Loan Foreclosure Analysis and Comparison

A Briefing

To The Housing Committee

March 3, 2008

Purpose

- To determine the cause of the Subprime mortgage crisis which was triggered by a sharp rise in home foreclosures starting in the United States during the fall of 2006 and has become a national financial crisis during 2007 and 2008
  - Compare the data with the City of Dallas, the County, the State and Nationwide by types of loans, income level of borrowers most effected and percentage of loans that survived remedies to prevent foreclosure

What happened?

- **In Texas**
  - Subprime lending has grown with its relaxed underwriting criteria coupled with non-traditional loan products – Subprime Loans
    - Many borrowers who would not qualify under Prime financing were able to purchase homes with lower credit scores with Subprime loans at higher interest rates in both fixed and Adjustable Rate Mortgages (ARMs)
    - The average Texas credit score of 648, compared with a national average of 675, would likely fall between being qualified for a Prime ARM and a Subprime fixed rate - a lot of the people in Texas are right on the edge between Subprime and Prime
  - Since 2001 the residential foreclosure rates have been on the rise – most notably concentrated in Subprime ARM's

SOURCE: Federal Reserve Bank of Dallas

United States
Prime vs. Subprime

- **65% of homes have mortgages**
  - 86% are priced at prime and 76% have fixed interest rates – the rate available for borrowers with the best credit
  - 14% of these mortgages are Subprime mortgages – priced at higher interest rates than prime loans
    - Of these 14% Subprime loans more than 50% are Adjustable Rate Mortgages and 17% - 20% of these are interest only loans

SOURCE: Federal Reserve Bank of Dallas

Texas
Prime vs. Subprime

- In Texas, the foreclosure inventory in fourth quarter 2006 was running at historic norms for Prime Mortgages - one foreclosure for every 200 loans or .5%
- Conversely, in Texas, the Subprime Mortgage foreclosure rate was 8 foreclosures for every 200 loans or 4%

SOURCE: Federal Reserve Bank of Dallas

Texas Subprime

- **Because 75% of all Subprime loans were originated after 2003, the situation is to be compounded over the next two years as interest rates on these Subprime loans are scheduled to increase**
  - Even if the foreclosure rate climbs to 10% of all Subprime loans, that means that 90% of the families who financed with subprime loans are still living in their homes – a home they may not have been able to own otherwise

SOURCE: Federal Reserve Bank of Dallas

Dallas County – Highest Foreclosure Rate in Texas from 01/01/02 to 06/30/06

- Dallas County reported 15,406 foreclosure with a 5.6% foreclosure rate per total mortgages
- Dallas County shows foreclosures are in areas where the incomes are below 90% of the median county income, with a 22% or more high school drop out rate and a majority minority population
- At least 24% of these loans were made at a higher interest rate – at least 3 percentage points above prime mortgages

