



The Nation's Foreclosure Epidemic: Causes, Consequences and Remedies

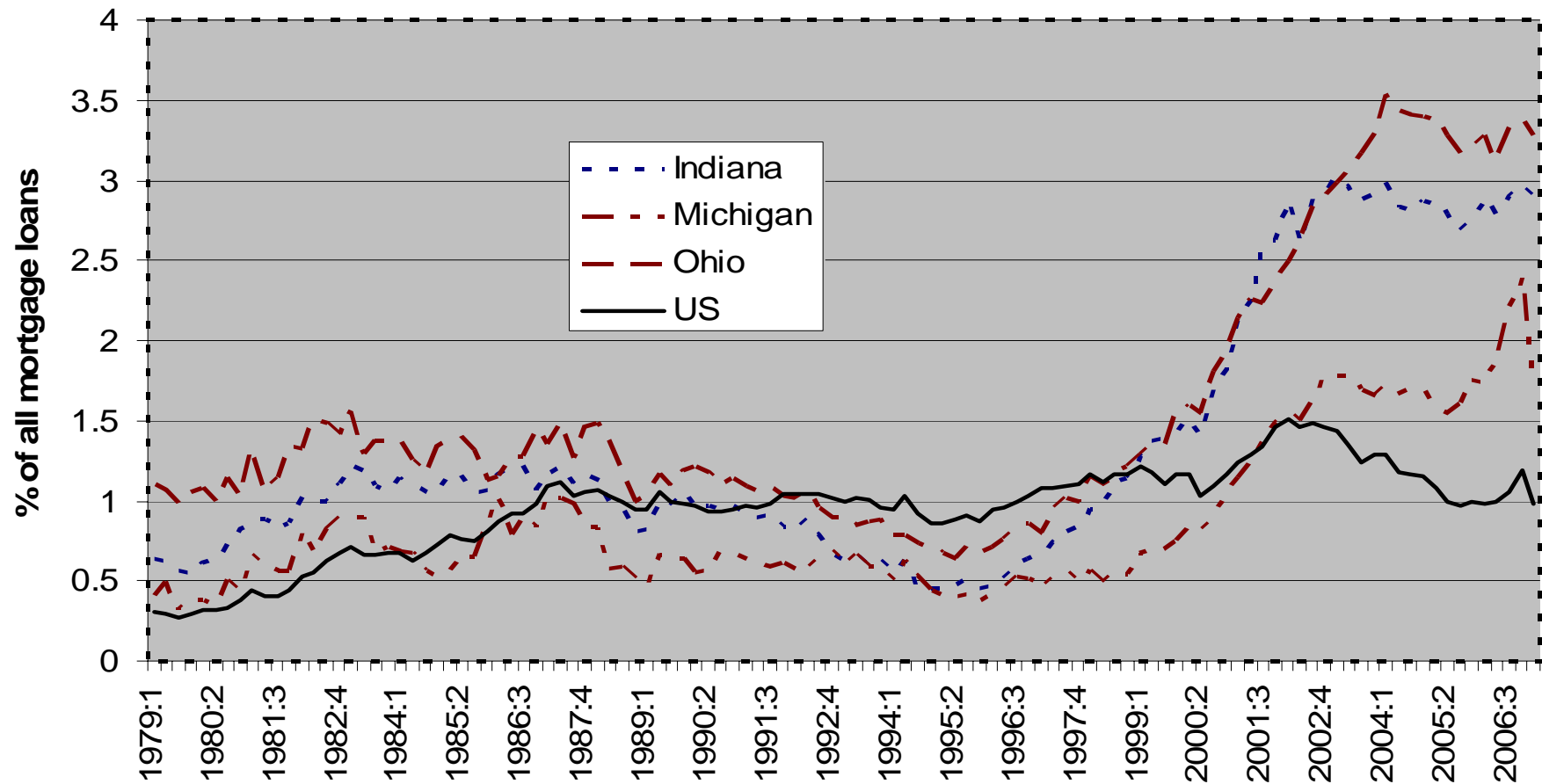


The Federal Reserve
Bank of Chicago



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Ohio and Indiana foreclosure rates lead the nation
(Foreclosure inventory end of quarter)





