ECONOMIC UPDATE

REGIONS

February 19, 2019

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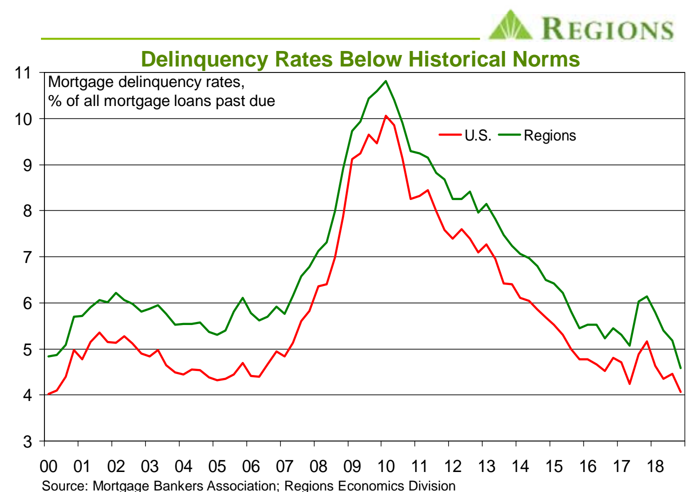
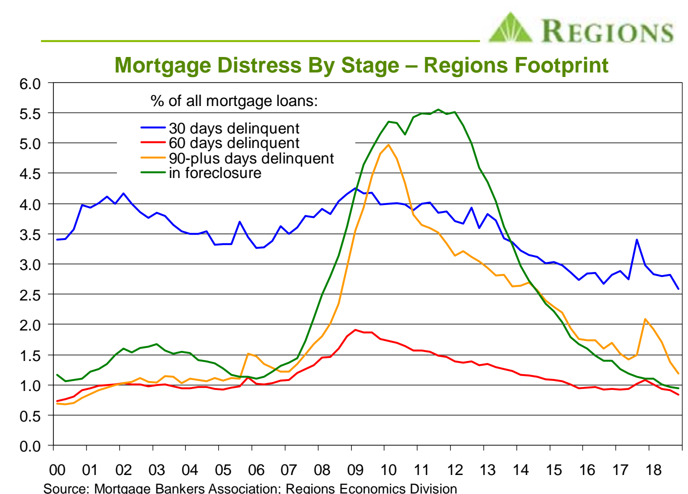
Q4 2018 Mortgage Delinquencies & Foreclosures: Regions Footprint

- For the U.S. as a whole the mortgage delinquency rate fell to 4.06 percent in Q4 2018 from 4.46 percent in Q3
- Within the Regions footprint, the mortgage delinquency rate fell to 4.59 percent in Q4 2018 from 5.18 percent in Q3
- Foreclosure starts were down 2.10 percent year-on-year for the U.S. as a whole, and up 8.35 percent for the Regions footprint

The Mortgage Bankers Association (MBA) recently released their data on mortgage delinquencies and foreclosures for Q4 2018. For the U.S. as a whole the mortgage delinquency rate, which encompasses all stages of delinquency but not those loans in some stage of foreclosure, fell to 4.06 percent in Q4 2018 from 4.46 percent in Q3. Utilizing the MBA data, we calculate a comparable delinquency rate for the 15-state Regions footprint, which is a weighted average (based on the number of total mortgage loans serviced in each state) of the delinquency rates reported for the individual states. The delinquency rate for the Regions footprint fell to 4.59 percent in Q4 2018 from 5.18 percent in Q3. As of Q4 2018, the MBA survey covers roughly 37.952 million first lien mortgage loans for the U.S. as a whole and roughly 14.217 million first lien mortgage loans within the Regions footprint.



