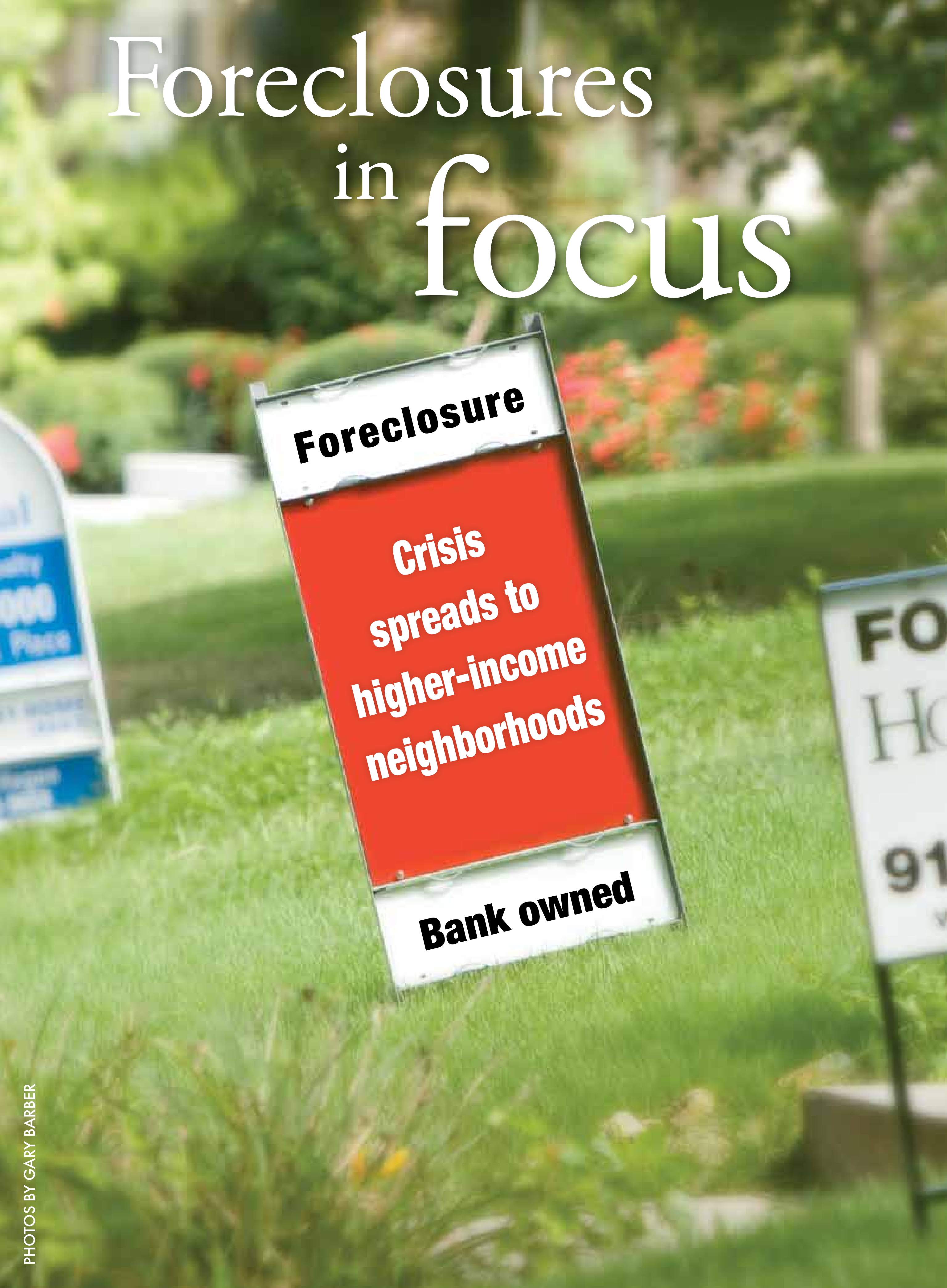
Foreclosures in focus



PHOTOS BY GARY BARBER

During the last 30 years, David Jewell developed a successful one-man marketing company in Kansas City, Mo., and worked as an adjunct professor at local colleges and universities.

