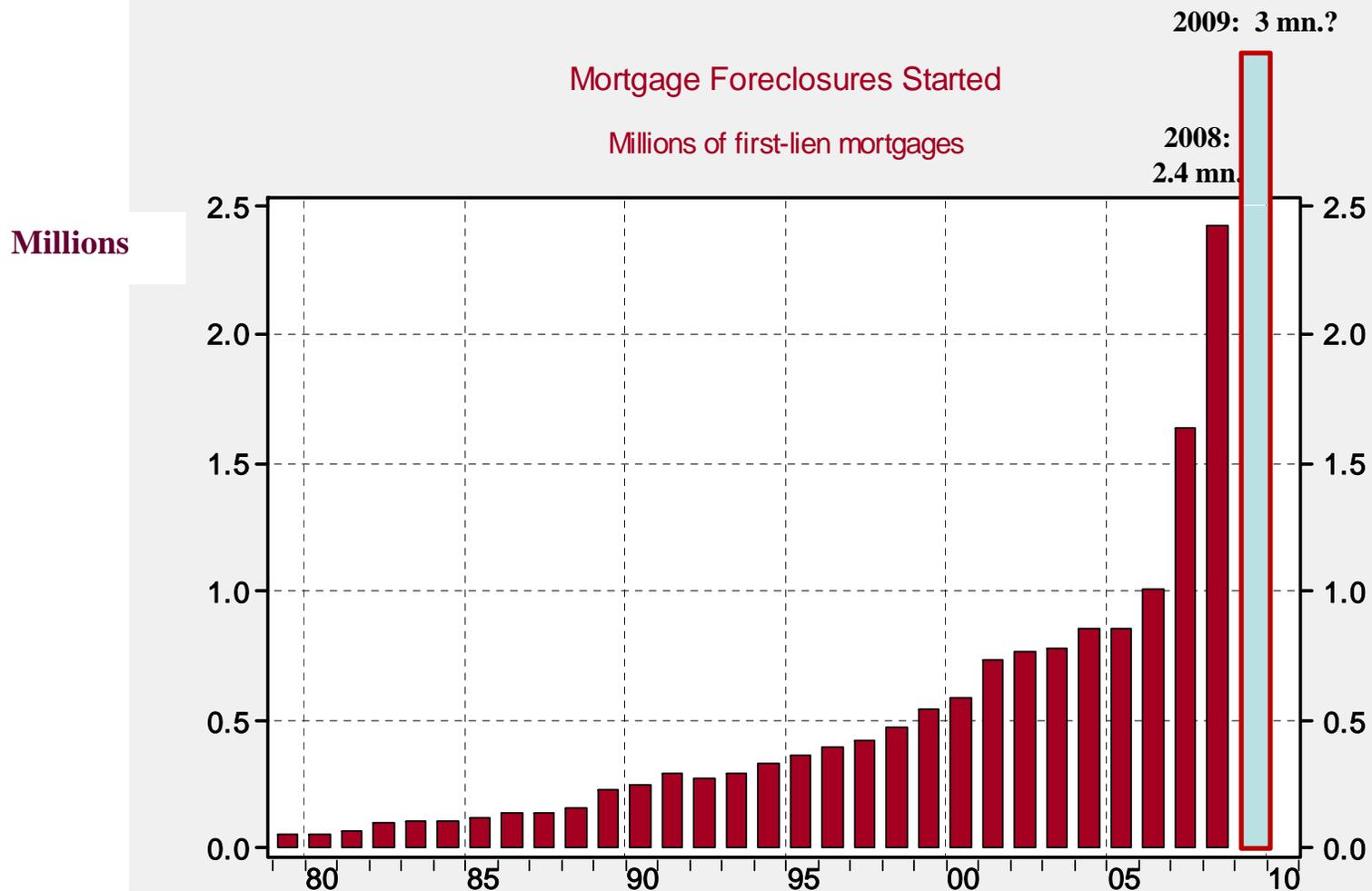
## *Important Reminder*

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- **These comments do not necessarily reflect the views of the Federal Reserve Bank of St. Louis or of the Federal Reserve System.**



## *U.S. Foreclosure Starts Reached 1 Million in 2006, 2 Million in 2008—3 Million in 2009?*



Source: Mortgage Bankers Association.

Annual data through 2008.



## *Federal Foreclosure-Prevention Initiatives*

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- **US Government**

- **Treasury Department:** [www.financialstability.gov/](http://www.financialstability.gov/)

- **Anti-fraud efforts involving:**

- **Dept. of Justice (FBI)**

- **HUD**

- **FTC**

- **FinCEN**

- **State attorneys general**

- **Making Home Affordable Program (HAMP).**

- **Dept. of Housing and Urban Development (HUD):** [www.hud.gov/foreclosure/index.cfm](http://www.hud.gov/foreclosure/index.cfm)

- **Counseling.**

- **Information.**



## *Federal Foreclosure-Prevention Initiatives*

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- **Federal banking supervisors**

- **St. Louis Fed:**

- [www.stlouisfed.org/foreclosure/](http://www.stlouisfed.org/foreclosure/)

- **Federal Reserve Board of Governors:**

- [www.federalreserve.gov/consumerinfo/foreclosure.htm](http://www.federalreserve.gov/consumerinfo/foreclosure.htm)

- **FDIC:**

- [www.fdic.gov/consumers/loans/prevention/toolkit.html](http://www.fdic.gov/consumers/loans/prevention/toolkit.html)

- **OCC:**

- [www.occ.gov/consumernews\\_foreclosure.htm](http://www.occ.gov/consumernews_foreclosure.htm)

- **OTS:**

- [www.ots.treas.gov/?p=ConsumersCommunities](http://www.ots.treas.gov/?p=ConsumersCommunities)



## *Recent Research on Foreclosures (I)*

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- **Factors that do *not* appear to be important in explaining the foreclosure surge since 2006.**
  - **ARM interest-rate resets.**
    - *Most defaults occur at other times, often before the reset. Short-term benchmark rates have dropped sharply since 2007.*
  - **Securitization.**
    - *There's no difference in frequency of securitized mortgages being modified, holding constant the profitability of doing so.*
  - **Subprime purchase loans.**
    - *Most subprime defaults are refinance loans, associated most often with home-equity extraction. Often a refi of prime loan.*
  - **Mortgage rates.**
    - *Defaults are explained better by other factors.*



## *Recent Research on Foreclosures (II)*

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- **Primary causes of foreclosure**
  - **Most foreclosures have “dual triggers”:**
    - Adverse life event + House-price decline => Mortgage default.
    - Unemployment and illness are most common adverse events.
    - If house prices were rising, could sell to avoid default.
  - **Risk characteristics of the borrower and the loan can increase sensitivity to trigger events.**
    - High leverage (LTV ratio) => small equity cushion.
    - High debt-service burden (DTI ratio) => tight cash flow.
    - Poor financial habits, proxied by low credit score (FICO).
    - Loan features not understood by the borrower, including adjustable rates; prepayment penalties; lack of T&I escrow.



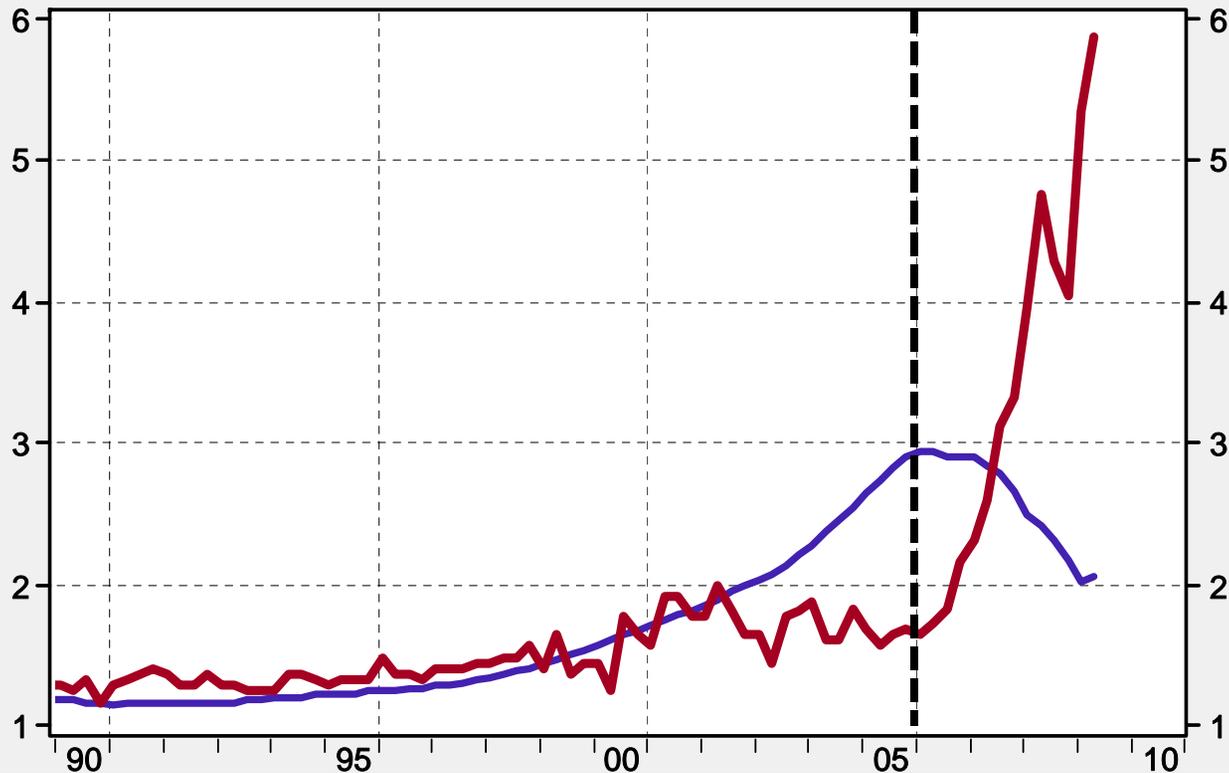
# Foreclosure Surge Began When House Prices Began to Fall

