2016

U.S. Residential Mortgage Default Performance Update & Market Analysis

THEFIVESTARINSTITUTE

U.S. RESIDENTIAL MORTGAGE DEFAULT PERFORMANCE UPDATE & MARKET ANALYSIS

U.S. Residential Mortgage Default Performance Update & Market Analysis

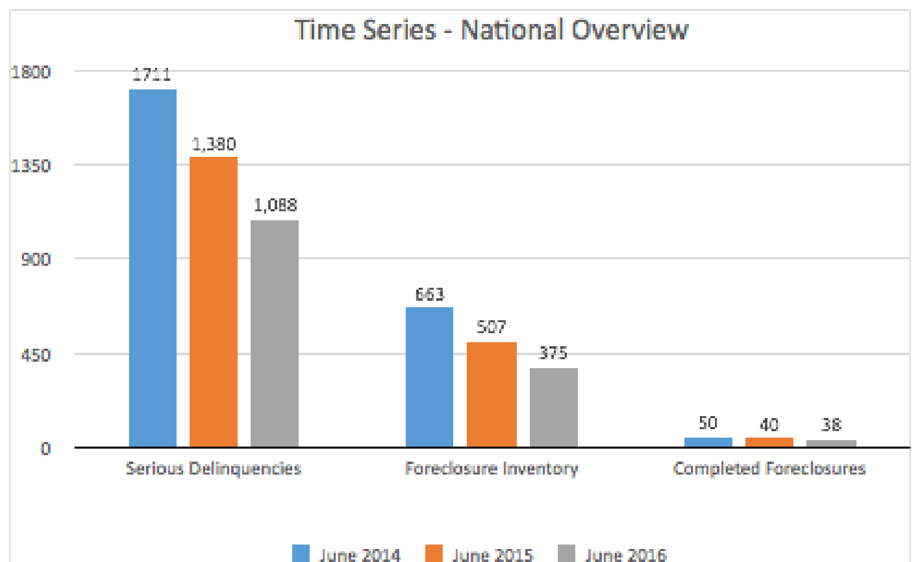
The residential mortgage servicing industry is worlds away from where it was six years ago at the peak of the housing crisis, and many housing metrics have returned to their pre-crisis levels of "normal" activity—which has led many to question what will become of default servicing.

Reductions in mortgage defaults and delinquencies have become the "new norm" in the housing industry in the last six years since the peak of foreclosure activity. But while default-related housing metrics have steadily improved over the last six to eight years, another measure of the health of the housing market has been steadily losing ground during that same period—the nation's homeownership rate.

Where is the default servicing industry headed—and will the homeownership rate improve in the near future?

DELINQUENCIES AND DEFAULTS—NOW VS. THEN

To illustrate just where default numbers are these days compared to before the crisis, CoreLogic found in its June 2016 National Foreclosure Report that 2.8 percent of residential mortgage loans were in serious delinquency (90 days or more overdue), which computes to about 1.09 million properties (see Graph 1)—the lowest number since September 2007, about a year before the crisis began.



Graph 1
Numbers in Thousands
Source: CoreLogic National Foreclosure Reports for June 2016, June 2015, and June 2014

Likewise, according to CoreLogic, only 1.0 percent of residential homes were in some state of foreclosure in June, which amounts to approximately 375,000 properties (see Graph 1)—again, the same as in September 2007. June 2016's decline represented nearly a 26 percent drop over-the-year and was the 56th consecutive month that the foreclosure rate experienced a year-over-year decline (see Graph 2).

Graph 2
Source: CoreLogic's June 2016 National Foreclosure Report

Those numbers prompted CoreLogic President and CEO Anand Nallathambi to declare, "The impact of the inexorable reduction over the past several years in both foreclosure trends and serious delinquencies is driving the long-awaited return to more historic norms for the U.S. housing market."

The improvements in the housing market over the last six years have been driven by a number of factors, namely economic improvements. The Bureau of Labor Statistics has indicated that about 9.3 million jobs were added from January 2009—when President Obama took office—until December 2015. The unemployment rate has fallen below 5 percent, and lenders have tightened their underwriting standards, which has improved credit quality. A low mortgage rate environment—the average 30-year fixed-rate mortgage has been below 4 percent for 32 straight weeks and is currently hovering slightly above the all-time low—has resulted in a spike in refinances.

"The decline in delinquency and defaults is due to a combination of falling and now low unemployment, tight underwriting standards since the crash, steadily and strongly rising house prices, and low interest rates," said Mark Zandi, Chief Economist with Moody's Analytics. "Delinquencies are about as low as they have ever been, and new defaults aren't too far away from record lows. These are the best of times for mortgage credit. Mortgage quality will eventually begin to weaken, but we are good year or two away from that."

One default metric remains elevated compared to pre-crisis levels, though—the number of completed foreclosures, which is a true measure of how many

homes are lost to foreclosure. Numbers indicated that the foreclosure backlog built up during the crisis is still being cleared out; in some cases, particularly in judicial states, foreclosures take years to complete. In June 2016, CoreLogic reported that there were 38,000 foreclosures completed during the month (see Graph 1), which is still nearly double the pre-crisis monthly average of about 21,000 (from 2000 to 2006).

"Though the current rates are very low, the number of properties that either have problems or the borrowers still have challenges is still significantly higher," said Tom Booker, Managing Director of The Collingwood Group. "So if you look at the combined rate from 2006 to today, it's falling off. But if you look at what the actual rate is, looking at loans from 2010 forward and from 2006 forward, it's still higher than the average default rate has been in the mortgage business for the last 50 years. So we're not quite back to normal yet. There's still a lot of properties that need to work their way through the system."

