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REPORT ON THE SCOPE AND IMPACT OF FORECLOSURES AND SUBPRIME LENDING IN FAIRFAX COUNTY

Fairfax County has experienced a substantial increase in residential property foreclosures between 2005 and 2007. In concert with an increased foreclosure rate the number of non-traditional (subprime) mortgages originated between 2005 and 2007 also increased.

The purposes of this Report are to:

- Document the level, location and impact of the residential real estate foreclosure activity;
- Document the level location and impact of subprime mortgage lending on foreclosure activity in Fairfax County and to;
- Identify current and proposed actions designed to mitigate the impact of future foreclosures in the real estate market.

In order to better understand the scope and possible impact of foreclosure and subprime mortgage lending activity in Fairfax County it is useful to first examine the state of the current housing stock and the general residential mortgage market.

There are currently 391,138 housing units of all types available in Fairfax County. An estimated 277,000 of these units are owner occupied. A total of 30,171 of owner occupied homes are classified as condominiums.

According to Federal Home mortgage Disclosure Act data, a total of 28,620 home purchase mortgages were originated in 2006, a decrease from the approximately 37,000 home purchase mortgages originated in 2004. Of the total 2006 home mortgage loans originated, a total of 3,345 can be considered as investor loans. (Non-occupant loans represent loans for investment properties).

. For this report the term foreclosure is defined as “the legal process by which property that is mortgaged as security for a loan may be sold to pay a defaulting borrower's loan”.¹

1. Joseph Pahl: The Four Steps of the Foreclosure Process.

There are four steps in the foreclosure process in Virginia. They are:

1. Delinquency of payment
2. Notice of default (Pre-Foreclosure)
3. Notice of sale
4. Foreclosure auction.

Foreclosure actions can be completed in as little as 60 days.

It is estimated that 198 residential foreclosures occurred in Fairfax County in 2005 and 4,527 foreclosures in 2007.² The trend rate of foreclosures accelerated throughout 2007 ranging from 347 foreclosures in the first quarter to 1,722 foreclosures in the fourth quarter of 2007.³ It now appears that the trend rate is further accelerating in 2008. The George Mason University Center for Regional Analysis estimates that 4,724 foreclosures occurred in the three month period between November 30, 2007 and February 15, 2008.⁴ This is an estimated annualized total of 18,896 foreclosures.

Fairfax County foreclosures appear to be clustered in specific areas of the County, including such areas as Springfield, Herndon, Centreville, and Route 1. (See maps "Foreclosure by Neighborhood in Fairfax County" and "Foreclosures in Fairfax County") A Department of Tax Administration (DTA) analysis of residential sales in Fairfax for 2007 found that an estimated that 3% or more of all qualified sales in seventeen Fairfax County neighborhoods could be classified as foreclosure sales; and that in eleven neighborhoods, 10% or more of all qualified residential sales could be classified as foreclosures. (A neighborhood is defined by DTA as residential properties of similar type, ages and condition located in a common geographic area.)⁵

A mortgage foreclosure certainly has a negative personal impact on the affected borrower. However increased levels of foreclosure activity may also have a negative community impact. While the overall foreclosure rate for Fairfax County may not be statistically significant, it is important to note that increased levels of foreclosures occurring within individual communities of Fairfax County can have substantial negative impacts within these neighborhoods, including depressed property values, increased housing vacancies, decreased property maintenance, and increased crime.

2. County Executive Presentation of the Fiscal Year 2009 Advertised Budget Plan; RealtyTrac.

3. County Executive Presentation of the Fiscal Year 2009 Advertised Budget Plan; RealtyTrac.

4. Center for Regional Analysis; George Mason University, March 2008.

5. Fairfax County Department of Tax Administration "Residential Foreclosures Jan1, 2007 to March 4, 2008.

Evidence suggests that foreclosures are a contributory factor in a trend toward a lower list to sales value ratio for County residential properties. In 2005 the ratio of residential property list to sale prices for Fairfax County property was 101% (Property sold for more than listed price) Since 2005 the list/sales ratio for Fairfax properties has steadily declined to a low of 90.6% in December 2007. ⁶ The decreased list to sales ratio corresponds to the increase in foreclosure levels between 2005 and 2007. This suggests a relationship where foreclosure sales, occurring at less than market value, may affect the overall County list/sales ratio.