SOURCE: Federal Reserve Bank of Dallas

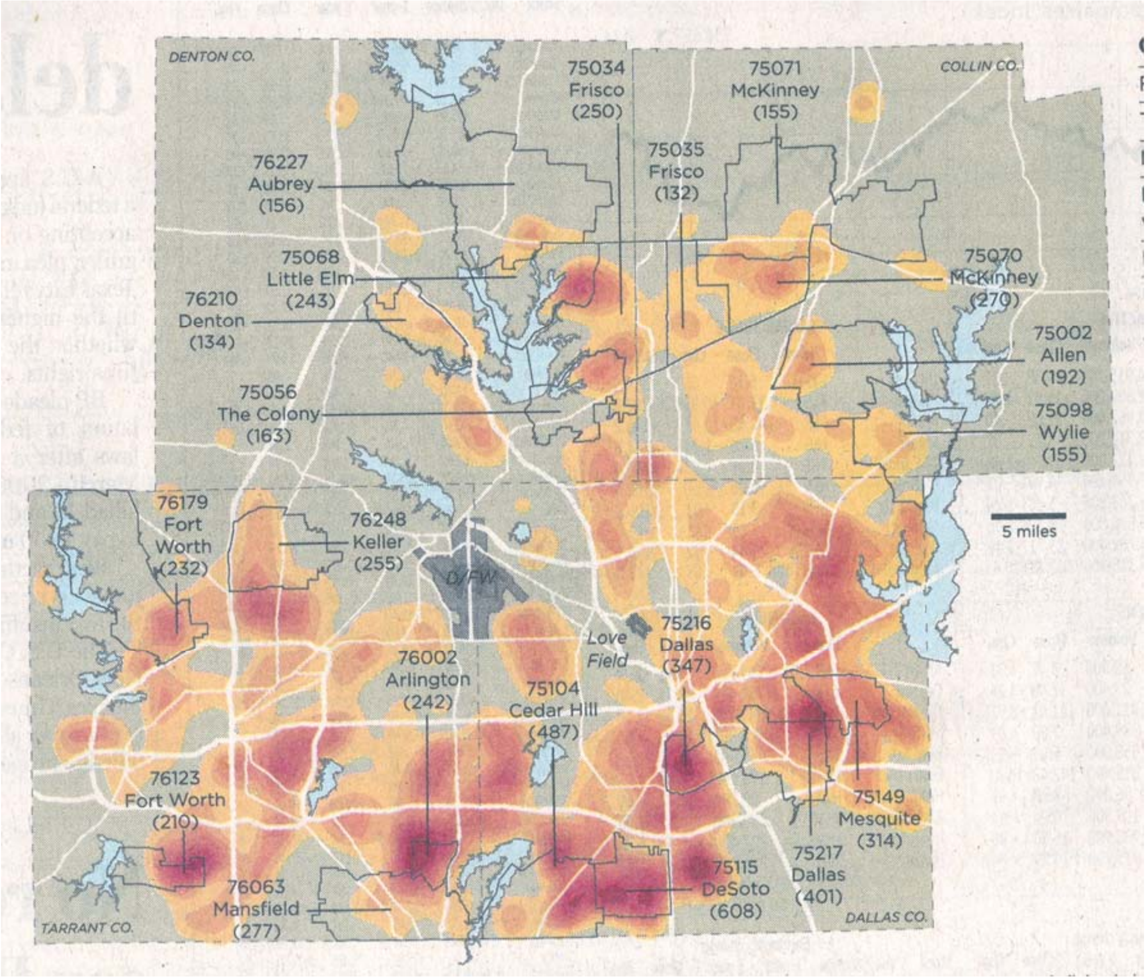
Top County Foreclosure Rankings in Texas – Dallas County is #1 for 01/01/02 – 06/30/06 – 3 ½ year period

Rank	County	Total Foreclosures 1/1/2002 – 6/30/2006	Foreclosures/Mortgages
1	Dallas	15,406	5.6%
2	Bexar	6,040	3.3%
3	Travis	3,327	3.1%
4	Harris	12,689	3.0%
5	Cameron	706	3.0%
6	El Paso	1,547	2.1%

SOURCE: Federal Reserve Bank of Dallas and Elizabeth Mueller/Texas Department of Housing and Community Affairs report, 2006

Dallas County Foreclosures for 2007

- 9,214 foreclosures in 2007 vs. 15,406 foreclosures for prior 3 ½ year period
- Major increase in foreclosures for 2007 compared to prior 3 ½ year period
- Two highest foreclosure zip code tracts are 75217 with 401 foreclosures and 75216 with 347 foreclosures
- Two more years of ARM/Sub Prime loan resets @ an average increase of 3% on the first reset, with final interest caps as high as 12%
- First 6 months of 2007, there were 23,284 foreclosure filings
- Foreclosure/foreclosure filings ratio is approximately 25% which tracks the national average



SOURCES: Foreclosure Listing Service: North Texas Council of Governments
ERSI: Dallas Morning News Research February 29, 2008

Past Causes for Foreclosure

- Past studies have sited causes such as the length of the foreclosure process, economic conditions such as job loss, family breakup and high debt load relative to income
- Texas has the worst average credit score in the U.S., which could result in Texans paying higher interest rates on mortgage loans
  - Republic Mortgage Insurance Company (RMIC) analysis found that Texas has a high proportion of loans to borrowers with lower credit scores and loans with high Loan to Value ratios
  - Higher debt qualifying ratios than in prior years is also a contributing factor - currently lenders allow a monthly debt to gross income up to 35%/45% for energy efficient new construction, or 33%/43% for FHA existing and in the past they used a 28%/36% qualifying ratio – the first number is the allowance for the mortgage debt and the second number is for total debt
    - There are also programs like Home Opportunities that allow 100% financing with only one ratio for all debt which can range from 42% to 45% of monthly debt to gross income

SOURCE: Federal Reserve Bank of Dallas

Study Shows a Need for Financial Education

- A lack of education may put borrowers at a disadvantage in navigating the lending process
- Concentrated foreclosure activity has severe consequences for residents and communities
  - According to HUD, foreclosures filed within two years of the loan origination are strong indicators of fraudulent and abusive lending practices
    - These results indicates a need for more research to determine the cause of foreclosure and possible solutions

