

# Mortgage Delinquency, Foreclosures, and Subprime Lending in New Hampshire. How Big is the Problem?

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## Overview

As is the case with every other state in New England and most other states in the country, New Hampshire has a growing real estate foreclosure problem. Most of the news articles over the past several months point to figures for the size of the problem nationally (i.e. two plus million home owners may lose their homes to foreclosure) and alternately blame subprime lenders, over-stretched borrowers, greedy investors, overly optimistic real estate agents, job losses in the rust belt, hurricane Katrina, the general malaise in the real estate market, or all of the above. This report analyzes the available data to present the nature and size of this problem in New Hampshire.

Chart 1

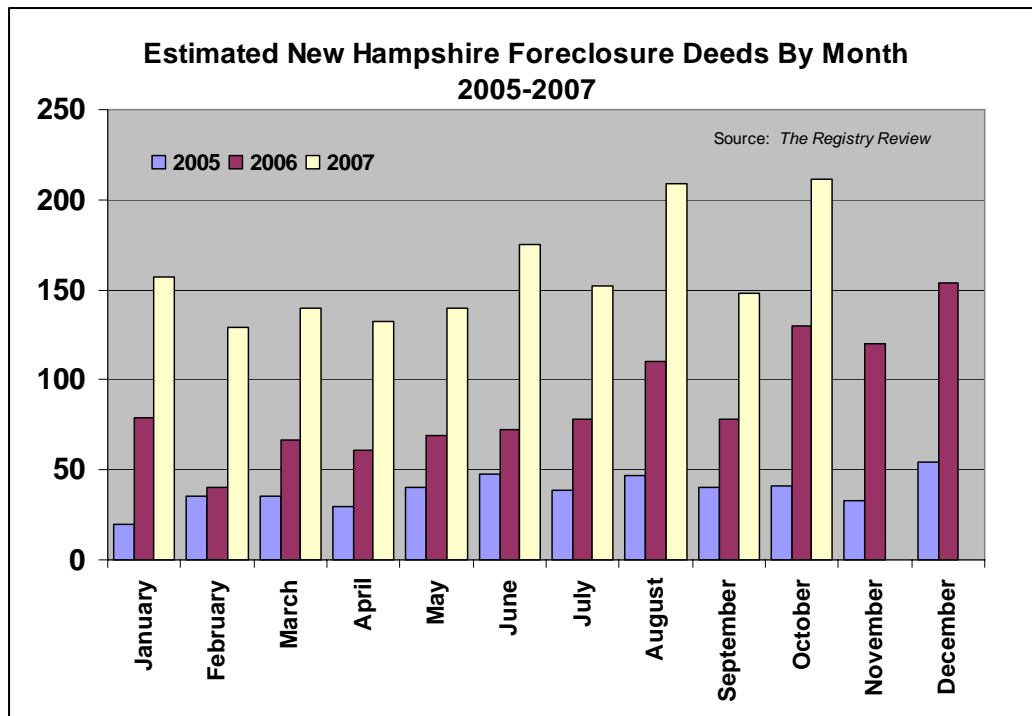


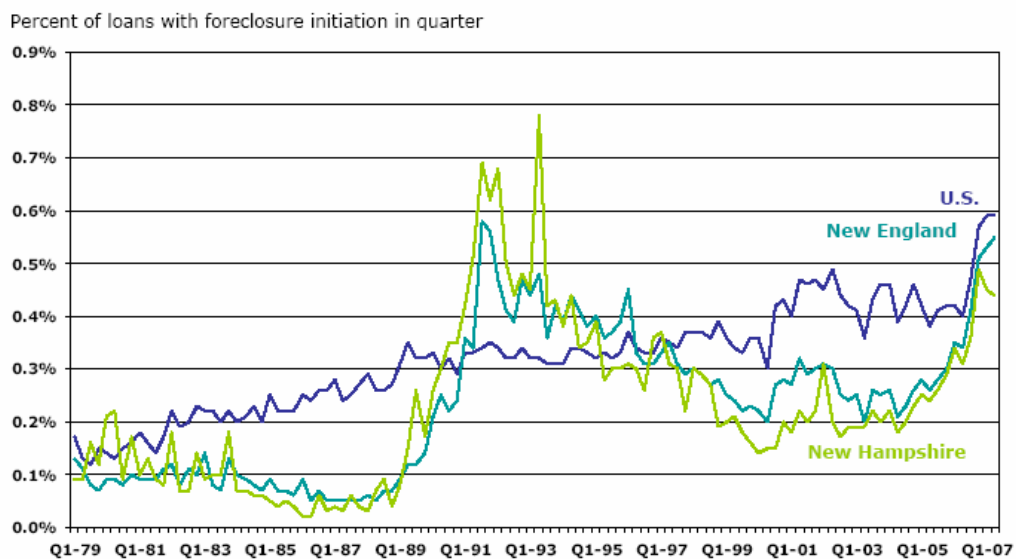
Chart 1 offers a reasonably current picture of the growing property foreclosure problem in NH. In 2005 foreclosure deeds averaged fewer than 40 per month, and totaled less than 500 for the year. Beginning in 2006, the rate of foreclosures began to increase and for the first 10 months of 2007 the average was 159 foreclosure deeds per month. At that rate foreclosure deeds will approach 2,000 for the year. The majority, but not all, of these foreclosure deeds are for residential property, and not all of the foreclosed residential properties are owner occupied primary residences. In addition, foreclosure deeds represent only those properties that could not leave the foreclosure process any other way. The majority of borrowers entering foreclosure settle the outstanding debt (property sold or transferred and/or debt paid) before a foreclosure deed is issued.

## Comparing Foreclosure Initiations

Based on the Mortgage Bankers Association *National Delinquency Survey*<sup>1</sup>, foreclosures were started on 0.44% of all New Hampshire mortgages during the second quarter of 2007; about one loan entering foreclosure out of every 227 mortgage loans. That rate has more than doubled over the past three years, and is approaching but still below foreclosure rates experienced in New Hampshire and New England in the early 1990's, (See Chart 2). In contrast, the foreclosure rate for the US has reached an all time high in each of the past three quarters.

