

The Long and Short of Housing: The Homeownership Boom And the Subprime Foreclosure Bust

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August 28, 2007**

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The Growing Subprime Market

■ Spectacular Growth

- 1988 - \$3 billion
- 1996 - \$38 billion
- 2004 - \$529 billion
- 2006 – 15% of the mortgage market

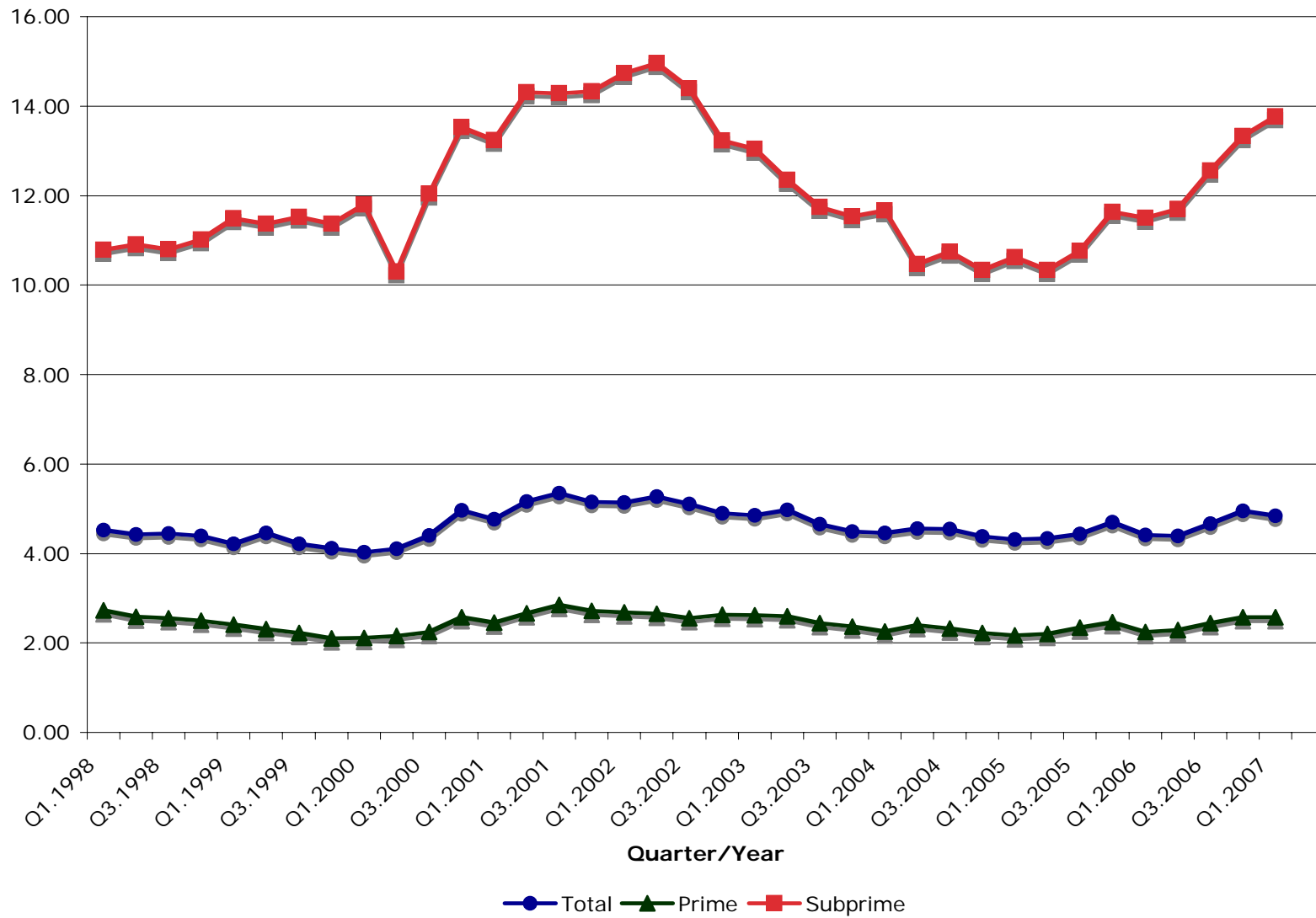
■ Why?