SOURCE: Federal Reserve Bank of Dallas

Causes/Solutions

- In Texas there is no guardian looking out for the borrower in the complex home mortgage process
- In New York, where buyers must pay a lawyer to represent them in the home loan transaction, it costs $300, but its worth it
- Research shows that about ½ of the borrowers facing foreclosure fail to seek help
    - The risk of foreclosure has caused them to lose the ability to strategize and make rational decisions

SOURCE: Federal Reserve Bank of Dallas

Status of Dallas Case Study

- The Federal Reserve has not indicated a time frame for a Dallas Case Study

Case Study – San Antonio

- In San Antonio a neighborhood study was preformed where 28% of the homes were foreclosed – four out of the six families interviewed said that the lenders did not escrow enough money to cover the real estate taxes because they escrowed the old amount based on the land value, instead of based on the new improved property
  - This put these four families at a deficit of $2,500 during the first year of the mortgage

SOURCE: **Federal Reserve Bank**
Olivia Yu, Assistant Professor, University of Texas at San Antonio

Case Study – San Antonio

- **Additional observations regarding the case study on a subdivision in San Antonio which experienced a 28% foreclosure rate:**
  - Home values dropped by 13%
  - Of the 306 loan originations, 14.7% were high cost ARMs
  - More than 2/3 of the 86 foreclosures took place within three years of the loan originations
  - Most homes were new construction homes
  - The borrowers were moderate median income ($44,500)
  - The subdivision had an above average minority rate of 79.4%

SOURCE: Federal Reserve Bank
Olivia Yu, Assistant Professor, University of Texas at San Antonio

High Cost Loans

- An analysis of 2005 Home Mortgage Disclosure Act data for San Antonio showed that the highest minority rate (80% or more) had the largest share of high-cost mortgages and the predominately white neighborhoods (80% or more) had the lowest share of high cost mortgages

SOURCE: Federal Reserve Bank of Dallas

Dallas' Mortgage Assistance Program (MAP)

- Weighted by sample size the foreclosure rate is 2.4% which is 4.3% below the 6.7% average annual foreclosure rate and is also 3.2% below the Dallas County 5.6% for all Subprime conventional loans during this period
- Since the inception of the MAP program in 1991, there were 165 defaults out of 3,438 loans during the years 1997 – 2005 and only 57 resulted in foreclosures*
  - This is a because MAP borrowers are less likely to buy homes they cannot afford; and
  - The MAP assistance allows these borrowers, whose incomes are 80% and below the Area Wide Mean Income, to qualify for prime rate loans with lower rates which put them in a lower risk category for foreclosure

SOURCE: Federal Reserve Bank of Dallas

Dallas Housing Finance Corporation's Single Family Mortgage Programs

- The 2006 Single Family Program with 5.99% interest rate also offers 3.5% of the loan in down payment and/or closing cost assistance
  - All DHFC Bond Program loans have a fixed interest rate
  - Approximately 9 loans are seriously delinquent out of a possible 237 of the present DHFC Single Family Bond Programs during 2002 – 2008
    - Even though the number of loans that have been foreclosed upon are not available, mortgage data history indicates 25% of seriously delinquent loans go into foreclosure and this would calculate to be 2% or approximately 30% of the Dallas County average of 5.6%
    - In all, the DHFC has originated 1487 loans since 1985

Factors That Should Mitigate Default Rates In The Future

- **Some positive signs towards the stabilization of defaults are low unemployment rates, slowing of new construction and less use of high-risk ARMS and other products**
  - RMIC is reviewing its loans and identifying those with upcoming interest rate resets and finding ways to solve the problem before it occurs by conducting regulatory reviews with lenders, providing analytical tools and guidance on portfolio risks and encouraging prudent practices through strong credit policies

SOURCE: Federal Reserve Bank of Dallas

Mortgage Industry Response

- Foreclosure is a lose – lose for everyone involved
- Fannie Mae, now the largest buyer and guarantor of mortgages in the U.S., is working with national and community based nonprofits, in addition to lenders, loan servicers and mortgage insurers on strategies to increase homeownership retention rates

SOURCE: Federal Reserve Bank of Dallas

Mortgage Industry Response

- **Wells Fargo's Steps to Success Program offers upfront education for all non-prime borrowers, those with less than perfect credit or low use of credit, according to Stephanie Christie, Senior Vice President of Wells Fargo Home Mortgage**
  - The program has 3 elements; credit cleanup, hands on banking and automatic payment options
  - Fewer delinquencies occur among program participants than among a larger sample of nonprime customers

