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The Determinants of State Foreclosure Rates: Investigating the Case of Indiana

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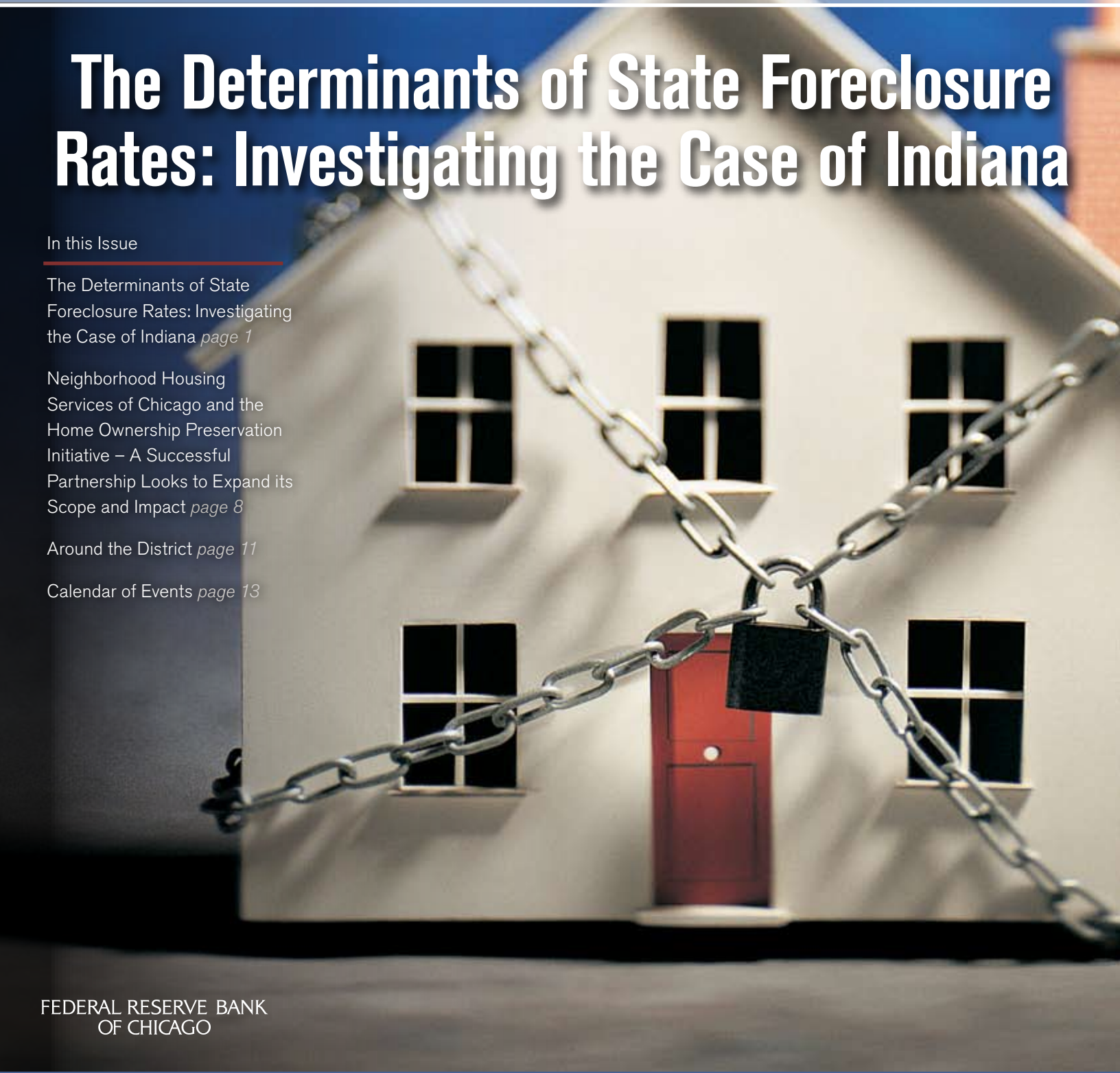

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The Determinants of State Foreclosure Rates: Investigating the Case of Indiana

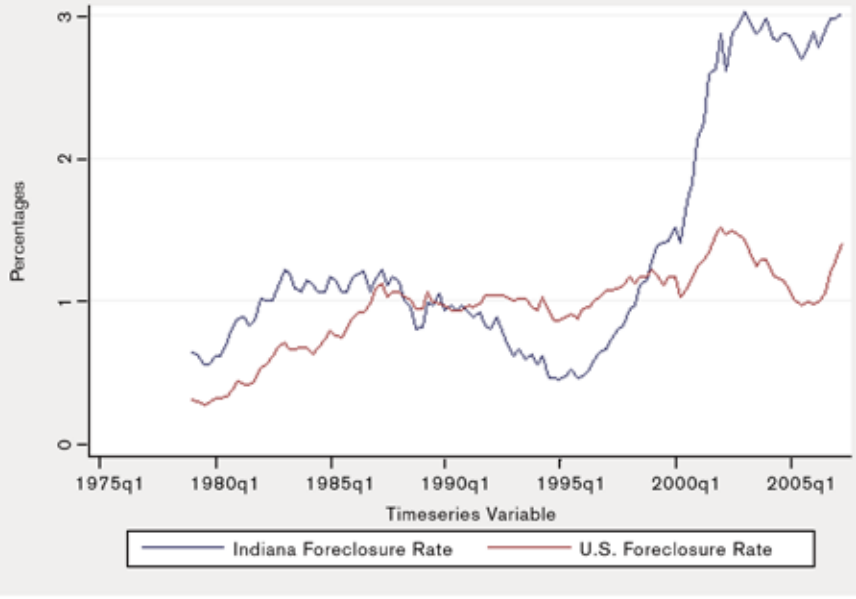
by Leslie McGranahan

Foreclosure rates are defined as mortgages in the foreclosure process as a percentage of all mortgages. These rates vary fairly dramatically across states. While the average foreclosure rate in the 50 states and the District of Columbia in the second quarter of 2007 was 1.25 percent, these rates ranged from a high of 3.60 percent in Ohio to a low of 0.44 percent in Wyoming. One state that has exhibited high foreclosure rates over the past decade is Indiana. Indiana ranked second highest after Ohio in the second quarter of 2007 with a foreclosure rate of 3.01 percent. The goal of this article is to look at the determinants of state foreclosure rates with particular attention to the set of factors referred to in discussions of Indiana's high rates. Three primary factors have been responsible for Indiana's high foreclosure rates: the poor performance of the housing market and economy, the high levels of subprime and FHA borrowing in the state, and the relatively long duration of Indiana foreclosures. However, even after taking these factors into account, Indiana's foreclosure rates are higher than would be anticipated.

