

Foreclosures: Something Wicked this Way Comes

By Akosua A. Cook

Homeownership is the cornerstone of the American Dream and the nation's primary source of wealth accumulation. In general, public policy promotes homeownership, but many policies focused on removing the barriers to homeownership have not adequately addressed the ability to sustain homeownership. The nation is now in the midst of an economic downturn that has been termed "the subprime mortgage meltdown," as subprime mortgage foreclosures in the United States increased significantly in late 2006 and 2007. This analysis will assess this national trend to determine its implications for Orange County, Florida.

Last year, a reported 1.2 million homes were foreclosed. This year to date, there have been more than 900,000 foreclosure filings. Many observers blame the subprime market for the current foreclosure crisis. Originally a positive method of bringing needed credit to underserved communities, subprime loans were intended for borrowers with limited incomes and poor or nonexistent credit histories. Borrowers in the subprime market

entered foreclosure at a rate of 2.43 percent in the first quarter of this fiscal year, substantially higher than the prime foreclosure rate of 0.25 percent. The current foreclosure rate for subprime loans is 4 percent. Economy.com expects foreclosures for that group to reach 10 percent by mid-2008.

According to the First American Corporation, nearly 93,000 subprime-loan homeowners in Florida were facing foreclosure as of February. Florida faces greater exposure than the U.S as a whole. As of the end of January, approximately 20 percent of all Florida mortgages were subprime, compared to 15.3 percent nationally. While the impact of the subprime meltdown has not been as severe in the Central Florida housing market, as compared to the state's, this does not mean the region has not been or will not be affected.

While some target the marketing practices of subprime lenders and the lack of effective government oversight, others are

concerned that mortgage brokers may be steering borrowers to unaffordable loans, appraisers may be inflating housing values, and Wall Street investors may be backing subprime mortgage securities without verifying the strength of the portfolios. Borrowers also have been criticized for entering into loan agreements they could not meet. It is apparent that there could be several underlying factors affecting the dynamics of this market.

To better understand the dynamics of foreclosure, an introduction to the procedure is necessary. Foreclosure is a process that allows a lender to recover the amount owed on a defaulted loan by selling or taking ownership of the property securing the loan. The foreclosure process begins when a borrower defaults on loan payments and the lender files a public default notice. The foreclosure process can end with the borrower paying off the default amount during a pre-foreclosure period, which reinstates the loan; the borrower selling the property to a third party during the pre-foreclosure period; a third party buying the property at a public auction at the end of the pre-foreclosure period; or the lender taking ownership of the property, usually with the intent to sell it on the open market.

However, reselling a foreclosed home in a

listless market will be a difficult proposition. It is possible that the turnover in subprime Florida home loans is contributing to the region's housing slowdown. The inventory of homes for sale through the Orlando Regional Realtor Association has nearly doubled since January 2006, while the year-over-year change in median price for homes sold through ORRA members has been reduced to nil as of March, a precipitous drop from the 24 percent increase experienced in January 2006.

There are currently 26,018 homes available for purchase through the local multiple listing service (MLS). Inventory increased by just 95 homes in July 2007; June 2007 saw an increase of 460 homes and May 2007 saw an increase of 1,028. Compared to last year, the July 2007 inventory level is 31.22 percent higher than July 2006. The current inventory level reflects a 19-month supply at the current pace of sales.

In June, Florida garnered the dubious distinction of maintaining the country's second highest number of foreclosure filings for five consecutive months. While the 21,035 foreclosure filings reported in June reflected a 3 percent decrease from the previous month, it was still double the number reported at the same time last year. The state posted the fourth highest foreclosure rate in the nation, one foreclosure filing for every 347 households — twice the national average.

Orange County residents are fortunate, in that the county was not among the most severely

impacted. Five counties accounted for 61 percent of all foreclosure filings in the state of Florida for the month of June. Miami-Dade County led all counties, reporting 5,110 foreclosure filings, followed by Broward, Palm Beach, Hillsborough and Pinellas. Orange County reported 476 foreclosure filings for the same month. The rate of 1 foreclosure for every 759 households placed Orange County on par with the national average and less than half that of the state.

However, in May, Florida's pre-foreclosure rates increased by approximately 7 percent, with the largest jump in foreclosure activity occurring in Lee and Orange counties. Although foreclosure rates in Orange County generally have remained stable, May showed a disturbing increase of approximately 27 percent, highlighting the unpredictability of the market.

The peak default time for loans is three to five years after origination. The homeowners who capitalized on low interest rates and a booming housing market with adjustable rate mortgages that were written within the last three years will soon be reset at higher interest rates. Therefore the real estate downturn here and in the nation is likely to worsen.

As residents of Florida, Orange County homeowners have to address another layer to an already complex issue. Experts predict an active hurricane season, and a major storm could increase energy and repair costs and push homeowners who are already at the brink of foreclosure over the edge. Combine rising energy costs with the sub-prime lending crisis and adjusting ARM loans and this trend is far from abating

The ripple effect of the subprime meltdown has already caused several mortgage companies to fail, others to stop providing subprime loans, and many more to tighten lending standards on all loans. Central Florida has lost 340 jobs this year due to mortgage company closures.

According to Duane LeGate, president of House Buyer Network, Orange County, Florida currently is the most vulnerable market. The House Buyer Network specializes in short-sales by arranging quick sales for home owners in distress and facing the possibility of foreclosure. Based on traffic to his website and past trends in other metropolitan areas, he predicts that by January or February 2008, the headlines in Orange County will read foreclosure spikes, lower prices and longer inventories.

Is there a way to forestall disaster?

The Fed lowering interest rates could have a positive impact on the market, or lenders could increase their loan modification efforts. These are concessions made to mortgage borrowers that would alter the terms of their loans, even lower payments, and ultimately allow homeowners to keep their homes.

It would be a challenge for Orange County to intercede, by way of government policy, in this housing crisis considering the ultimate causes stem from market and national-level trends; but community groups, lenders, and state and local governments across the country have effectively implemented a variety of home preservation programs, including those that involve targeted outreach to delinquent borrowers, financial counseling, and restructuring consumer debt. It is difficult to predict what, if any interventions are coming, but what is clear is that in the future, credit-challenged borrowers will have to seek out subprime loan alternatives. We cannot continue forward as we have done in the past.

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