Chart 2

### Foreclosure rates for United States, New England, and New Hampshire, through Q2-07



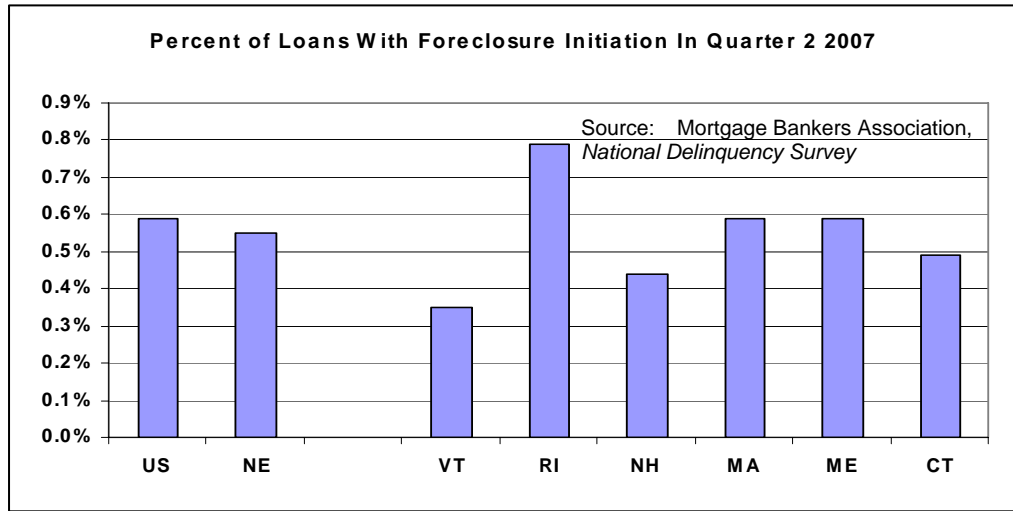
FEDERAL RESERVE  
BANK OF BOSTON™

Source: Mortgage Bankers Association/Haver Analytics

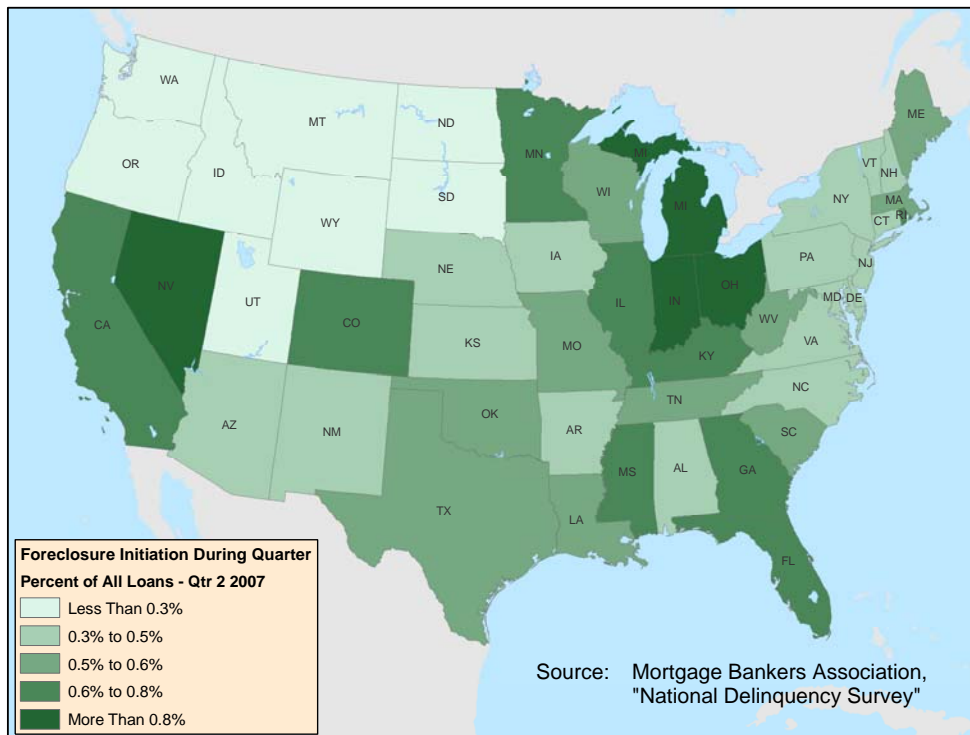
While it may be little consolation, the second quarter foreclosure rate in New Hampshire is slightly better than the rate for New England, the US, and all other New England states except for Vermont (See Chart 3).

<sup>1</sup> The Mortgage Bankers Association, *National Delinquency Survey* is one of the most recognized sources of residential mortgage delinquency and foreclosure rates. The survey is based on a sample of more than 44 million mortgage loans serviced by mortgage companies, commercial banks, thrifts, credit unions and other lenders. The survey provides quarterly delinquency and foreclosure statistics at the national, regional and state levels.

Chart 3



The map below offers evidence that there are areas of the country where the problem is more significant than in the New England states. The north-central states of Ohio, Michigan and Indiana have some of the highest foreclosure rates, due in part to the significant levels of job loss throughout that region. California, Nevada and Florida also have very high foreclosure rates, most likely due to high levels of speculative development and investor purchases.