Indiana Foreclosures

In every quarter since the first quarter of 1991, the foreclosure rate in Indiana has exceeded that in the nation as a whole. Since the end of 2004, Indiana's foreclosure rate has been more than double the national level. In conjunction with this, mortgages 30, 60, and 90 days past due have also vastly exceeded the national level. Figure 1 depicts the Indiana and national foreclosure rates from 1979 to 2007. The number of properties beginning the foreclosure process, foreclosure starts, has followed a similar pattern, with foreclosure starts exceeding the national level in every quarter since the third quarter of 1998.

Figure 1: Indiana and National Foreclosure Rates



Source: Data from Haver Analytics Database

Introducing Regression

To investigate the high levels of foreclosure in Indiana, the determinants of foreclosure rates are examined across the 50 states and Washington, DC, between 1989 and 2006 using regression analysis. This time frame was chosen because of issues of data availability. The means and standard deviations of the variables included in the regressions as potential factors influencing foreclosure rates, and

Table 1: Variables Related to State Foreclosure Rates and Starts

	Mean	St. Dev	Source	Notes	Indiana Mean
Foreclosure Rates (% of Loans)	1.024	0.587	Mortgage Bankers Association	Annual value set at fourth quarter value.	1.553
Foreclosure Starts (% of Loans)	1.379	0.644	Mortgage Bankers Association	Annual value is sum of four quarterly values.	1.860
5 Year % Change in OFHEO	27.389	22.151	Office of Federal Housing Enterprise Oversight	Annual value is calculated from avereage index in four quarters	21.924
State Unemployment Rate	5.173	1.412	Bureau of Labor Statistics	Annual value is average of 12 monthly values	4.525
Manufacturing Employment as a Percent of Total	10.413	4.504	Bureau of Economic Analysis	Data on manufacturing employment missing in 2002 for WY & DC, estimated by averaging adjacent years.	18.441
5 Year % Change in Median Income	3.650	8.615	U.S. Bureau of the Census	2006 CPI-U-RS adjusted dollars	3.659
Homeownership Rate (% of Households)	67.670	6.678	U.S. Bureau of the Census		71.972
Percent of Population with BA or More	24.052	5.447	U.S. Bureau of the Census	Percent of population 25 years and over	17.867
ARM Percent (% of Conventional Loans with Adjustable Rates)	21.049	12.762	Federal Housing Finance Board	Conventional loans only	22.833
Loan to Price (Average Loan)	77.462	3.735	Federal Housing Finance Board	Conventional loans only	78.317
Percent of Mortgages that are FHA (as a Percent of All Mortgages Serviced)	21.190	12.292	Mortgage Bankers Association	Annual value is based on average quarterly mortgage numbers	25.042
Percent of Mortgages that are Subprime (as a Percent of All Mortgages Serviced)	5.803	4.546	Mortgage Bankers Association	Annual value is based on average quarterly mortgage numbers	7.565
Dummy=1 if Foreclosures are Primarily or Exclusively Judicial	0.490	0.500	Comparison between www.realtytrac.com, and www.bargain.com	Assumed constant over time	1.000
Foreclosure Process days	136.863	83.237	Comparison between www.realtytrac.com, and www.bargain.com	Assumed constant over time	260.000
State and Local Per Capita Property Tax Revenue (1000s of Current $)	0.791	0.416	U.S. Bureau of the Census	Revenue data for 2001 & 2003 estimated by averaging adjacent years	0.762

foreclosure starts are presented in Table 1. The final column of the table shows the mean for the state of Indiana over the time period.

Five sets of variables are analyzed: measures of the state economy; attributes of the state population; measures of features of the portfolio of mortgage loans in the state; classifications of the legal foreclosure environment; and a measure of state property tax revenues. Each of the variable groups is evaluated in detail below.

All of the variables are available for 1989 through 2006 with two exceptions: property tax data is not available after 2004, and data on percentages of subprime loans are only available starting in 1998.

Regression results are presented in Table 2. Each column represents the results for a different regression. The different regressions cover different time periods. The first column includes the entire data set from 1989 to 2006. The second column adds property tax information excluding 2005 and 2006 as local property tax – data has not been released for those years. In the third and fourth columns, the sample is divided into two separate time periods, 1989-1997 and 1998-2006. The final column adds a variable on subprime mortgages that is only available for the later dates. The coefficients indicate how a one-unit change in the underlying variable influences the foreclosure rate. An asterisk on a coefficient demonstrates whether the estimated coefficient is statistically significantly different from zero. All of

...states with higher unemployment, lower median income growth, and lower home price appreciation have experienced higher foreclosure rates.

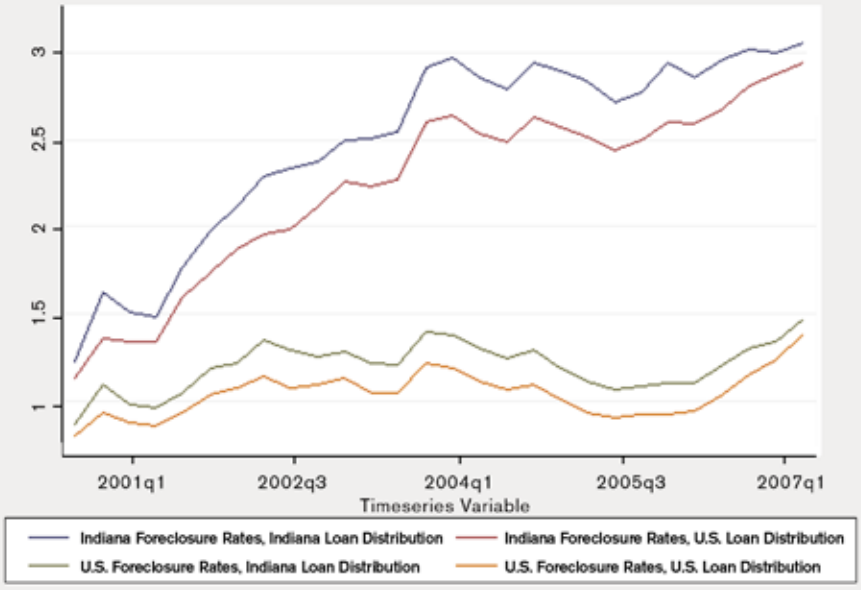
the regressions include year fixed effects, which control for differences over time in the national economy and other factors. In addition, standard errors are clustered by state, which assumes that unmeasured attributes of a state are similar over time.

