

# **The Economics of Homeownership: Implications of Current Foreclosure and Market Trends**

Governor's Housing Conference  
November 13, 2008

Virginia Housing Development Authority



# Attitudes toward home purchase have changed dramatically

- A generation ago, homeownership was mainly seen as a means to achieving economic self-sufficiency and security—  
**Then: “One’s home is one’s castle”**
- But, changes in the Tax Code since 1986 have caused more people to begin viewing their home as a financial asset—i.e., as a tax haven, an investment tool, and a way of leveraging consumer debt—  
**Now: “One’s home is one’s ATM and savings account”**

# This new attitude contributed to and was reinforced by the boom

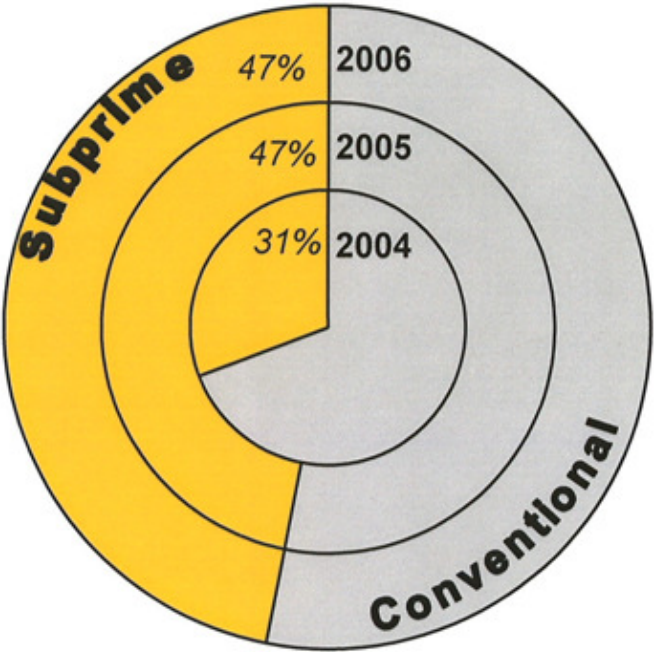
- Following the 2000 stock market bust, home purchase was promoted as the best and safest of investments
- This inflated home sales and caused prices to skyrocket
- Spiraling values reinforced the new attitudes, and led to both imprudent first-mortgage borrowing and high usage of home equity lines of credit

# Many homebuyers and owners fell prey to poor borrowing choices

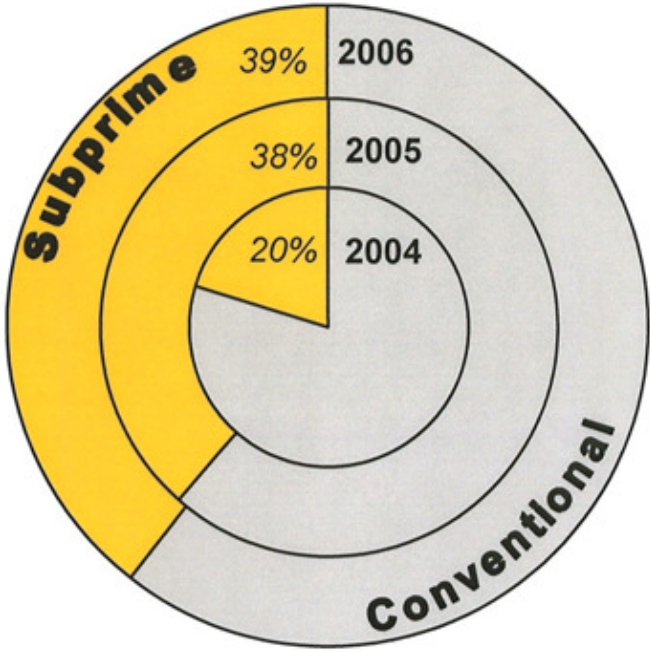
- Risky, high-cost subprime loans became an alternative to credit repair for households with low credit scores
- Two-thirds of subprime loans in Virginia were used for cash-out refinancings
- Adjustable rate mortgages with low teaser rates allowed purchase of homes that borrowers simply could not afford
- Low documentation loans opened the door to fraud and unsubstantiated underwriting