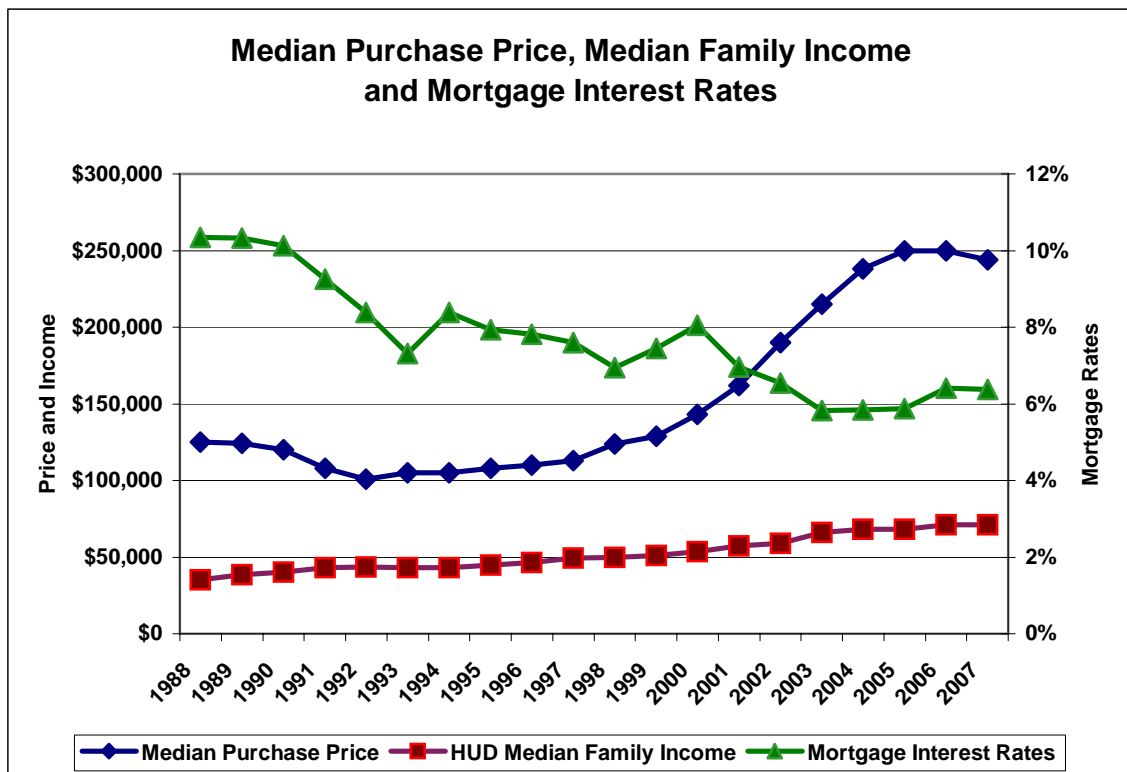


## Affordability

So what happened? Is the current foreclosure problem in New Hampshire the result of questionable lending practices, more specifically subprime lending, or is it the result of a turn in the real estate market? It wasn't that long ago that the real estate market in the state was riding the wave of the longest expansion in decades. The median sale price of homes in New Hampshire increased by 75% between 2000 and 2005, and by almost 150% since 1992, the end of the last "real estate recession". The rate of home ownership in the state reached 73% in 2005, up from 70% in 2000 and, at that time, the highest owner occupancy rate in New England, the fifth highest in the nation. Was too much of a good thing really too much? Perhaps so. The result of the rapid increase in prices was a significant decline in affordability.

Chart 4 plots three major real estate market indicators: median home sales price, median family income, and prevailing mortgage interest rates (right hand scale). The relationship between these indicators helps identify the affordability problem in New Hampshire as it developed over the past decade. Between 1992 and 2000, median home prices were between 2 and 2.7 times median family income, and the market perception was one of affordability. The decline in long term mortgage interest rates from about 8% in 2000 to less than 6% by 2003 contributed to the demand for ownership housing and accelerated the increase in prices so that by 2003, the median price was 3.25 times median family income.

Chart 4



While home prices were no longer viewed as affordable, the desire to become a part of the American home ownership dream and, in some cases, the desire to own the “home you always dreamed of” provided continued market demand and supported a further increase in prices beyond where the lack of affordability alone would have tempered them. By 2005, the median home price of \$250,000 was 3.7 times the median family income of \$68,000.

Over this same time period, existing home owners were experiencing unprecedented growth in their greatest asset, their home, and seeking easier ways to tap this wealth to fund home improvements, additional real estate purchases, education expenses, and/or repayment of other consumer debt. Loans for home refinance accounted for 60 percent of all first lien mortgages in New Hampshire in 2004 and 57 percent in 2005.

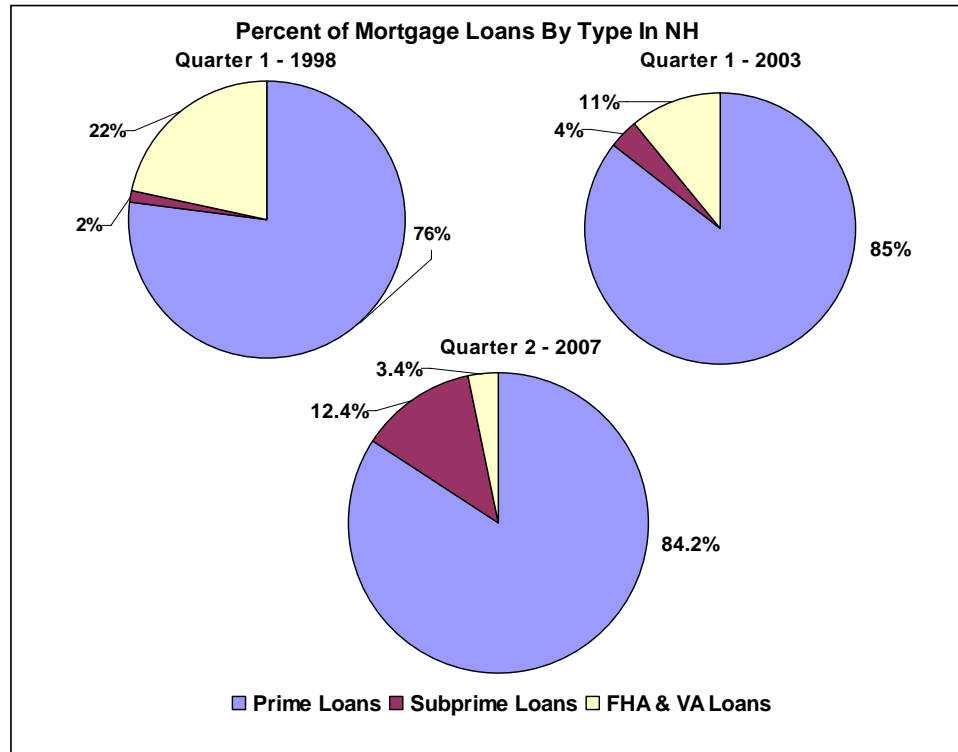
### **Subprime Mortgages**

By as early as the late 1990s the largely deregulated and very competitive mortgage industry began offering products to meet these changing demands. The risk associated with lending to “subprime borrowers” with poor credit, large loan amounts, and higher than previously acceptable debt to income ratios translated into higher mortgage rates and thus a higher cost to the borrower and a greater return for the investor. To surmount the growing affordability problem more exotic mortgage products began to emerge, including adjustable rate loans with introductory rates held artificially low, but still likely at or above rates for prime borrowers. After the initial period of the loan (typically two years), allowable rate resets are or will be well above the prevailing market rate. “Low doc” loans (undocumented borrower income or expenses), 100 percent financing, and negative amortization loans were also introduced as exotic loan products.