Economic Variables

To measure the effect of the state economy on foreclosures, four measures of the economic situation are included – house price appreciation (as measured by the Office of Federal Housing Enterprise Oversight) and growth in median income over the previous five years, the state unemployment rate, and the percent of the workforce in manufacturing. These measures capture the ability of homeowners to earn enough money to pay their mortgages. Low home price appreciation may limit the ability of homeowners to take out additional equity from their homes in order to make a mortgage payment during a difficult period.[1] Individuals may have bought more costly houses than they could afford in hopes that their income would grow sufficiently to cover payments, especially once teaser rates had expired. Measures of median income growth capture the likelihood that income growth kept up with these mortgage obligations. A bad labor market, as measured by the unemployment rate, may influence the ability of a homeowner to find a new job following job loss. The ability to find a job with a comparable wage following job loss may be particularly challenging in states with a high concentration in manufacturing. To capture this, a measure of the percent of the workforce in manufacturing is included.

The regressions indicate that states with higher unemployment, lower median income growth, and lower home price appreciation have experienced higher foreclosure rates. Also, a greater job concentration in manufacturing increased foreclosures between 1989 and 2006. Overall, these measures of the economy have had a substantial influence on state foreclosure rates.

Figure 2: Simulations of Foreclosure Rates for Fixed Loan Distributions



Source: Author's calculations based on data from Haver Analytics Database

Table 2: Regressions Predicting State Foreclosure Rates

	1989-2006	1989-2004 Adding Property Tax Info	1989-1997	1998-2006	1998-2006 Adding Sub Prime
5 Year % Change in OFHEO	-0.014*** (0.002)	-0.015*** (0.002)	-0.015*** (0.002)	-0.013*** (0.002)	-0.015*** (0.002)
State Unemployment Rate	0.127*** (0.027)	0.123*** (0.026)	0.093*** (0.024)	0.178*** (0.050)	0.144*** (0.051)
Manufacturing Employment (as a % of Total)	0.006 (0.006)	0.006 (0.007)	-0.008 (0.010)	0.025* (0.015)	0.020 (0.013)
5 Year % Change in Median Income	-0.006*** (0.002)	-0.005** (0.002)	-0.004*** (0.002)	-0.002** (0.004)	-0.002 (0.004)
Homeownership Rate (%)	-0.002 (0.005)	-0.002 (0.005)	-0.001 (0.005)	-0.001 (0.009)	-0.001 (0.008)
Percent of Population with B.A. or More	0.022*** (0.006)	0.027*** (0.006)	0.029*** (0.009)	0.013 (0.009)	0.018** (0.008)
ARM Percent	0.002 (0.002)	0.001 (0.002)	0.000 (0.002)	0.007 (0.002)	0.005 (0.004)
Loan to Price	0.017* (0.009)	0.017* (0.010)	0.011 (0.016)	0.011 (0.010)	0.005 (0.009)
Percent of Mortgages that are FHA	0.004 (0.003)	0.004 (0.003)	0.000 (0.005)	0.018** (0.008)	0.018*** (0.007)
Percent of Mortgages that are Subprime					0.055* (0.029)
Dummy=1 if Foreclosures Primarily or Exclusively Judicial	0.142** (0.067)	0.130* (0.068)	0.060** (0.089)	0.230** (0.098)	0.224*** (0.082)
Days to Process Foreclosures	0.001*** (0.000)	0.001*** (0.000)	0.001** (0.000)	0.002** (0.001)	0.002*** (0.001)
Per Capita State and Local Prop. Tax Revenue ($1000s)		-0.024 (0.059)			
Constant	-0.807 (0.817)	-1.110 (0.879)	-0.817 (1.090)	-1.506 (1.096)	-0.962 (0.923)
Observations	918	816	459	459	459
R-squared	0.59	0.59	0.63	0.58	0.62

Standard errors clustered by state in parentheses, * significant at 10%; ** significant at 5%; *** significant at 1%
Year Fixed Effects Included in All Specifications

Table 3: Loans by Type and Associated Foreclosure Rates: Indiana vs. United States, 2007:Q1

	Number of Loans	Percent of Loans	Foreclosure Rate
Indiana			
PRIME			
-FRM	458,404	61.3%	1.15
-ARM	56,058	7.5%	3.19
SUBPRIME			
-FRM	53,793	7.2%	6.37
-ARM	58,572	7.8%	12.93
FHA			
-FRM	90,828	12.1%	3.63
-ARM	8,111	1.1%	5.23
VA	22,032	2.9%	2.82
TOTAL	747,798	100.0%	3.00
	Number of Loans	Percent of Loans	Foreclosure Rate
U.S.A.			
PRIME			
-FRM	23,694,889	61.6%	0.38
-ARM	6,079,823	15.8%	1.09
SUBPRIME			
-FRM	2,130,443	5.5%	3.29
-ARM	2,901,511	7.5%	6.46
FHA			
-FRM	2,371,167	6.2%	1.85
-ARM	192,924	0.5%	2.73
VA	1,110,281	2.9%	1.05
TOTAL	38,481,038	100.0%	1.23

Source: Data from Haver Analytics database

These measures have had mixed effects in Indiana. As can be seen in Table 1, while Indiana has experienced lower house price appreciation and has higher manufacturing employment than the nation as a whole, Indiana has had lower unemployment than the nation and median income growth in line with national levels. Based on these factors and year fixed effects alone, one would estimate an average foreclosure rate of 1.03 percent in Indiana between 1989 and 2006, compared to 1.02 percent for the nation as a whole.[2]

Population Characteristics

Two population characteristics that have been discussed potentially contribute to foreclosures – the education of the state population and the homeownership rate. Education is measured as the percent of the population with at least a BA. It has been hypothesized that states with a more educated workforce would have lower foreclosures because workers with more education and who earn high incomes have an easier time finding jobs and sustaining their income. Additionally, more educated individuals may be more informed about the functioning of the mortgage market and less likely to select mortgage products poorly suited to their needs. High homeownership rates are thought to contribute to foreclosures because the marginal borrowers in areas with high levels of homeownership are more fragile and may be more prone to economic dislocations. Neither of these variables behaves as predicted. Controlling for the other variables, homeownership rates are uncorrelated with foreclosures, while states with a higher proportion of college educated residents have experienced higher foreclosure rates. Based on this result, Indiana's low proportion of college educated workers has served to reduce foreclosures. However, it seems likely that the percent of workers with a BA is picking up an omitted characteristic of the population that is correlated with both foreclosures and educational attainment. Individual level data would be useful to fully investigate the link between education and foreclosures.