# Minority homebuyers depended heavily on high-cost mortgages

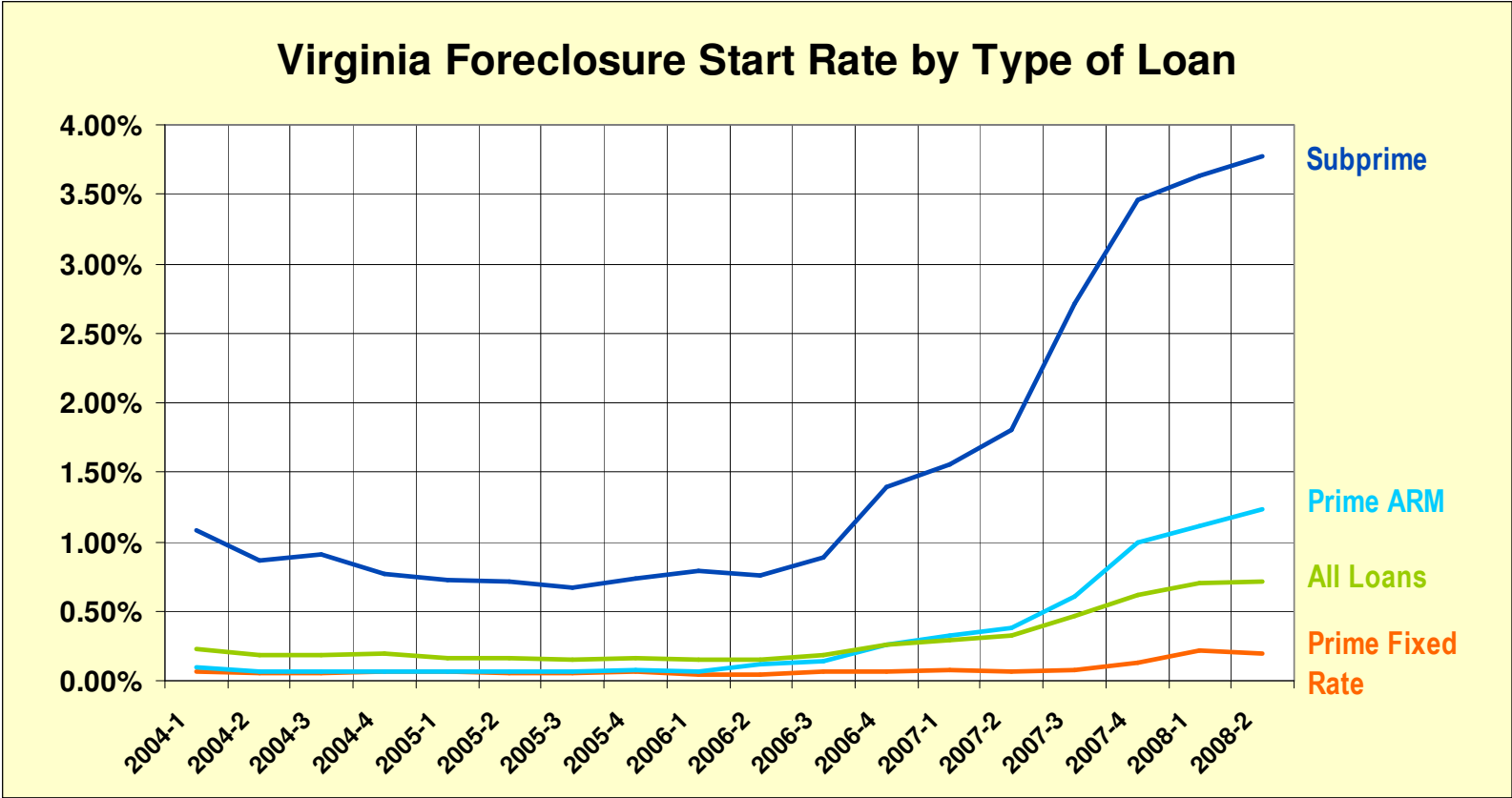
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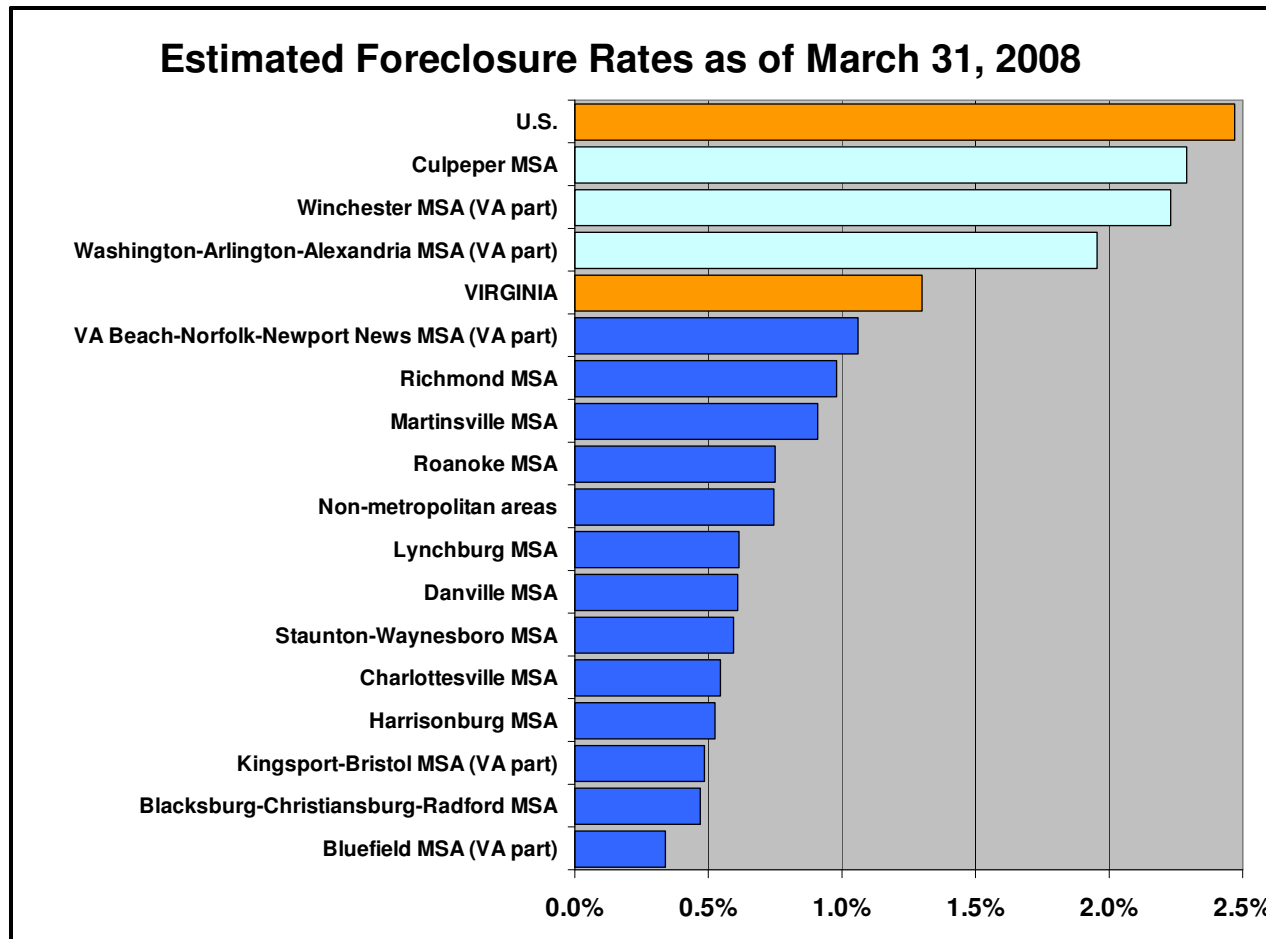


