

A Reprint from *Tierra Grande*

IN TEXAS

do we have a FORECLOSURE problem?

By James P. Gaines

“The apparent froth in housing markets may have spilled over into mortgage markets. The dramatic increase in the prevalence of interest-only loans, as well as the introduction of other, more-exotic forms of adjustable-rate mortgages, are developments that bear close scrutiny. To be sure, these financing vehicles have their appropriate uses. But to the extent that some households may be employing these instruments to purchase a home that would otherwise be unaffordable, their use is adding to the pressures in the marketplace.”

— Federal Reserve Chairman Alan Greenspan
American Bankers Association Annual Convention,
Palm Desert, California
September 2005

A lot of recent attention has been devoted to the so-called housing price “bubble.” At first, press reports noted the high rates of increase in sales activity and price levels in key local markets, primarily in California, Nevada, Florida and New England.

In Texas, local Realtors reported record sales volumes and record high prices although the rates of increase, especially in prices, have been more modest compared with other areas. Recent reports focus on when (not if) the bubble will burst, what factors will precipitate this event and what data may signal it. Leading indicators include national and Texas foreclosure rates, and foreclosure rates in certain Texas metropolitan areas, especially Dallas and Austin.

Texas’ Foreclosure History

Data reported on foreclosure postings, foreclosure activity and the actual number of new foreclosure sales provide an interesting picture of what is happening in Texas and the rest of the country. Current trends may reflect Texas’ historical economic and foreclosure activity (Figure 1).

During the recessionary 2000–01 period, the Texas foreclosure rate was significantly less than the U.S. average. But both rates began to exhibit a general upward trend in overall percentage of loans foreclosed, corresponding to record low interest rates

Steps in Foreclosure Process

Delinquency	Notice to Cure	Default Notice and Posting	Foreclosure Sale	Active Foreclosure Inventory
Borrower delinquent making payments, makes no arrangements with lender for forbearance.	Lender notifies borrower of delinquency with demand for borrower to cure delinquency. In Texas, borrower has 20 days to cure delinquency.	Borrower sent formal notice of default and intent to sell property at foreclosure; lender activates acceleration clause in loan; appropriate documentation filed in county courthouse that property posted for foreclosure. This step initiates required time period for borrower to cure default by paying amount due plus interest and other costs. In Texas, foreclosure sales occur on first Tuesday of month, 21 days after notice and posting.	If borrower is unable to cure default within allotted time, property sold at auction on courthouse steps. Typically, lender bids on property up to what is owed by borrower. If no one else bids more than lender, lender will own property and attempt to sell it directly. If foreclosure sale does not cover full amount due, lender may have a deficiency judgment against borrower for difference.	Properties acquired by lenders at foreclosure sales are held in their "real estate owned" inventories and are marketed like any other property through real estate agents and companies that specialize in marketing foreclosed properties.

Derived from "A Homeowner's Rights Under Foreclosure" (<http://recenter.tamu.edu/pdf/825.pdf>) by Judon Fambrough, Real Estate Center at Texas A&M University.

and highly aggressive mortgage lending practices. By 2003, Texas foreclosures again exceeded the national average, but this increase may reflect the slower pace of home price increases plus more liberal underwriting criteria and lower interest rates rather than an underlying market weakness.

Within the past year, data from Foreclosure.com, one of the largest providers of current property foreclosure and preforeclosure data, indicate that Texas' rate of new foreclosures (monthly foreclosure sales) has trended downward, while the rest of the United States is trending upward (Figure 2).

The number of properties actually sold at foreclosure sales and now in lenders' inventory (Table 1) is dramatically different from the number of foreclosure postings (Table 2).

In the high-appreciation states of California, Florida and Nevada, properties actually sold at foreclosure number significantly less than postings. The principal reason is fairly simple. In states with rapidly increasing home prices, an owner served with a default notice and foreclosure posting can easily sell the property and cure the default, probably at a profit. In states with less appreciation, such as Texas, owners typically do not have the opportunity to sell the property at a high enough price to cure a default.