WHAT LIES AHEAD

A certain amount of delinquency and default will always exist in the housing market. "For all the loans that are out there, there will always be excessive debt, illness, divorce, unemployment, or some other disruptive factor within a household that pushes a consumer into foreclosure," said Ed Delgado, President and CEO of the Five Star Institute.

CoreLogic concurred that distress will always exist in the housing market, even though there has been a steady decline since peaking six to seven years ago. According to its April 2016 distressed data report, REO properties and short sales accounted for close to 9 percent of all single-family residential home sales in April, which is less than one-third of its peak of 32 percent reached in 2009. CoreLogic estimates that at the current rate of decline, the distressed sales share should reach its pre-crisis "normal" level of 2 percent in the middle of 2017.

The analysts at CoreLogic are not the only ones who believe that.

"My belief and most of the economists I've talked to agree with this is that by next year in 2017 at some point in the year we will be back to pre-crisis normal levels of foreclosure activity," Ten-X Chief Marketing Officer Rick Sharga said. "And there is a very good chance that we will actually see an inversion in 2018 where for the first time in decades we will see a lower number of properties in foreclosure that we normally see historically simply because the lending standards over the past few years have been tough."

Some predict that it might take a little bit longer. “The ability to move those properties through the system is really a function of investors and bankers being able to get them up for auction and for them to be bought and worked through the process,” Booker said, noting that in America, there is a way to turn non-performing credits into current, performing credits—but it takes time. In some cases, a very long time. “My sense is, at the current course and speed, that could be five or seven years,” he said. “That’s the concern. There are communities that are suffering.”

While some foreclosure metrics are at or below pre-crisis levels, Trulia Chief Economist Ralph McLaughlin said there is still room for improvement, “but given where we’re at in this economic cycle, I think a stable year-over-year trend in the foreclosure rate or even possibly an upward movement, depending on what happens with the economy, is likely in the years ahead.”

THE FALLING HOMEOWNERSHIP RATE

One remnant from the crisis that remains a concern is the country’s falling homeownership rate, which peaked at 69.2 percent in the second quarter of 2004 (see Graph 3 below). Since then, approximately eight million homes have been lost to foreclosure, according to CoreLogic. The most recently reported homeownership rate for Q2 2016 was 62.9 percent, the lowest since the Census Bureau began tracking the data in 1965.

Graph 3
Source: U.S. Census Bureau Homeownership Rate for Q2 2016

Will the homeownership rate get better? In the last few years, government agencies have taken various actions, including lowering the FHA’s Mutual Mortgage Insurance Premiums and instituting a 3 percent down payment program for loans guaranteed by Fannie Mae and Freddie Mac. But the homeownership rate has continued to drop.

Laurie Goodman, Co-Director of the Urban Institute's Housing Finance Policy Center, said she believes the homeownership rate will continue to decline for the next 15 years. "The reason is simple," she said. "In the millions of new households forming over the next 15 years, new renters will outnumber new homeowners—causing a sustained surge of rental housing demand that will significantly affect millennials, seniors, and minorities, and expose important gaps in our current housing policies." Goodman also cited flat wage growth, "extremely tight credit" and student loan debt not just for those who graduate, but those who don't graduate, as a drag on the U.S. homeownership rate.

McLaughlin said he doesn't see the homeownership rate getting any better in the next three to five years for two primary reasons. "One is just simple demographics," he said. "The share of the population that is between the ages of 18 and 34 is the largest cohort in the U.S. That's a lot of young people, and young people tend to rent. Those young people are going to be forming new households over the coming years, and the households that are going to form are going to continue to be renter households. Eventually, those households are going to get older, they're going to marry, they're going to have kids, and they're going to want to buy. But that's probably a few years off. So at least from a demographics perspective, we aren't likely to see pressures or upward movements of the homeownership rate for two, three, four, or five years."

The second reason McLaughlin said the homeownership rate will not immediately improve is the large number of Gen Xers who lost their homes to foreclosure during the crisis.

"More Gen Xers lost their homes than any other cohort," he said. "They have yet to return to the housing market en masse. If the homeownership rate were likely to be buoyed up at any point in the near future, it would be from their return into homeownership rather than millennials jumping into homeownership. We haven't seen that yet, but we're at the point where a foreclosure would start to come off a person's credit report and that might allow them to get a mortgage or at least get a good rate on a mortgage. I don't see any short-term movements in the homeownership rate. Any sort of upward movements might not come for two, three, or four years."

Interviews for this analysis:

Tom Booker, Managing Director, The Collingwood Group

Ralph McLaughlin, Chief Economist, Trulia

Laurie Goodman, Co-Director, Housing Finance Policy Center, Urban Institute

Rick Sharga, Chief Marketing Officer, Ten-X

Ed Delgado, President and CEO, The Five Star Institute

Mark Zandi, Chief Economist, Moody's Analytics

Reports used in this analysis:

» CoreLogic's National Foreclosure Reports for June 2014, June 2015, and June 2016

» CoreLogic Distressed Home Sales Data for April 2016

» U.S. Census Bureau Residential Vacancy and Homeownership Report for Q2 2016

» Freddie Mac Primary Mortgage Market Survey, Week Ending August 11, 2016

» Employment Situation for July 2016, Bureau of Labor Statistics

For additional information, commentary, and analysis, please contact

Brian Honea
The Five Star Institute
Brian.honea@TheFiveStar.com