



Subprime

LOAN REPORT

Kansas City

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FEDERAL RESERVE BANK of KANSAS CITY

Kansas City Subprime Loan Report

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The Kansas City metropolitan area had a below-average foreclosure rate when compared to the nation's 100 largest metropolitan areas for 2007.¹ However, defaults by subprime borrowers have been widely implicated as a key factor boosting foreclosures nationally, and Kansas City has a typical level of subprime borrowing. Our analysis of data on securitized subprime loans reveals 60 percent of subprime borrowers in the Kansas City metropolitan area (MSA) are successfully paying their mortgages, but delinquencies are higher than the national average for subprime loans. Kansas City subprime borrowers have also been paying above-average interest rates; however, recent declines in international interest rates should help borrowers with adjustable rates. The key findings show that:

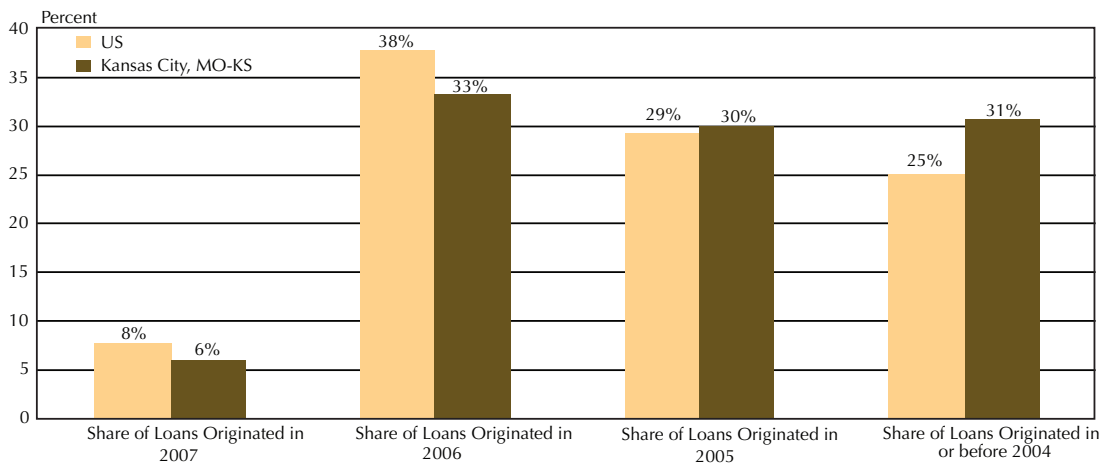
1. Existing Kansas City-area subprime loans were originated earlier than the nation, with more than 30 percent originated in 2004 or before.
2. About 60 percent of Kansas City-area subprime loans are current, but payment delinquencies are running above the national average.
3. Kansas City-area borrowers had lower average credit scores but were more likely to have provided full documentation with their loan.
4. Kansas City-area subprime borrowers have also been paying above-average interest rates in both fixed- and adjustable-rate loans.
5. More than half of the adjustable-rate loans in the Kansas City area had already reset as of December 2007, but declining international interest rates should help borrowers.

Existing Kansas City-area subprime loans were originated earlier than the nation, with more than 30 percent originated in 2004 or before.

The average subprime loan in the Kansas City area is 32 months old, but many originations occurred in 2006 and 2005. The origination of privately financed subprime loans all but disappeared in 2007, nationally and in Kansas City. The share of subprime loans originated in 2007 represents less than 6 percent of outstanding subprime loans for Kansas City, versus about 8 percent for the United States.

Chart 1

The Timing of Subprime Origination



About 60 percent of Kansas City-area subprime loans are current, but payment delinquencies are running above the national average.

In the Kansas City MSA, 28 percent of subprime loans are past due by more than 30 days, 5 percent are currently in foreclosure and 6 percent are in “REO,” which means the lender has already taken ownership of the property. The below average “in foreclosure” is consistent with Kansas City having a lower foreclosure rate than other metropolitan areas. Still, the higher-than-average delinquency figures indicate that Kansas City subprime borrowers are having trouble keeping current.

Kansas City-area borrowers had lower average credit scores but were more likely to have provided full documentation with their loan.

Though it is often thought that the FICO credit score determines whether a loan product is subprime, several factors come into play. FICO is the credit score developed by Fair Isaac & Company and is frequently used by many mortgage lenders to determine the possibility that the borrower may default. In reviewing the average FICO scores for subprime borrowers, Kansas City MSA borrowers had a lower score — 603 — in comparison to the United States at 617. The share of the property financed also affects the classification of the loan, particularly when the loaned amount is more than 90 percent of the value of the property. “High” initial loan-to-value ratio loans (LTV greater than 90 percent) were more common in the Kansas City MSA: 44 percent compared to 37 percent of subprime loans nationally. Low-documentation loans are also more likely to be classified as subprime. Subprime loans in the Kansas City MSA were mostly full documented: 81 percent compared to the U.S. average of 67 percent.