But the recession had a direct and sudden impact on Jewell's firm last year. Along with many in the media and advertising industries, Jewell began receiving fewer and fewer contracts. By the fall of 2008, long-time clients he had come to depend on cut their marketing budgets, and Jewell's business suffered.

"I was doing very well until September," Jewell says. "Suddenly, I went from being incredibly busy to having zero business."

With his income drastically cut, Jewell missed a mortgage payment, and despite his best efforts, he was never able to catch up with the growing late fees and penalties assessed by his bank. Earlier this year his lender started foreclosure proceedings, and Jewell lost his house in Brookside—a trendy, urban neighborhood highly desirable for its parks, tidy shops and well-kept homes.

"I know the same thing is happening to a lot of people," says Jewell, who held a traditional, fixed-rate mortgage. "It's becoming more and more common for people who work hard for their living to find themselves in a foreclosure."

As the country's foreclosure crisis continues to grow, many homeowners are in a similar position. Rising unemployment rates and declining property values are combining to put additional pressure on household budgets. As a result, foreclosures are becoming more common in higher-income neighborhoods that were previously immune from the crisis, says Kelly Edmiston, a senior economist in the Kansas City Fed's Community Affairs Department.

Edmiston, who recently studied the causes of foreclosures and the effects on neighborhoods in the Tenth District, has found a number of factors help explain foreclosure trends, including income levels, housing market conditions and economic issues such as unemployment and self-employment rates. The District includes western Missouri, Kansas, Colorado, Oklahoma, Nebraska, Wyoming and northern New Mexico—a region that has seen its share of foreclosures, but not at the level found in other areas.

"Foreclosure rates have been higher in low-income neighborhoods for some time, but only to the degree that subprime mortgages took hold in those areas," Edmiston says. "What we are seeing now is that foreclosures are heading into higher-income areas, and that's due to weaker economic conditions and a declining housing market."

Recent trends

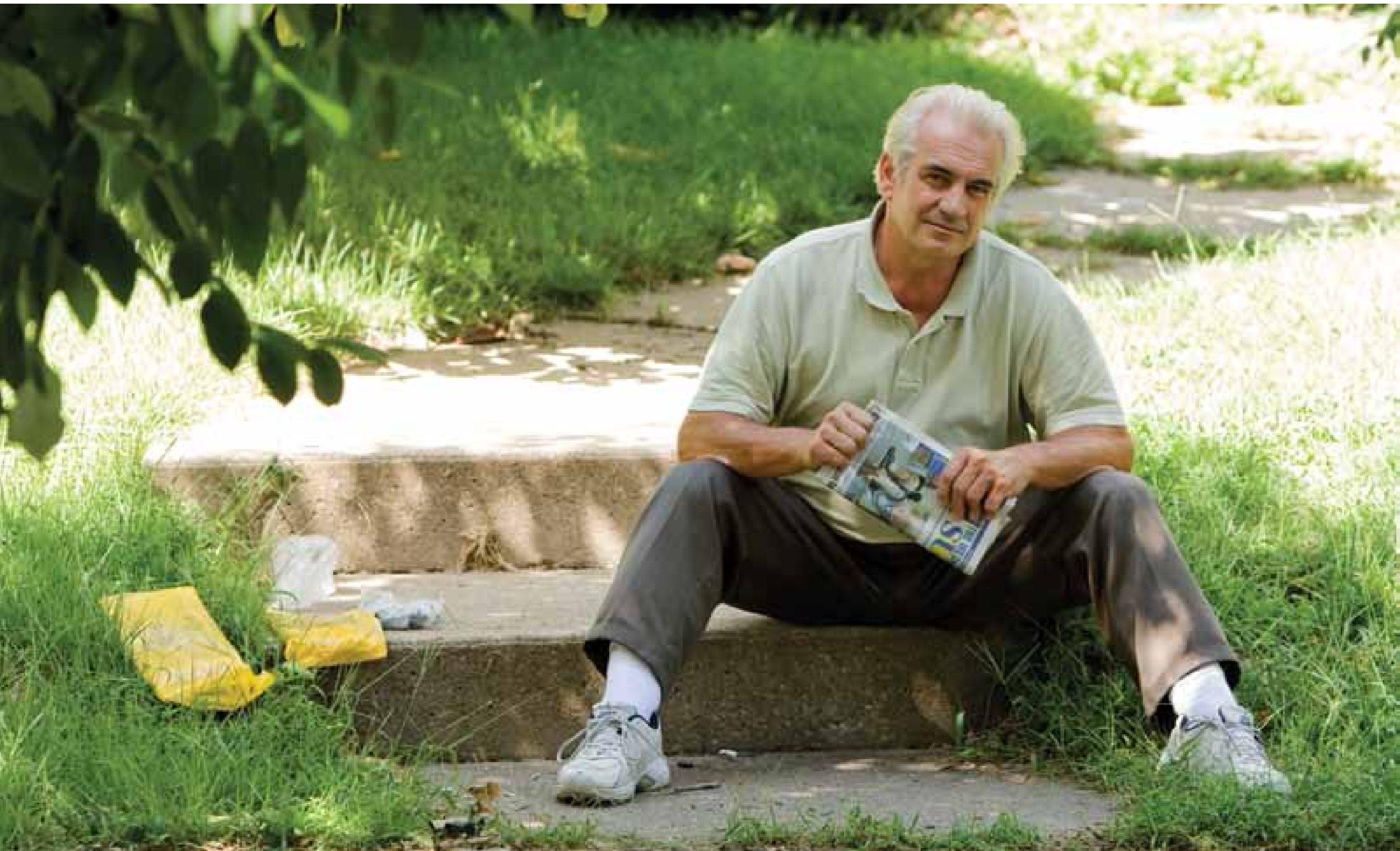
During the last few years, foreclosure rates across the country have skyrocketed, but some areas have been hurt more than others. The areas that have been hit the hardest—including Nevada, Arizona and Florida—are many of the same places where prices soared the highest during the real estate boom.