While initially not characterized as such, these higher risk mortgage products eventually became the subprime mortgage market. The broad definition of a subprime loan includes any loan not made to a prime borrower; that is, someone with good credit, verifiable income, assets, and liabilities, a down payment, occupying the home being purchased or refinanced, and where the loan amount is not qualified as jumbo (currently over \$417,000). Subprime loans are part of the conventional mortgage loan market. They are not government backed (FHA and VA) loans. Further, subprime loans are not synonymous with *predatory lending*. Predatory lenders prey on consumers with high debt or those in a financial crisis that have available equity. After refinances that often consolidate debt, the home owner actually incurs increased debt and loans with high fees and interest rates, ultimately stripping them of their equity and even leading to foreclosure. Subprime products were no doubt used to facilitate predatory lending. Subsequently, the difference between subprime and predatory has become blurred. While subprime lending has recently lost respectability, during the rising real estate market it allowed many otherwise qualified borrowers with tarnished credit to achieve the goal of home ownership and the seemingly guaranteed financial reward of equity growth. It also permitted many very well qualified upper income borrowers to easily finance the more expensive homes in many New Hampshire communities.

In 1998, subprime loans<sup>2</sup> accounted for just 2 percent of New Hampshire's mortgage loans (see Chart 5). By 2003, subprime loans had grown to a 4% market share, while government backed loans had shrunk to an 11% market share and prime loans had increased in share to 85%. By the middle of 2007, subprime loans in the state made up about 12 percent of all mortgages, while prime loans continue to represent more than 80% of the market.

Chart 5

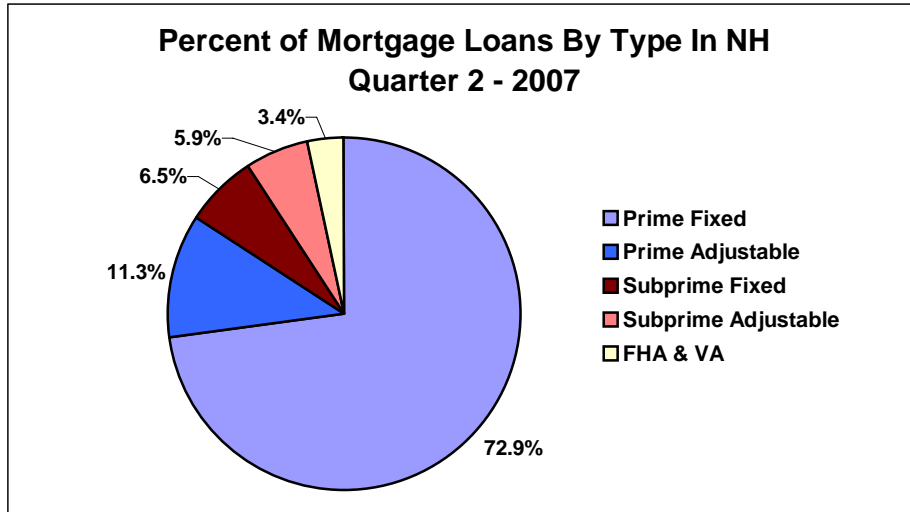


Both prime and subprime loans can be further broken down into fixed rate and adjustable rate mortgages (Chart 6). Adjustable rate mortgages (ARM) have an initial interest rate that resets after a period of time, typically 2 or 3 years, and then annually. The reset interest rate is usually related to an economic index. Common indexes used by lenders include the activity of one, three, and five-year Treasury securities.

The market shares for subprime adjustable rate and fixed rate mortgages in New Hampshire are nearly equal, at 5.9% and 6.5% respectively. So, about half of the subprime mortgages are ARM's. At 11.3% of the market, prime adjustable rate mortgages account for a larger portion than either of the subprime products; but, in contrast, they are a significantly smaller portion than prime fixed rate loans.

<sup>2</sup> Mortgage Bankers Association, *National Delinquency Survey*. MBA divides the conventional loan sample between prime and subprime based on whether the servicer handles primarily prime or subprime loans. Therefore, there are some prime loans in the subprime sample and some subprime loans in the prime sample.