Studies have indicated that for each foreclosed property, surrounding properties within a 1/8 mile area lose from 0.9% to 1.44% of their value. ⁷ The depression of community property values impacts not only residents seeking to sell homes, but also those seeking to refinance home mortgages or those seeking to obtain second mortgage/line of credit financing; as the homeowners cannot meet the new loan to value ratios required to obtain financing.

Subprime mortgage loan activity has also impacted residential property values. The Center for Responsible Lending (CRL) in a January 2008 paper, estimated that in 2005-2006, foreclosed properties with subprime loans, located in Fairfax County, lost \$5,545/property in value. With a projected 3,085 subprime loan foreclosures the CRL estimates that the Fairfax County housing stock lost \$1.12 Billion in real property value during the 2005-2006 period. CRL estimated that each residential property mortgage foreclosure may impact the value of as many as 65 adjacent properties. ⁸

Foreclosures also have other social and physical impacts on communities. Vacant homes may be “targets of vandalism, theft of wiring or other building components or arson” ⁹ There is also concern that vacant/foreclosed properties will not be adequately maintained, impacting the physical condition of the community. A joint Georgia Institute/Woodstock Institute study concluded that a 1% increase in the foreclosure rate of a community could lead to as much as a 2.3% increase in violent crime. ¹⁰

SUBPRIME MORTGAGE LENDING IN FAIRFAX COUNTY

The increasing use of subprime mortgage loans has been identified as a contributing factor to the increasing rate of Fairfax residential property foreclosure. Subprime mortgages have been increasingly used in Fairfax County, rising from 4.2% of all Fairfax County residential mortgages in 2003 to 13.5% of all mortgages in 2007. ¹¹

6. County Executive Presentation of the Fiscal Year 2009 Advertised Budget Plan; Metropolitan Regional Information Systems (MRIS)

7. Subprime Spillover: Foreclosures Cost Neighbors \$202 Billion: 40.6 Million Homes Lose \$5,000 on Average: Center for Responsible Lending January 18, 2008. Hereafter CRL

8. CRL

9. and 10. The External Cost of Foreclosures: The Impact of Single-Family Mortgage Foreclosures on Property Values; Fannie Mae, Vol 17 issue 1, 2006; Immergluck and Smith

11. County Executive Presentation of the Fiscal Year 2009 Advertised Budget Plan

A subprime mortgage is defined as a higher than normal cost mortgage made to individuals with weakened credit histories or with reduced repayment capacity. Characteristics of such mortgage instruments may include:

- Adjustable interest rates;
- Rates 3% or more above prime;
- Balloon payments;
- Prepayment penalties;
- Loans with limited documentation of borrowers' loan qualifications.

Subprime mortgages usually permit an initial low mortgage rate or interest only term and adjust or "reset" to a higher permanent rate after two or three years.

Many subprime loans made in 2004 - 2006 are now resetting (interest rate and term is adjusting) to new higher adjusted interest rates or converting to higher fixed interest rate loans. As mortgage rates have adjusted, the individual monthly mortgage payment has dramatically increased. In many cases property owners cannot pay the adjusted monthly mortgage payment. In some instances the costs of the new mortgage terms exceed the present value of the property (negative amortization).

Three factors are cited as contributing to subprime mortgage foreclosures.

- Risky Loans: Subprime loans generally contain terms which increase the risk of foreclosure;
- Loose Underwriting: In many cases lenders originate subprime loans to less creditworthy borrowers without adequately calculating the impact that the loan terms will have after the adjustment period or reset;
- Lack of Accountability: The proliferation of third party mortgage brokers and the wholesaling of mortgages to third party investment entities reduce the level of oversight of mortgage loans and diffuse the responsibility and consequences for making bad loans.¹²

Subprime lending is considered to have contributed to the increase in the total number and rate of foreclosures in Fairfax County. The Center for Responsible Lending in a 2006 analysis estimated that nationally, 19% of all subprime mortgages originated from 1998 to 2006 will result in foreclosure.¹³ With 13% of all Fairfax County mortgage loans defined as subprime and an estimated default rate of subprime loans of 19%¹⁴ it is estimated that between 600 and 900 subprime mortgages per year will result in foreclosure between 2008 and 2010.

12. Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners; Center for Responsible Lending; Schloemer, Li, Ernst and Keest, December 2006. (Hereafter : CRL Losing Ground 2006)

13. CRL Losing Ground

Analysis has determined that the location (cluster) pattern of Fairfax County residential foreclosures corresponds closely to the cluster pattern for subprime loans. Analysis also indicates that the areas of Herndon, Centreville and Route 1 Corridor show a high incidence of both subprime loans and of residential mortgage foreclosures.