SOURCE: Federal Reserve Bank of Dallas

Countrywide Assisting Subprime Mortgage Borrowers

- The latest initiative calls for Countrywide to try to manage payment plans for borrowers that are already behind in payments
  - Borrowers with Subprime hybrid ARMs, which typically were issued with low “teaser” interest rates that adjust higher after two or three years, could be offered the option to refinance into a lower prime rate loan or have their initial interest rate frozen for five more years
  - Borrowers with fixed rate Subprime loans could be offered short-term repayment plans, loan modifications or adjustments, including having their interest rate frozen or adding their overdue balances to their principal loan amount

SOURCE: Real Estate Center Online News

ACORN Housing Foreclosure Prevention Fair

- On February 16, 2008, ACORN Housing had a housing fair at the Martin Luther King Center Gym near Fair Park
  - 65 people caught up in the mortgage crisis, gathered to meet with lenders, housing counselors and attorneys to discuss ways to avoid foreclosure
    - The event was one of a national series of Foreclosure Prevention Fairs sponsored by ACORN – The Association of Community Development Organizations for Reform Now
    - Many who attended Saturday's fair had Adjustable Rate Mortgages in the teens or had suffered a dramatic drop in income due to a job loss
    - One attendee said that her interest rate went from 6% to 11% and would go up to 13% by April, 2008 putting her on the edge of foreclosure

SOURCE: Dallas Morning News

Homeownership Preservation Foundation (HPF)

- HPF has worked with over 100,000 consumers since the non-profit was founded in 2004
- HPF has counseled 1,500 Texas Homeowners in 2005 and 3,000 in 2006
  - It anticipates 6,000 – 8,000 calls from Texas in 2007
  - It has a toll free number (800-995-HOPE) available 24 hours per day
  - Early communication with borrowers is the key to preventing foreclosures in the future and avails the borrower the opportunity to opt for a quick sale or sale in lieu of foreclosure
  - The local affiliate is the Dallas Hope Partnership which is affiliated with the North Texas Housing Coalition, its fiscal agent by contract

SOURCE: Federal Reserve Bank of Dallas

Housing Department's Efforts

- In 2004, the Housing Department donated $25,000 to the Dallas Hope Partnership, through the North Texas Housing Coalition (NTHC) to be dedicated to foreclosure prevention efforts through their Homeownership Center
- The Housing Department has donated $7,600 in 2004, $125,000 in 2005, $125,000 in 2006 and $50,000 in 2008 to the NTHC for homeownership and foreclosure prevention
  - 80 clients have completed loss mitigation for foreclosures as part of foreclosure prevention in conjunction with Dallas Hope Partnership with 47 clients saving their homes
    - Approximately 60 clients are currently in the pipeline and have been counseled for foreclosure prevention
  - We are running well below the average in our Housing Programs and will continue to maintain a higher standard with our MAP and DHFC Program to keep them at a lower risk and will continue to fund the NTHC in their efforts to prevent foreclosures

Percentages of Loans that Survive Foreclosure with Foreclosure Prevention Efforts

- It is still too early to determine how many loans will survive the attempts to prevent foreclosure

Upcoming Events/ Statewide Task Force

- The Texas Foreclosure Prevention Task Force press conference will be held on March 17 at 11 a.m. at the United Way of Metropolitan Dallas, 1800 N. Lamar Street, Dallas, TX
- Speakers include Alphonso Jackson, HUD secretary and Michael Gerber, TDHCA executive director. This event is one of a series of statewide events beginning in March
- The Texas Foreclosure Prevention Task Force is the brainchild of the Texas Department of Housing and Community Affairs (TDHCA) and the national nonprofit organization NeighborWorks
  - Together with other industry and community stakeholders they have formed this task force to help reduce home foreclosures and the impact of foreclosure on Texas families and communities

Bankruptcy – Chapter 13

- Chapter 13 Reorganization Plan allows the debtor to save their homes and cars but often requires that they repay their unsecured debt
  - Legislation is pending in Congress that could spur more people to file Chapter 13 to save their homes – for primary residences the bills would allow the bankruptcy judges to lower the interest rates and reduce values to the current appraisals

SOURCE: New York Times

RECOMMENDATIONS

- The Mortgage Industry, during the loan origination process, must be more accountable for facilitating the educational process and provide better direction to new borrowers
- That the borrowers have counseling on who to contact if they cannot pay their mortgage payments, during the origination process, so they are aware of what organizations can assist them through this crisis such as Homeownership Preservation Foundation, North Texas Housing Coalition or the Dallas Urban League
- Support legislation that requires the borrower to be represented by an attorney at closing
- Continue to provide support to the North Texas Housing Coalition
- Maintain current underwriting standards with MAP and DHFC Single Family Bond Programs