Fraction of All First-Lien Mortgages Entering Foreclosure  
Percent at annualized rates

S&P/Case-Shiller U.S. National Home-Price Index  
Average level in 1987 equals 1

Percent of first-lien mortgages

House-price index equals one in 1987



Sources: Mortgage Bankers Association and Standard & Poor. Quarterly data through Q2.2009.



# Household Borrowing Grew Much Faster Than Income for 25 Years

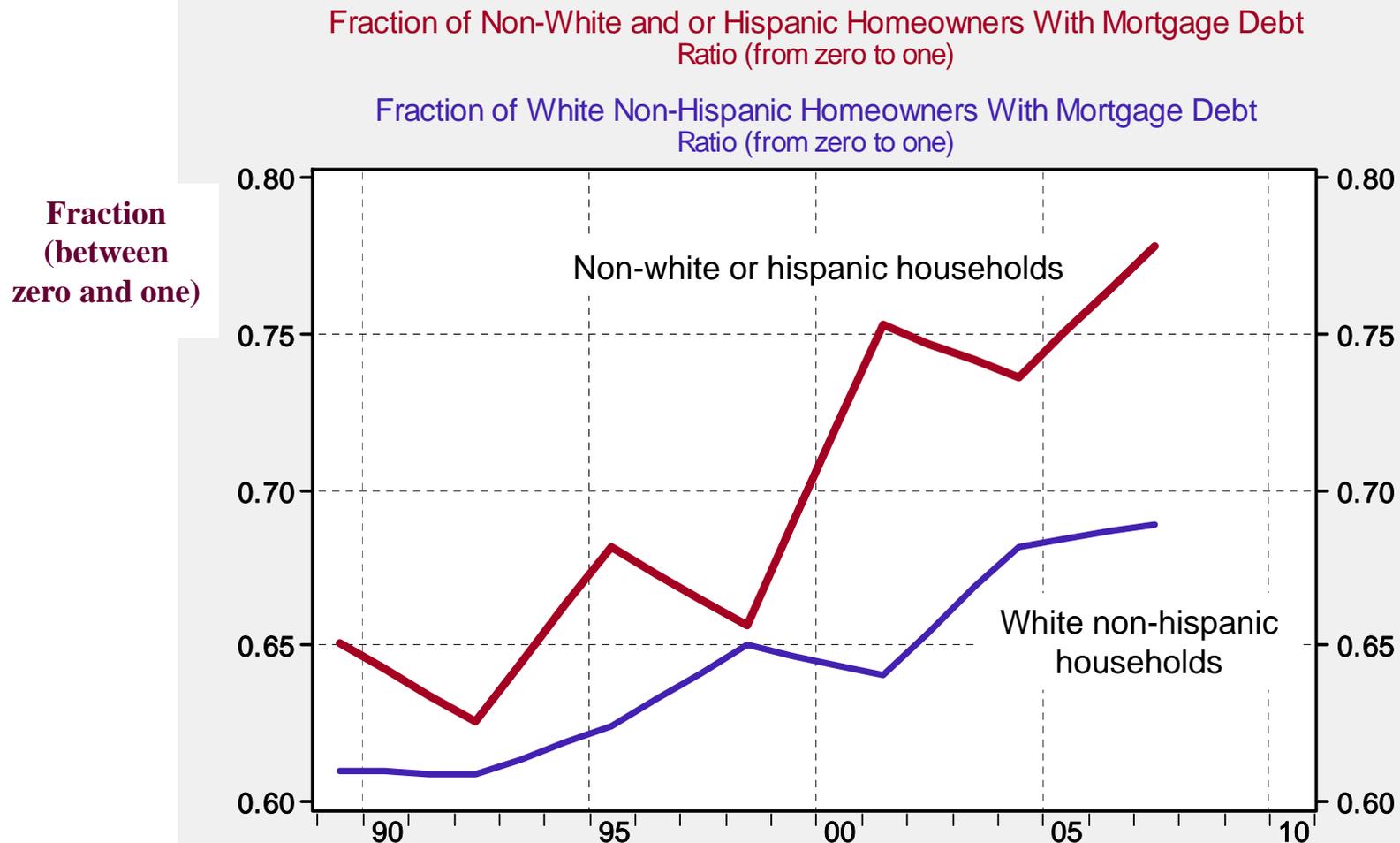
Ratio of Household Debt to Disposable Personal Income  
Percent



Source: Federal Reserve *Flow of Funds Accounts*. Quarterly data through Q2.2009.



## More Families Took on Mortgage Debt



Source: Federal Reserve *Survey of Consumer Finances*. Triennial survey data through 2007.

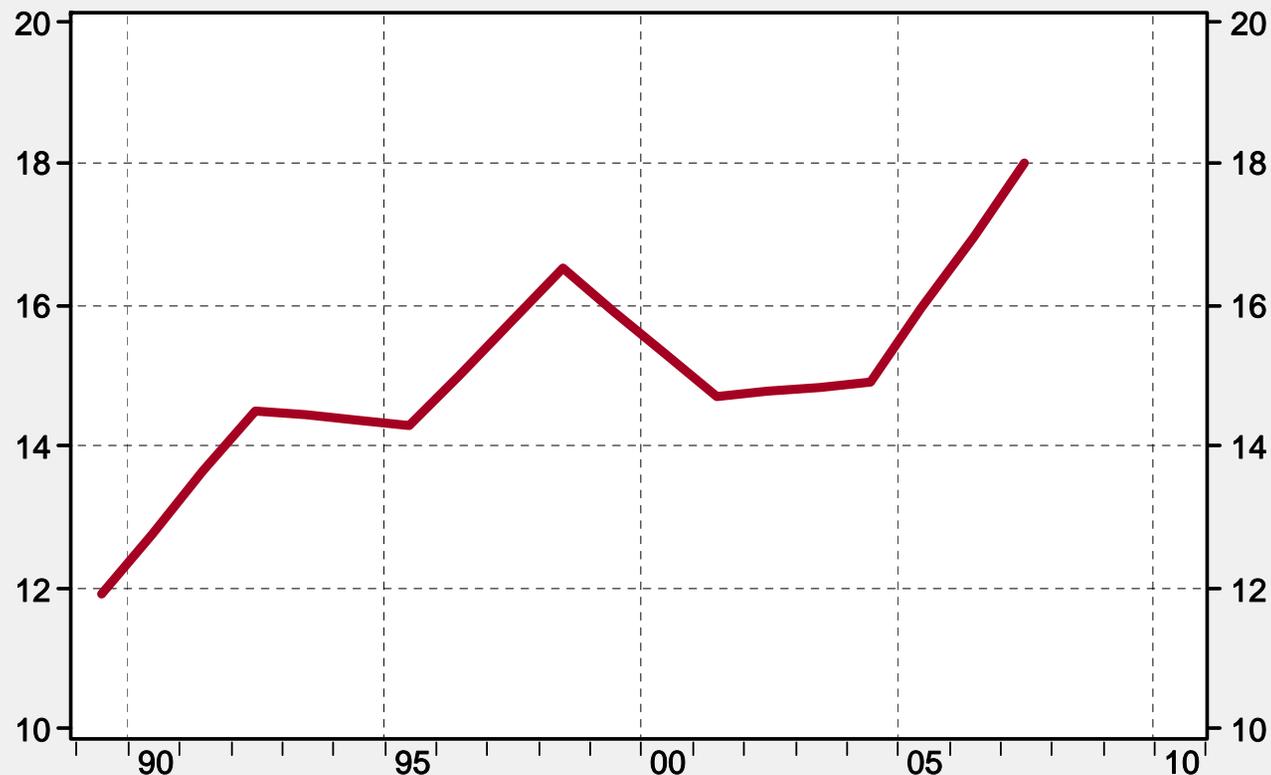


## *More Families Took On Extreme Debt Burdens (Debt Service > 40% of Income)*

Fraction of Homeowning Families With Total Debt Payments More than 40% of Income

Percent of homeowning families

Percent of  
homeowning  
families



Source: Federal Reserve *Survey of Consumer Finances*. Triennial survey data through 2007.