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Indiana and U.S. foreclosures in the first quarter of 2006

	Foreclosure rate	Loans serviced	Loans in Foreclosure	Percent of loans serviced	Percent of foreclosed loans
Indiana					
Prime	1.40%	573,745	8,032	69.5%	32.7%
Subprime	9.57	122,033	11,679	14.8	47.5
FHA	3.95	107,198	4,234	13.0	17.2
All loans	2.98	825,008	24,585	100.0	100.0
United States					
Prime	0.54	33,924,965	183,195	78.6	32.6
Subprime	5.10	5,878,011	299,779	13.4	53.4
FHA	2.19	2,981,809	65,302	6.8	11.6
All loans	1.28	43,895,066	561,857	100.0	100.0



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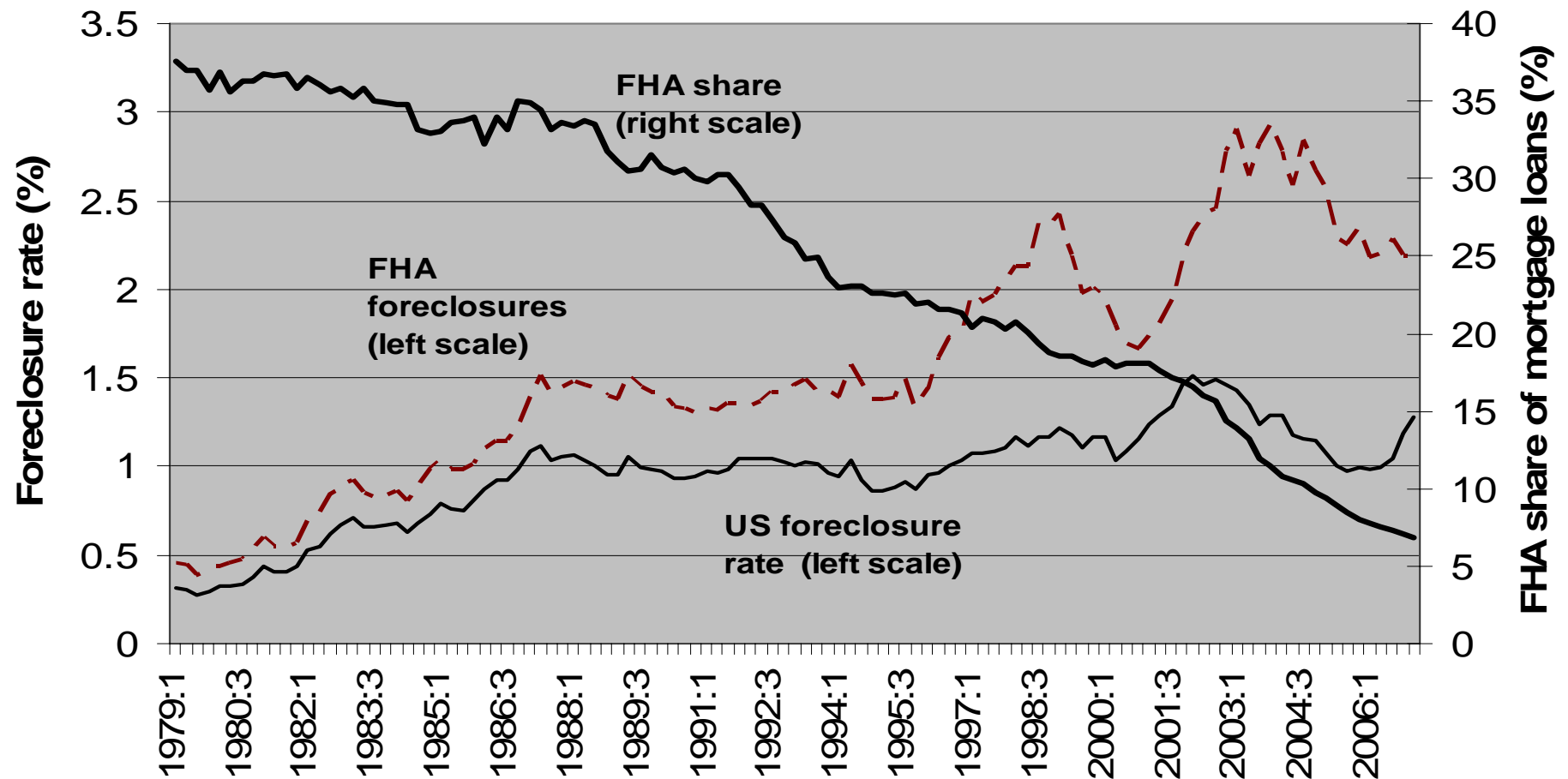
Subprime loans are more likely to be adjustable (ARM) than to have a fixed rate (FRM)

