# Economic SYNOPSES

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# Some Closure on Foreclosures?


**Rajdeep Sengupta,** *Economist*
**Bryan J. Noeth,** *Research Associate*


Since 2007, mortgage delinquencies and foreclosures increased significantly with the deterioration in the U.S. housing market. Among other factors, a high unemployment rate has contributed to this landscape by reducing borrowers' incomes, and a persistently high rate will continue to have negative effects. However, some recent developments, including a sharp decline in long-term delinquencies, suggest that there may be an end in sight for the foreclosure woes.

The chart shows data from the past decade: serious delinquencies (more than 90 days), foreclosure starts (when lenders have started foreclosure proceedings), and foreclosure inventory (completed foreclosures). During the 2001 recession, the delinquency rate and foreclosure inventory increased somewhat. In the most recent episode, from the start of the subprime mortgage crisis in 2007, delinquencies have increased fivefold, as both the number of households entering delinquency and the average *duration* of that delinquency have increased.[1] Yet, the number of foreclosure starts has become more volatile and has actually not kept pace with the number of seriously delinquent mortgages.

Ultimately, the national foreclosure rate doesn't depend solely on the borrower's ability to pay. Lenders' willingness to negotiate also affects the end result, as do their incentives and legal obligations.

When a borrower defaults on a loan, the lender has the choice to foreclose, but foreclosure is a complex process that varies by state: Borrowers must be notified of impending foreclosure, usually three to six months after the first missed payment. And, depending on the state, foreclosure actions may be judicial, which requires court approval, or non-judicial, which is an administrative matter independent of the courts.

In addition, lenders have found it difficult to handle the recent volume of foreclosures. Many mortgage lenders and servicers have placed moratoria on foreclosure proceedings after defective procedures were discovered; perhaps most visible was the "robo-signing" scandal in which bank employees processed thousands of foreclosure documents without evaluating their accuracy. For a limited number of borrowers, government programs have reduced foreclosures, although many analysts are skeptical these programs have had a significant effect.[2]

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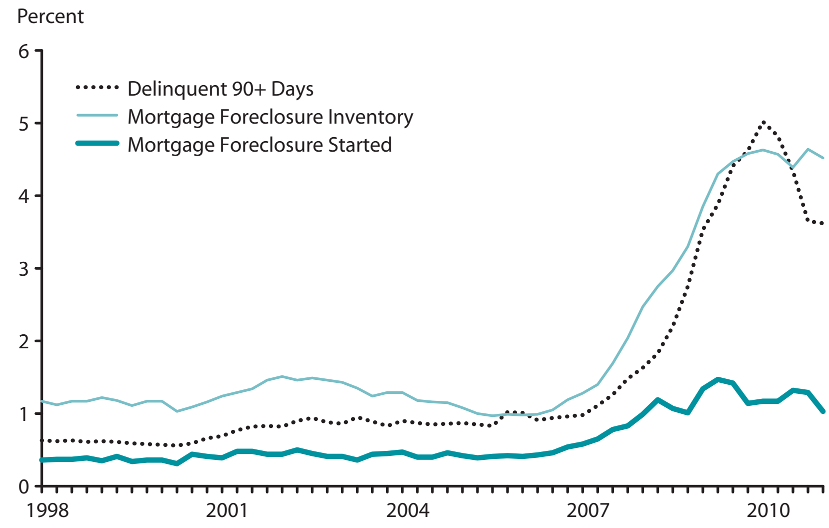
**Mortgage Foreclosures and Delinquencies**




SOURCE: Mortgage Bankers Association/Haver.

A final observation concerns the cost of foreclosure. Contrary to popular perception, the foreclosure process can be very costly for a lender. A number of states have anti-deficiency laws that prevent the lender from recovering the difference between the final (post-foreclosure) sale price and the outstanding balance of the mortgage. An alternative for the lender is to renegotiate the loan, a process that often is less costly than outright foreclosure—by some estimates, there is a sevenfold difference between modification write-offs and foreclosure losses.[3] Therefore, it remains a puzzle as to why such large numbers of mortgages in default enter into foreclosure in the first place.

Although the recent data must be viewed with caution, fewer serious delinquencies and a slowing of foreclosures may indicate a more beneficial balance between the needs of borrowers and lenders. ■

[1] According to Lender Processing Services, the average duration of seriously delinquent loans has jumped from 192 days in early 2008 to 374 days as of April 2011.

[2] See Gerardi, Kristopher and Li, Wenli. "Mortgage Foreclosure Prevention Efforts." Federal Reserve Bank of Atlanta *Economic Review*, 2010, *95*(2), pp. 1-13 and references therein.

[3] However, modifications are less frequent than might be expected from their cost savings. See White, Alan M. "Deleveraging the American Homeowner: The Failure of 2008 Voluntary Mortgage Contract Modifications." *Connecticut Law Review*, 2009, *41*, p. 1107.

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