- FIRREA in 1989: more stringent underwriting and examination standards for traditional lenders
- An opportunity for finance companies

The Changing Subprime Market

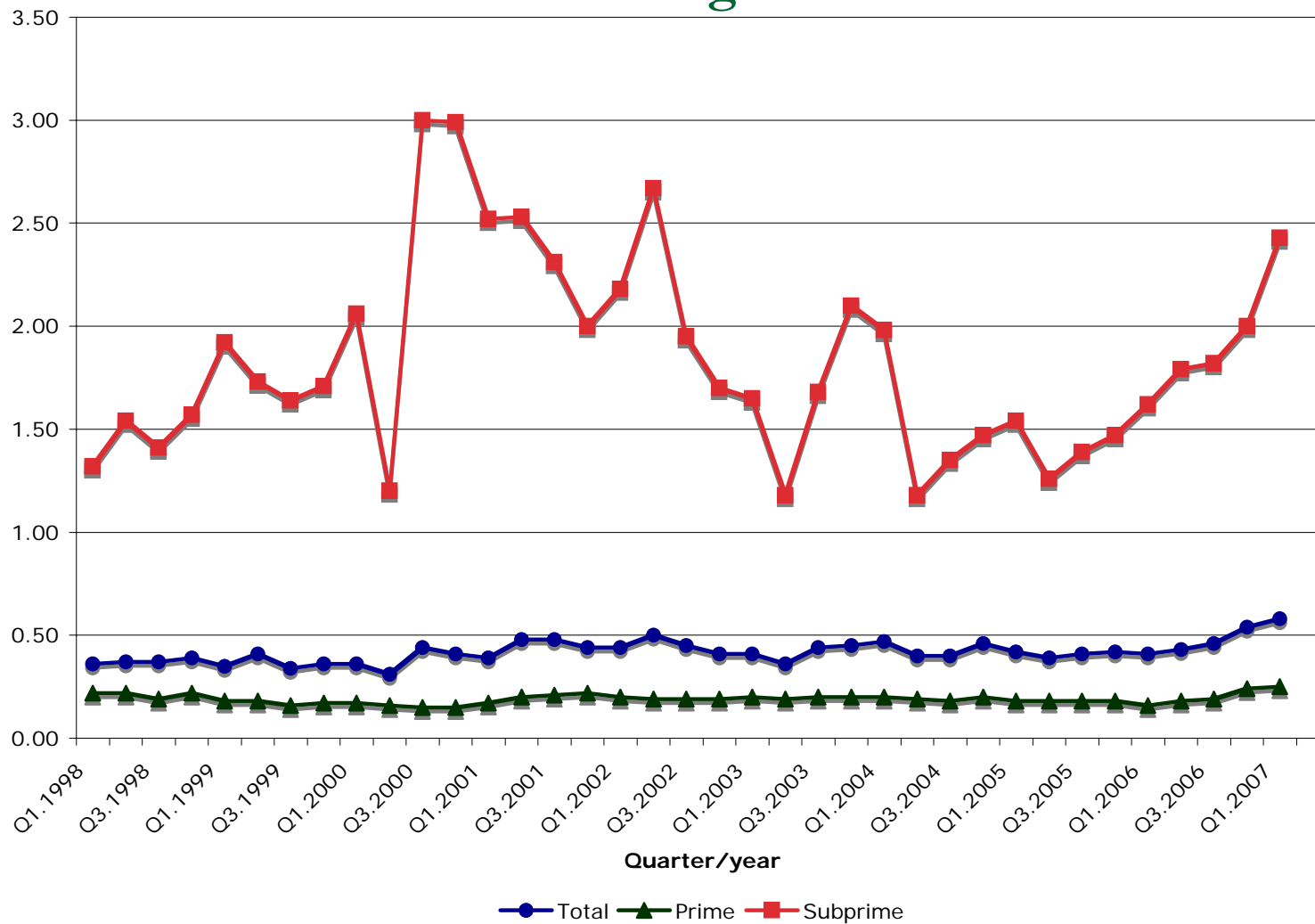
- 1996
 - 2% were home purchase loans
 - 70% LTV
- 2002
 - 33% were home purchase loans
 - < 90% LTV
- 2006
 - 44% were home purchase loans
 - Getting close to 100% LTV, with riskier terms