Loan Attributes

The next set of variables captures attributes of mortgage loans. They include measuring the percent of conventional loans with adjustable rates, the loan to price ratio of the average loan, the percent of mortgages insured by the FHA, and (in 1998-2006) percent of mortgages that are subprime. ARMs, FHA, and subprime loans all have higher foreclosure rates than conventional fixed rate prime loans, so higher percents of these loans should increase foreclosures. Similarly, loans with a higher loan to price ratio indicate

Table 4: Regressions Predicting State Foreclosure Starts

	1989-2006	1989-2004 Adding Property Tax Info	1989-1997	1998-2006	1998-2006 Adding Sub Prime
5 Year % Change in OFHEO	-0.017*** (0.002)	-0.017*** (0.002)	-0.017*** (0.002)	-0.016*** (0.002)	-0.019*** (0.002)
State Unemployment Rate	0.125*** (0.030)	0.116*** (0.027)	0.083*** (0.030)	0.185*** (0.049)	0.144*** (0.044)
Manufacturing Employment (as a % of Total)	0.012 (0.008)	0.011 (0.008)	-0.001 (0.010)	0.030* (0.015)	0.024* (0.013)
5 Year % Change in Median Income	-0.006*** (0.002)	-0.006*** (0.002)	-0.006* (0.003)	-0.000 (0.003)	0.001 (0.003)
Homeownership Rate (%)	-0.005 (0.005)	-0.007 (0.005)	-0.007 (0.006)	0.001 (0.009)	-0.001 (0.007)
Percent of Population with B.A. or More	0.020*** (0.007)	0.024*** (0.007)	0.026*** (0.010)	0.010 (0.010)	0.016* (0.008)
ARM Percent	0.004 (0.002)	0.003 (0.002)	0.001 (0.002)	0.012** (0.005)	0.010** (0.005)
Loan to Price	0.021** (0.010)	0.020* (0.011)	0.017 (0.019)	0.011 (0.009)	0.004 (0.009)
Percent of Mortgages that are FHA	0.009** (0.004)	0.007** (0.003)	0.003 (0.005)	0.029*** (0.008)	0.030*** (0.006)
Dummy=1 if Foreclosures Primarily or Exclusively Judicial	0.022 (0.079)	0.010 (0.081)	-0.062 (0.103)	0.117 (0.103)	0.109 (0.081)
Days to Process Foreclosures	0.000 (0.000)	0.000 (0.000)	0.000 (0.000)	0.001 (0.001)	0.001 (0.001)
Per Capita State and Local Prop. Tax Revenue ($1000s)		-0.080 (0.054)			
Percent of Mortgages that are Subprime					0.068** (0.026)
Constant	-0.860 (0.820)	-0.188 (0.967)	-0.423 (1.359)	-0.959 (1.091)	-0.177 (0.895)
Observations	918	816	459	459	459
R-squared	0.60	0.59	0.59	0.63	0.68

Standard errors clustered by state in parentheses, * significant at 10%; ** significant at 5%; *** significant at 1%
Year Fixed Effects Included in All Specifications

that the borrower has less equity in the home and is less able to sell the house to payoff an existing loan and therefore more likely to default. All of these variables have the predicted signs and the loan to price ratio for the entire sample and the FHA percent and percent subprime in 1998-2006 have statistically significant effects on foreclosures. Indiana has had higher levels of all of these variables during the time period under investigation. Table 3 shows the number and percent of loans by type for Indiana relative to the U.S., as well as associated foreclosure rates for first quarter of 2007. These patterns have been relatively consistent over time. A lower percentage of Indiana's loans are in the categories with the lowest foreclosure rates, particularly in prime ARMs.

These loan-based variables combined with year-fixed effects lead to a prediction of a foreclosure rate of 1.05 percent for Indiana from 1989 to 2006 as compared to a national average of 1.02 percent, and a foreclosure rate of 1.40 percent from 1998 to 2006 as compared to a national average of 1.17 percent.

Another way to investigate the contributions of greater numbers of subprime and FHA loans on the aggregate state foreclosure rate is to predict what Indiana's overall foreclosure rate would be if Indiana's foreclosure rates within loan category were fixed, but Indiana mimicked the national distribution of loans by type. Alternatively we could explore what Indiana's foreclosure rate would be if we take Indiana's distribution of loans, but apply national foreclosure rates. These numbers are graphed in Figure 2 (for the years where data is available). This graph shows that the higher foreclosure rates within category are the primary drivers of the high foreclosure rate, because foreclosures remain high when the U.S. loan distribution is used.

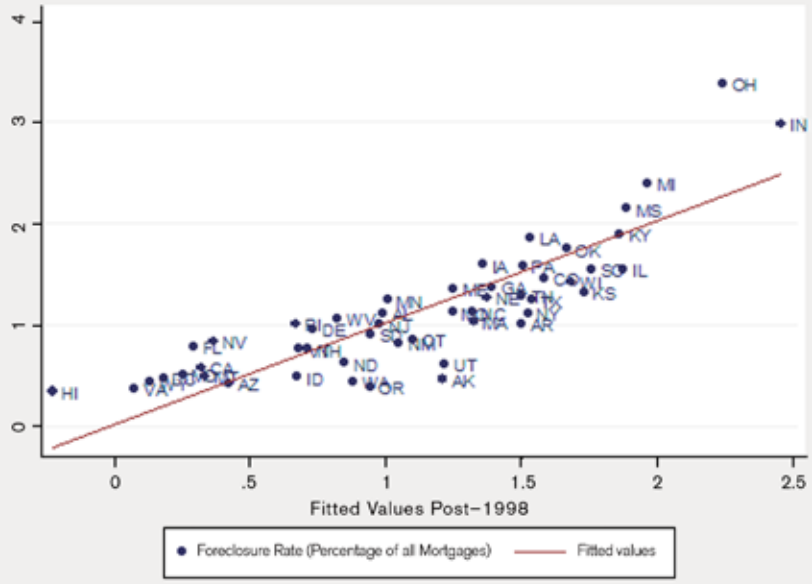
Foreclosure Process

The next two variables measure attributes of the legal foreclosure process. The first variable measures whether foreclosures in the state are primarily judicial or nonjudicial. The second variable measures the average number of days to process a foreclosure. In general, judicial foreclosures are more cumbersome than nonjudicial foreclosures. As a result it may be more costly for lenders to initiate foreclosure in judicial foreclosure states. Judicial foreclosures may take longer than nonjudicial foreclosures. According to realtytrac.com, Indiana's process period is twice as long as the 51 jurisdiction average. The regression results show that both of these variables serve to increase the level of foreclosures. Indiana has a relatively long judicial foreclosure process, so these legal attributes partially explain the high foreclosure rate in Indiana. The foreclosure outcome measure used is

In general, judicial foreclosures are more cumbersome than nonjudicial foreclosures. As a result it may be more costly for lenders to initiate foreclosure in judicial foreclosure states.

the stock of foreclosures at a given time, so the longer foreclosure process means that each foreclosure contributes to the stock for a longer period. One may be concerned both about the number of homes in the foreclosure process at a given point and the number of homes entering foreclosure (the flow). Table 4 reflects the same regression analysis as Table 2, but with foreclosure starts as the dependent variable. These results are broadly similar to the previous results with the exception that the variables measuring the foreclosure process are no longer statistically significant. This pattern would occur if the legal conditions extend the duration of foreclosures rather than increase the number of homes entering into foreclosure.