## *Recent Research on Foreclosures (III)*

- **Loan modifications—Uncommon and ineffective**
  - **Loan modifications during late 2008:**
    - **Principal-balance increases (62% of modifications); Interest-rate reductions (27%); Term extensions (11%); Principal-balance decreases (1%).**
    - **No difference in frequency of securitized and portfolio mods—servicers appear to be maximizing value of mortgages.**
  - **Why are voluntary renegotiations so rare?**
    - **Only 7 percent of seriously delinquent borrowers have received payment-reducing loan modifications.**
    - **Servicers are reluctant to offer modifications due to:**
      - **Self-cure risk: One-third of seriously delinquent borrowers are able to become current again with no assistance.**
      - **Re-default risk: Borrowers offered a modification re-default 50 to 70 percent of the time.**



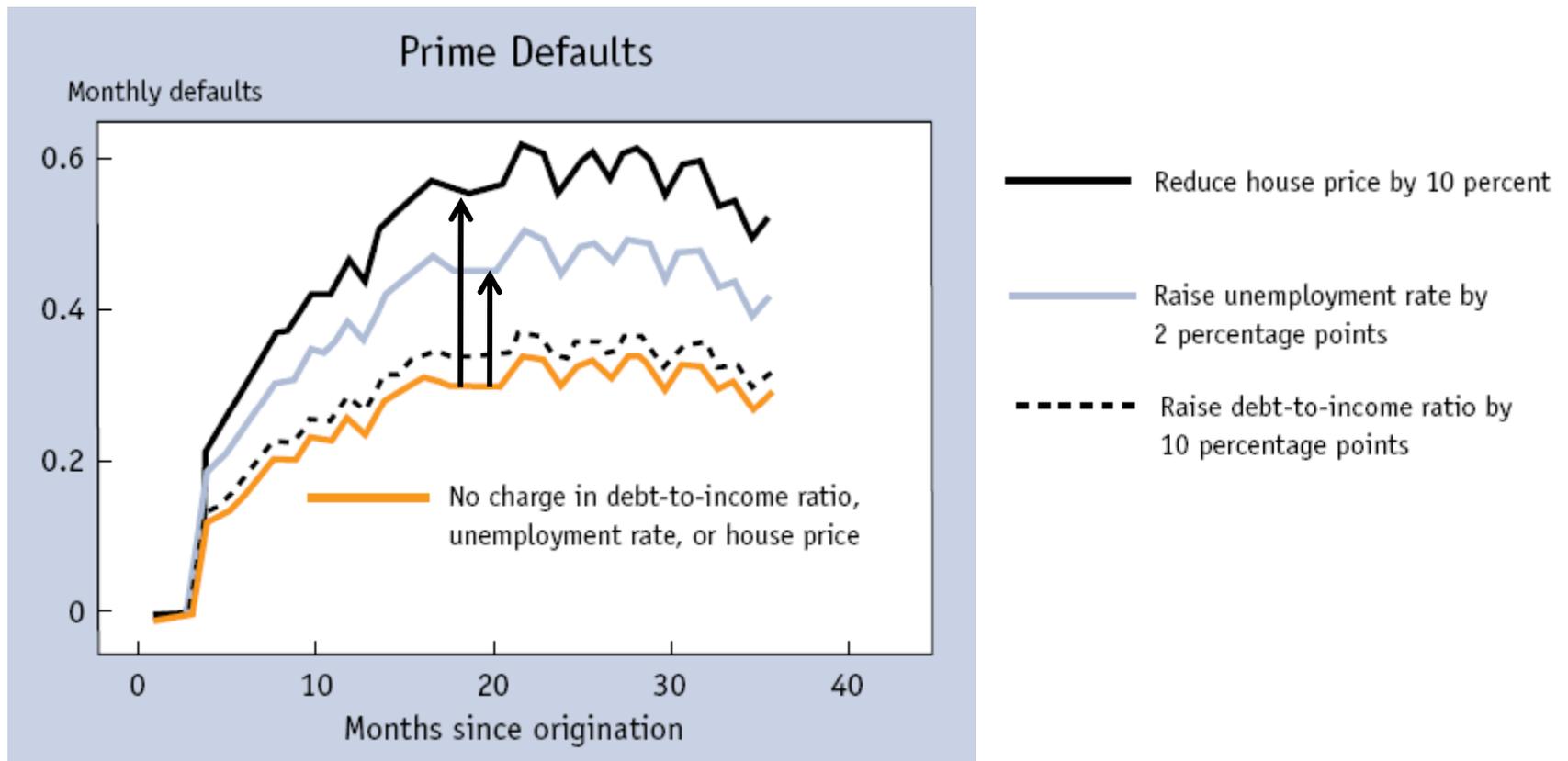
## *Foreclosures Nationwide and in St. Louis*

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- **The foreclosure crisis to date**
  - **Midwest suffered first; now Southwest and Southeast are in worst shape.**
  - **Primary factors driving foreclosures higher:**
    - **Falling house prices and resulting negative homeowners' equity.**
    - **Rising unemployment rates.**
    - **Exacerbated by high risk built into millions of mortgages,**
- **The outlook: When will the St. Louis foreclosure crisis subside?**
  - **St. Louis is following national cycle, but somewhat more moderate.**
  - **Key role of the dual triggers—No relief until house prices begin to rise and unemployment falls.**



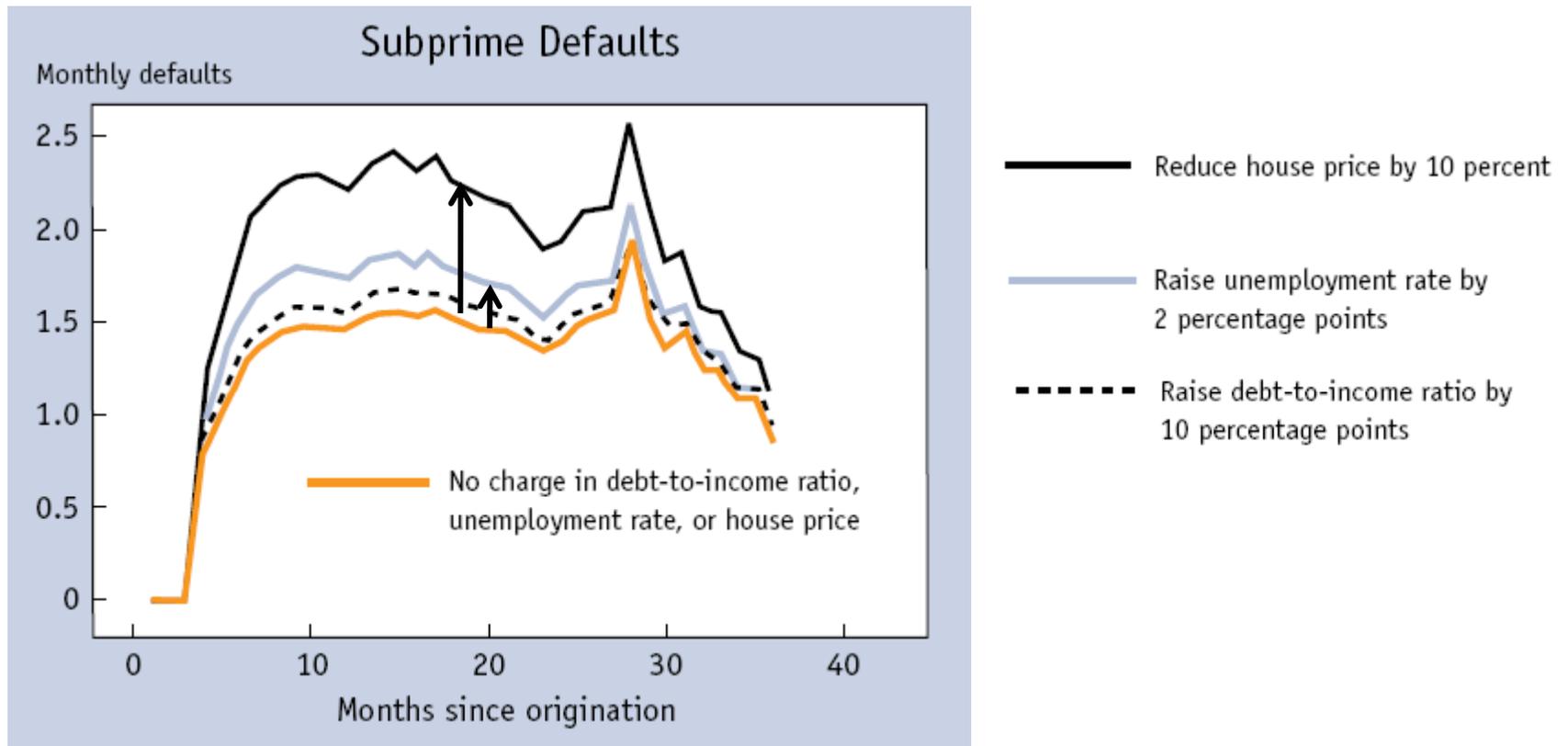
## *How Much Do Key Risk Factors Affect Defaults on Prime Mortgages?*



Source: "Reducing Foreclosures", by Christopher L. Foote, Kristopher S. Gerardi, Lorenz Goette, and Paul S. Willen, in *Research Review*, Federal Reserve Bank of Boston, Issue No. 11, January-June 2009, [www.bos.frb.org/economic/ResearchReview/issue11/issue11.pdf](http://www.bos.frb.org/economic/ResearchReview/issue11/issue11.pdf).



