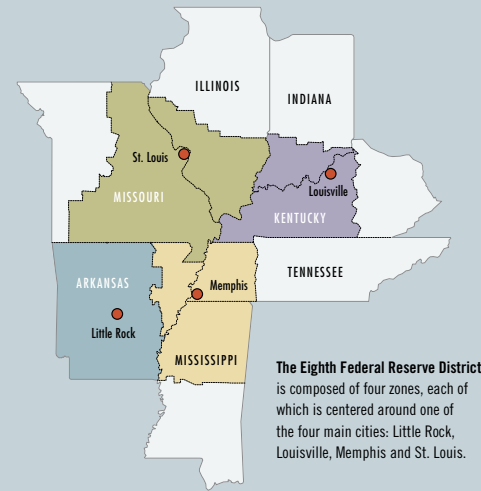


Eighth District States Weather the Mortgage Foreclosure Storm

By Yuliya Demyanyk and Michael Pakko



One of the symptoms of the ongoing problems in the nation's housing markets is a sharp rise in mortgage delinquencies and home foreclosures. From the second quarter of 2007 through the second quarter of 2008, homeowners with more than three missed monthly payments or in foreclosure rose from 2.5 percent to 4.5 percent of all outstanding mortgages.¹

Table 1 summarizes the data for Eighth District states as of the second quarter of 2008. The data show that our region has suffered along with the nation. In fact, three Eighth District states—Illinois, Indiana and Mississippi—have had higher proportions of delinquencies than the national average. But the other states in the region—Arkansas, Kentucky, Missouri and Tennessee—have fared better than the national average. Arkansas, in particular, has experienced a much lower rate of delinquencies and foreclosures than the rest of the country has.

Historically, the leading factor in delinquencies and foreclosures is related to unemployment, with homeowners who lose their jobs falling behind in their mortgage payments. In contrast, a distinctive factor in the recent run-up in delinquency rates is falling house prices. Hence, some of the highest delinquency rates are in those states that have suffered the largest declines in house prices. For example, the comparable rates for delinquency and foreclosure combined in Florida and Nevada are 8.4 and 7.6 percent, respectively.

In the Eighth District, however, the run-up in house prices was more subdued and the subsequent slowdown has been milder

than in the country as a whole. Consequently, the share of mortgages in the District that are delinquent or in foreclosure is less likely to be related to house price swings and is more likely to be related to job losses. This is particularly the case in those states that have suffered large losses in manufacturing employment.

For the nation and the District, there are distinct differences in the pattern of delinquencies across various types of mortgages. Fixed-rate mortgages (FRM) have lower delinquency and foreclosure rates than do adjustable-rate mortgages (ARM). Almost all ARMs in the subprime mortgage market are so-called 2/28 or 3/27 hybrid loans, i.e., the rates are fixed for either two or three years and then they reset to a higher rate. These types of hybrid loans are generally not found in the prime mortgage market.

Among prime mortgages, the rate of delinquency and foreclosure is nearly five times higher for ARMs than for FRMs. Moreover, the rate of delinquencies and foreclosure is much higher for subprime loans than for prime loans, and the rates for subprime ARMs are much higher than the rates for subprime FRMs. These patterns are clear in each of the Eighth District states. In fact, those states that have delinquency and foreclosure rates above the national average for all mortgages taken together tend to have rates above the national averages for each category of mortgage loans.

Subprime Mortgages Failing Faster

Not only have subprime mortgages shown higher delinquency rates than prime loans in

general, but subprime mortgage loans have shown high rates of delinquency, foreclosure and default only months after origination. This has been true for borrowers across a range of credit scores (see Yuliya Demyanyk's article elsewhere in this issue) and has also held true for Eighth District states.

On average across the country, subprime loans that were originated in 2006 and 2007 showed, respectively, 14 and 17 percent serious delinquency rates within one year of origination.² In contrast, for subprime loans that were originated in 2002, 2003 and 2004, the serious delinquency rate was 5 percent.³

Analyzing serious delinquency rates for subprime loans within the first year of origination, there are again differences between the rates for FRM and ARM loans. Table 2 shows the percentage of subprime loans that became seriously delinquent within the first 12 months of origination. For every origination year, FRM loans had lower serious delinquency rates than ARM loans of the same ages. However, even within the relatively better performing FRM group, loans originated in 2007 performed much worse than those originated in 2005. The serious delinquency rate for 2007 FRM loans, 12 months after origination, is 2.7 times larger than that for 2005 loans.