While further declines in mortgage delinquency rates in Q4 come as no surprise in the context of an ongoing multi-year downward trend, the magnitude of the declines seen in Q4 may seem surprising. What we suspect is happening is that the Q4 data reflect the effects of Hurricanes Harvey and Irma fully passing through the MBA data. Those hurricanes led to spikes in delinquency rates for the U.S. as a whole and for the Regions footprint, with a much more pronounced effect on the footprint as the two states most impacted by the storms – Florida and Texas – are far and away the largest two states in the footprint. As we've noted in past updates, the MBA recognizes that forbearance is in place for borrowers impacted by events such as hurricanes yet, in keeping with their standard practice, requests that servicers report such loans as being delinquent when payments are not made in accordance with the original terms of the mortgage loans. As these hurricane-related delinquencies have cured and/or impacted loans have come off the books, delinquency rates have fallen back into line with the pre-hurricane trends. That is how we'd suggest looking at the top chart – i.e., look at the delinquency rates for Q4 2018 in the context of those that prevailed in Q2 2017, or, the last quarter of clean data before the hurricanes hit. As we'll discuss in more detail later, the year-on-year increase in foreclosure starts in the Regions footprint in Q4 2018 is likely more a reflection of foreclosure starts having slowed significantly in Florida and Texas in Q3 2017 – in the wake of the hurricanes – and since having returned to more normal levels than it is a reflection of a sudden deterioration in loan performance across the footprint.



To us, the bigger story here is that early-stage mortgage delinquency rates have dropped below their longer-term historical norms. We use the period from Q1 1980 through Q4 2006 as the basis for estimating longer term norms for mortgage delinquency rates, as this period includes normal cyclical activity without being biased higher by the worst effects of the excesses in mortgage lending in the years leading up to the 2007-09 recession. With the exception of Mississippi, "early-stage" delinquency rates, i.e., those loans in the 30-day and 60-day delinquency buckets, are below the longer-term norms in each state in the Regions footprint and this is also the case for the U.S. as a whole. Some of these deviations are substantial – as of Q4 2018, Illinois' incidence of early-stage delinquency was 126 basis points below the longer-term norm, with Tennessee's rate 125 basis points lower, South Carolina's rate 118 basis points lower,