# Higher cost & adjustable rate loans make up 80% of foreclosures



Source: Mortgage Bankers Association (MBA)

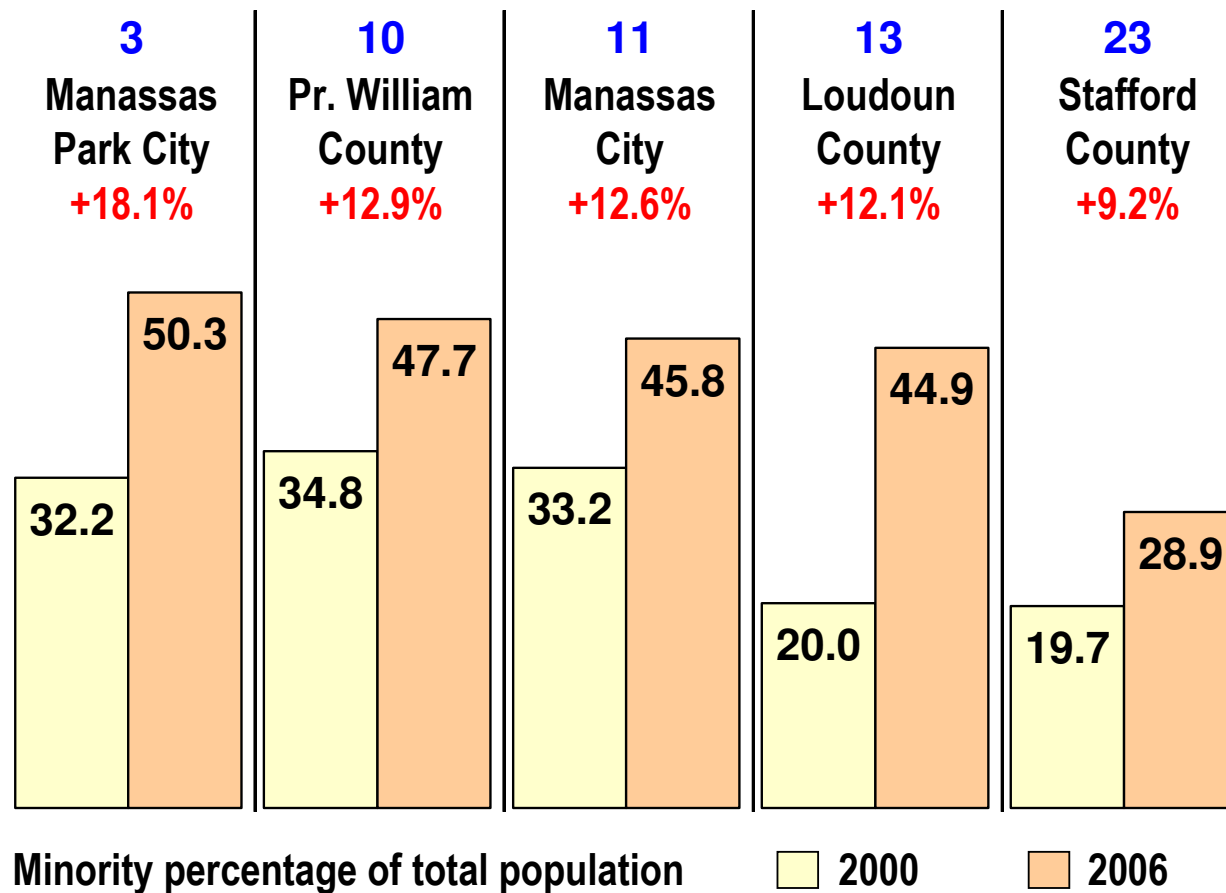
# Foreclosures are much worse in NoVA than elsewhere in the state