Figure 3: Predicted Foreclosures Compared with Actual Foreclosures, 2006

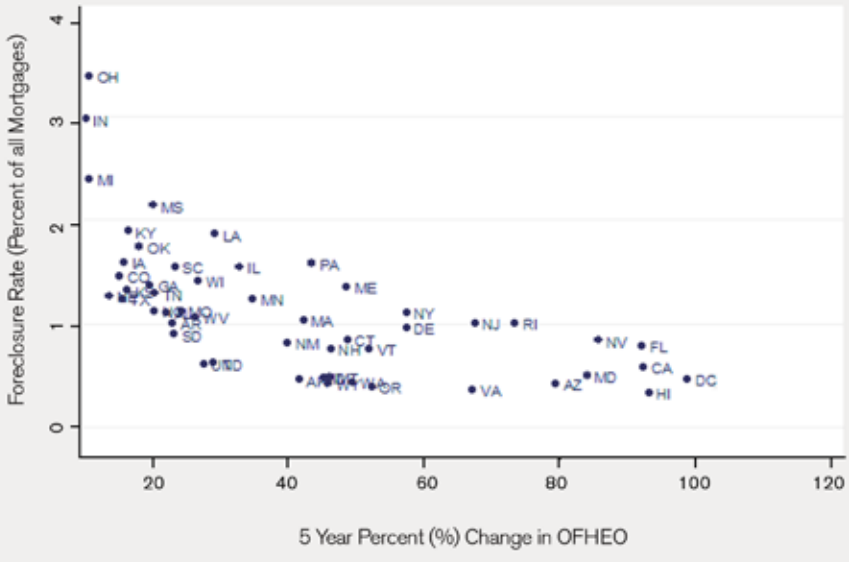


Source: Author's calculations

Property Taxes

The final variable in the regressions measures combined state and local per capita property tax revenue in the state. High property taxes may divert homeowner resources away from mortgage payments leading to higher levels of default. State and local property tax revenue data is only available through 2004, so the regression including property tax information covers a shorter span of time. The regression shows that property tax revenues have no effect on foreclosures. In addition, the point estimate has the opposite sign from that predicted, with higher property taxes correlated with lower levels of foreclosure. If we substitute the percent change in per capita property taxes to capture unanticipated property tax increased, there is still a statistically insignificant effect on foreclosures (with a negative coefficient). Property taxes have been getting a great deal of press in Indiana as a result of a court ordered reassessment of property. While the regression does not point to a large role for property taxes by state, changes within the state may be influencing foreclosures in certain markets. Property tax rates have gone up dramatically in some areas in Indiana.[3] Further analysis at the county or individual loan level may find a relationship between property taxes and foreclosures.

Figure 4: Foreclosure Rates vs. Home Price Appreciation, 2006



Source: Author's calculations and data from Haver Analytics Database

Based on all of the variables included in the regressions, Indiana's estimated average foreclosure rate is 1.19 percent. This is higher than the national average, but substantially lower than Indiana's actual average value of 1.55 percent. Figure 3 is a graph of the forecast levels of foreclosures based on the regression in Column 5 of Table 2 compared to the data on foreclosures for 2006. States

listed above the 45 degree line have experienced foreclosures higher than are predicted by the regression model while states below this line have experienced lower foreclosures. The model does a very good job predicting foreclosure rates for most states except for Indiana and Ohio, which are substantially above the 45 degree line.

Two factors not adequately controlled for in the model may be influencing this outcome. First, mortgage fraud may be higher in these markets. It is very difficult to measure the incidence of mortgage fraud and, therefore, no measure is included in the regressions. The Mortgage Asset Research Institute does develop some state rankings of fraudulent activities based on lender reports. Indiana was ranked second in the Mortgage Fraud Index in 2003 and 2004, but dropped out of the top 10 in 2006. Ohio was also not in the top 10 in 2006. Both Indiana and Ohio were in the top 10 for subprime fraud in 2006 (Sharick et al. 2007). The FBI's measure of "Mortgage Fraud Hot Spots" for 2006 includes Indiana and Ohio, but neither state was on the FBI's list in 2003 or 2004 (FBI 2005; 2006). It is difficult to rule out mortgage fraud as part of the issue in Indiana, but it is likely to be a small contributor. Tatom (2007) calculates that the total number of "suspicious" reports is less than 5 percent of total foreclosures.

The second factor that may be influencing high foreclosure rates in Indiana and Ohio are nonlinearities in the effects of house prices on foreclosure rates. The effect of particularly low home price appreciation may be especially large. The linear regression framework assumes that the difference between 5 and 10 percent home price appreciation on foreclosures is the same as the difference between 25 and 30 percent home price appreciation. This assumption may be incorrect. Figure 4 graphs foreclosure rates versus five-year home price appreciation for 2006. The three states with the lowest house price appreciation – Indiana, Ohio, and Michigan, had the highest foreclosure rates.

Conclusion

In this article, variation in foreclosure rates were investigated across states over the past 18 years, to attempt to explain reasons for the high rate of foreclosures in the state of Indiana. Economic conditions, foreclosure processes, and loan characteristics all explain some of the differences in foreclosure rates. In addition, some variables hypothesized to contribute to foreclosure rates do not appear to do so, including high homeownership rates, low levels of educational attainment, and property taxes. Based on the factors that impact foreclosures nationally, Indiana is predicted to have higher foreclosure rates than the national average, but not levels as high as those experienced.

NOTES

1 Causality may also be reversed with higher foreclosure rates affecting house price appreciation.

2 Another potential culprit is the role of the auto sector in the state economy. Auto employment is not included in the regressions, because data is only available for half of the states. In addition, as is discussed in Tatom (2007), the problems with foreclosures in Indiana predate the declines in the auto sector.