Subprime Delinquencies



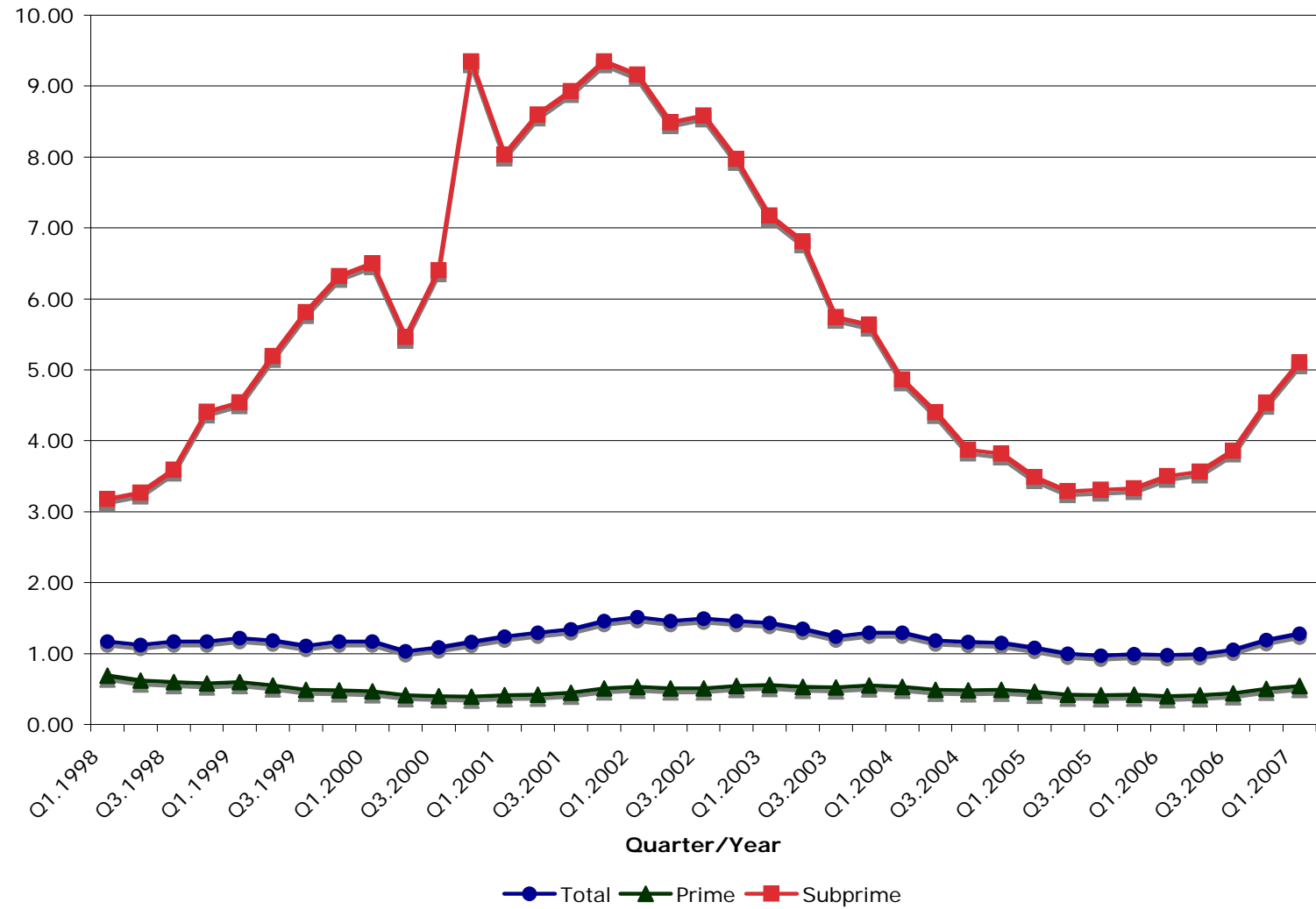
Subprime Foreclosures (1)

Homes Entering Foreclosure



Subprime Foreclosures (2)