When concentrated in a community, subprime mortgage lending, resulting in foreclosure, has the same impact on a community as conventional residential mortgage foreclosures. These potential impacts include:

- Deferral of maintenance during the pre-foreclosure period and during vacancy;
- Decrease in price for individual and general community property devaluation if multiple foreclosure occur;
- Increase in housing supply, as subprime and prime foreclosures are added to the normal housing sales market;

MITIGATION OF THE FORECLOSURE ISSUE

Prior to 2006 high real estate mortgage foreclosure rates were seen not as a national issue but an issue limited to rapidly developing markets with strong speculative components. Fairfax with a growing, but stable housing stock, was not seen as being affected.

Since 2006 the issue of high levels of residential mortgage foreclosures has been recognized as a national issue and as an issue impacting Virginia and Fairfax County.

To date no comprehensive mitigation program or resolution to the subprime lending or residential mortgage foreclosure issues has surfaced at any level of government.

The Federal government has introduced the following initiatives:

- Hope Now: Under this initiative the Federal Government will assist subprime borrowers with adjustable rate loans to:
 - Refinance an existing loan into a new private mortgage;
 - Move borrowers into an *FHASecure* loan; or
 - Freeze borrower's current interest rates for five years.
- Project Lifeline: This initiative is an extension of the Hope Now initiative and includes all borrowers experiencing mortgage payment difficulties. The primary features of this initiative include:
 - Participation in foreclosure counseling, mortgage work out and rate freeze by six national banks including:
 - Bank of America Corp.,
 - Citigroup Inc.
 - Countrywide Financial Corp.,
 - J.P. Morgan Chase and Co.,
 - Washington Mutual Inc. and
 - Wells Fargo & Co.

- FHA Secure: Under this program the Federal Housing Administration will
 - Allow families with strong credit histories who had been making timely mortgage payments, but are now in default, to qualify for refinancing before their loans reset;
 - Implement a risk-based premiums program that match the borrower's credit profile with the insurance premium they pay- i.e., riskier borrowers pay more;
 - Expand the maximum loan amount that a borrower may qualify for as a conventional mortgage.

On March 18, 2008 the Federal Reserve Board reduced the Federal Funds Rate, the interest rate banks charge each other for loans, by three quarters of one percent (750 basis points) to 2.25%. As many adjustable rate mortgage interest rates are linked to this rate, the impact to mortgage borrowers with adjustable rate mortgages may be to lower mortgage reset costs and lower monthly mortgage payments. This in turn may lead to decreased foreclosures.

Governor Tim Kaine has created the Virginia Statewide Foreclosure Prevention Task Force. The goals of the Task Force are to:

- Collect and analyze data to assess foreclosures in Virginia and determine level of homeownership preservation needs.
- Identify and review financial and programmatic resources available to homeowners to minimize the number of foreclosures.
- Recommend outreach, counseling and educational programs and activities that focus on foreclosure prevention and support to homeowners.
- Review existing Virginia laws and regulations and recommend appropriate revisions, including legislative actions if needed.

CONCLUSIONS:

Residential mortgage foreclosures have been occurring in Fairfax County at an increasing rate since 2006. This trend will continue through 2008 and 2009. The rate of mortgage foreclosures will decline beginning in 2010.

Residential mortgage foreclosures are clustered in specific geographic areas of Fairfax County with ten “neighborhoods” indicating residential sales foreclosure rates of 10% or more of total neighborhood sales in 2007. Because foreclosures in these “neighborhoods” are concentrated there is a potential for negative financial and physical impacts to occur including: depressed property values; depressed property sales; deferred property maintenance; and higher levels of crime.

Subprime mortgage lending practices are a contributing factor to Fairfax County's increased level of residential mortgage foreclosures. The geographic pattern of subprime lending (clustering) closely matches the pattern of residential property mortgage foreclosures.

Reforms in mortgage lending and underwriting practices effectively closed the subprime mortgage market in 2007. Subprime mortgage foreclosures will decline beginning in 2010 as existing subprime loans reset or are refinanced.

There are currently no Federal or State programs available that can effectively mitigate the trend of mortgage foreclosures.

Attachments

Maps:

- Foreclosures By Neighborhood in Fairfax County
- .Foreclosures in Fairfax County
- Conventional Home Loans by Neighborhood
- Subprime Home Loans by Neighborhood