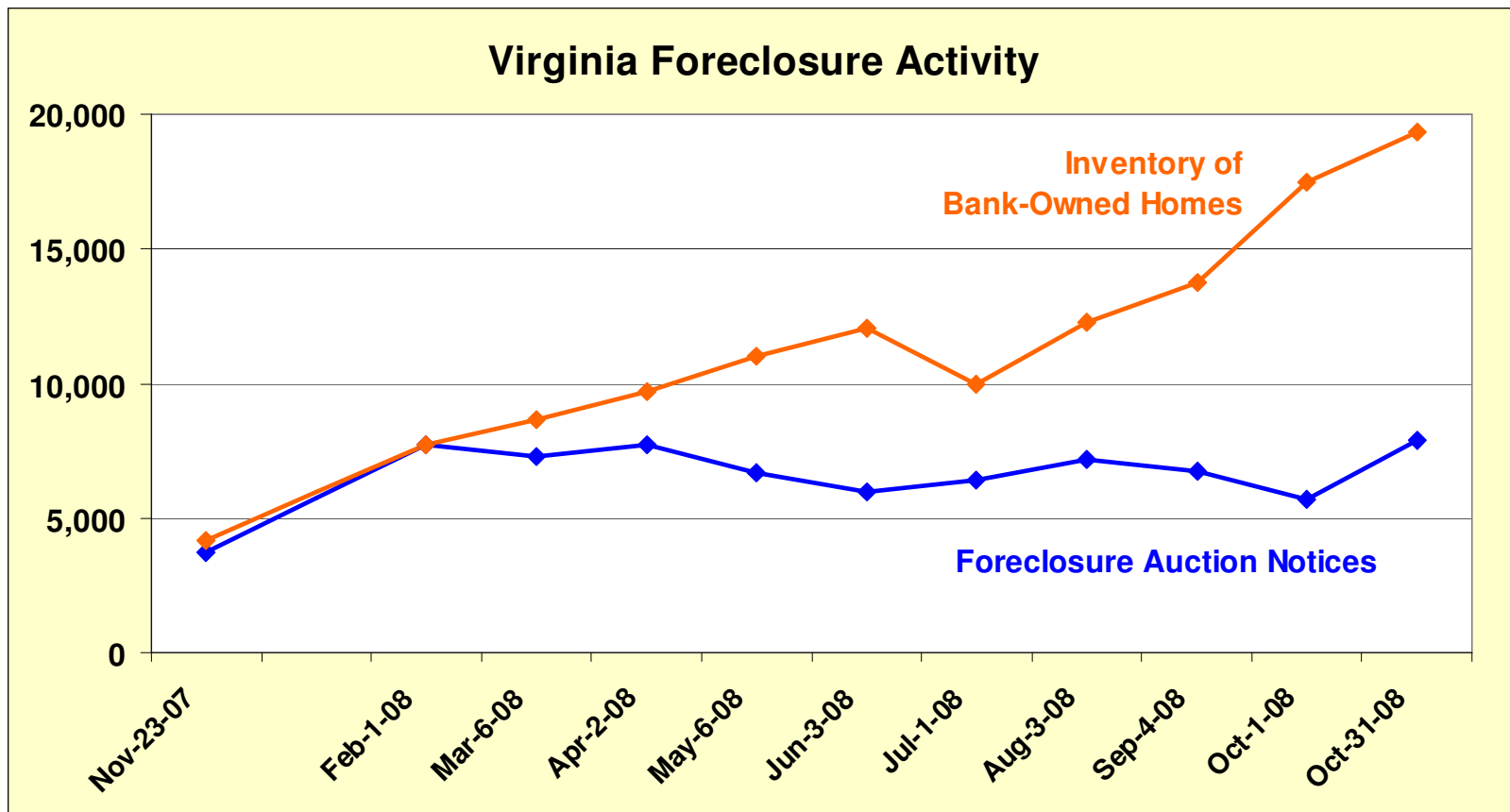
Area estimates are based on data from the MBA and First American LoanPerformance