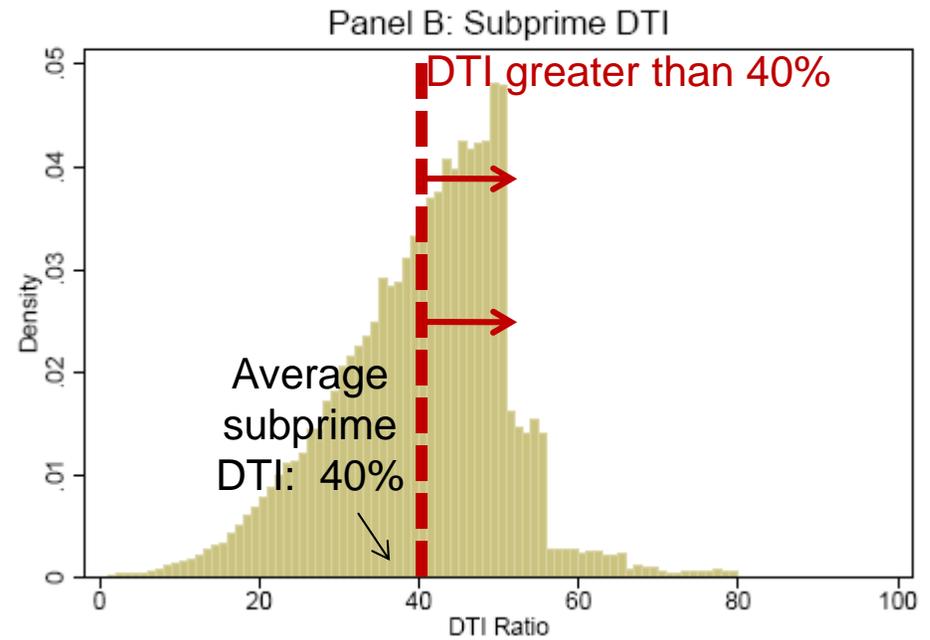
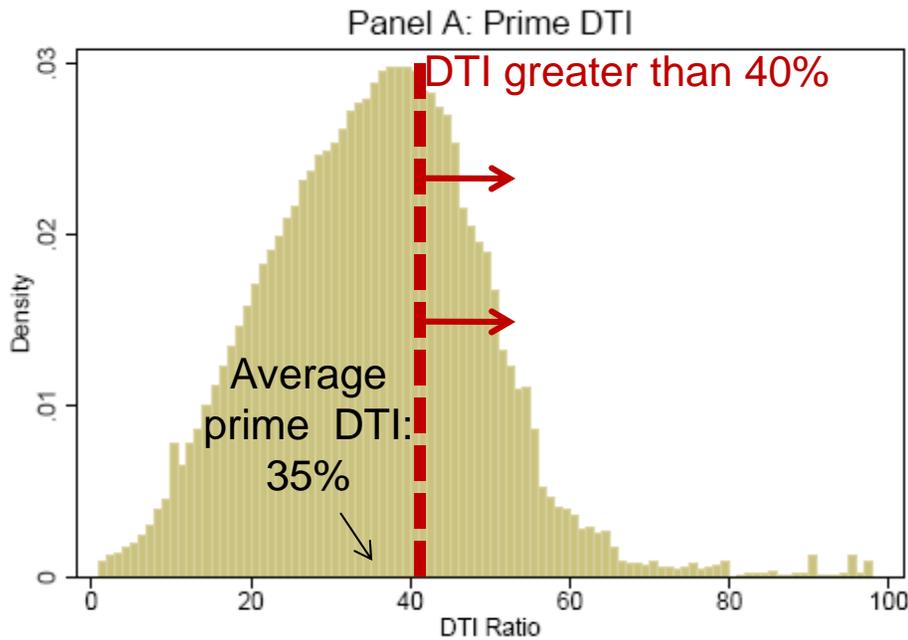
## *How Much Do Key Risk Factors Affect Defaults on Subprime Mortgages?*



Source: "Reducing Foreclosures", by Christopher L. Foote, Kristopher S. Gerardi, Lorenz Goette, and Paul S. Willen, in *Research Review*, Federal Reserve Bank of Boston, Issue No. 11, January-June 2009, [www.bos.frb.org/economic/ResearchReview/issue11/issue11.pdf](http://www.bos.frb.org/economic/ResearchReview/issue11/issue11.pdf).



# *Subprime-Mortgage Borrowers Generally Have Heavier Debt-Service Burdens*

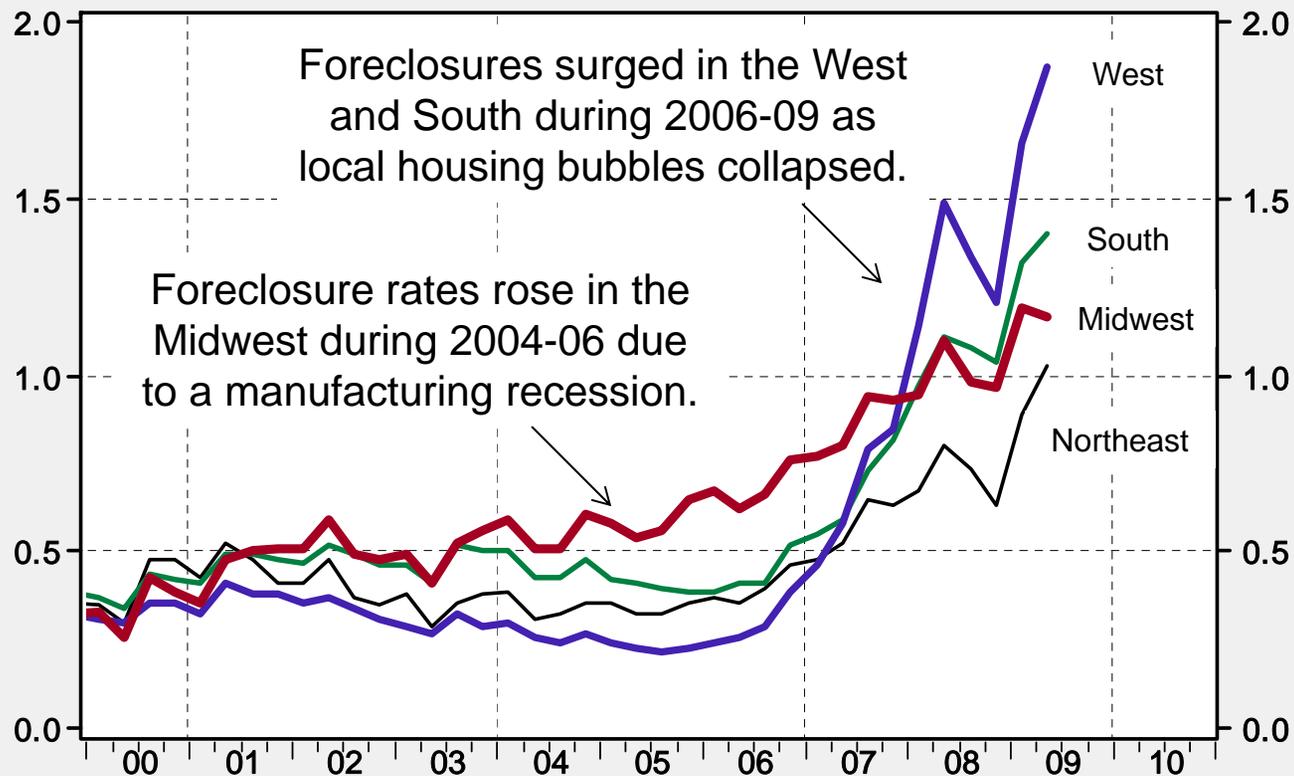


Source: "Reducing Foreclosures: No Easy Answers", by Christopher L. Foote, Kristopher S. Gerardi, Lorenz Goette, and Paul S. Willen, NBER Working Paper 15063, [www.nber.org/papers/w15063](http://www.nber.org/papers/w15063).