This discrepancy may also reflect the fact that many homes are being purchased by first-time homebuyers who qualify for loans based on initially lower interest rates and more liberal underwriting criteria applied by aggressive lenders. Many people are able to acquire a loan and buy a house but are unable to keep

up with payments on the loan because of high property taxes, insurance costs, maintenance and other normal homeownership costs for which they are not prepared. Higher numbers of foreclosures in states like Texas probably indicate easier home credit and the owner's inability to sell the property on default because of low rates of home price appreciation.

Foreclosure Postings

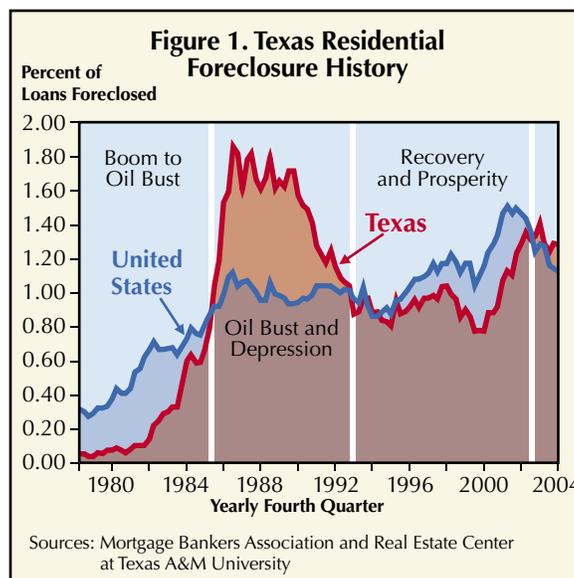
Texas does not have the most properties posted for foreclosure but not yet sold at auction (preforeclosures). That title easily goes to California (Table 2). The total number of postings is somewhat misleading, though, as the period

properties are required to be posted prior to an actual sale is longer in California (as long as 120 days) than in Texas (41 days). Also, lenders in different markets have different default and foreclosure policies.

A better perspective on home foreclosure is gained by comparing Texas' foreclosure experience with other states based on population and the total housing stock (a proxy for the total number of home loans). On a per-capita basis or on a per-housing-unit basis, Texas' rate of preforeclosures is more in line with the national average and is less than half the rate of some high-growth states.

Texas' rate of 63.3 preforeclosure postings per 100,000 people (Table 3) is slightly greater than the U.S. average of 57.6 postings but less

than one-quarter of the rates in Nevada, and significantly lower than those in California, Florida and Arizona, the leading home appreciation states.



Similarly, Texas' rate of 16.1 preforeclosures per 10,000 housing units (Table 4) is slightly greater than the U.S. average of 13.8 but significantly lower than the posting rates of the leading home appreciation states.

Need for Concern?

As the saying goes, everything is bigger in Texas. But it's not altogether clear that there is reason to be overly concerned about the large number of home foreclosures reported in the state.

Like markets across the country, Texas' housing market has prospered during the past several years because of low interest rates and the push by mortgage lenders to make qualifying for new loans easier. Although most Texas localities reported record sales and price levels, the state's rate of home appreciation ranked lowest among the 50 states and the District of Columbia.

As in many other states, the number of first-time homebuyers has increased and is evidenced by rising homeownership rates. Lenders continue to make qualifying for mortgage loans easier through numerous private as well as government

programs, including Alternative-A ("Low-Doc" and "No-Doc") loans, home equity lines of credit and Option ARM (negative amortization) loans. Buyers are able to acquire homes with reduced down payments and low initial monthly payments.

For some homebuyers, reality sets in as adjustable mortgage interest rates change and as they incur normal homeownership costs such as taxes, insurance, maintenance and homeowner association fees. Defaults and delinquencies that lead to foreclosures occur most often during the first few years of ownership.