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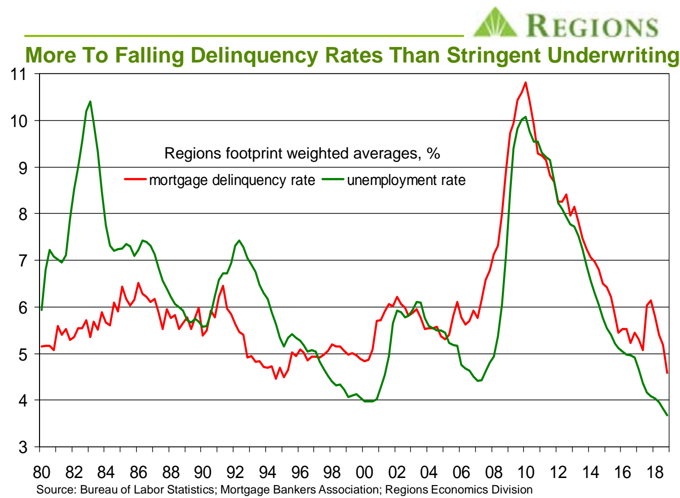
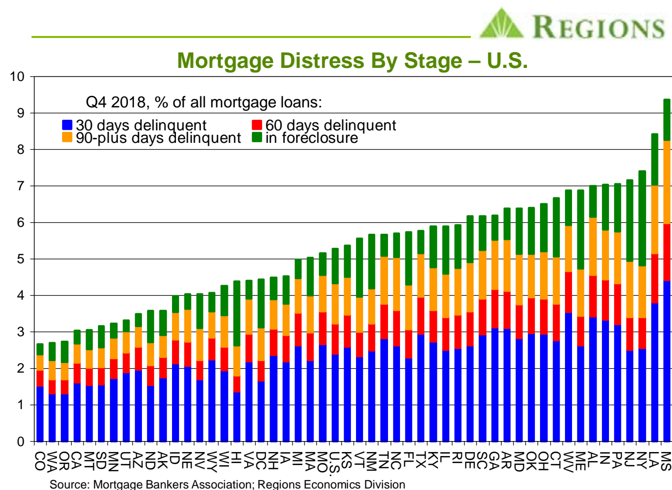
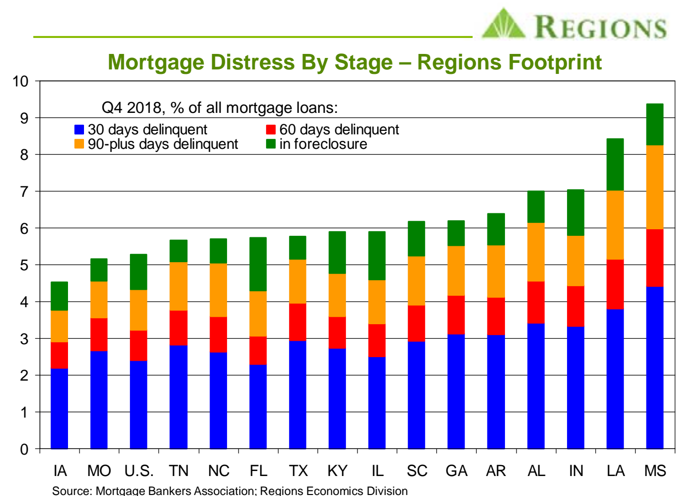
and Florida's rate 107 basis points lower (the national average rate is 81 basis points lower than the longer-term norm). In contrast, 90-day delinquency rates remain above their longer-term norm in each of the in-footprint states and for the U.S. as a whole – as of Q4 2018, the 90-day delinquency rate for the U.S. was 1.11 percent, or, 33 basis points above the long-term average rate of 0.78 percent. Foreclosure rates, or, the percentage of outstanding mortgage loans in some stage of the foreclosure process, are the final component of overall mortgage distress, and for the U.S. as a whole the foreclosure rate had fallen below, albeit only slightly, the longer-term norm as of Q4 2018. Within the Regions footprint, Alabama, Florida, Kentucky, and Louisiana are the only states in which foreclosure rates as of Q4 2018 remained above their longer-term norms, but it is worth keeping in mind that the latter three states are judicial states, in which the foreclosure process tends to be considerably lengthier than is the case in non-judicial states. While each of these states has seen a steadily declining foreclosure rate, the backlog of foreclosures that built up after the 2007-09 recession has yet to be cleared.



It seems, given the degree to which early-stage delinquency rates have continued to decline, only a matter of time before 90-day delinquency rates also drop below their longer-term norms. One reason for the marked improvement in mortgage loan performance is that mortgage underwriting standards have been much more stringent in the post-recession years than had been the case in the years leading up to the 2007-09 recession. As we have highlighted in our write-ups of the Federal Reserve Bank of New York's quarterly reports on household debt, in the post-recession years mortgage loan originations have been highly concentrated amongst borrowers with credit scores of 760 or above. As such, anything other than steadily improving mortgage loan performance would be a surprise.