## *Elevated Foreclosure Rates First in Midwest (2004-06), Then West & South (2006-09)*

Quarterly Foreclosure-Start Rate in the Midwest Census Region (%)  
 Quarterly Foreclosure-Start Rate in the West Census Region (%)  
 Quarterly Foreclosure-Start Rate in the South Census Region (%)  
 Quarterly Foreclosure-Start Rate in the Northeast Census Region (%)



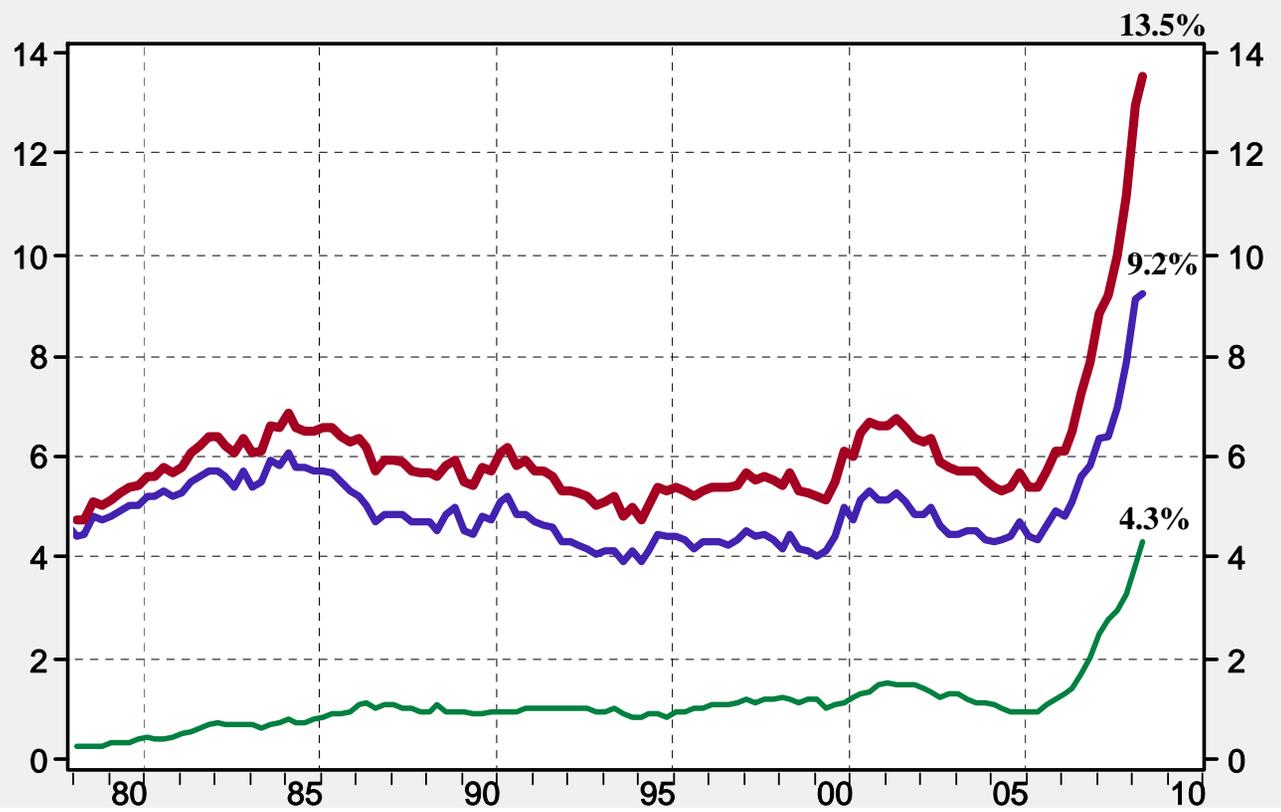
Sources: MBA /Haver



# Residential-Mortgage Delinquency and Foreclosure Rates Still Rising Sharply

Fraction of First-Lien Mortgages Delinquent or in Foreclosure (%)  
Of Which: Fraction 30+ Days Past Due (%)  
And: Fraction in Foreclosure (%)

Percent of first-lien mortgages



Source: Mortgage Bankers Association.

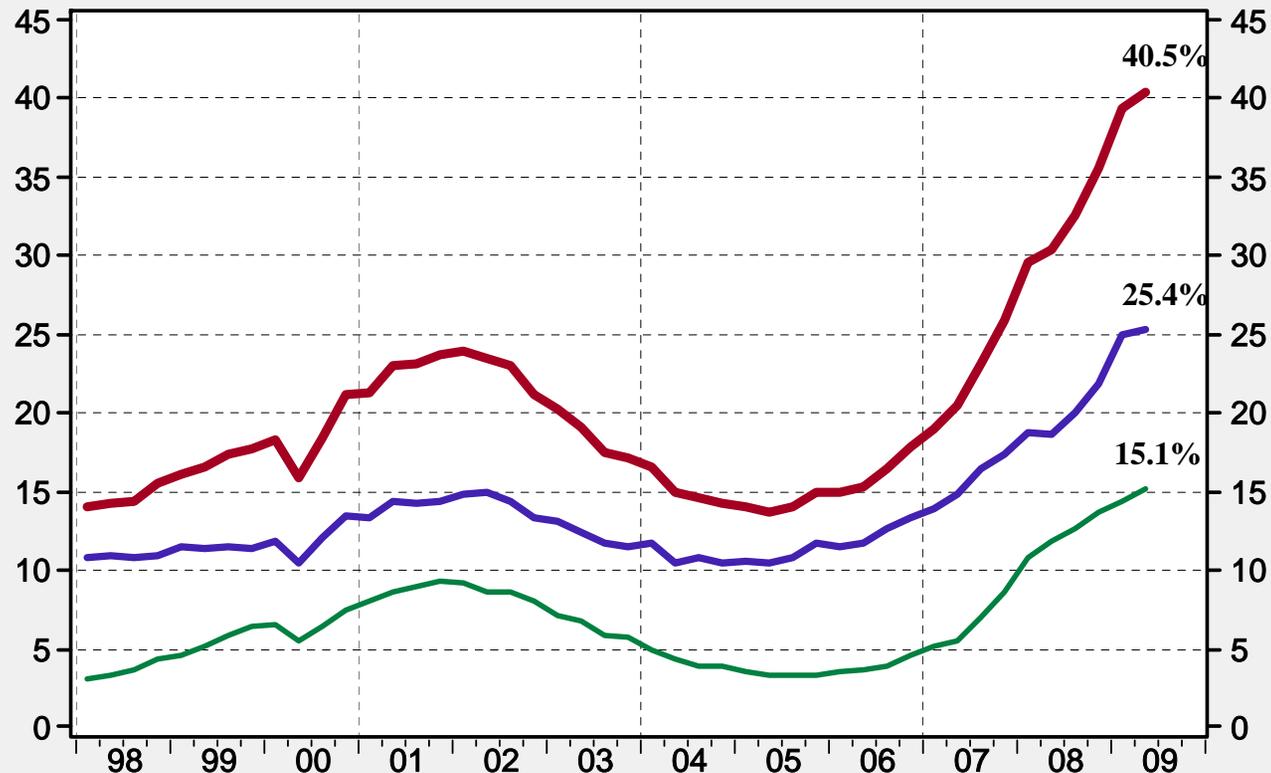
Quarterly data through Q2.2009.



# 40% of Subprime Mortgages Are Delinquent or in Foreclosure

Fraction of Subprime Mortgages Delinquent or in Foreclosure (%)  
 Of Which: Fraction 30+ Days Past Due (%)  
 And: Fraction in Foreclosure (%)

Percent of first-lien mortgages



Source: Mortgage Bankers Association.

Quarterly data through Q2.2009.