3 Desiree Hatcher and Harry Ford provided useful insight into property tax patterns across the state of Indiana.

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Neighborhood Housing Services of Chicago and the Home Ownership Preservation Initiative – A Successful Partnership Looks to Expand its Scope and Impact

This article was prepared by:
Michael van Zalingen, Director of Home Ownership Services, NHS of Chicago
Nosheen Hemani, Home Ownership Preservation Initiative Program Coordinator, NHS of Chicago
Michael Berry, Manager, Consumer and Community Affairs Department, Federal Reserve Bank of Chicago

The Federal Reserve Bank of Chicago's Consumer and Community Affairs department has, since the mid-1990s, worked with various Seventh District organizations and agencies to address foreclosures and their harmful impact in communities. Most notably, the Reserve Bank has supported and partnered with Neighborhood Housing Services (NHS) of Chicago to mitigate the destabilizing effect that foreclosures have on vulnerable communities – those with older housing stock, lower income, largely minority (and/or recent immigrant) populations, and little commercial or retail investment. The Homeownership Preservation Initiative (HOPI) was conceived and established by NHS, and is the organization's principal vehicle to address foreclosures in vulnerable Chicago communities. The partnership's results have generated national attention, and strong interest in adapting its methods to other parts of the country, which is ongoing. HOPI's success is due in large part to committed partners that include the City of Chicago, which has made critical investments in call centers for homeowners, among other steps, and financial institutions such as JP Morgan Chase, Citigroup, HSBC, and GMAC/RESCAP, which have committed staff and resources, and worked with NHS creatively to open lines of communication and assistance between investors and servicers on one side, and counselors and homeowners in default on the other.

HOPI is a multi-faceted program providing preventative measures such as homebuyer counseling, remedial services including loan workouts and supplementary financing, as well as property disposition when foreclosure or other type of property transfer (e.g., deed-in-lieu of foreclosure) is the only plausible outcome. From 2003 to 2006, the pilot phase of the program, more than 4,300 individuals received counseling. Over 1,300 foreclosures were averted, primarily through a combination of revised repayment plans, emergency loans, or loan reinstatement after other borrower assets were applied. Well over 300 buildings, one- to four-unit residential properties were reclaimed and resold.

The impact of vacant properties on communities can be significant. A Fannie Mae Foundation study indicated that the financial impact of one foreclosure on a city block is an approximately 1 percent immediate decline in home values in the vicinity (approximately one-eighth mile) . The effect is more pronounced in underinvested communities, and is intensified with successive nearby vacancies. A critical aspect of HOPI is that it includes a mechanism for

"NHS of Chicago is recognized for its Home Ownership Preservation Initiative, a unique public-private partnership with the City of Chicago, the Federal Reserve Bank of Chicago, and financial institutions, HOPI serves as a national laboratory for innovative programs, partnerships, and lending products that are replicated across America to assist homeowners at risk of foreclosure."

acquiring, rehabilitating, and reselling foreclosed homes, thereby reducing vacancies and bringing these buildings back to owner-occupied status.

Over a 31-year existence, NHS of Chicago has proven itself a capable steward of public funds, and also a mortgage lender to, by industry standards, some of the highest risk borrowers, with a very low lending loss rate of approximately 3 percent. In September 2007, the Community Development Financial Institutions (CDFI) Fund, a division of the United States Treasury Department, awarded NHS $950,000 to fund a "soft second mortgage" pool for loans the organization makes under the auspices of HOPI. Treasury Secretary Henry Paulson announced the award in person at a press conference at NHS headquarters. A Chicago Sun Times article noted: "NHS of Chicago is recognized for its Homeownership Preservation Initiative, a unique public-private partnership with the City of Chicago, the Federal Reserve Bank of Chicago, and financial institutions, HOPI serves as a national laboratory for innovative programs, partnerships, and lending products that are replicated across America to assist homeowners at risk of foreclosure."

October HOPI Partnership Meeting Summary

Most recently, the Chicago Fed hosted a meeting of the HOPI partnership on October 30, 2007. NHS updated the partnership on HOPI's results, and initiated dialogue on innovative new ways to prevent foreclosures with help from loan servicers and the investment community, which is in the midst of a crisis stemming from the large quantity of high-risk loans securitized since widespread marketing of nontraditional mortgages began in 2003. At the meeting, the HOPI partners discussed ways of addressing the challenges posed by the rapidly increasing rate of mortgage delinquency and foreclosure across Chicago.

The goal of the meeting was to provide a forum where participants could build on past progress while collaborating to develop new solutions – despite the significant impact of HOPI on Chicago foreclosures, the rate of foreclosure has rapidly increased and threatens many communities citywide. Data reflecting the overwhelming increase in foreclosures locally and nationally underscored the gravity of the problem and the need for greater outreach, the importance of counseling, and of reaching creative, innovative solutions.

The first presentation reviewed the state of the servicing environment, including the rise in delinquencies and the many contributing factors from the regulatory and investment perspectives. There was consensus on the progress being made in the servicing environment although there was not consensus on what is required to slow the rapid pace of foreclosures.

Regulators at the meeting suggested the most effective way to reduce foreclosures – in part echoing a recent call from FDIC Chairman Sheila Bair to lenders to maintain introductory rates on ARMs to head off future defaults that will result from ARM resets – is to allow blanket loan modifications. Investors noted the challenge of obtaining good borrower data showing the economic effects of loan modifications on borrowers, which in turn would allow better assessment of the impact of the foreclosures on the value of investments.

The first panel further discussed improvements in loss mitigation; servicer representatives described the approaches taken within their respective institutions. The improvements included multifaceted outreach efforts with better coordination of roles and terms between servicers and counselors, infrastructure enhancements to facilitate improved information sharing and dissemination, and the importance of partnering with nonprofit housing counseling agencies. All on the panel agreed that counseling agencies play a crucial role in providing linkage and obtaining accurate borrower financials.

The second panel discussed the obstacles to improvement in loss mitigation from the perspectives of the servicer, the investor, and the counselor. The servicer view emphasized the difficulty in contacting borrowers, the need to streamline the loan modification process, and investor limitations. The investor view stressed the need for better foreclosure mitigation data to evaluate its impact (on security value), and other factors to consider, given the complicated nature of the structure of securities. The counselor view highlighted dramatic increases in demand for services and the lack of sufficient funding/resources. The panels also touched on the need for improved communication and coordination between servicers and counselors, and the importance of developing alternatives to foreclosure that ideally do not displace homeowners in default.

