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Economic Perspectives

Foreclosures continue at record pace. *Is the end in sight?*

Florida home foreclosures have been setting new records month over month for over a year. September was no exception. According to RealtyTrac, Florida's foreclosure rate jumped nine-percent over August with 47,956 new filings during the month and 127,306 new filings during the third quarter. Today, one in 178 Florida housing units is in some stage of foreclosure. That compares with a national rate of one in 475. Florida's foreclosure rate now ranks second in the nation — behind only Nevada. Not surprisingly, sun belt cities had the highest foreclosure rates in the third quarter. Cities with the highest rates were all located in California, Florida, Arizona and Nevada. Two Florida cities made the unenviable top 10 national foreclosure cities. Ft. Lauderdale came in at number five with 2.3% of its housing units in foreclosure and Orlando at number eight with 1.87% of its housing units in foreclosure. Is the end in sight? Yes, but not soon. Foreclosures will be a lingering problem into 2011.

Foreclosures have been occurring in waves since the housing bubble burst in 2006. First, it was flippers and speculators who discovered that the market had turned and they had a property that was worth significantly less than the debt. This group was originally intent on making a quick buck by flipping the property to someone else at a higher price. Loan files are replete with evidence that some of these borrowers lied about their intent to occupy the property or misled lenders about their financial capacity.

With no emotional attachment and with little to lose except their reputation and future credit worthiness, this group defaulted quickly — sometimes without having made a single payment. That wave has largely passed.

Florida Mortgage Loan Delinquency and Foreclosure Rates

	% Past Due	30 Days	60 Days	90 Days	Foreclosure
Prime Fixed	3.83%	2.14%	0.79%	0.89%	2.75%
Sub Prime Fixed	17.19%	8.26%	3.53%	6.00%	14.11%
Prime ARM	8.97%	3.54%	1.92%	3.52%	11.80%
Sub Prime ARM	19.31%	7.75%	4.65%	6.91%	35.66%

SOURCE: Mortgage Bankers Association Q2 2008

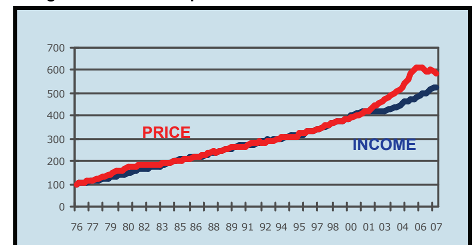
A second wave of defaults began in about the third quarter of 2007. This wave was led by borrowers — predominately sub prime — who had purchased at the peak in 2005 and early 2006. Nearly all sub-prime loans made in that time period were "2-28 loans" meaning the interest rate was fixed for two years then reverted to an adjustable rate with adjustments tied to six month LIBOR (London Inter-bank Offered Rate). When a reset occurred, the average payment jumped about $350 to over $1,500 per month. That was enough to push some borrowers into default.

We are now in the third wave of foreclosures which is being driven by negative equity, weakening employment market and an inability to refinance at manageable rates and terms. The third wave is expected to flood the market well into 2010. Today, an estimated 12.0 million homeowners are under-water with their mortgages. That is, they owe more than the security property is worth. Negative equity is generally not a primary default driver. Most borrowers don't have a precise idea of what their property is worth and most tend to estimate high. Nevertheless, when negative equity is combined with reduced work hours, a job loss or even an unexpected expense, default becomes much more likely.

The chart to the left is based on data from the Mortgage Bankers Association and shows second quarter 2008 delinquency and foreclosure rates for both prime and sub prime loans as well as fixed and adjustable rate loans. As might be expected, traditional prime, fixed rate mortgages continue to experience the lowest delinquency and foreclosure rates. The foreclosure rate is 2.75%, which is high by long-term historical standards but pales in comparison to sub-prime adjustable rate mortgages where 35.66% are in default.

Income and house price. The long-term relationship between home prices and household income was in balance for many years. With the extraordinary run up in prices earlier this decade, prices surpassed affordability as is visually apparent on the following chart. Fearing future inability to purchase a home at rapidly escalating prices, many borrowers, who might not otherwise have done so, purchased at what was arguably an inflated price and financed with one of the more exotic mortgage loans that kept early payments low and required little or no down payment or proof they could even afford the payment when it adjusted. Prices are now moving back in line with the long term trend. Nevertheless, as loans made at the peak adjust and the underlying collateral value falls, more borrowers will default.

Long Term Relationship Between House Price & Income



SOURCE: Moody's Economy.Com

The chart at the bottom of the page shows foreclosure activity and composition in all counties served directly by Seacoast National Bank. Foreclosures are highest in the urban counties; a reflection of price run up, overbuilding and bust. They are lowest in the rural counties where those events did not occur.

State of the mortgage market. At the peak of the bubble in 2005, there was an estimated $920 billion in securitized sub-prime debt outstanding. New originations as late as June 2006 topped $165 billion. Today, sub- prime outstandings are about half of the peak and those balances are not being replaced. New sub-prime originations totaled only $4.0 Billion in the second quarter of 2008. Alt A originations were similarly low and Payment Option ARM new originations were virtually non-existent.

The market appears to have passed the worst of the sub-prime debacle and resulting foreclosures.

The next group of loans to reset are so-called Option Payment ARMS where borrowers could choose to pay an amount even less than the interest owed. The monthly deficiency was added to the loan balance. Total outstandings are estimated to be about $250 Billion. These loans were expected to start resetting in 2009 however falling house prices have increased loan to value ratios which, in turn, triggered contractual resets a year early. While a reset does not automatically mean a default, many will default as a result of rising payments — many of which will be very significant due to negative equity being amortized. We expect these resets to occur well into 2010.

Perhaps the most significant unknown is the effect of the *negative feedback loop* the market is experiencing today. As foreclosures occur, the security property is often put back on the market at a price less than the original debt. If a sale occurs, it is likely to affect surrounding properties driving their values down, triggering more foreclosures and thus repeating the cycle.

Foreclosure Activity In Florida Counties Served Directly by Seacoast National Bank — All Data From RealtyTrac.Com

County	New Filings September 2008	Pre-Foreclosure	Auction	Bank Owned	Foreclosure / Household
Orange	3265	11718	1655	3060	1 in 134
Seminole	767	3328	256	686	1 in 221
Osceola	1609	4887	662	1436	1 in 68
Lake	500	1849	351	971	1 in 268
Brevard	1740	5024	790	1547	1 in 149
Indian River	503	1285	107	270	1 in 147
St. Lucie	1096	4651	903	1385	1 in 114
Martin	260	968	211	314	1 in 288
Okeechobee	43	159	17	46	1 in 381
Hendry	57	149	12	68	1 in 229
DeSoto	34	129	3	77	1 in 422
Glades	4	18	0	3	1 in 1506
Highlands	207	669	47	308	1 in 256
Hardee	13	34	1	26	1 in 792
Palm Beach	2656	11193	1216	2912	1 in 237
Broward	6404	20751	6429	10170	1 in 124

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