Chart 2

Subprime Loan Status

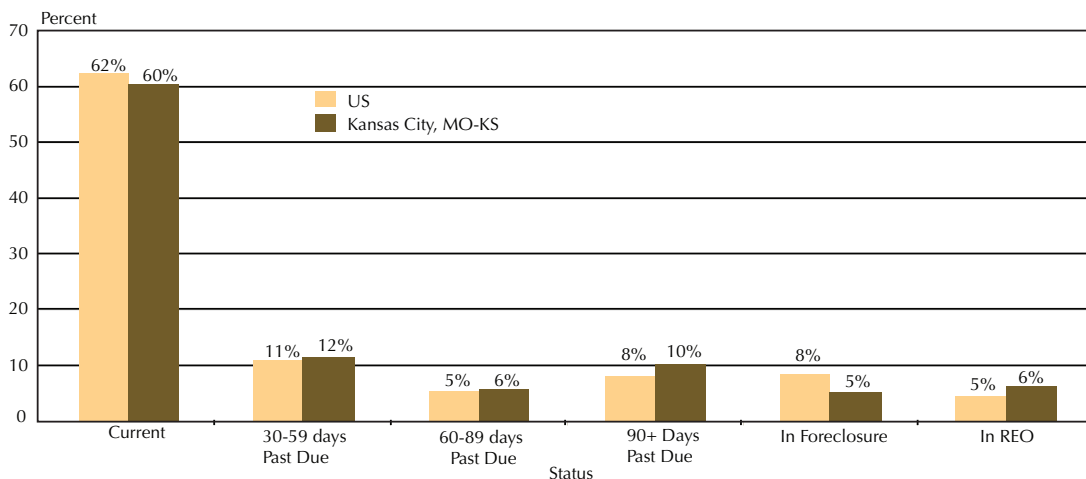
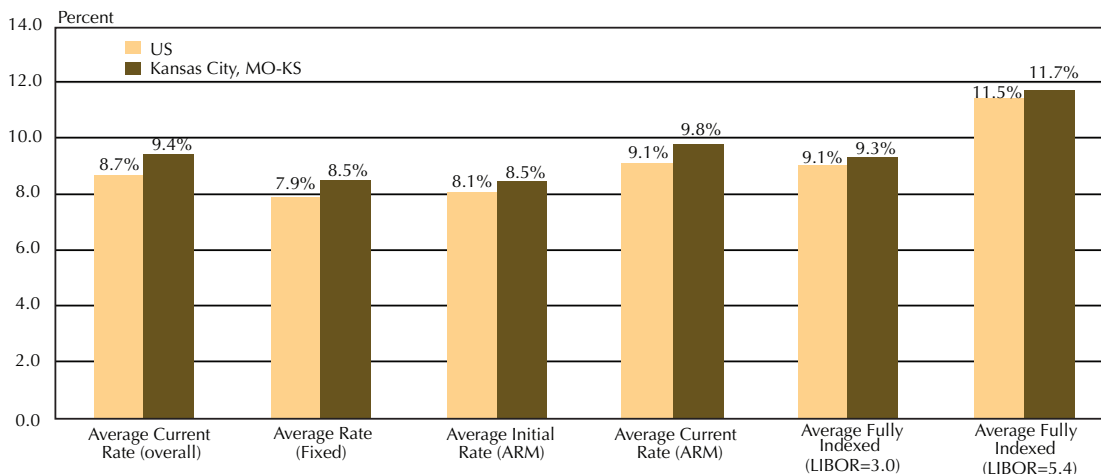


Chart 3

Average Interest Rates on Subprime Loans



Kansas City-area subprime borrowers have also been paying above-average interest rates: 9.4 percent in the Kansas City area, versus 8.7 percent nationally.

Rates paid by Kansas City MSA borrowers are higher in both fixed- and adjustable-rate loans. Kansas City MSA fixed-rate borrowers paid an average rate of 8.5 percent, versus 7.9 percent nationally. 70 percent of subprime borrowers in the Kansas City MSA have an adjustable-rate mortgage (ARM), versus 65 percent of national subprime borrowers. Adjustable-rate products can lower initial payments, but subprime borrowers did not tend to receive a very low “teaser” rate. The average initial rate for an ARM in the Kansas City MSA was 8.5 percent, compared to the U.S. rate of 8.1 percent. Interest-only loans (where borrowers are not required to make payments on the principal) represent only 5 percent of the pool in Kansas City, versus 13 percent nationally.

More than half of the adjustable-rate loans in the Kansas City area had already reset as of December 2007, but declining international interest rates should help borrowers.

Many people are concerned about the potential for these loans to reset to high rates, but this depends on the underlying interest rate. Subprime ARMs are generally indexed to the London Interbank Offered Rate (LIBOR). Throughout much of 2007, LIBOR was near 5.4 percent, making resets to nearly 12 percent likely in the Kansas City MSA. However, LIBOR has declined substantially over the past few months, making resets likely to be closer to 9.3 percent in the Kansas City MSA. Subprime loans tend to reset every

six months after the first reset, so many households may see their rates decrease from past resets. Many loans may be restricted to fall no lower than the initial interest rate, but resets would still typically be lower than current rates.

Subprime borrowers may still want to refinance their properties as their financial situation or the interest rate change. Like last year’s relative high interest rates, today’s relatively lower interest rates are subject to change. One factor limiting refinancing options are prepayment penalties, which, depending on their size, can make refinancing prohibitively expensive. About 72 percent of Kansas City MSA subprime loans included a prepayment penalty at origination, compared to 73 percent for the United States. However, as of December 2007, the prepayment penalty was still in effect for about 36 percent of the loans in Kansas City. For the group of homeowners with prepayment penalties still in effect, the decline in LIBOR is particularly helpful and may alleviate some of expected difficulties from resets.

¹See the RealtyTrac report for 2007 at <http://www.realtytrac.com/Content-Management/pressrelease.aspx?ChannelID=9&ItemID=4119&acct=64847>

This analysis of subprime loans in the Kansas City MSA was conducted using estimates provided by the Federal Reserve Board and the Federal Reserve Bank of Kansas City based on First American LoanPerformance data from December 2007. This data source includes more than 70 percent of subprime loans made nationally, so these estimates should accurately reflect the subprime loan pool in the Kansas City MSA. Jane Dokko and Andreas Lehnert at the Board of Governors provided many of the estimates used in this report.

The analysis and views in this report are the authors’ and do not necessarily reflect the views of the Federal Reserve System.