Foreclosure Fallout: Effects on Affordable Housing Development

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The views expressed are those of the author and do not necessarily reflect the positions of Federal Reserve Bank of Kansas City or the Federal Reserve System.
Foreclosure Fallout

• Today’s Outline
  – The current foreclosure status
  – The impacts on the mortgage market
  – When will this end?
Foreclosures accelerated in 2007 ... 

Home Foreclosure Inventory

Percent of loans serviced

Source: Mortgage Bankers Association
Percent of Loans in Foreclosure
(Started during the First Quarter 2008)

Source: Mortgage Bankers Association
Led by rising foreclosures of ARMs and Subprime loans.

Foreclosure Rates by Mortgage Type

Percent of loans serviced

Source: Mortgage Bankers Association
Payment Structure, by Mortgage Type
$200,000, June 2004

<table>
<thead>
<tr>
<th>Loan Product</th>
<th>Initial Payment</th>
<th>Reset Payment</th>
<th>Reset Date</th>
<th>Increase (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>30-Year FRM</td>
<td>$1,237</td>
<td>$1,237</td>
<td>None</td>
<td>0%</td>
</tr>
<tr>
<td>3/1 ARM</td>
<td>$1,039</td>
<td>$1,420</td>
<td>Jun. 2007</td>
<td>37%</td>
</tr>
<tr>
<td>3/1 I-O ARM</td>
<td>$786</td>
<td>$1,462</td>
<td>Jun. 2007</td>
<td>86%</td>
</tr>
<tr>
<td>Option ARM</td>
<td>$643</td>
<td>$1,555</td>
<td>Aug. 2007</td>
<td>142%</td>
</tr>
</tbody>
</table>

Assumptions: Option ARM has a 7.5% annual increase limit and a 110% negative amortization cap; Option ARM interest accrual is based off 1 year ARM rate as reported by Fannie Mae; Option ARM Minimum Payment is equivalent to a 1% interest rate; FRM is from Fannie Mae 30 Year FRM Index; ARM is set from LIBOR plus a 2.25% margin; 3/1 Interest Only ARM amortizes in 30 years.

Source: Edmiston (2007)
Nationally, home prices are falling.

U.S. Home Price Indexes

Percent change from previous year

Case-Shiller
OFHEO

Source: OFHEO and Standard & Poor's
Foreclosure Fallout

• Today’s Outline
  – The current foreclosure status
  – The impacts on the mortgage market
    • Collapse of mortgage-backed securities
    • Tighter credit standards
    • Increasing costs of funds for banks
    • Rising mortgage rates
The spread widened between mortgage-backed securities and other financial instruments.

Short-term Commercial Paper and Fed Funds Rates

- Overnight AA Asset-backed Commercial Paper Rate
- Effective Fed Funds Rate
Credit standards have tightened.

Credit Standards on Residential Real Estate Loans

Net percent reporting tighter credit standards

Source: Federal Reserve Board of Governors
The cost of longer term funds has risen for financial firms.

Overnight and Longer Term
Financial Commercial Paper Rates Spreads

Percent

-0.4 -0.2 0.0 0.2 0.4 0.6 0.8 1.0

Jan-07 Apr-07 Jul-07 Oct-07 Jan-08 Apr-08 Jul-08

-0.4 -0.2 0.0 0.2 0.4 0.6 0.8 1.0

30 day commercial paper
90 day commercial paper
Fixed-rate mortgage rates have risen.
Foreclosure Fallout

• Impacts on Mortgage Financing
  – Collapse of mortgage-backed securities
  – Tighter credit standards
  – Increasing costs of funds for banks

• Impacts on Homeowners
  – Potential loss of equity
  – Deteriorating credit worthiness
  – Where do we live (affordable housing issues)?

• Impacts on Communities
  – Concentrated foreclosures pull down prices
  – Neighborhood deterioration
  – Where do people live (affordable housing options)?
  – Local budgetary impact (expenditures and revenues)
What Can be Done?

• Try to fix the servicer problem
  – bring servicers and borrowers together
  – bring servicers and lenders together
• Educate Homeowners
  – before they buy
  – when they are in trouble
    • contact servicer
    • counseling agencies (888-995-HOPE)
• Educate and Inform Communities
  – what can happen
  – resources that are available


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Mortgage resets will last through 2012.

Timing of Mortgage Resets

Source: Loan Performance, UBS
A new balance in the housing market.

Home Prices and Per Capita Incomes

Index (1991=100)

- Home Prices
- Personal Incomes

Source: OFHEO, Bureau of Economic Analysis, NAR, Dept. of Commerce

Home Inventories, Sales, and Starts

Index

- Month’s supply of homes
- Housing starts
- Existing home sales

Source: OFHEO, Bureau of Economic Analysis, NAR, Dept. of Commerce
Conclusion

• Foreclosures present many financial challenges to market participants and communities.

• The challenges will continue until a new equilibrium in the housing market is formed.

• The key to easing housing market challenges starts with education.