Homes in Foreclosure



Subprime Foreclosure Projections

- Mortgage Bankers Association
 - During this year, 10.8% subprime ARM default rate
 - 200,000 to 300,000 defaults this year
- Center for Responsible Lending
 - Over the life of the loan, 15-20% defaults for 2004-2006 subprime loan cohorts
 - 500,000 to 600,000 defaults per year

Forbearance

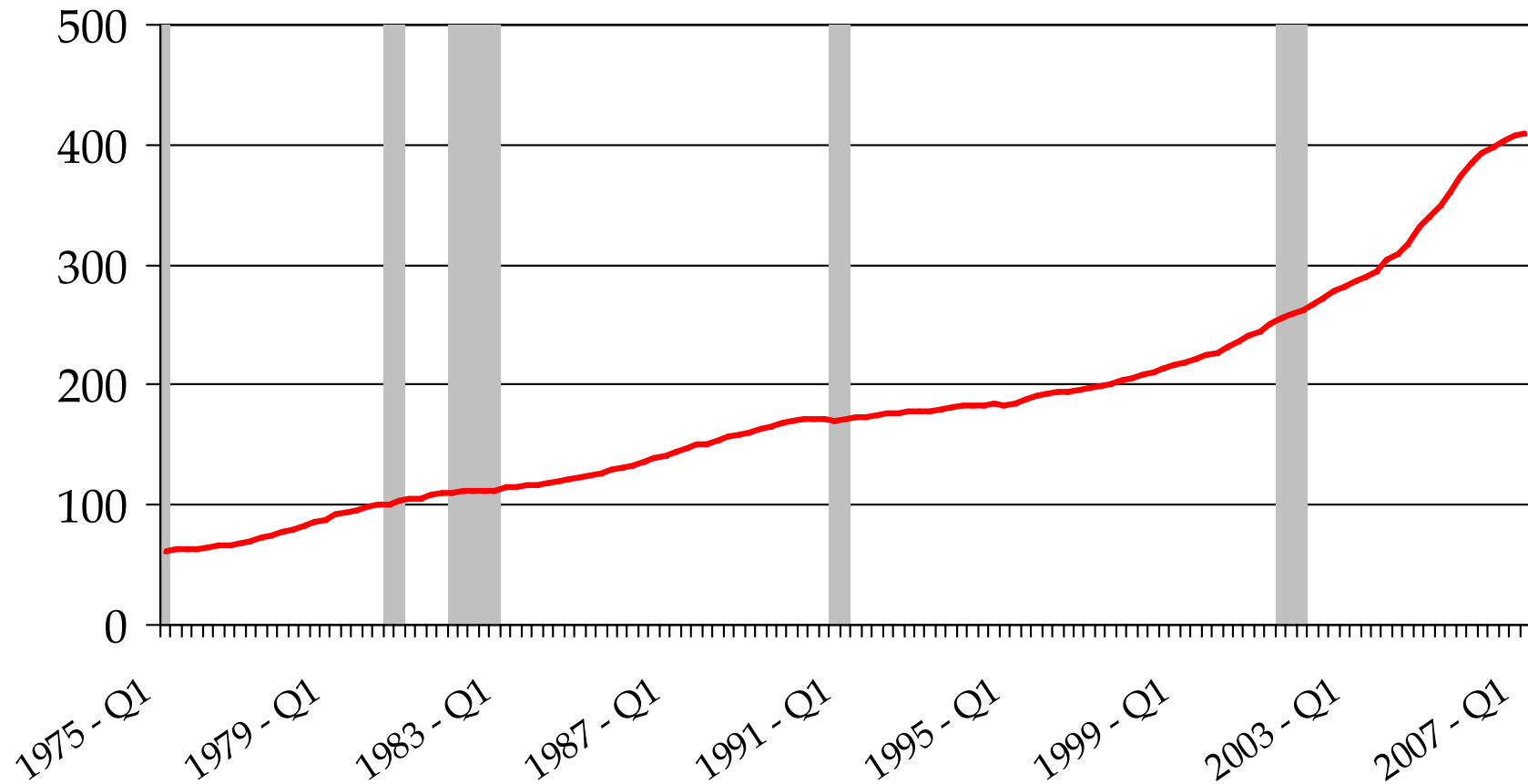
- Regulators urging lenders to work with distressed subprime borrowers
- Loss mitigation for FHA borrowers:
50% are current within a year
- Forbearance for conventional borrowers:
Over 50% are current within a year
- Reduces FHA claims and losses
- Complicates mortgage securitization?