# Foreclosure “hot spots” in NoVA have large, growing minority populations

RANK AMONG TOP 25 JURISDICTIONS NATIONALLY  
IN RATE OF MINORITY POPULATION GROWTH

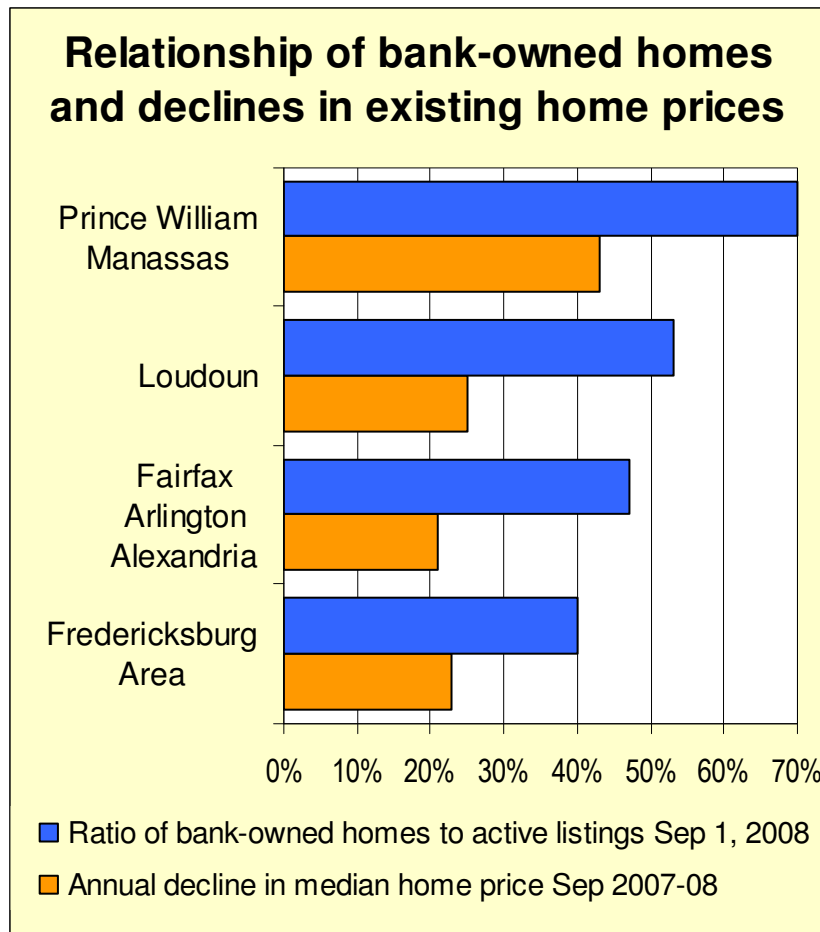


# Despite a leveling of foreclosures, bank-owned homes are up sharply



Source: RealtyTrac

# A build-up of bank-owned properties puts downward pressure on prices



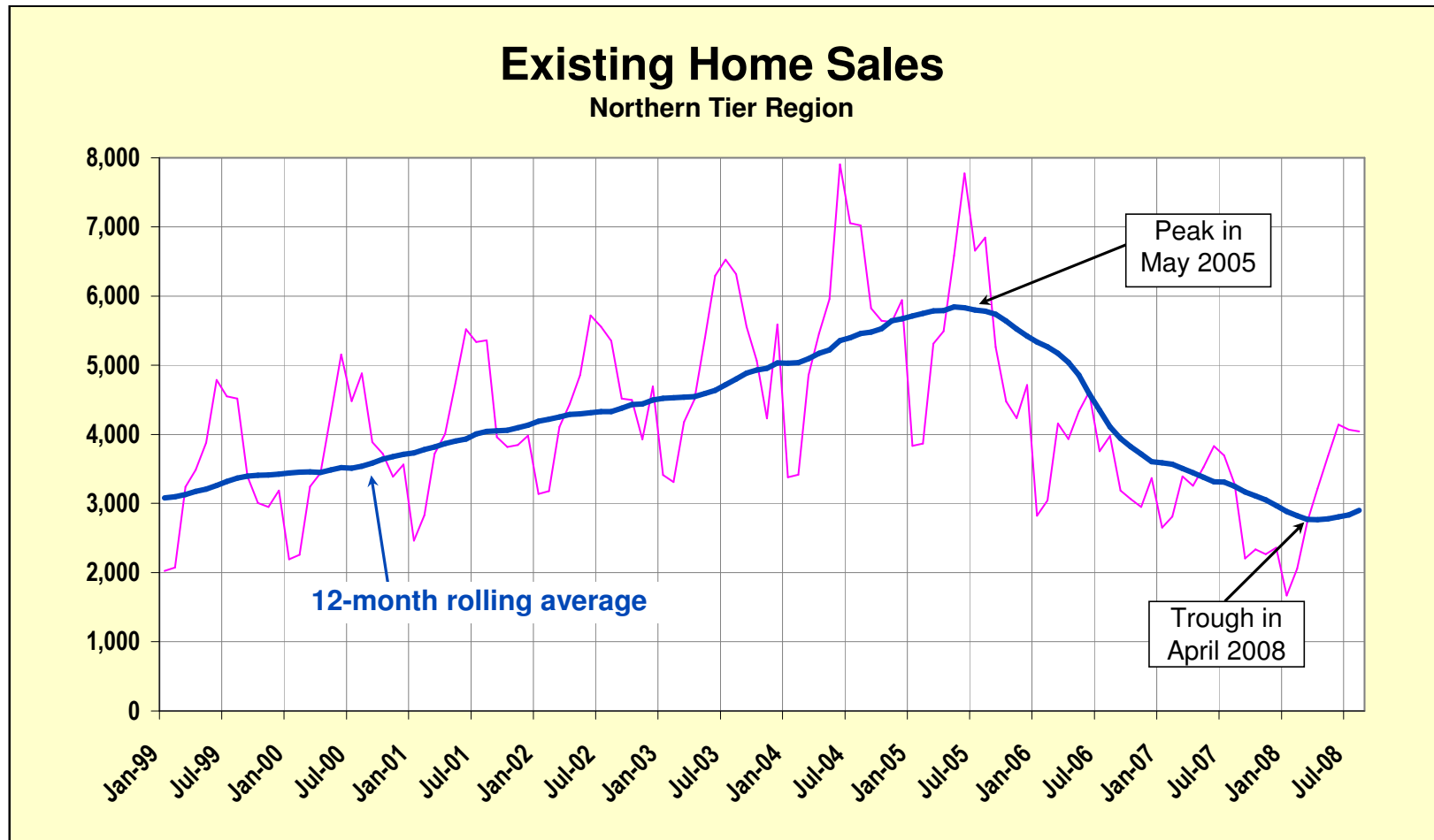
- Historically, home prices have been “sticky” during market downturns—i.e., price declines are retarded by an unwillingness of sellers to accept losses.
- This has meant that price corrections often occur through depressed rates of appreciation over protracted periods of time.
- However, a build-up of bank-owned homes changes that dynamic due to the pressure on lenders to turn over properties quickly even in the face of substantial losses.