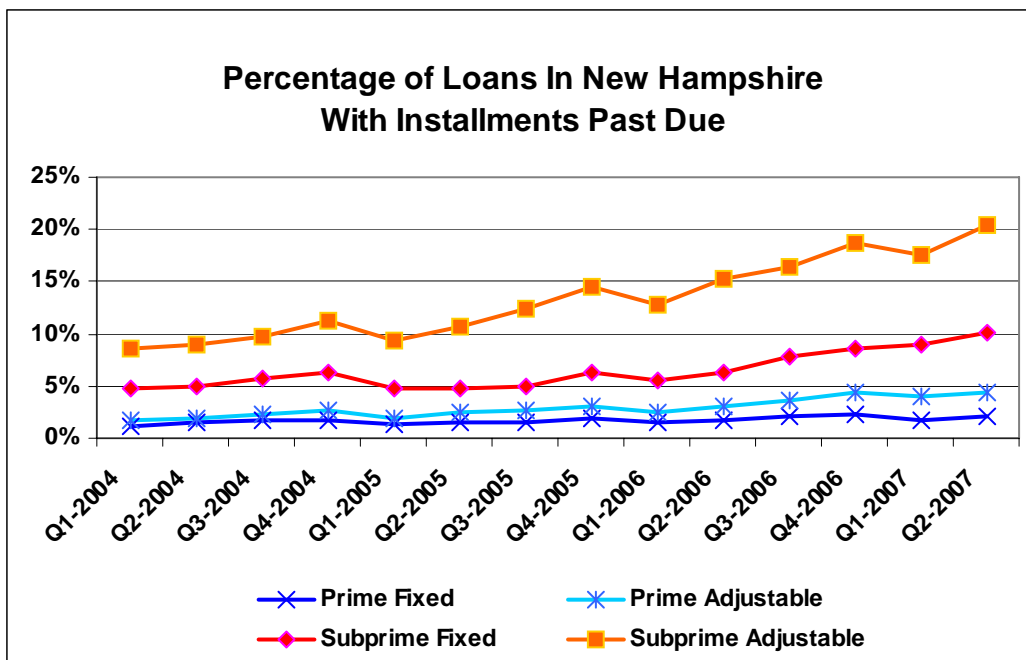
Chart 6



### Mortgage Performance

Chart 7 shows the percentage of loans in New Hampshire with installments past due by conventional loan type, by quarter since 2004. Between 2004 and 2007 the delinquency rate for prime fixed rate mortgages increased only slightly, while the delinquency rate for subprime adjustable rate loans more than doubled.

Chart 7

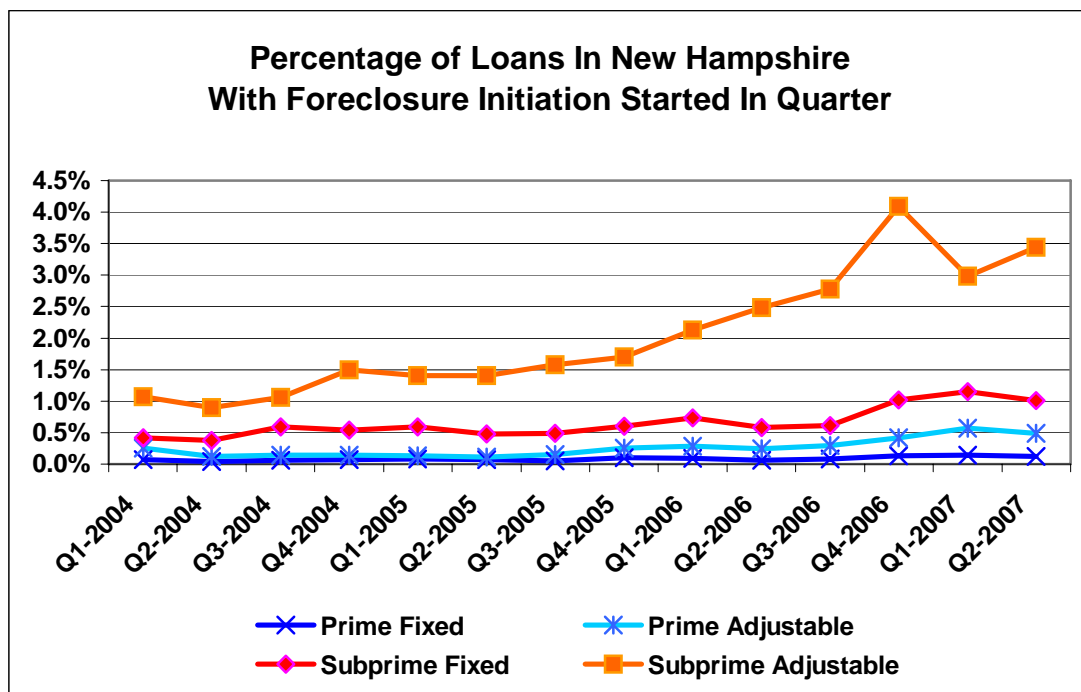


The delinquency rate for subprime fixed rate loans and prime adjustable rate loans has also increased significantly. This chart provides a good depiction of the risk stratification of these loan categories.

At 20 percent in the second quarter of 2007, two out of every 10 subprime adjustable rate loans are past due by one or more payments. At the other end of the spectrum, only two out of every 100 prime fixed rate loans are delinquent in this same quarter.

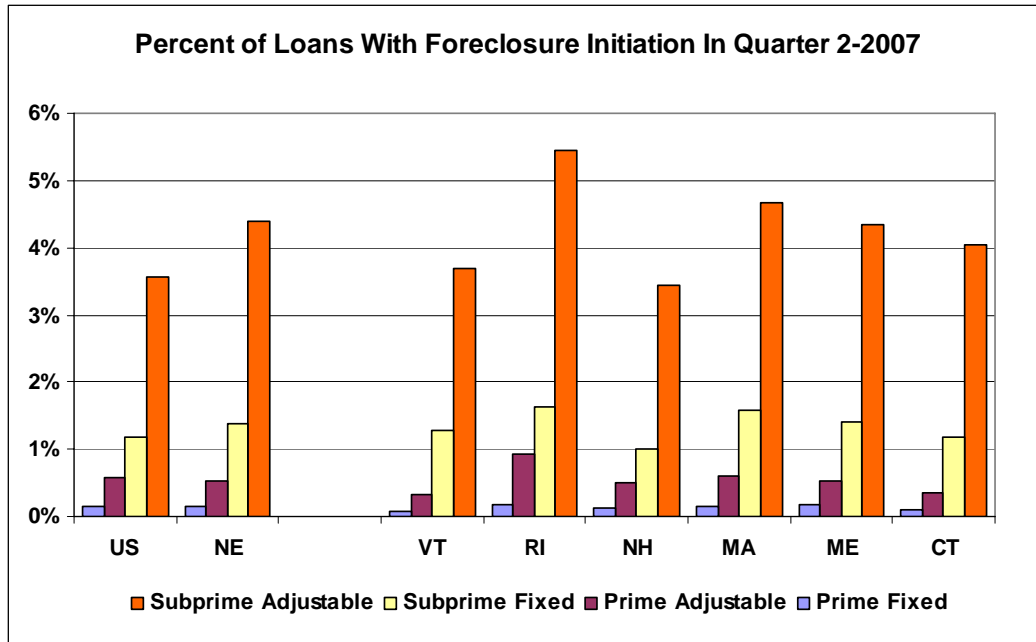
The foreclosure rates (Chart 8) for these mortgage products show similar trends and risk stratification. Since 2004, foreclosure rates for prime fixed rate loans show only a slight increase while for subprime adjustable rate loans the foreclosure rate has roughly tripled. As of the second quarter 2007, prime fixed rate loans entered foreclosure at a rate of slightly more than one loan per one thousand; whereas a subprime adjustable rate loan was more than 25 times more likely to enter foreclosure. While not as dramatic a change, the foreclosure rates for prime adjustable rate loans and subprime fixed rate loans have also seen significant increases over the past two years.