Remember the Bubble? House Prices

House Price Index

Q1-1975 to Q1-2007

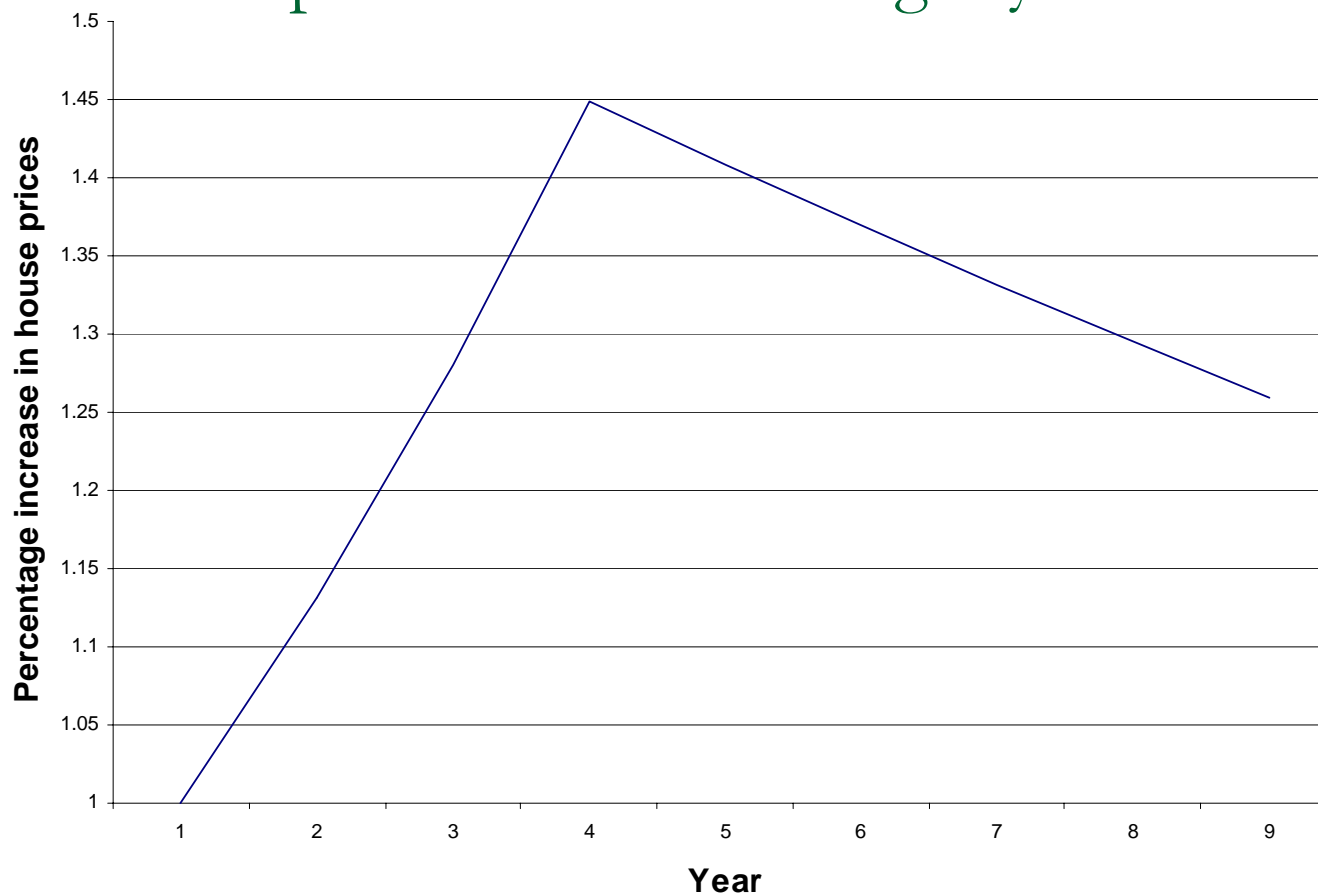
(Q1-1980=100)



Source: Office of Federal Housing Enterprise Oversight.