Source: MRIS and RealtyTrac.com

# Price declines and foreclosures have become mutually reinforcing

- Initially, weak housing market conditions result in declining rates of appreciation and, in time, actual declines in resale prices.
- This stimulates foreclosures for at-risk borrowers who find themselves “upside down” with their mortgage and unable to refinance or sell.
- As foreclosure activity becomes substantial, then large numbers of distressed sales further depress market prices.
- As inventories of bank-owned homes build, the pressure to lower prices becomes intense.
- Sustained price declines weaken buyer confidence and cause lenders to tighten lending standards. In a worst case scenario—as we see today in Northern Virginia—this creates a self-reinforcing downward cycle.

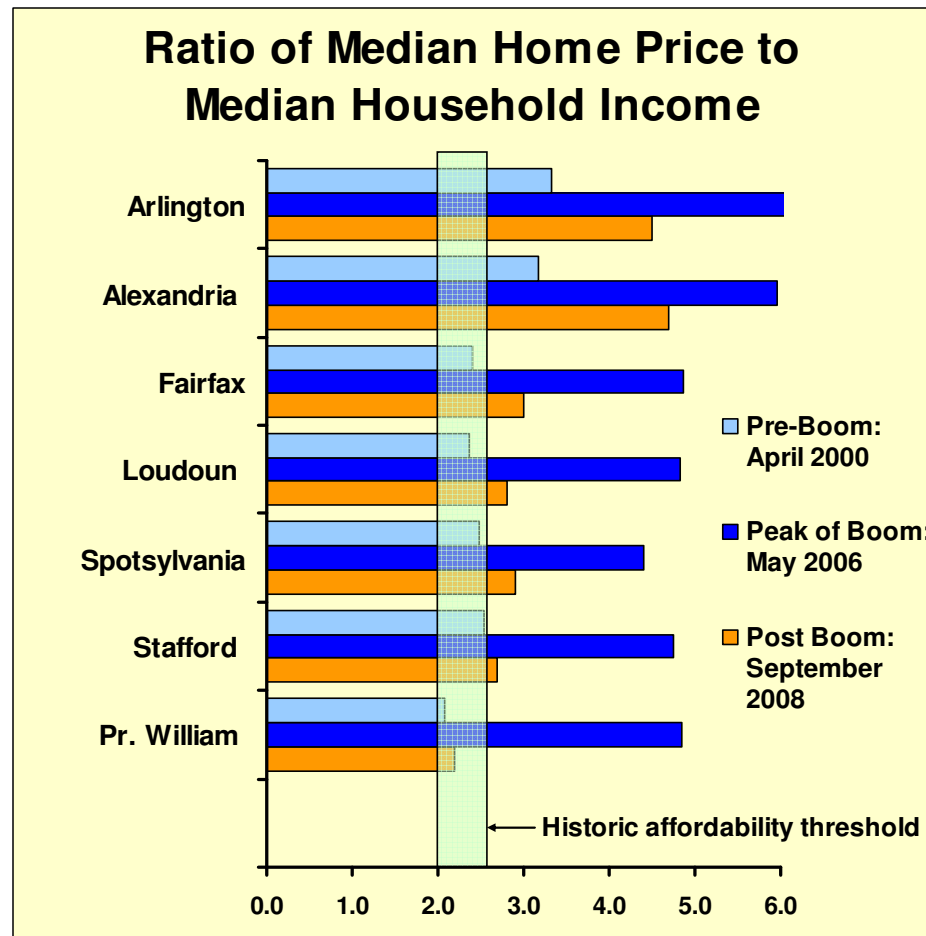
# In Northern VA, falling prices are now reviving existing home sales