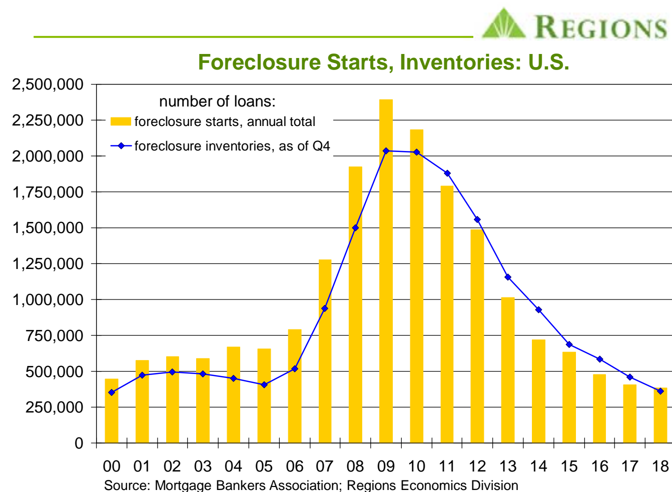
That said, it would be wrong to attribute the entire improvement in mortgage loan performance to tougher underwriting standards alone. An economic expansion that will, if it persists through July, become the longest on record has fostered a prolonged period of steadily improving labor market conditions. As seen in the chart to the side, patterns in mortgage delinquency rates are closely aligned with the unemployment rate, which has been even more the case since the 2007-09 recession (again, the post-hurricane spike in delinquency rates stands out but is not indicative of underlying economic or labor market conditions). The mortgage delinquency rate shown in the chart is the same weighted average rate encompassing all delinquency buckets (i.e., 30-day, 60-day, and 90-day) shown earlier but with a longer history; the unemployment rate is a weighted average rate for the Regions footprint using the same (mortgage loan) weights for each of the in-footprint states used to calculate the delinquency rate. At 3.7 percent as of Q4 2018, the weighted average unemployment rate is the lowest on record over the 1980-2018 period, and our baseline forecast anticipates further declines over coming quarters. If so, that augurs well for further declines in mortgage delinquency rates. Our point being that in addition to the underwriting component, there is also an economic component to the persistent decline in mortgage delinquency rates. It does follow that when the next recession does come, the more stringent mortgage loan underwriting standards that have been in place over the past several years should mean that, while delinquency rates and foreclosure rates will rise, those increases will not be of nearly the same magnitude seen as those around the 2007-09 recession.

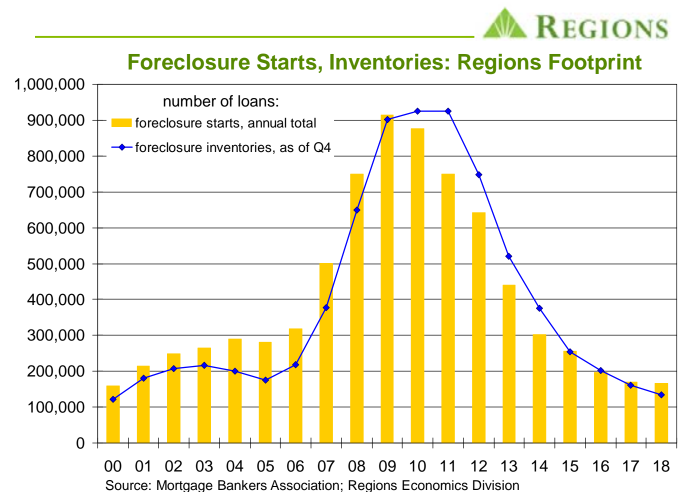




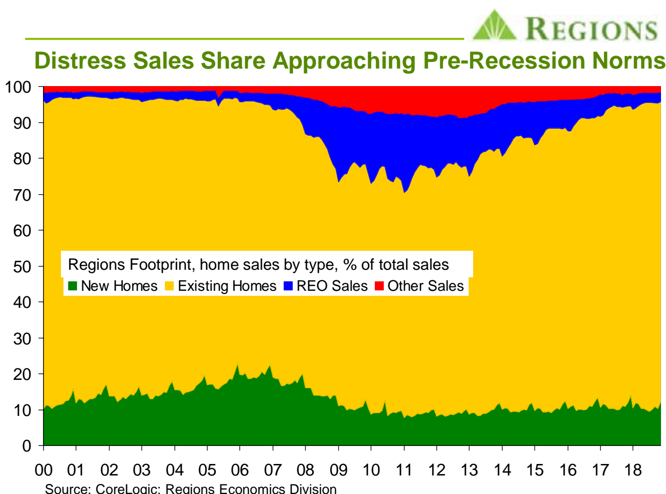
The above charts show mortgage distress by stage on a state-by-state basis as of Q4 2018, the first shows data for each state and the second shows only the Regions footprint. At 9.36 percent, Mississippi had the nation's highest rate of mortgage distress as of Q4, with Louisiana second at 8.42 percent. At just 2.67 percent, Colorado had the nation's lowest rate of mortgage distress as of Q4, with Iowa