Bubbles and Slow Leaks:

The FDIC's definition of a "housing bubble":
25% price increase over eight years



Potential “bubbles”?

- Just starting? (0.81% in latest quarter)
 - 49 markets out of 282 (17%)
 - 7 markets out of 36 in Indiana, Michigan, & Ohio (Anderson, Michigan City)
- The first year? (3.2% decline over latest year)
 - 10 markets – 8 in California (Sacramento)
- More than one year?
 - 4 markets – Santa Barbara, Sacramento, Kokomo & Anderson
 - Kokomo the biggest drop during 2006 (down 5.3%), slight increase in 2007:Q1

The Future of Subprime Lending: Regulation

- Scared lenders
- Guidance for financial institutions
 - – 2/28 & 3/27 ARMs
 - low-doc and no-doc
 - prepayment penalties, etc.
- Same guidance for GSEs – but a lag?
- State-chartered institutions?

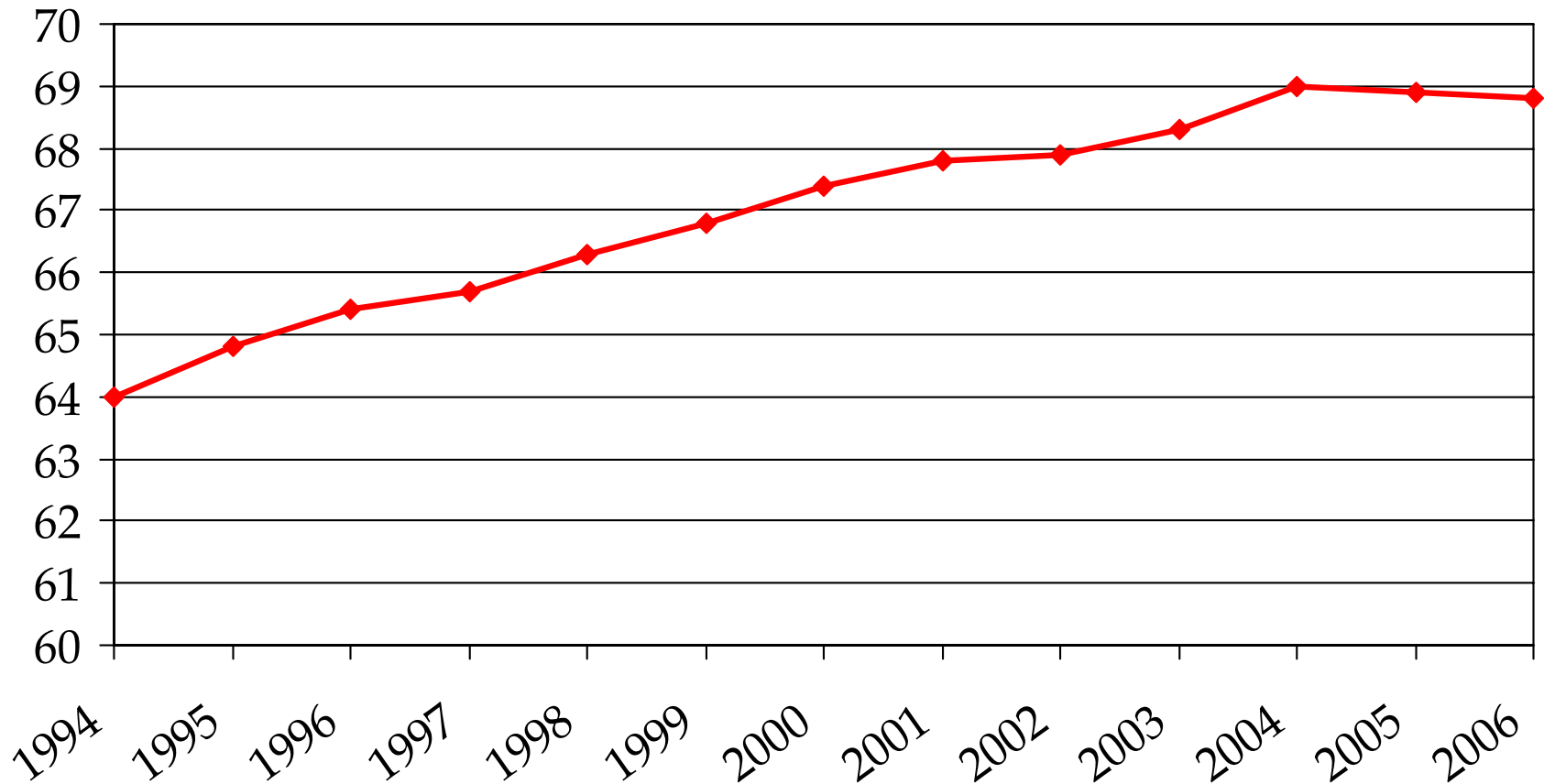
The Future of Subprime Lending: Education