The groups that should be most concerned about foreclosures in Texas are lenders and purchasers of mortgage-backed debentures (unsecured notes or bonds). If lenders continue to make riskier loans that get packaged into the

secondary mortgage market, the market may not bail them out through higher prices. ➔

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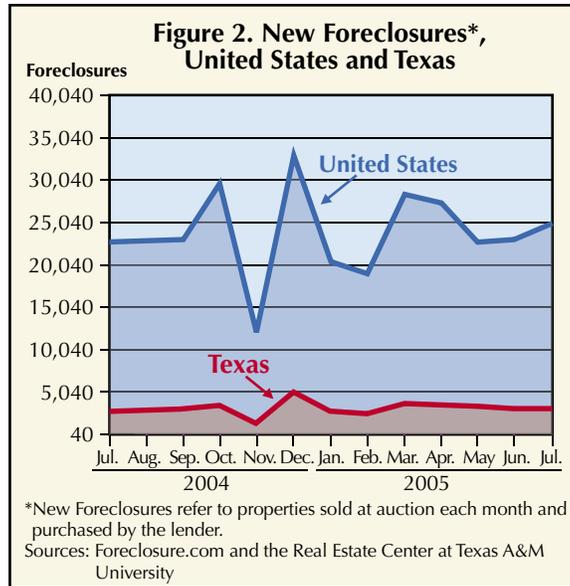


Table 1. Active Foreclosures*, Selected States, August 2005

Texas	14,313
Ohio	10,885
Michigan	9,552
Georgia	8,371
Colorado	7,211
Indiana	6,312
Illinois	4,563
Oklahoma	1,962
Mississippi	1,556
Kansas	1,385
Florida	1,134
Arizona	1,040
California	721
Virginia	695
Maryland	568
New Jersey	415
Nevada	258

Table 2. Preforeclosures, Selected States, August 2005**

California	67,779
Florida	24,896
Illinois	15,623
Texas	14,227
Arizona	8,682
Nevada	6,043
Oklahoma	2,668
New Jersey	1,457
Colorado	1,244
Indiana	146
Ohio	94
Georgia	85
Michigan	44
Maryland	32
Mississippi	29
Virginia	27
Kansas	20

Table 3. Preforeclosures Per 100,000 Population*, Selected States, August 2005**

Nevada	258.8
California	188.8
Arizona	151.2
Florida	143.1
Illinois	122.9
Oklahoma	75.7
Texas	63.3
United States	57.6
Colorado	27.0
New Jersey	16.7
Indiana	2.3
Georgia	1.0
Mississippi	1.0
Ohio	0.8
Kansas	0.7
Maryland	0.6
Michigan	0.4
Virginia	0.4

Table 4. Preforeclosures Per 10,000 Housing Units*, Selected States, August 2005**

Nevada	61.9
California	52.9
Arizona	35.3
Florida	31.1
Illinois	30.7
Oklahoma	17.0
Texas	16.1
United States	13.8
Colorado	6.2
New Jersey	4.3
Indiana	0.5
Georgia	0.2
Kansas	0.2
Mississippi	0.2
Ohio	0.2
Maryland	0.1
Michigan	0.1
Virginia	0.1

Note: Texas, Indiana, Oklahoma, Ohio, Colorado, Kansas, Mississippi and Michigan were the bottom eight states in home price appreciation in 2Q2005 as reported by Office of Federal Housing Enterprise Oversight: Nevada, California, Florida, Maryland, Arizona, Virginia and New Jersey were among the top ten states with the highest home price appreciation).

* Active foreclosures are foreclosed properties sold at auction and now in lenders' real estate owned accounts.

** Preforeclosures are properties posted for foreclosure but not yet sold at auction.

*** State population estimates as of July 1, 2004, U.S. Census.

Sources: Foreclosure.com and Real Estate Center at Texas A&M University



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