Data for the Eighth District states show that this region's experience with subprime loans was quite similar to the nationwide trend. For both FRMs and ARMs, the national trend has shown rising delinquency rates over the three origination years from 2005 to 2007. However, Missouri, Illinois, Tennessee and Arkansas had higher serious

TABLE 1
Residential Mortgage Delinquency Rates For Eighth District States

STATE	PERCENT 90+ DAYS DELINQUENT OR IN FORECLOSURE, 2008-Q2						
	All Mortgages	Prime			Subprime*		
		Total	FRM†	ARM†	Total	FRM	ARM
Missouri	3.1	1.5	1.1	4.7	13.2	7.2	20.8
Illinois	4.7	2.3	1.4	6.3	20.1	11.3	27.9
Indiana	5.7	2.9	2.2	9.2	18.5	12.3	27.8
Kentucky	4.0	1.9	1.4	6.4	15.8	9.9	26.1
Tennessee	3.7	1.7	1.3	6.4	12.6	7.8	20.4
Mississippi	5.0	2.5	1.9	10.1	16.1	11.6	25.1
Arkansas	2.7	1.5	1.0	6.1	11.4	7.8	18.1
U.S. Total	4.5	2.4	1.3	6.8	17.9	9.6	26.8

* The Mortgage Bankers Association divides the sample of conventional mortgages into prime and subprime categories based on whether the servicer handles primarily prime or subprime loans. Therefore, there are some prime loans in the subprime sample and some subprime loans in the prime sample.

† FRM = Fixed-Rate Mortgages ARM = Adjustable-Rate Mortgages

SOURCES: Mortgage Bankers Association, National Delinquency Survey/Haver Analytics

TABLE 2
Subprime Securitized Loans, Serious Delinquency Rates (Percent) 12 Months After Origination*

ORIGINATION YEAR	Fixed-Rate Mortgages			Adjustable-Rate Mortgages		
	2005	2006	2007	2005	2006	2007
Missouri	4.5	9.7	14.6	12.3	17.3	22.0
Illinois	5.2	9.4	14.0	8.5	12.8	18.6
Indiana	7.2	11.0	10.2	12.3	17.1	14.2
Kentucky	7.7	12.3	9.4	12.4	14.2	14.4
Tennessee	12.0	10.0	16.0	11.6	16.1	21.1
Mississippi	5.6	9.7	10.7	18.1	17.4	23.2
Arkansas	5.7	10.0	16.3	9.1	13.6	12.2
U.S. Total	4.2	7.7	11.2	8.1	15.0	18.7

* A loan is called seriously delinquent if mortgage payments on it are past due for more than two months, a property is in foreclosure or the property is real-estate owned (taken over by a bank or trustee.)

SOURCE: Authors' calculations, based on FirstAmerican CoreLogic LoanPerformance securities data.

delinquency rates for 2007-vintage FRM loans than the national average. The ARM and FRM rates for Indiana and Kentucky and the ARM rates for Arkansas peaked for loans originated in 2006 and have fallen or leveled off in the next year.

On average in the U.S. and in every state in the Eighth District, more than half of all mortgages have rates that are scheduled to adjust at some point. About 30 percent of those are scheduled to reset before June 2009.⁴ This can, of course, be problematic for borrowers whose rates (and payments) adjust dramatically. However, given the average initial mortgage interest for the states in the Eighth District and the current level of interest rates, the typical reset would mean an approximate increase in

the average interest rate of only one percentage point.

Yuliya Demyanyk and Michael Pakko are economists at the Federal Reserve Bank of St. Louis. For more on Demyanyk's work, see www.stlouisfed.org/banking/PDFs/CVs/Demyanyk_vitae.pdf. For more on Pakko's work, see <http://research.stlouisfed.org/econ/pakko/index.html>.

ENDNOTES

- ¹ Mortgage Bankers Association, National Delinquency Survey/ Haver Analytics.
- ² A loan is called seriously delinquent if mortgage payments on it are past due for more than two months, a property is in foreclosure or is real-estate owned.
- ³ Authors' calculations based on FirstAmerican CoreLogic LoanPerformance securities data, June 2008.
- ⁴ More information about subprime mortgages by state can be found at the web site of the Federal Reserve Bank of New York. See www.newyorkfed.org/mortgagemaps.