The third panel focused on designing new products for distressed borrowers. The panelists agreed on the need for developing a standardized method of evaluating borrower capacity to repay, looking beyond credit scores. A discussion on new product design focused on principal reduction and ideas of shared equity, localized or region-specific securities, and creating new financing vehicles.

Nelson Merced of NeighborWorks America presented the results of the (follow-up) national survey of nonprofit housing counselors. The survey results indicated overall progress in servicing although indicators of inconsistency supported the general themes of the

meeting, and the continued need to streamline communication, collaboration, and terminology between servicers and counselors.

Three work groups were also convened at the meeting. One focused on improving the servicer/counselor relationship, and agreed on the need for a standardized form for obtaining borrower authorization and financials to improve coordination and accelerate default resolution. The second group focused on the need to create new products to help those that cannot benefit from current loss mitigation initiatives. The group agreed that some form of principal reduction will be required to help these borrowers at any level of significant scale going forth. The final group discussed strategies to deal with growing REO (real estate owned – foreclosed buildings primarily) inventories. Although several ideas were explored and there was not clear consensus, there was agreement on the need for innovations as there is no longer any interest among speculative investors for REO properties, and nonprofits undertake a fairly labor-intensive and costly process to place first-time buyers in reclaimed homes.

New Steps and Renewed Emphases to Increase Impact

NHS and the HOPI partnership look to improve and expand the reach of the program, a goal with renewed urgency in the current environment. These broad areas include steps to reach borrowers with high probability of default at the earliest possible stage. Among borrowers with adjustable rate loans and questionable (based on initial underwriting) post-reset capacity to repay, communication from servicers or counselors should begin before the reset to head off default. Within areas that have high concentrations of ARMs and historically vulnerable populations, third-party counselors should be engaged to conduct early outreach. A second recurring meeting theme and forward-looking goal is to develop further flexibility in loan workouts, including adjustable- to fixed-rate conversions, partial principal deferments or write-downs, extended amortization periods, and more open communication between workout specialists and financial institution (lender) decision makers. A third general goal of HOPI is to encourage servicers to coalesce the roles, terminology, and objectives of collections and loss mitigation personnel, and make greater use of third-party counselors, whose role is focused on producing the most efficient outcome for borrowers in default.

Conclusion

HOPI continues to positively impact Chicago communities in stemming foreclosures and serve as a national model for regions facing high foreclosure rates. In the coming months, *Profitwise News and Views* will cover further progress of the partnership, as well as efforts to introduce methods developed over the course of the program to other areas of the Seventh District, and around the country.

NOTES

1 Immergluck, D., Smith, G., "The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values," Housing Policy Debate, Volume 17 Issue 1, 2006, Fannie Mae Foundation, at: www.fanniemaefoundation.org/programs/hpd/pdf/hpd_1701_immergluck.pdf.

2 Chicago Sun Times, September 21, 2007; "Feds bask in Chicago's halo effect; Politico visits a dubious distinction."

3 More information on HOPI and other NHS programs is available at: www.nhschicago.org.

4 For a discussion of mortgage securitization, see: Chicago Fed Letter, November 2007, "The Role of Securitization in Mortgage Lending."

5 Chiu, S., "Nontraditional Mortgages: Appealing but Misunderstood," Profitwise News and Views, December 2006, at: www.chicagofed.org/community_development/files/12_2006_pnv_nontraditional_mortgages.pdf.

Around the District

ILLINOIS

Illinois Adopts Anti-predatory Lending Law and Announces Borrower Outreach Initiative to Help Fight Foreclosures

With the nation's foreclosure rates continuing to rise, the State of Illinois took action to provide Illinois homeowners facing foreclosure with opportunities to meet directly with lenders, community housing counselors and local, state, and federal housing officials during a series of Homeowner Outreach Days scheduled for November through January. The state encourages all homeowners who are struggling to meet their monthly payments to take advantage of the Homeowner Outreach Days, and to educate themselves about the issue.

In addition, legislation was signed by the governor that will help reduce the risks of Illinois families seeking new mortgages. The Cook County provisions of Senate Bill 1167 will take effect on July 1, 2008. The statewide provisions of the law will take effect on June 1, 2008.

For additional information, see press release at www.ihda.org/admin/Upload/Files//5f95c2fa-5427-423d-9361-1cc77ba7e831.pdf.

INDIANA

New Foreclosure Helpline

According to a press release issued by the Indiana Lieutenant Governor's Office, beginning November 7, Hoosiers who are in danger of losing their homes to foreclosure can call a toll-free number, 877-GET-HOPE. Services provided by the hotline include budgeting help, a written financial plan or assistance in contacting lenders. If more extensive assistance is needed, the counselor will refer the homeowner to a certified foreclosure intervention specialist.

For more information, visit the Indiana Foreclosure Prevention Network (IFPN) at www.877GetHope.org.

IOWA

Iowa Increases Tourism Funding

Unknown to most Americans, Iowa has a thriving tourism business, amounting to a $5.4 billion industry and employing more than 62,300 people statewide. Tourism generated over $280 million in state taxes, and over 200,000 travel parties visited an Iowa Welcome Center in 2006.

As a result of these facts and in an effort to boost this thriving industry, the Governor of Iowa, Chet Culver, announced recently that new state dollars are being expended to help the Iowa Welcome Centers extend their hours open to the traveling public. "Our welcome centers are an incredible resource for people traveling throughout Iowa," said Governor Culver. "Certified travel counselors at each center can assist with directions, suggest additional destinations and answer travel-related questions. They are front-line ambassadors for our state, and now with extended hours, more people will be able to use their services."

For more information, contact www.traveliowa.com, or call (800) 345-IOWA.

Source: www.iowalifechanging.com

MICHIGAN

Governor Granholm Announces Plan to Combat Mortgage Foreclosure Epidemic in Michigan

According to Michigan State Housing Development Authority (MSHDA), Governor Jennifer M. Granholm announced plans to assist Michigan homeowners facing mortgage foreclosure by offering new refinancing options. The programs will be administered by MSHDA.

The two MSHDA initiatives are:

- The Adjustable Rate Mortgage

(ARM) Refinance Program that will assist homeowners who have an ARM in refinancing to a lower-interest, fixed-rate loan; and

- The Rescue Refinance Program, which will assist individuals who have a delinquency on their mortgage and who are at risk of losing their home.

For more information, visit Michigan State Housing Development Authority at www.michigan.gov/mshda.