posting the lowest rate in the Regions footprint (4.53 percent). Mississippi's 30-day (4.42 percent), 60-day (1.56 percent), and 90-day (2.29 percent) delinquency rates are the highest in the nation, but its foreclosure rate is not close to being the highest in either the U.S. or the Regions footprint. Florida's 30-day (2.29 percent) and 60-day (0.78 percent) are below the national average but, at 1.43 percent, Florida's foreclosure rate is the eighth highest in the nation and the highest in the Regions footprint. At its peak, however, Florida's foreclosure rate stood at 14.49 percent (Q3 2011, when the total rate of mortgage distress was 23.46 percent), so the significant progress made since then is the much more relevant story than it still being a bit above the national average foreclosure rate.





That progress, of course, has been broad based across states, both nationally and within the Regions footprint. The two charts above show, for the U.S. as a whole for the Regions footprint, annual foreclosure starts and the foreclosure inventory as of Q4 of each year. For the U.S. as a whole, there were a total of 382,745 foreclosure starts in 2018, down 6.28 percent from 2017 and an 84.0 percent decline from the peak of 2.392 million foreclosure starts in 2009. There were a total of 166,890 foreclosure starts in the Regions footprint in 2018, down 2.05 percent from 2005 and an 81.74 percent decline from the peak of 913,982 foreclosure starts in 2009. As noted above, however, we think a sizeable number of foreclosure starts in Florida and Texas were pushed from 2017 into 2018 in the wake of Hurricanes Harvey and Irma, thus holding down the percentage decline in starts for the footprint as a whole in 2018. Indeed, Florida saw a 9.51 percent increase in foreclosure starts in 2018, with a 16.85 percent increase in Texas. Of the remaining states, North Carolina (down 19.08 percent), Tennessee (down 12.20 percent), South Carolina (down 10.51 percent), and Alabama (down 10.33 percent) saw the biggest drop-offs in foreclosure starts in 2018. How we like to put this is that with inflows into the foreclosure process having steadily slowed for a number of years, it follows that outflows from the foreclosure process, i.e., foreclosed homes going back on the market, would also have slowed. For the U.S. as a whole and the Regions footprint, 2018 saw the lowest year-end level of foreclosure inventories since 2000. If we are correct that delinquency rates have lower to go, then so too do foreclosure starts and foreclosure inventories.



One implication of steadily declining foreclosures has been a steadily decline in the share of total home sales accounted for by distressed properties, as seen in the chart to the side. At year-end 2018, REO sales accounted for just 2.72 percent of all home sales in the Regions footprint, while "other sales (mainly short sales, also included in the "distress sales" category) accounted for 1.59 percent of total home sales. Though still a bit above historical norms, these shares are nonetheless far from the cyclical peaks of 21.76 percent and 8.83 percent, respectively. Earlier in this cycle, the paring down of the large backlog of distress inventories helped hold down the pace of house price appreciation, but as that backlog has all but been cleared, inventory constraints in the for-sale segment of the housing market have become more pressing, thus helping fuel a faster pace of house price appreciation.

To be clear, that is by no means to be taken as a complaint. For the housing market, the road back to "normal" has been a long and twisted one, and we're not quite there yet. But, with mortgage loan performance continuing to improve and foreclosure starts closing in on two-decade lows, we can at least go back to analyzing supply and demand on their own merits without having to consider the lingering effects of the excesses seen during the last cycle. That is a welcome, not to mention long overdue, development.

