Real Estate Economic News and Insight — June 19, 2008

Economic Perspectives

Credit quality deteriorates, foreclosures rise & borrowers remain stretched

Credit quality continues to weaken as consumers face reduced home equity and household wealth together with rising inflation in energy and food prices. Real income and purchasing power have declined over the last 12 months. Households continue to be squeezed by a harsh job market that is holding down wage increases. Mortgage data released by the Mortgage Bankers Association and the Federal Reserve Board show that both mortgage delinquencies and foreclosures continue to rise at a record pace. The current delinquency rates are now the highest on record and far above what was experienced in the 1990 and 2001 recessions, The effect of foreclosures is also expanding beyond homeowners and is now being felt by homeowner associations, municipalities and others as a full 2.9% of U.S. homes are vacant and for sale — the highest rate since 1956.

First quarter 2008 data from the Mortgage Bankers Association show a startling rise in both delinquency and foreclosure rates. No longer confined solely to sub-prime loans, the total first quarter 2008 delinquency rate for all types of 1-4 family residential mortgage loans in the U.S climbed to 6.35% while foreclosures climbed to one-percent. These rates are now the highest on record and far above 1990 and 2001 recession levels.

The problem is also no longer confined to adjustable rate mortgages (ARM). Fixed rate loans are increasingly under stress as well given the erosion in the underlying collateral value and the fact that even prime borrowers are becoming less willing to pay when they see the value of their property continuing to shrink. The following table shows delinquency and foreclosure rates for Florida 1-4 family residential loans.

	% Past Due	30 Days	60 Days	90 Days	Foreclosure
Prime Fixed	3.3%	1.95%	0.68%	0.68%	1.34%
Sub Prime Fixed	15.87%	7.48%	3.08%	5.31%	6.32%
Prime ARM	8.15%	3.48%	1.85%	2.82%	5.85%
Sub Prime ARM	19.71%	8.08%	4.77%	6.87%	23.33%

As might be expected, fixed rate loans to prime borrowers show the lowest delinquency and foreclosure rates at 3.3% past due and 1.34% in foreclosure. Alternatively, sub prime adjustable rate loans are the highest at 19.71% past due and 23.33% in foreclosure. The sub-prime category, which is arguably the cause of the credit crisis that began last August, is especially significant. The spread between prime and sub-prime continues to widen and the astounding level of both delinquency and foreclosure activity clearly under-scores the severity of the sub-prime problem.

In terms of fixed versus adjustable rate loans, the fixed rate delinquencies are near previous recession highs while adjustable rate loan delinquencies are much higher.

Of the total adjustable rate loans facing reset, very few are prime, agency (FHA or VA) or portfolio loans made by local banks. By far the largest share are securitized sub-prime. A reset does not automatically trigger a foreclosure but many sub-prime loans that have, or will soon, reset were made with so-called "teaser rates." Those interest rates are adjusting upward fairly dramatically now. Additionally, the majority were high ratio (loan to value) loans and collateral values have declined meaning that a significant number of sub-prime adjustable rate borrowers owe more than their property is worth and can no longer sell or refinance. The alternative is usually foreclosure.

The peak in sub-prime loans facing reset occurred in the fourth quarter of 2007. Given the few options sub-prime borrowers have, many are, in fact, facing foreclosure. This combination of circumstances helps explain the recent surge in foreclosures 4-6 months after reset.

The number of borrowers entering foreclosure has declined thus far in the second quarter as foreclosures work their way through the legal process.

There was another (but slightly lower) "twin peak" in resets which occurred in April. As a result we can probably expect to see foreclosures rise again, though not as dramatically, in the forth quarter of 2008 and first quarter of 2009.

While this analysis would suggest that foreclosure rates will decline in the first half of 2009 as sub-prime resets clear, there is still a wild card. A continued weak economy could easily drive prime borrowers into foreclosure. We see this as a real possibility given diminished household wealth, home prices that continue to decline as well as labor market and inflationary pressures.

Homeowners are giving up in this order. Flippers, speculators, legitimate investors and homeowner occupants. During the extraordinary run up of prices in the era of cheap money, flippers and speculators contracted to buy new residential properties but never expected to close on their purchase. They expected to simply

EQUAL HOUSING LENDER MEMBER FDIC
NASDAQ: SBCF

"flip" the contract or the property to another buyer and make a huge profit doing so. When the residential market collapsed, they were unable to flip the property and were forced into foreclosure or some form of settlement with their mortgage lender.

Alternatively, homeowners held on to the end, many striving diligently to *not* go to foreclosure. In the second half of 2007, approximately 56% of foreclosures were flipper, speculator and investor. As those clear the legal process, many more homeowners are going to foreclosure.

Another trend worth exploring is that during 2007, roughly one-third of the properties entering "pre-foreclosure" (the first legal step) actually went through the entire process and ended with the property being returned to the lender. About two-thirds were able to recover or settle with their lender. Today that ratio is approaching one-half as more borrowers exhaust their options to avoid foreclosure.

A table showing foreclosure activity in Florida counties served by Seacoast National Bank appears below. In every urban county, the number of properties in the pre-foreclosure stage has declined thus far in the second quarter while auction and bank owned categories have increased. This suggests that the legal process of foreclosure is working naturally. As previously mentioned however, the composition will probably change again later this year as another wave of foreclosures works its way through the legal system.

Another interesting characteristic is that the rate of foreclosures moving into the auction category has slowed. Our read of this is that some owners are not fighting foreclosure and are voluntarily returning the property to the lender via a deed in lieu of foreclosure. It will take another quarter or two to determine if this is a trend or not.

Other consequences of foreclosure. Besides the obvious effect foreclosure has on property owners and their lenders, the extraordinary level of foreclosure activity is taking its toll in other areas as well.

Approximately 2.9% of U.S. homes are vacant and for sale. While that is only a fraction of U.S. homes, it is the highest rate since 1956. Homes standing empty quickly fall into disrepair if maintenance is not performed as necessary. Code enforcement violations cited by cities and counties are on the rise.

Vandalism is also on the rise as vacant homes are stripped of appliances and anything of value. Sometimes the vandalism is as severe as stripping electrical systems to steal copper wire.

Community associations are finding it harder to collect maintenance and other association fees in order to provide both maintenance and service.

SOURCE: Realtytrac.com (June 12, 2008)

Residential Foreclosures by Seacoast County

County	Pre-Foreclosure	Auction	Bank Owned
Orange	7312	1189	2023
Seminole	1944	286	520
Osceola	3126	485	777
Lake	1293	247	481
Brevard	3246	624	1424
Indian River	825	60	234
St. Lucie	3610	593	1222
Martin	575	144	265
Okeechobee	93	13	36
Hendry	111	13	51
DeSoto	93	1	50
Glades	11	1	0
Highlands	305	61	221
Hardee	30	1	14
Palm Beach	8394	746	2391
Broward	13144	3475	5304

The material contained in this newsletter has been prepared by Seacoast National Bank. The content is provided for use by real estate, financial services and other professionals only and is not intended for consumer distribution. The material provided is for informational and educational purposes only and should not be construed as investment and/or mortgage advice. Although the material is deemed to be accurate and reliable, there is no guarantee it is not without errors.

Economic Perspectives **is prepared by William L. Pittenger, Senior Vice President, Chief Real Estate Economist & Risk Advisor,**

Seacoast National Bank. E-Mail Mr. Pittenger at William.pittenger@seacoastnational.com