- Financial Literacy
 - Chicago Fed: Financial Literacy for Immigrants
 - US Government: National Commission on Financial Literacy and Education
- Homeownership Counseling
 - 1.1 million buyers/year
 - Pre-purchase counseling reduces FHA defaults
 - Pre-purchase counseling reduces Freddie Mac delinquencies

The Homeownership Boom, In Context

Homeownership Rate: 1994-2006

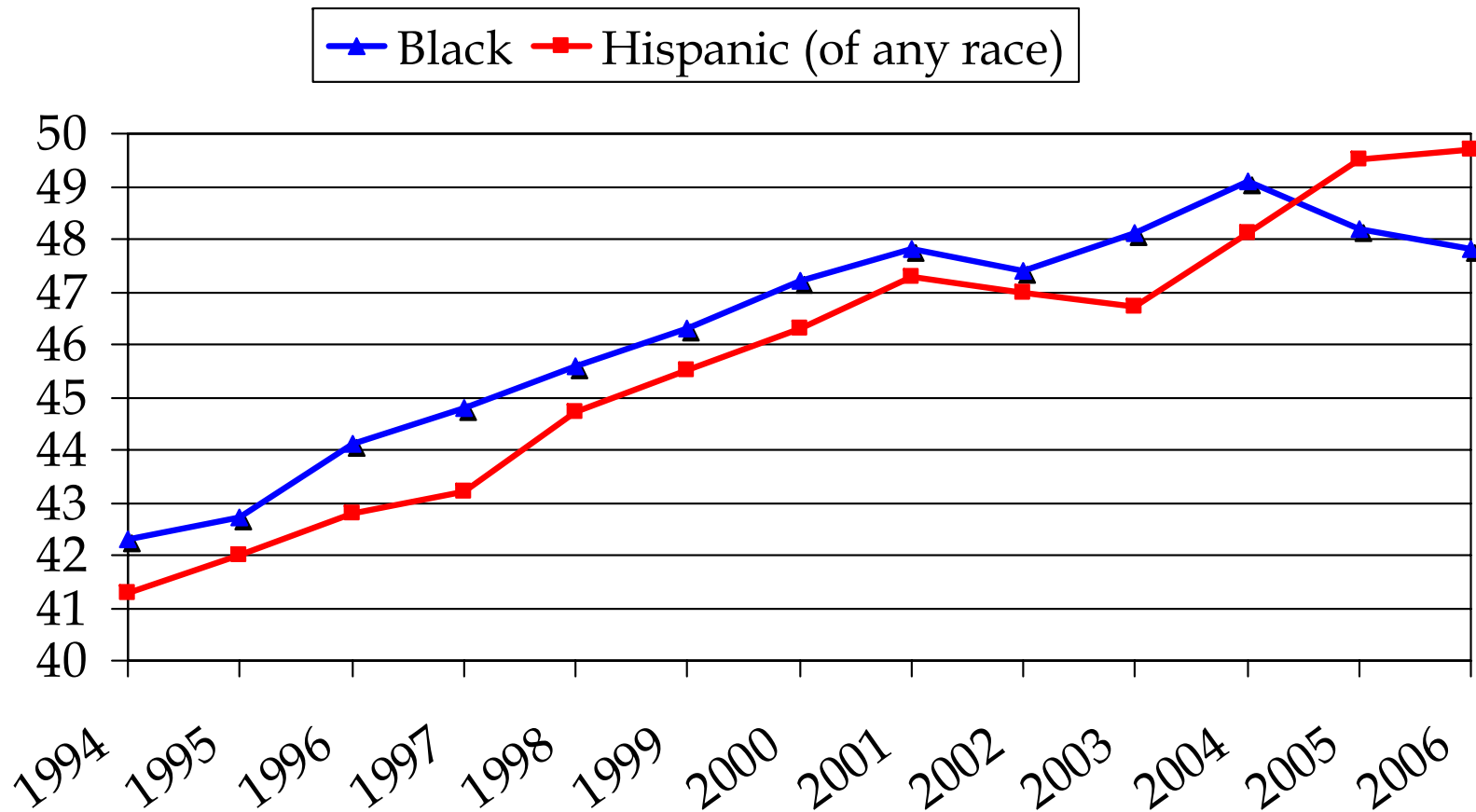
(percent)