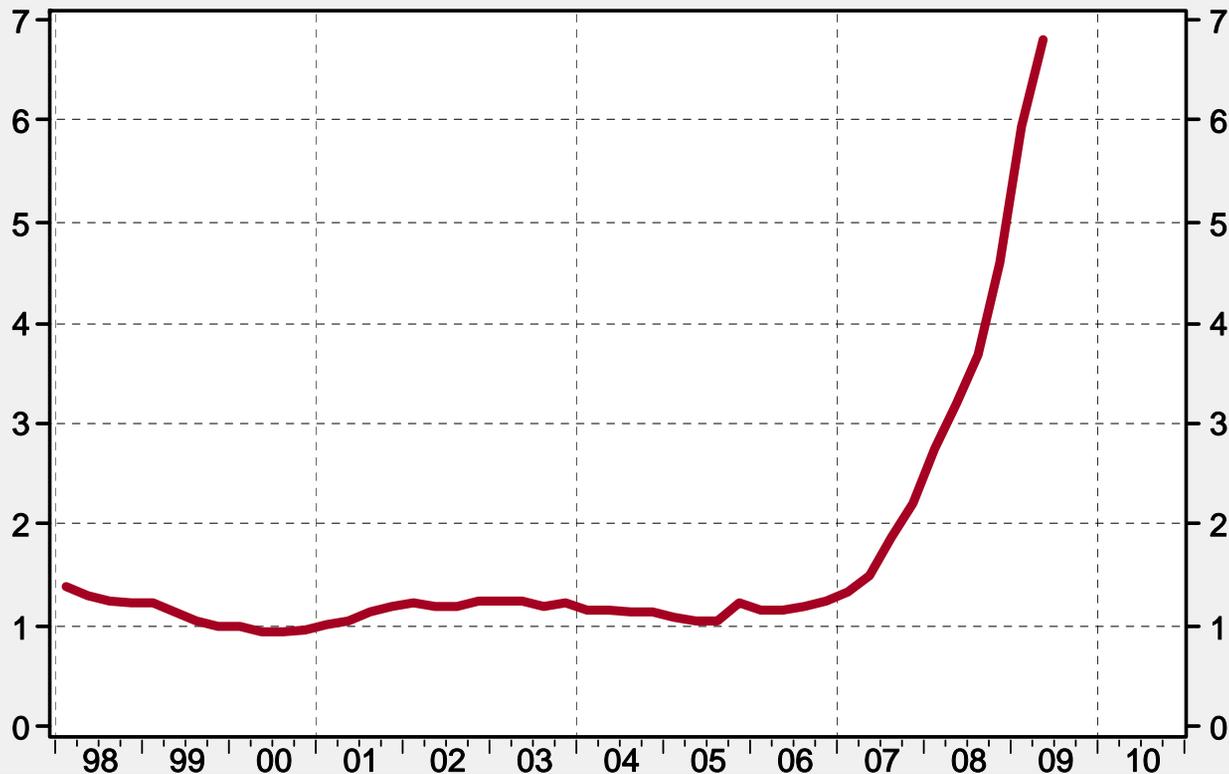


## *Even the Prime-Quality Mortgage Market is Breaking Down (Includes Alt-A)*

Share of Prime Mortgages 60+ Days Delinquent or in Foreclosure

Percent of mortgages

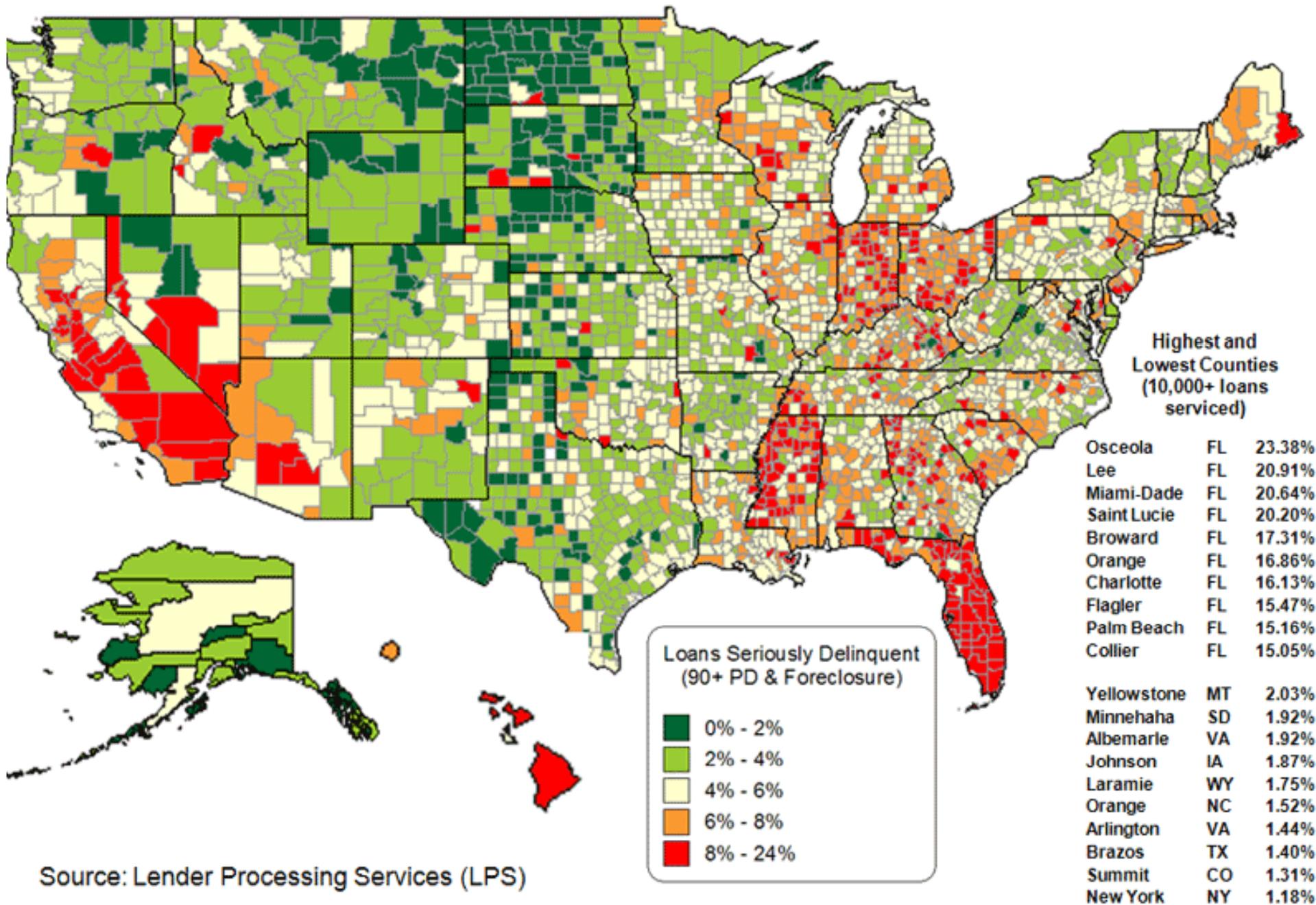
Percent of first-lien mortgages



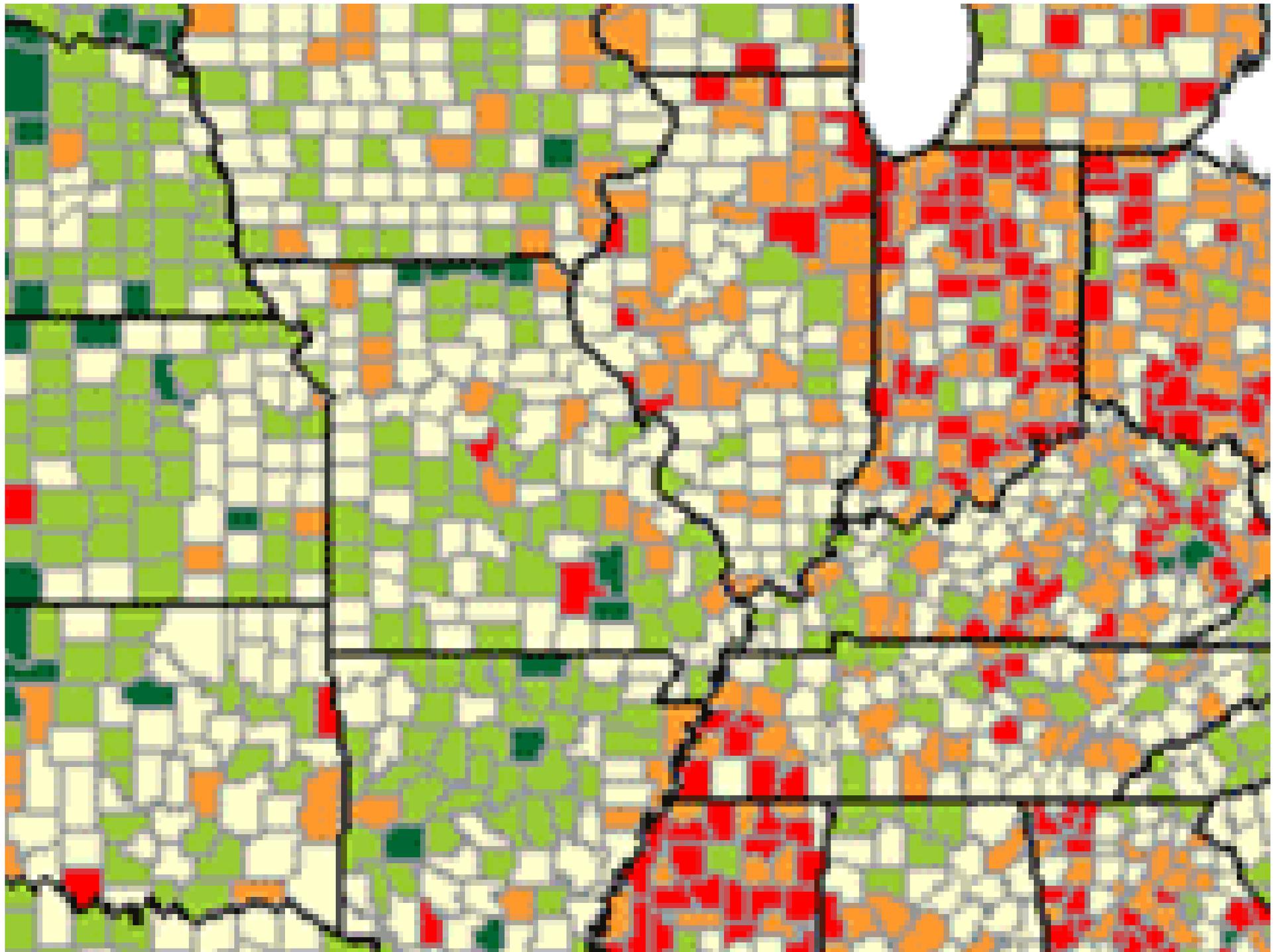
Source: Mortgage Bankers Association.