Chart 8



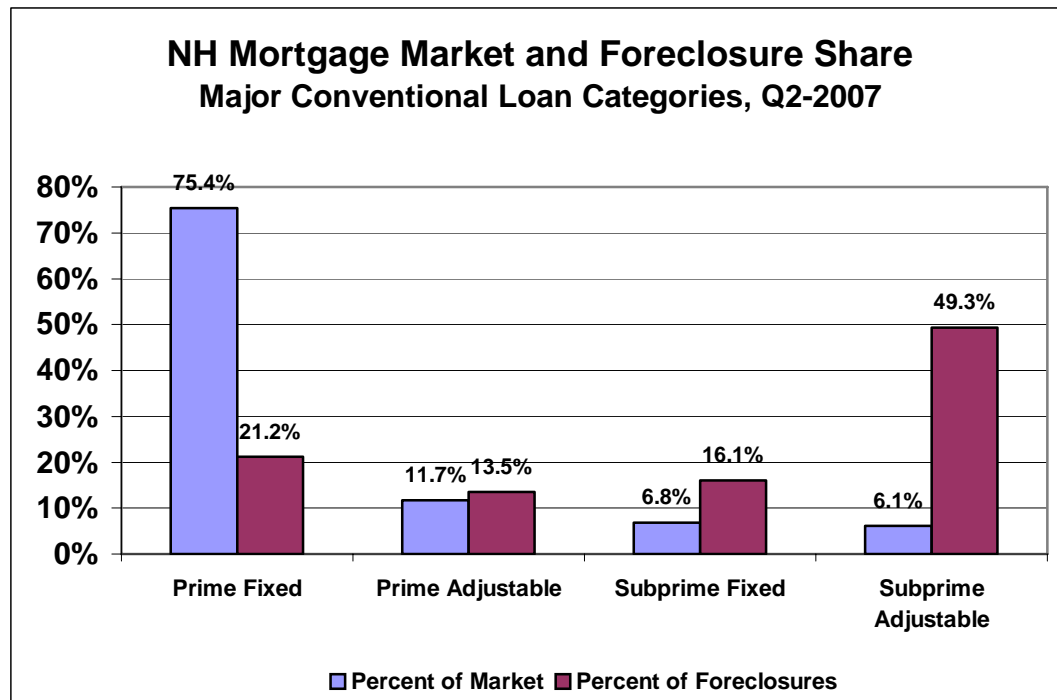
The foreclosure initiation rates for these conventional loan categories in other New England states are similar, if only slightly worse than in New Hampshire (Chart 9). Perhaps more importantly, the risk relationships between loan types are almost identical.

Chart 9



Summarizing the market share and foreclosure rate data presented above, it is apparent that while prime fixed and adjustable rate mortgages make up 83% of all mortgage loans or 87% of all conventional mortgage loans, they account for less than 35% of foreclosures in these loan categories (Chart 10). Conversely, subprime loan products account for only 13% of conventional mortgage loans, but 65% of foreclosure initiations for loans in these categories.

Chart 10



## New Hampshire Subprime Loans

Based on this evidence, there is little doubt that subprime loans make up the lion's share of loans entering foreclosure; but, we still haven't explored the question of how many loans this represents in New Hampshire. The Mortgage Bankers Association *National Delinquency Survey* indicates that nationally their survey covers "over 80 percent of approximately 50 million outstanding loans in the housing market." However, it is not clear what percent of outstanding loans in New Hampshire are covered by the survey. Fortunately it is possible to estimate the total number of outstanding first lien mortgages in the state based on US Census data.

The 2005 American Community Survey<sup>3</sup> indicates a total of 254,938 owner occupied housing units in New Hampshire with a mortgage. The same source also indicates vacant housing for seasonal or occasional use totaling 57,584. A significant portion of these homes would also have mortgages. Further, these numbers need to be time trended forward two years to derive a current estimate of housing units with a mortgage or total number of outstanding mortgages in New Hampshire. The estimate of total outstanding first lien mortgages in the state as of the second quarter 2007 is approximately 293,300. Using this base number and applying the rates derived from the *National Delinquency Survey* results in the estimates shown on Table 1, as of the second quarter 2007.

Table 1

<b>All Loans</b>	<b>Percent</b>	<b>Loans</b>
Loans with payment past due	4.3%	12,640
Loans with foreclosure started during the quarter	0.44%	1,290
Loans in foreclosure inventory at the end of quarter	1.01%	2,960

<b>Prime Loans</b>	<b>Percent</b>	<b>Loans</b>
Est. number of prime loans	84.2%	246,970
Prime loans with payment past due	2.54%	6,270
Prime loans with foreclosure started during the quarter	0.17%	420
Prime loans in foreclosure inventory at the end of quarter	0.50%	1,240

<b>Subprime Loans</b>	<b>Percent</b>	<b>Loans</b>
Est. number of subprime loans	12.4%	36,300
Subprime loans with payment past due	15.12%	5,490
Subprime loans with foreclosure started during the quarter	2.19%	800
Subprime loans in foreclosure inventory at end of quarter	4.47%	1,620

<sup>3</sup> U.S. Census, 2005 American Community Survey.

## Other Data Sources

To this point in the article most of the analysis of the mortgage market in New Hampshire has been based on the Mortgage Bankers Association *National Delinquency Survey*. However, an alternative set of data, the Federal Financial Institutions Examination Council's "Home Mortgage Disclosure Act" data for 2004, 2005, and 2006, (HMDA data) are frequently used to shed light on mortgage loans throughout the US and, more specifically, subprime loans.<sup>4</sup> The Home Mortgage Disclosure Act requires most regulated mortgage lenders to file documentation annually disclosing information about all mortgage loan applications. Within this data set, there is no specific indicator for subprime loans; however, lenders are required to identify those loans with an interest rate greater than three percentage points above the rate for comparable maturity US Treasuries securities. Since they typically carry a higher interest rate, this indicator is used as a proxy for subprime loans. A tabulation of the most recent HMDA data for New Hampshire resulted in the numbers in Table 2.

