Delinquency and Foreclosure: A National Framework

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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
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

Source: State of the Nation’s Housing, 2006, Joint Center for Housing Studies of Harvard University
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
"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

- **Borrower Behavior**
  - consumer credit usage
  - income/employment
  - property maintenance

- **Housing Market**
  - house prices
  - collateral risks

- **Business Practices**
  - lax lending
  - fraud
  - appraisals
  - inspections
  - seller grants

- **PolicyLab**
Growth in Mortgage Fraud

Source: Suspicious Activity Reports (SARS), Federal Bureau of Investigation, 2005
Most Reported Scams Involve Borrower or Broker Fraud

SARS Fraud Reports: Lending-Related Categories

Source: Suspicious Activity Reports (SARS), Federal Bureau of Investigation, 2005
### Why Did Borrower Take Out This Loan?

<table>
<thead>
<tr>
<th>Use of Loan Proceeds</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Home Improvement/Repair</td>
<td>35%</td>
</tr>
<tr>
<td>Bill Consolidation</td>
<td>24%</td>
</tr>
<tr>
<td>Taxes</td>
<td>6%</td>
</tr>
<tr>
<td>Investments</td>
<td>5%</td>
</tr>
<tr>
<td>Medical Costs</td>
<td>5%</td>
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<tr>
<td>Appliances</td>
<td>5%</td>
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<tr>
<td>Education</td>
<td>4%</td>
</tr>
<tr>
<td>Other</td>
<td>7%</td>
</tr>
</tbody>
</table>

72% of Defaulted Loans Are Refinances

Source: Chicago Mortgage Default Counseling Survey, 2005
Causes of Borrower Falling Behind

Source: Chicago Mortgage Default Counseling Survey, 2005
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.”

Source: NHS Chicago Inc, HOPI Borrower Focus Groups, May 2006
Why Did You Not Contact Your Lender?

Source: Chicago Mortgage Default Counseling Survey, 2005
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

- % increase in rating of counseling
- % less likely to complete foreclosure
- % more likely to follow up

Source: Chicago Mortgage Default Counseling Survey 2005
Connecting Distressed Borrowers to Services

1. Contact Community-based Organization
2. Call Hotline to Credit Counseling
3. Contact Lender/Servicer

- Distressed Borrower
- 3rd party will increase trust, information or change behavior

Improve Budgeting
Increase Timely Payments

Connect with Lender/Servicer
(50% of delinquent borrowers not in contact)

Forbearance or Workout

Emergency Loan or Grant

Reo Disposition
Home resold to mortgage ready borrower

Property Services
Home preserved for resale or continued ownership

Refers to Community-based Organization

Preserves:
Borrower
House
Neighborhood

Analyzing Elements of Leading Nonprofit Default Intervention Programs
PolicyLab Consulting Group, LLC
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
- * 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