Quarterly data through Q2.2009.

# Percent of All First Liens Seriously Delinquent by County – July 2009



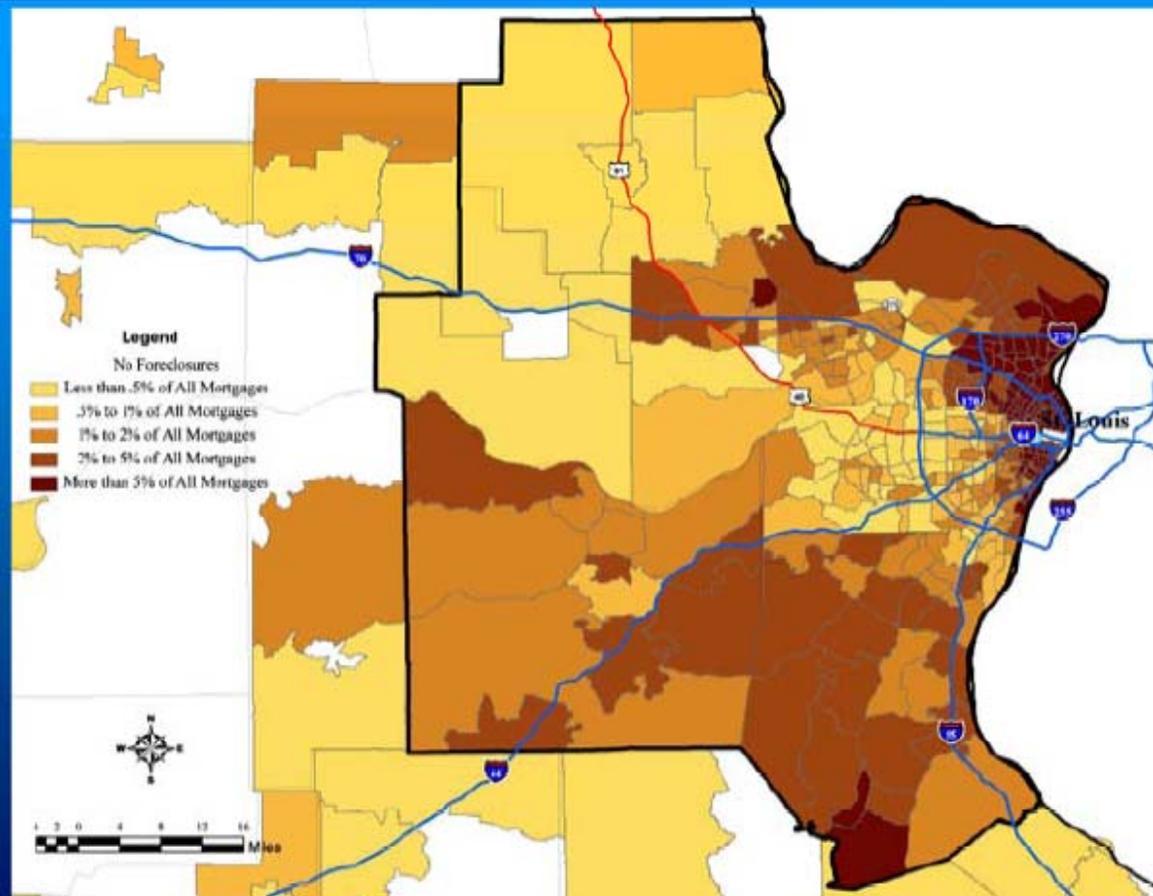
Source: Lender Processing Services (LPS)





## *St. Louis MO Foreclosures Are Clustered in the North and South*

St. Louis Foreclosure Rate, 2007



Source: Kelly Edmiston, Kansas City Fed, via Mike Duncan, St. Louis County Dept. of Planning, [www.stlouisco.com/planning/foreclosure/Apanov08.pdf](http://www.stlouisco.com/planning/foreclosure/Apanov08.pdf).

April 15, 2008

K. Edmiston, FRB KC

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## *St. Louis County Foreclosures Still Rising Sharply*

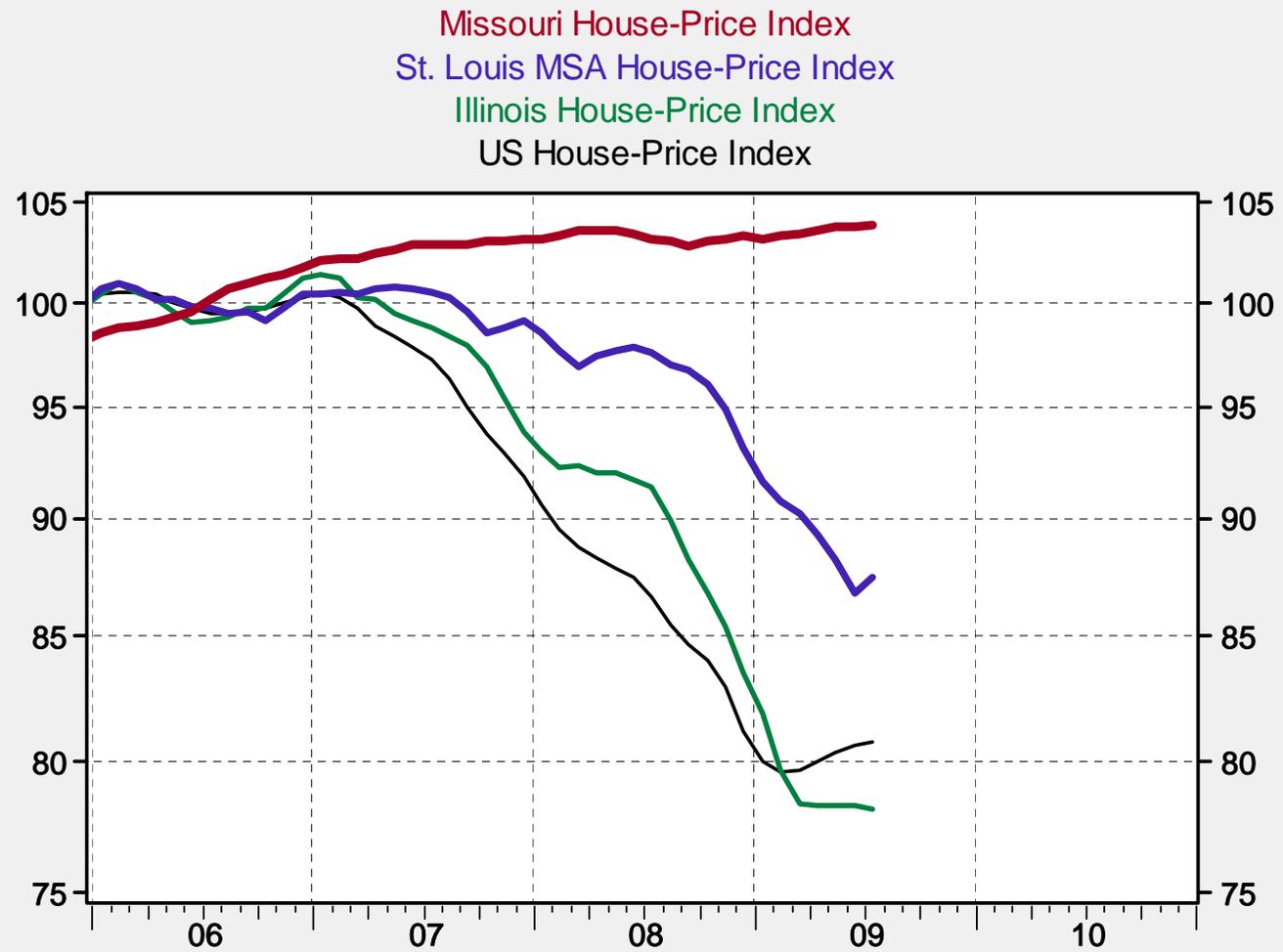


Source: Mike Duncan, St. Louis County Dept. of Planning,  
[www.stlouisco.com/plan/foreclosure/Apanov08.pdf](http://www.stlouisco.com/plan/foreclosure/Apanov08.pdf).



# *St. Louis House Prices Have Fallen Only Half As Much As Nationwide (10-15 Percent)*

Average values in 2006 equal 100



Source: LoanPerformance Corp.

Monthly data through July 2009.