Table 2

### HMDA Data for New Hampshire

#### Loans for Home Purchase and Home Refinance - 1 to 4 Family Homes - Secured by a first lien

Year	2004			2005			2006		
	Count of Loans	Subprime Loans*	Subprime as % of Total	Count of Loans	Subprime Loans*	Subprime as % of Total	Count of Loans	Subprime Loans*	Subprime as % of Total
Belknap County	3,205	368	11.5%	2,969	638	21.5%	2,423	576	23.8%
Carroll County	2,889	302	10.5%	2,561	489	19.1%	2,078	429	20.6%
Cheshire County	2,776	324	11.7%	2,593	575	22.2%	2,127	574	27.0%
Coos County	882	197	22.3%	930	353	38.0%	908	347	38.2%
Grafton County	2,741	351	12.8%	2,596	541	20.8%	2,243	517	23.0%
Hillsborough County	20,275	1,870	9.2%	18,432	3,209	17.4%	12,596	2,553	20.3%
Merrimack County	6,522	684	10.5%	6,149	1,226	19.9%	4,415	1,018	23.1%
Rockingham County	16,514	1,399	8.5%	14,377	2,323	16.2%	9,921	1,868	18.8%
Strafford County	5,667	627	11.1%	5,079	1,052	20.7%	3,769	882	23.4%
Sullivan County	1,464	224	15.3%	1,417	420	29.6%	1,126	379	33.7%
Co. Not Available	31	1		131	5		137	21	
<b>New Hampshire Total</b>	<b>62,966</b>	<b>6,347</b>	<b>10.1%</b>	<b>57,234</b>	<b>10,831</b>	<b>18.9%</b>	<b>41,743</b>	<b>9,164</b>	<b>22.0%</b>

\* Loans that are 3 or more percentage points above the comparable maturity Treasury securities.

Combining the numbers of loans and subprime loans for the three years 2004 through 2006 results in a total of just less than 162,000 loans, 16.3% of which were subprime. This is about 26,300 subprime loans for home purchase or refinance of one to four family homes, secured by a first lien, during the three most active years for subprime lending. The three year total for subprime loans is nearly one-third smaller than the total derived previously, but the difference is understandable since the three year base represents only about 55% of the total number of New Hampshire first lien mortgages. The HMDA data is useful for a structural analysis of mortgage lending in the state by year, but there is little further comparison with the data from the Mortgage Bankers Association *National Delinquency Survey* since the HMDA database is mortgage application driven and has no measure of delinquency or foreclosure activity.

<sup>4</sup> The Home Mortgage Disclosure Act (HMDA) was enacted by Congress in 1975 and is implemented by the Federal Reserve Board's Regulation C. Over the past 30 years it has undergone numerous changes and now collects data on all mortgage applications from qualifying depository and non-depository lending institutions. Data for mortgage loans in New Hampshire from large national mortgage lenders and even smaller lenders with offices in a metropolitan county are included in the data. Small lenders with offices only in non-metropolitan counties are not required to file.

## Near Term Projections

By applying a simple set of assumptions to the foreclosure rates and number of loans indicated in Table 1 above, New Hampshire Housing has projected the number of properties entering foreclosure over the next two years (8 Quarters) as shown in Table 3. The total number of first lien mortgages is projected to grow at about 1 percent per year. The foreclosure rate for all first lien mortgages is anticipated to increase slowly over the next year to around 0.55%, and then decline slowly over the remaining 4 quarters of the projection period. The result is an increase in the projected number of loans with foreclosure started during the quarter from just under 1,300 now to over 1,600 by the middle of 2008. Over the next two years, the total number of prime loans is projected to increase by about 3.8 percent, just less than 2 percent per year. At the same time, the number of prime loans entering foreclosure each quarter increases slowly through the middle of 2008 and then declines through the end of the projection period.

Table 3

Projected Foreclosures In New Hampshire Over the Next Eight Quarters

	Qtr 2 - 07	Qtr. +1	Qtr. +2	Qtr. +3	Qtr. +4	Qtr. +5	Qtr. +6	Qtr. +7	Qtr. +8
<b>Estimated Total First Lien Mortgages</b>	293,300	294,000	294,700	295,400	296,100	296,800	297,500	298,200	299,000
<b>Percent of Loans With Foreclosure Started During Qtr.</b>	0.44%	0.46%	0.49%	0.52%	0.55%	0.52%	0.49%	0.46%	0.43%
<b>Loans With Foreclosure Started During Qtr.</b>	1,290	1,350	1,440	1,540	1,630	1,540	1,460	1,370	1,290
<b>Estimated Number of Prime Loans</b>	247,000	248,100	249,300	250,500	251,700	252,900	254,100	255,300	256,500
<b>Percent of Prime Loans With Foreclosure Started during qtr.</b>	0.17%	0.18%	0.19%	0.20%	0.21%	0.21%	0.20%	0.19%	0.18%
<b>Number of Prime Loans With Foreclosure Started during qtr.</b>	420	450	470	500	530	530	510	490	460
<b>Estimated Number of Sub-Prime Loans</b>	36,300	34,000	31,800	29,500	27,200	24,900	22,500	20,200	17,900
<b>Percent of SubPrime Loans With Fcl Started during qtr.</b>	2.19%	2.49%	2.74%	2.99%	3.24%	3.49%	3.74%	3.99%	3.99%
<b>Number of SubPrime Loans With Fcl Started during qtr.</b>	800	800	900	900	900	900	800	800	700