Source: MRIS

# A big factor in Northern VA's sales rebound is increased affordability

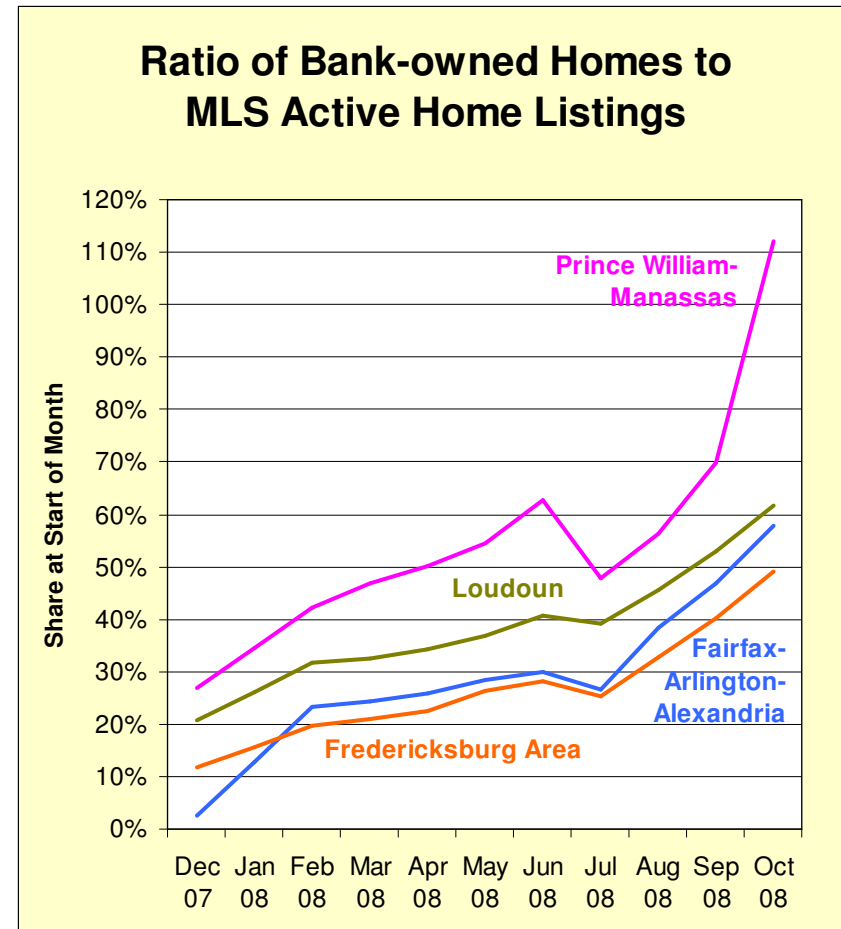
- In 2000, affordability was a problem mainly inside the Beltway
- At the peak of the boom, affordability pressures were severe even in the outer suburbs
- Today, affordability is returning to pre-boom levels



Source: MRIS and Census Bureau

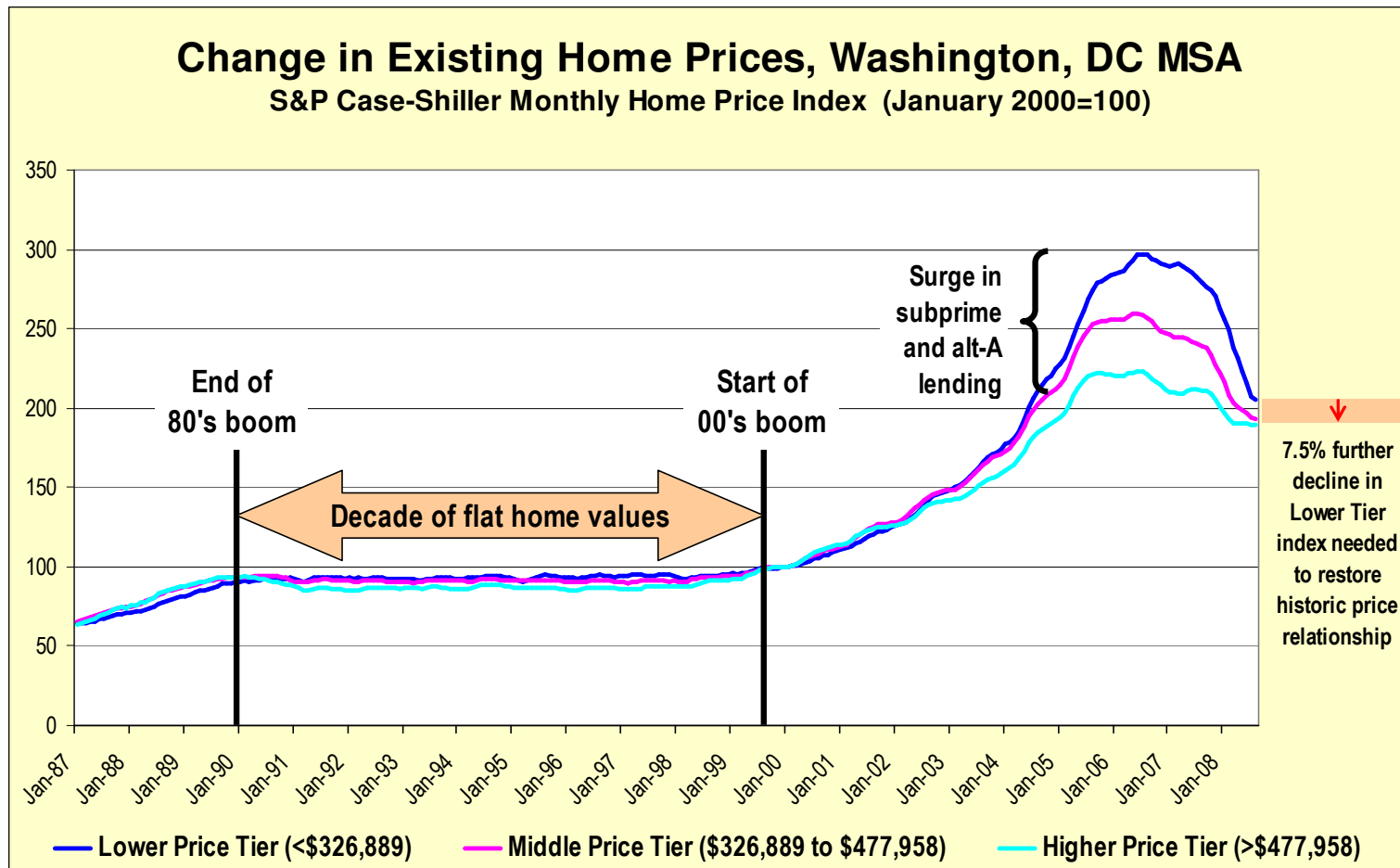
# Bank-owned homes remain a drag and continue to pressure prices