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Mortgage Distress, Regions Footprint

as of Q4 2018

STATE	30-day delinquency rate	60-day delinquency rate	90-day delinquency rate	foreclosure inventory	total mortgage distress rate	"early stage" delinquency rate	"serious" delinquency rate
Alabama	3.42	1.14	1.59	0.85	7.00	4.56	2.44
Arkansas	3.11	1.02	1.42	0.83	6.38	4.13	2.25
Florida	2.29	0.78	1.23	1.43	5.73	3.07	2.66
Georgia	3.12	1.06	1.34	0.67	6.19	4.18	2.01
Iowa	2.19	0.73	0.85	0.76	4.53	2.92	1.61
Illinois	2.51	0.89	1.19	1.31	5.90	3.40	2.50
Indiana	3.33	1.10	1.38	1.22	7.03	4.43	2.60
Kentucky	2.73	0.86	1.19	1.12	5.90	3.59	2.31
Louisiana	3.81	1.35	1.87	1.39	8.42	5.16	3.26
Missouri	2.67	0.89	1.01	0.58	5.15	3.56	1.59
Mississippi	4.42	1.56	2.29	1.09	9.36	5.98	3.38
North Carolina	2.64	0.96	1.46	0.65	5.71	3.60	2.11
South Carolina	2.93	0.99	1.32	0.93	6.17	3.92	2.25
Tennessee	2.83	0.95	1.30	0.59	5.67	3.78	1.89
Texas	2.95	1.01	1.19	0.63	5.78	3.96	1.82
U.S.	2.41	0.81	1.11	0.95	5.28	3.22	2.06

NOTE: all rates expressed as a percentage of outstanding mortgage loans, not seasonally adjusted

Source: Mortgage Bankers Association; Regions Economics Division

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Foreclosure Starts, Foreclosure Inventories

	Annual Foreclosure Starts					Foreclosure Inventories as of Q4				
	2000	2005	2009	2014	2018	2000	2005	2009	2014	2018
Alabama	3,991	8,237	20,426	10,763	6,537	2,327	4,540	12,985	8,220	4,242
Arkansas	2,269	4,721	9,634	5,574	3,318	1,620	2,715	6,203	4,621	2,168
Florida	40,600	28,156	370,907	77,051	32,178	30,368	14,336	461,472	154,428	37,336
Georgia	13,949	32,687	94,107	31,734	15,899	9,282	17,306	59,074	20,273	8,755
Iowa	1,622	5,508	10,015	4,318	2,810	1,206	4,643	9,593	4,899	2,176
Illinois	19,909	29,329	95,737	35,106	18,480	17,758	20,641	96,292	50,764	18,862
Indiana	12,491	27,942	39,198	16,089	9,194	10,834	21,257	36,311	17,418	8,232
Kentucky	4,111	8,859	16,260	8,083	4,611	3,265	7,013	14,137	8,802	4,285
Louisiana	5,776	7,340	16,196	8,631	6,833	4,038	5,134	15,066	9,734	6,040
Missouri	5,876	14,308	30,313	13,259	7,028	3,243	7,325	18,034	8,414	3,890
Mississippi	2,450	4,861	10,665	5,268	3,739	1,510	2,879	7,454	4,070	2,333
North Carolina	9,674	24,442	43,620	22,355	11,470	5,447	14,636	30,262	18,452	8,194
South Carolina	4,949	13,550	26,129	11,439	6,909	3,579	10,364	22,362	13,951	5,885
Tennessee	7,866	16,470	32,673	14,064	7,324	5,384	9,280	19,990	9,777	4,144
Texas	23,747	53,706	98,104	39,402	30,562	14,897	29,725	61,693	28,947	17,908
Regions Footprint	159,279	280,115	913,982	303,135	166,890	114,757	171,796	870,927	362,770	134,451
U.S.	445,526	657,087	2,391,516	720,678	382,745	353,927	408,221	2,034,722	928,926	360,542

Source: Mortgage Bankers Association; Regions Economics Division

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