Source: U.S. Census Bureau.

Minority Homeownership Rates: 1994 - 2006

(percent)



Source: U.S. Census Bureau.

Immigrants and Homeowners

- Rapid growth in homeownership, despite the surge in immigration
 - 4 million more Hispanic households in last decade – almost 50% increase
 - 2.6 million more Hispanic homeowners – 67% increase

- Not the pattern during past waves of immigration

Better Risk Measurement

The Information Revolution Comes to the Mortgage Market

- Conventional lending
 - LTV vs. FICO scores
 - Automated Underwriting Systems
- FHA: TOTAL Scorecard
- Subprime Lenders
 - Using new technology, but overshooting
 - 3.1% in foreclosure in 1996 vs. 10.8% in 2007

Conclusion:

The Subprime Debacle in Perspective

- The rise in subprime foreclosures is real, and people will be hurt.
- But the problem will be largely limited to subprime loans, and mitigated by public and private efforts.
- The growth in homeownership is also real, and results from technological changes in mortgage origination (despite the subprime mess).
- The roof is not caving in on the housing market.

BUT:

All Housing Markets are Local

What about Indiana?

What about the Midwest?

The States with Problems

Top Delinquency	Foreclosure Starts	In Foreclosure
1. Mississippi	1. Ohio	1. Ohio
2. Louisiana	2. Indiana	2. Indiana
3. Michigan	3. Michigan	3. Michigan
4. Georgia		
5. Indiana		
6. Ohio		

Highest FHA Default Rates

March 2007 (371 Markets)

- 1 – Detroit
- 2 – Flint
- 3 – Cleveland – Lorain – Elyria
- 5 – Youngstown – Warren
- 6 – Saginaw – Bay City – Midland
- 7 – Toledo
- 9 – Gary
- 10 – Kokomo
- 13 – Ann Arbor
- 16 – Mansfield
- 17 – Columbus (Ohio)
- 19 – Jackson
- 20 – Grand Rapids – Muskegon – Holland
- 21 – Hamilton – Middletown
- 22 – Akron
- 24 – Cincinnati

Smallest Five-Year Price Increases (282 Markets)

- 1 – Anderson (5%)
- 2 – Kokomo (6%)
- 3 – Detroit (8%)
- 4 – Lafayette (8%)
- 5 – Flint
- 6 – Warren, MI
- 8 – Canton
- 9 – Saginaw
- 10 – Springfield, OH
- 11 – Fort Wayne
- 12 – Akron
- 14 – Mansfield
- 15 – Dayton
- 16 – Toledo
- 17 – Cleveland
- 19 – Youngstown
- 20 – Muskegon
- 21 – Ann Arbor
- 22 – Indianapolis (14.5%)

Biggest One-Year Home Price Declines

(282 Markets)

- 11 – Bay City
- 13 – Detroit
- 15 – Flint

- 28 – Kokomo
- 32 – Lima

Highest Projected Subprime Foreclosure Rates (2006 Loan Cohort) (378 Markets)

- 15 – Saginaw
- 69 – Kokomo
- 97 – Mansfield

Explaining Local Markets

- The Auto industry
- Small cities with narrow economic bases
- Not sharing in the boom (or the bubble)

- Perhaps – not sharing in the subprime debacle?