In the Tenth District, foreclosures are also increasing rapidly, but have done so at a less-dramatic pace than in the Sunbelt or on the coasts, Edmiston says. In the second quarter of 2009, foreclosure rates ranged from a low of 1.2 percent of all outstanding mortgages in Wyoming to 2.7 percent in Colorado, according to the Mortgage Bankers Association. The national rate was 4.3 percent.

"In general, the more an area grew in terms of price, the more it fell," Edmiston says. "The Midwest didn't see as large of a run-up in prices, and the economy in the Tenth District was in better shape than in other places."

But when comparing neighborhoods

DAVID JEWELL SITS IN FRONT OF HIS RECENTLY FORECLOSED HOUSE in Kansas City, Mo. Jewell, who had a traditional mortgage, lost his home as the economy worsened and his business suffered. Research shows foreclosures are becoming more common in higher-income neighborhoods like Jewell's as unemployment rises and home values decline.



within the Tenth District, foreclosure rates vary widely. According to data Edmiston reviewed, neighborhood foreclosure rates ranged from 0 percent to as high as 17 percent across the seven-state region.

Income is one factor that helps explain the differences among neighborhoods, Edmiston says. In Tenth District neighborhoods where less than 5 percent of residents are classified as low-income, the average foreclosure rate is minimal. The rate rises to 13 percent on average in neighborhoods where more than half the residents are low-income.

"The neighborhood foreclosure rate in the Tenth District rises consistently with the share of the population that is low-income," Edmiston says. "But, the data show that the increase in foreclosures in these neighborhoods depends on how deeply subprime lending penetrated the area."

Although most subprime loans were made to those with low credit scores, Edmiston says many low-income residents were targeted by subprime lenders when they might have actually qualified for better terms under a traditional mortgage. These borrowers did not likely have much experience as homeowners, did not have adequate information and did not completely understand the loan they were receiving.

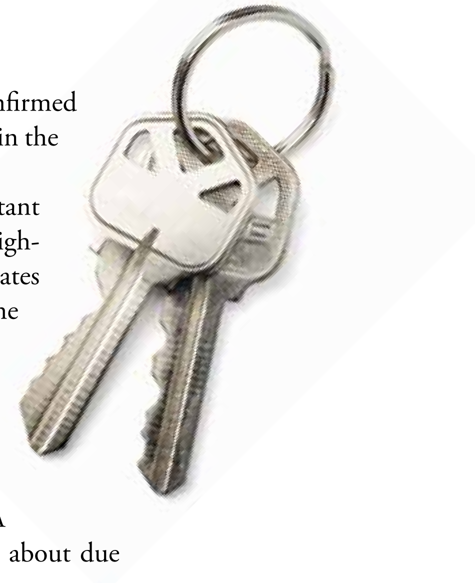
"That's why homebuyer education is so important," he says.