WISCONSIN

Northwest Side CDC Wins Economic Development Grant

The U.S. Department of Health and Human Services' Office of Community Services recently announced a grant of $677,000 for the Northwest Side Community Development Corporation's (CDC) business development and job training initiatives.

Known as its "80/20" plan, the real estate, business development, and job training programs are designed to build on the CDC's 25 years working on Milwaukee's Northwest side, which has suffered from manufacturing job losses. "We are thrilled to have the chance to work toward rebuilding the [30th Street Industrial] corridor, investing in new small businesses, and linking job needy residents to these options," said Howard Snyder, the group's founder and executive director.

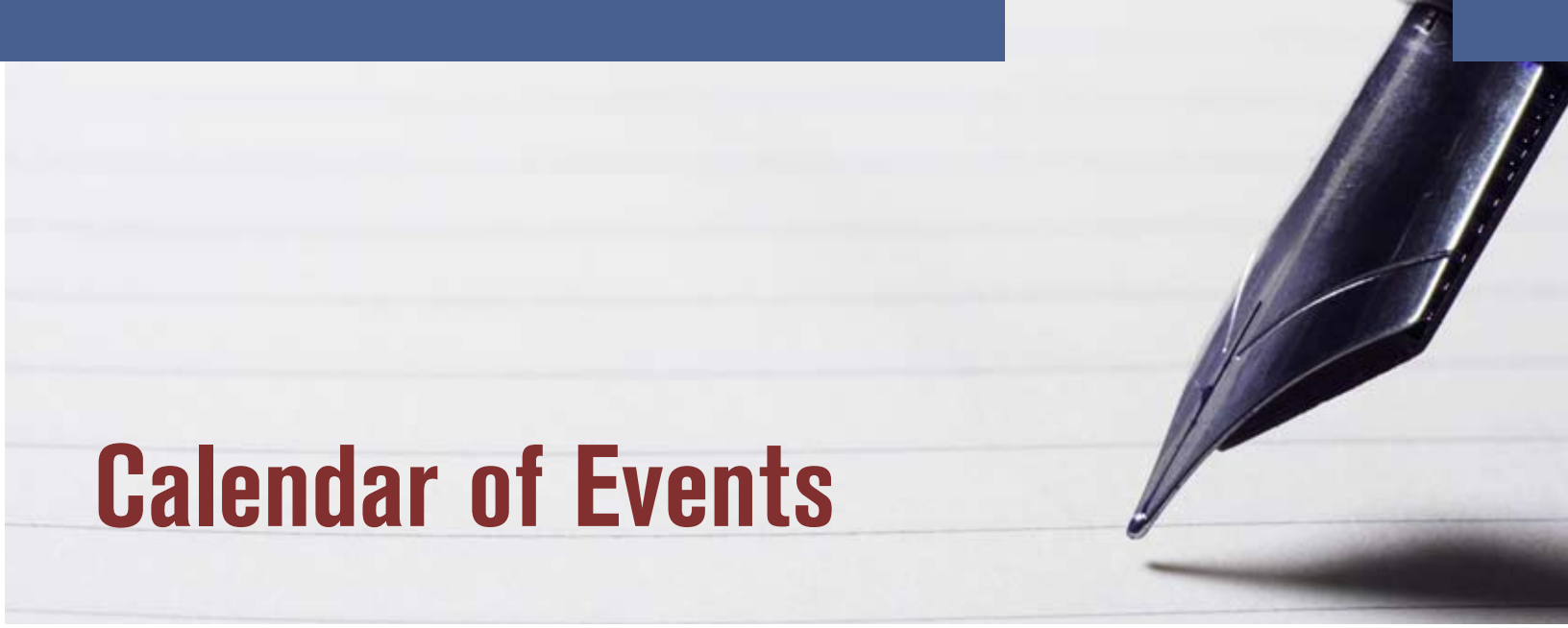
For more information on the funding announcement and the "80/20" plan, visit the Northwest Side CDC's Web site at www.nwscdc.org.

Call for Papers – Innovative Financial Services for the Underserved: Opportunities and Outcomes

Washington, DC
April 16-17, 2009

The Community Affairs officers of the Federal Reserve System are jointly sponsoring their sixth biennial research conference to encourage objective research into financial services issues affecting low- and moderate-income individuals, families, and communities. The theme of the 2009 conference centers on innovation in financial services.

For more information, e-mail Alan D. Barkema at KC.CAResearchConf@kc.frb.org, or call Kelly D. Edmiston at (816) 881-2004.



Calendar of Events

2008

Wisconsin Moves Forward to Address Foreclosures

Waukesha, WI
March 13, 2008

The Federal Reserve Bank of Chicago, the University of Wisconsin Extension, and Wisconsin Housing and Economic Development Authority will cosponsor an event during which participants will continue to address the problems wrought by foreclosures in Wisconsin. It will serve as the joint plenary meeting for three separate task forces that are working on building an effective community response: 1) Options and Outreach Task Force, 2) Stabilization and Maintenance Task Force, and 3) Financial Options and Strategies Task Force.

This event brings the task forces together to identify best practices, partnership opportunities, and information sharing arrangements to address Wisconsin's increasing rate of foreclosure. Participation with the task forces is completely voluntary and dependent on the commitment of those involved. Conference participants will comprise: community development professionals, financial industry practitioners, bankers, attorneys, economists, housing experts, secondary market specialists, policy makers, researchers, academics, and representatives of government agencies and foundations.

Registration and more information on this event will be posted soon at www.chicagofed.org/community_development.

Reinventing Older Communities: How Does Place Matter?

Philadelphia, PA
March 26-28, 2008

The Federal Reserve Bank of Philadelphia will host the third biennial Reinventing Older Communities conference. Experienced leading developers, mayors, researchers, and other practitioners around the country will share their successes, innovations, and challenges in reinventing their communities.

For conference updates, see www.philadelphiafed.org/cca/conferences.html, or contact Jeri Cohen-Bauman at (215) 574-6458 or via e-mail at Jeri.Cohen-Bauman/PHIL/FRS.

2008 National Interagency Community Reinvestment Conference

San Francisco, CA
March 30–April 2, 2008

This three-day event, jointly sponsored by the Federal Deposit Insurance Corporation, Federal Reserve Bank of San Francisco, Office of the Comptroller of the Currency, and Office of Thrift Supervision, will feature CRA examination training, creative strategies for community development, innovations in community development investing, and the National Community Development Lending School.

Registration materials will be available in January. Please visit the Federal Reserve Bank of San Francisco's Web site at www.frbsf.org/community/conference08.html for more information and accommodations.

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Consumer and Community Affairs Division

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230 S. LaSalle Street
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