	Indiana		United States	
	Foreclosure rate	Loans serviced	Foreclosure rate	Loans serviced
Prime				
-FRM	1.15%	458,404	0.38%	23,694,889
-ARM	3.19	56,058	1.09	6,079,823
Subprime				
-FRM	6.37	53,793	3.29	2,130,443
-ARM	12.93	58,572	6.46	2,901,511
FHA				
-FRM	3.63	90,828	1.85	2,371,167
-ARM	5.23	8,111	2.73	192,924



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FHA loans: falling market share, but higher foreclosure rate





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Accounting for Foreclosure in 2006

	Indiana	Ohio	Michigan	United States
Foreclosure rate	2.88%	3.27%	2.05%	1.05%
Homeownership rate	74.2	72.1	77.4	68.8
High loan-to-value share	31.0	20.0	32.0	19.0
FHA share	13.9	10.7	7.1	7.4
Employment growth	0.6	0.3	-1.1	1.8
Price appreciation rate	3.2	3.3	3.3	9.3
Unemployment rate	5.0	5.5	6.9	4.6



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Potential effects

- Housing markets - especially in affected neighborhoods
 - Price declines
 - Reduced construction
 - Slow sales turnover
 - Employment losses for construction
 - Sales
 - Financial transactions



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Potential effects

- Financial sector
 - Lender losses
 - Failures
 - Closed product lines
 - Secondary losses from forced asset sales
 - Higher risk premiums and interest rates for risky assets
 - Larger credit spreads
 - In some markets, liquidity shortages and market failure
 - Losses for large banks on prime brokerage business with hedge funds



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Potential effects

- Economy
 - Local and national employment and production losses
 - Recession risk
 - Increased policy risk and failure



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Size and duration of the problems?

- Already serious in Indiana and neighboring states
- Large spike in foreclosure for the nation
- Effects on GDP are already declining(?)
- Effects on housing markets will worsen, but at a slower pace (?)
- Greatest effects will be on foreclosed homeowners and their lenders
- Surge in foreclosures may continue for another two years.



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Size of the problem

- Residential mortgage debt is \$9.832 trillion (1/07)
- Most at risk mortgages are about 25%, or \$2.5 trillion
- Foreclosure risk: 15%, or \$370 billion.
- Losses to lenders are usually small, but let's say 50%.
- Direct losses due to foreclosure spike is about \$185 billion...
- But the losses of equity values will be as large in the housing sector and other financial markets, not to mention related effects on financial markets and the rest of the economy



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Remedies

- New regulations- large risk of rules that will limit credit availability for low income and risky borrowers
- Greater education of lender/investors on prudential lending
- Improved education of new and existing homeowner/borrowers on mortgages and cost of homeownership