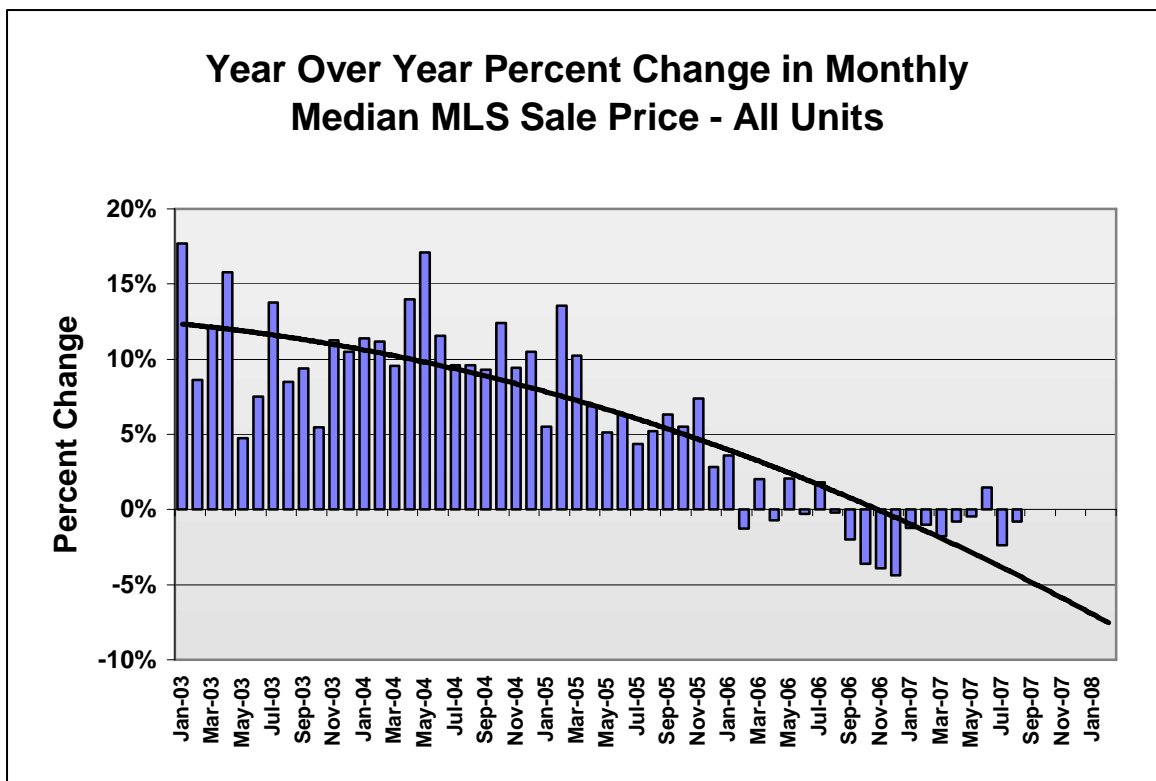
Over the projection period the total number of subprime loans in New Hampshire is expected to decline almost as dramatically as it increased between 2004 and 2007. At the same time however, the rate of subprime loans entering foreclosure increases steadily to about 900 per quarter by mid-2008, and totals 6,700 over the two year projection period.

While it is apparent from these projections that the foreclosure and subprime loan problem in New Hampshire is expected to continue over the next two years, the effect on the real estate market has already been felt. First, the availability of the subprime products sustained price appreciation beyond where the lack of affordability alone would have tempered the prices. Second, as distressed and foreclosed properties make their way onto the market, they add to the inventory of homes for sale. The number of homes on the market in New Hampshire as measured by Multiple Listing Service (MLS) current listings continues to be at or near a historic high point, while the pace of sales is down by more than 25% since the peak in 2004 and 2005. The resulting housing inventory is now in excess of 13 months. To date, however, the median sales price has remained surprisingly resilient with an overall decline as of mid-2007 of

only about 2.5% from its peak in 2006. But, adding more properties to the inventory on the market will continue the downward pressure on prices. Evidence suggests the real estate market is not yet half way through its downward price adjustment (Chart 11).

With market prices declining, the ability of a high loan-to-value property owner to sell their property without significant financial loss is limited. If, at the same time, the mortgage loan is an adjustable rate loan facing an upward reset (resulting in a payment that is even less affordable to the property owner) then remaining in the property becomes equally unlikely. For a variety of reasons including divorce, medical bills, and job loss, other home owners, even those with previously affordable mortgage payments, will find themselves in a position in which they can no longer afford their current level of debt.

Chart 11



While simplified in the argument above, this is why foreclosure rates have risen to their current level, and why this problem can be expected to continue for the next 24 to 30 months. Over this time period, many property owners will struggle to stay current with payments that by most analysis are unaffordable. Those borrowers who have sufficient equity, credit and verifiable income will find ways to refinance and stay in the property. Property owners who must sell and can afford to sustain the financial loss will do so by dramatically reducing the price. Some property owners who cannot refinance or sell the property may find success in renegotiating their loan with the mortgage lender; but the number of such cases is likely to be very small. Those who fall behind on their mortgage and cannot sell the property, refinance, or renegotiate the loan will ultimately face foreclosure. For those individual households the process is traumatic and the economic loss is real, but their numbers are not so large as to pose a direct threat to the overall New Hampshire economy. At present more than 95 percent of New

Hampshire mortgagees are current in their payments and almost 30 percent of owner occupied housing has no mortgage at all.

Unlike the late 1980s New Hampshire banks have limited exposure to the current round of delinquencies and foreclosures since most mortgage loans are securitized, a process where the risk is spread out among investors nationally and even globally. For almost twenty years, New Hampshire mortgage lenders have originated loans and been the conduit for the funds, but in most cases, not the funding source. Further, during this cycle, New Hampshire has not experienced the level of overbuilding and speculative development that took place here during the 1980s and has taken place recently in other parts of the country. These are significant differences between this and the previous "real estate recession" and there continue to be other indicators suggesting that the underlying economic conditions in New Hampshire remain healthy. But, it would be inaccurate to suggest that there is no overall risk to our economy.

The widespread nature of the subprime lending and foreclosure problems in the US continues to have a negative impact on the largest lending institutions in this country and the credit market globally. The Fed has already taken action twice to lower short term rates and the largest US banks have taken other actions to shore up the declining confidence in the credit market. If, however, these actions are not sufficient and the credit crisis worsens, a national recession may not be avoidable. If this were to happen, the real estate market and ultimately the foreclosure problem could worsen significantly in the nation and New Hampshire.

End