Housing market conditions

Along with income levels, housing market and economic conditions have played a role in the growth of foreclosures.

If homeowners fall behind on their mortgage in a declining market, they often have difficulty refinancing their loan or selling their home at a price that's high enough to cover their outstanding balance, Edmiston says. Foreclosure becomes the only option.

Several studies have found that when home prices fall, foreclosures tend to rise, and Edmiston's analysis confirmed that dynamic is at work in the Tenth District.



"The most important factor in explaining neighborhood foreclosure rates is the change in home values," Edmiston says. "If someone had 10 to 20 percent equity, they would want to sell their home rather than face foreclosure. A foreclosure often comes about due to a lack of equity."

Other housing market conditions, such as vacancy rates and owner-occupancy rates, also play a role, Edmiston found. As expected, higher vacancy rates led to higher neighborhood foreclosure rates, but surprisingly, Edmiston discovered that neighborhoods with higher owner-occupancy rates also had higher foreclosure rates. The finding seems to go against the idea that homeowners who live in their homes would be less likely to undergo a foreclosure because they have a personal stake in the home. The results indicate that those who buy homes as an investment rather than as a primary residence are able to more easily cope with losses in the housing market because they have a more-diversified and larger pool of assets, Edmiston says.

Economic conditions

At Neighborhood Housing Services of Kansas City, there is no shortage of homeowners who are looking for ways to save their homes from foreclosure. Along with homebuyer education courses, the nonprofit offers foreclosure intervention and mortgage default counseling.

"There has definitely been an increase in the demand for our services," says Mark Stalsworth, the agency's president and CEO. "There are people who have already had a modification on their mortgage, but they maybe weren't very sophisticated in what they signed up for. In some cases, their payments went up instead of going down."

Other homeowners "have fought it off as long as they could," Stalsworth adds. "Now they've reached the point where they don't know what to do. With high unemployment and lower home values, it's the absolute worst of everything now."

Stalsworth also has noticed a rising number of foreclosures in areas and neighborhoods that had generally avoided the crisis until recently.

"The target area for where foreclosures have hit has been a constantly expanding area," Stalsworth says. "The assumption was, 'I could always sell my house.' But now it's a buyer's market, and it can be extremely tough to sell a house."

There are several high-profile cases of foreclosures striking in middle-class and even wealthy neighborhoods in Kansas City. In July, a 16-room, five-bath home located on Ward Parkway—a boulevard surrounded by large and historic mansions—was sold on the courthouse steps when its owners defaulted on the mortgage. The home had remained empty for some time after the latest owners gave up on a renovation project.

Just across the state line in affluent Johnson County, Kan., several suburbs are also starting to take notice of the problem. Last spring, the cities of Olathe and Overland Park divided a $4.5 million federal grant from the Neighborhood Stabilization Program to purchase foreclosed and abandoned homes in an attempt to limit the impact on surrounding neighborhoods. The homes will be renovated and put back on the market as affordable housing.

As the reach of job losses expanded to more neighborhoods during the recession, foreclosures haven't been far behind. In fact, the loss of a job or income is one of the most common triggers for a mortgage default, Edmiston says. According to his analysis of the

Community Affairs

The Community Affairs Department of the Federal Reserve Bank of Kansas City supports the Federal Reserve System's economic growth objectives by promoting community development, financial education, and fair and impartial access to credit.

The department offers resources, events and research related to issues affecting economic prospects in low- and moderate-income communities. Staff often partners with community groups to explore prospective solutions.

- Free tools include the Foreclosure Resource Center, which is an online collection of regional trends, information on local foreclosure rates, links to consumer and community organizations involved in mitigation efforts, and more. Also online are resources for consumers, lenders and community groups.