## *About 30 Percent of St. Louis Homeowners Have Negative Homeowners' Equity*

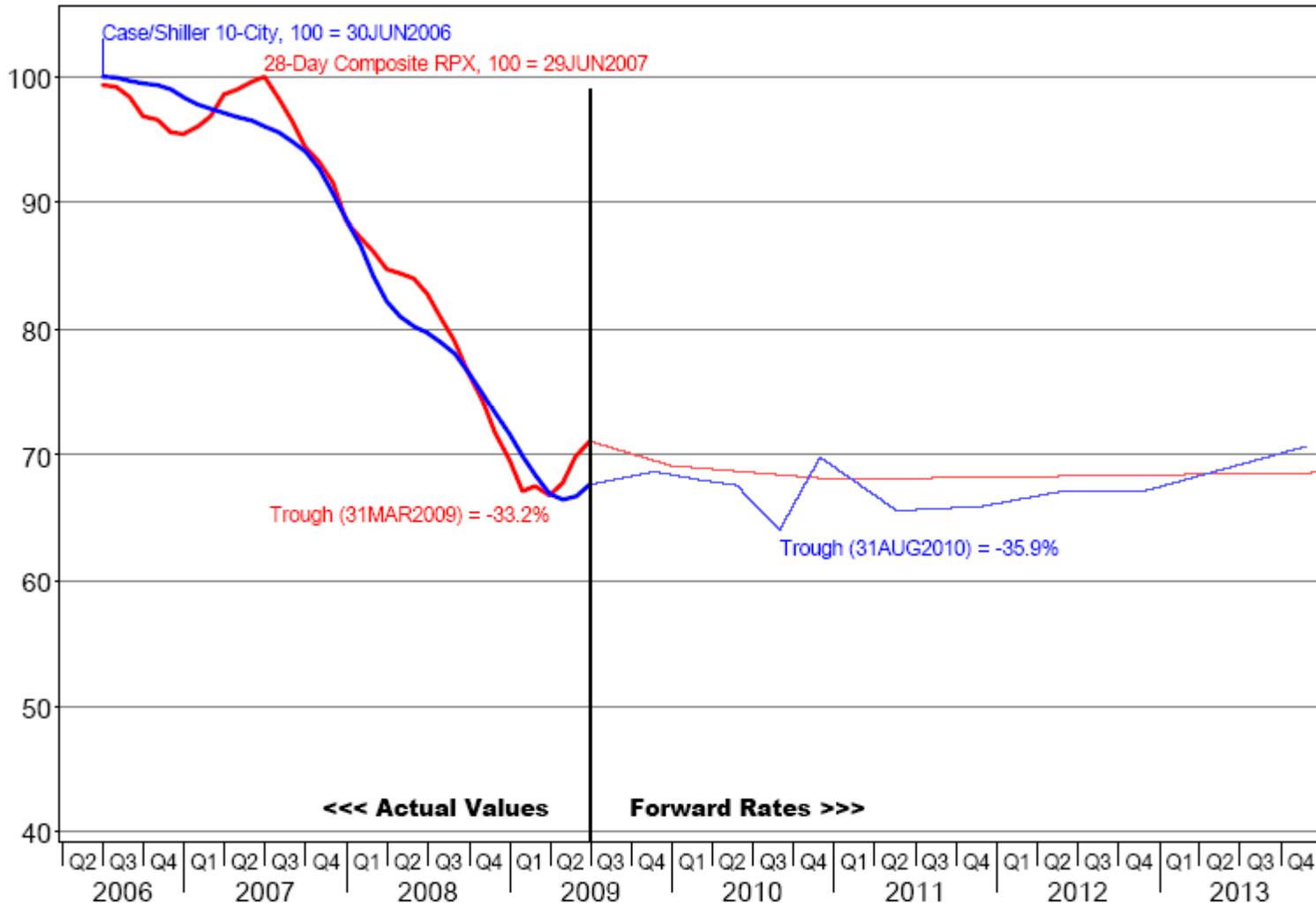
Estimates for Q2.2009	St. Louis MSA	USA
<b><u>Negative equity:</u></b> Fraction of homeowners with mortgage debt greater than the current market value of their house	<b>29.5%</b>	<b>32.2%</b>
Number of homeowners with negative equity	<b>170,871</b>	<b>15.2 mn.</b>
<b><u>Near-negative equity:</u></b> Fraction of homeowners with mortgage debt below, but within 5%, of the current market value of their house	<b>6.5%</b>	<b>6.0%</b>
Number of homeowners with near-negative equity	<b>38,000</b>	<b>2.5 mn.</b>

Source: First American Core Logic,  
[www.loanperformance.com/infocenter/library/FACL%20Negative%20Equity\\_final\\_081309.pdf](http://www.loanperformance.com/infocenter/library/FACL%20Negative%20Equity_final_081309.pdf).



# *Investors Do Not Expect Any House-Price Appreciation For Next Five Years*

Index levels equal 100 in 2006 or 2007

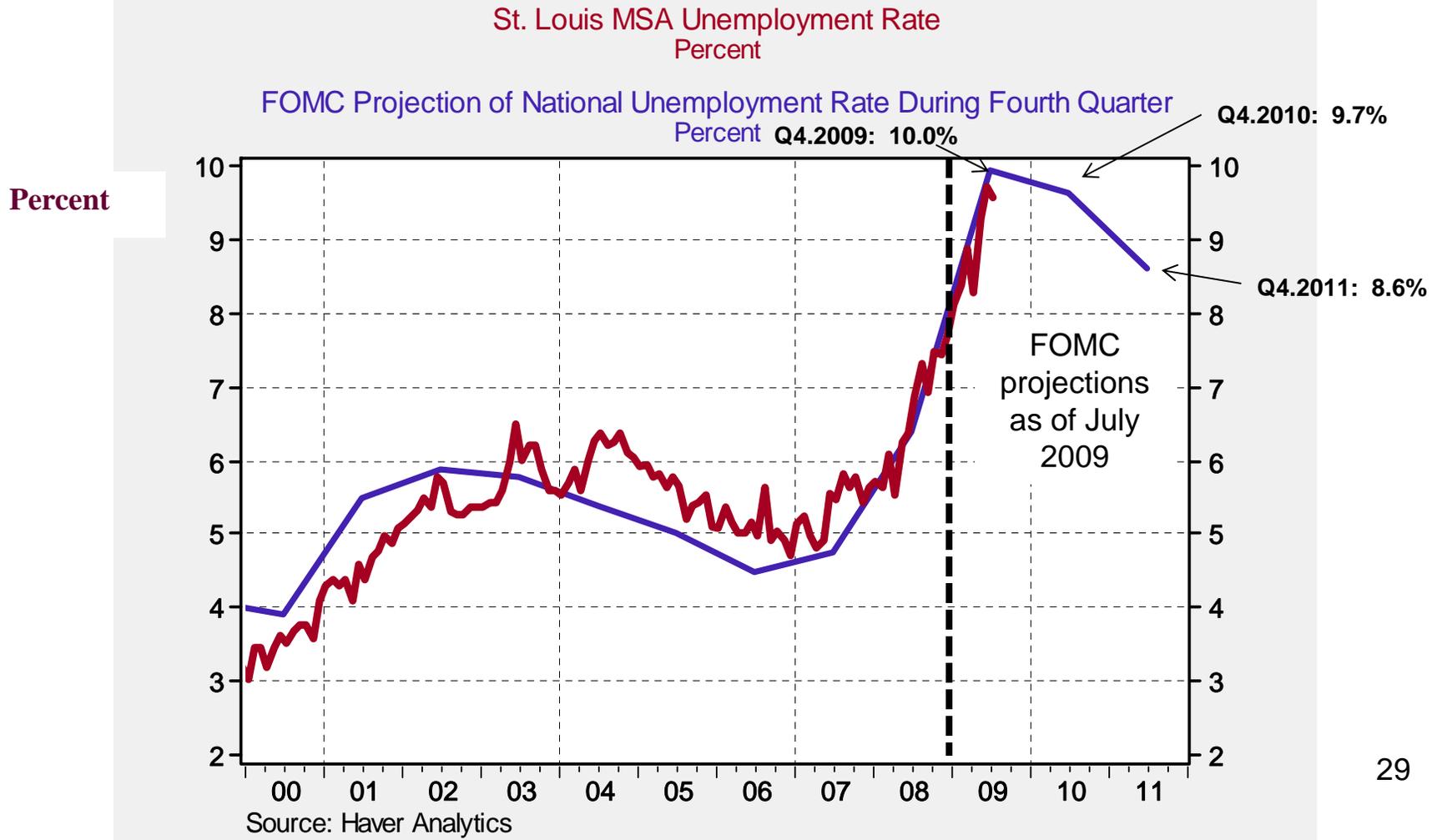


Sources: Bloomberg and ICAP.

Chart prepared by Mark Lueck of the Minneapolis Fed.



# *Fed's Economic Forecast: Unemployment Will Remain High Through 2011*





## *In Sum: The End of the Foreclosure Crisis May Not Arrive Before 2012*

- Foreclosure-prevention efforts have had minimal effects to date because they are rare and do not eliminate the “dual triggers” of default—adverse life events and negative equity.
- High rates of negative equity and unemployment are likely to persist at least through 2011, resulting in continued high rates of mortgage default (absent actions affecting dual triggers).
- As many as 20 percent of US households with mortgages could be hit by foreclosure during 2006-2011; St. Louis perhaps half as severe.