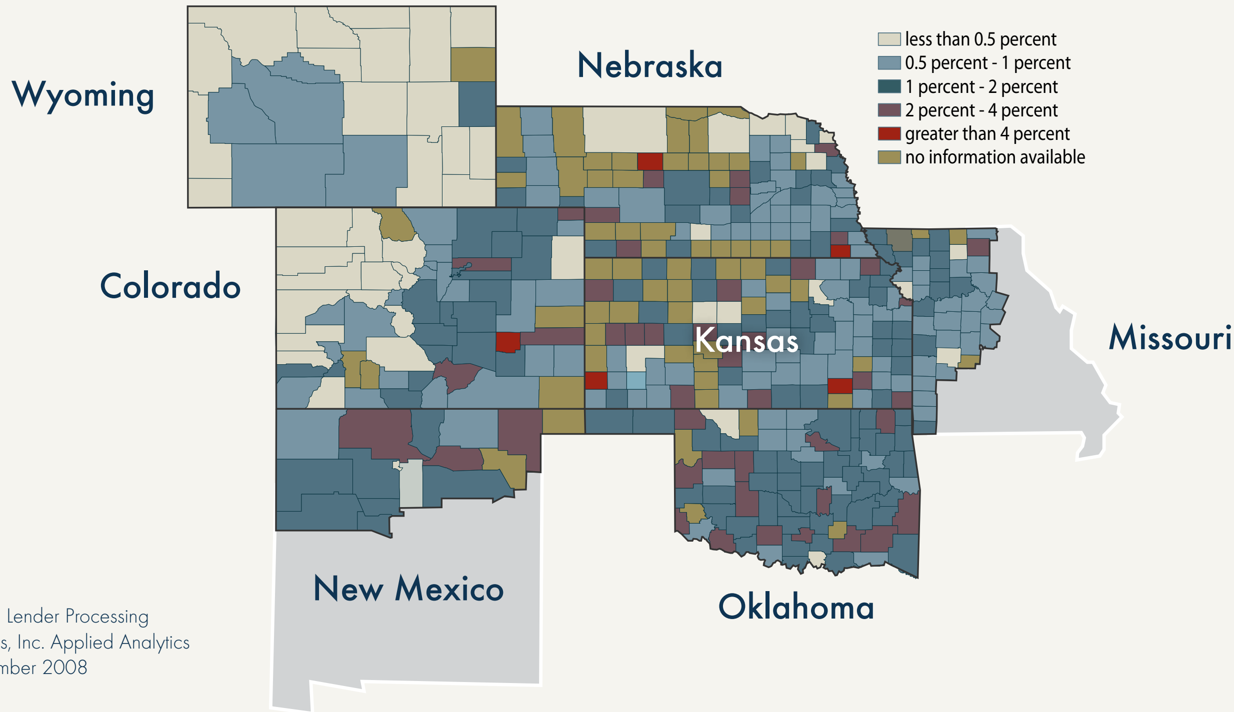
- Recent events include "Financial Education in Oklahoma: From Policy to Action" and "Creating and Streamlining the Mortgage Approval Process" in New Mexico.

- Recent research papers include "Financial Education at the Workplace," "The Role of Small Business and Large Business in Economic Development" and "Booms and Busts: The Case of Subprime Mortgages."

For more information on Community Affairs and to access its materials, visit **KansasCityFed.org/TEN**.

Foreclosure Rates By County

in the Tenth Federal Reserve District *



Source: Lender Processing Services, Inc. Applied Analytics
*December 2008

Tenth District, rising unemployment rates had a significant effect on neighborhood foreclosure rates.

A similar increase in the foreclosure rate can also be traced to the level of self-employment in a neighborhood. A high number of self-employed residents in a neighborhood can result in a higher foreclosure rate, Edmiston says.

"Self-employed workers' incomes are more volatile than salaried workers'," Edmiston says. "With the downturn in the economy, someone who is self-employed is more likely to have trouble making a house payment than someone who works for a wage or salary."

That was the position David Jewell found himself in earlier this year.

"When you own a business, you don't get paid unless you work," he says. "If there's no work, there's no money."

Following his foreclosure, Jewell has been living with his grown sons. But, he has seen some reasons in recent months to be optimistic. By re-focusing his business on small firms, his company has started picking up new clients.

"I'm busy again," he says, "and I'm finally coming out of it."

BY BILL MEDLEY, SENIOR WRITER

FURTHER RESOURCES

"CHARACTERISTICS OF HIGH-FORECLOSURE NEIGHBORHOODS"
By Kelly Edmiston
KansasCityFed.org/TEN

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.