- In June, at the spring peak in home sales, sharply lower prices briefly reduced the number and share of bank-owned homes in Northern Virginia.
- But since then, the seasonal slowdown in sales and fewer active listings have quickly rebuilt the bank-owned homes share of the market—this has accelerated price declines.



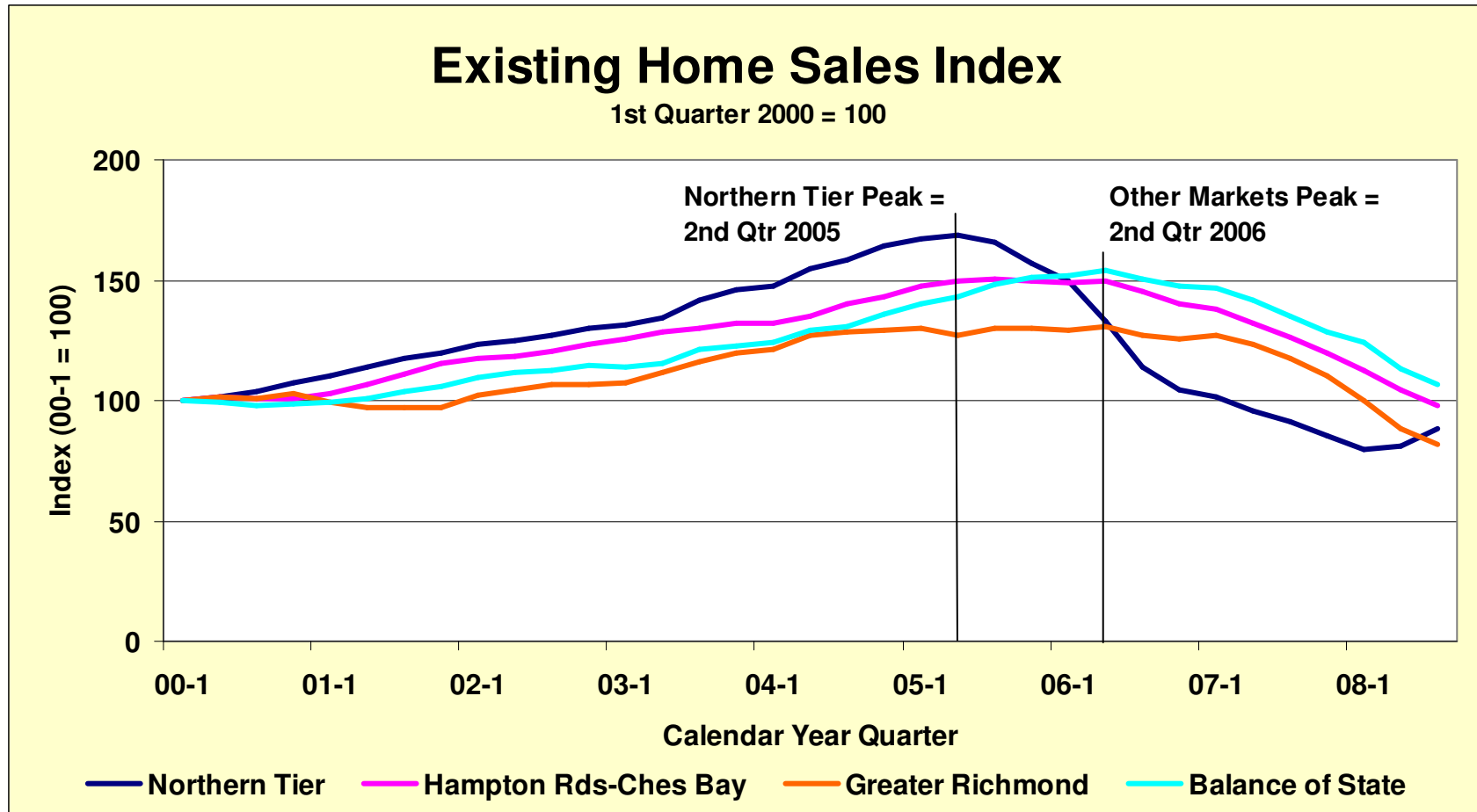
Source: MRIS and RealtyTrac.com

# Lower-end prices have been under the greatest pressure



Note: Tiered price breakpoints are as of September 2008

# Other markets are in an earlier phase of sales and price declines



Source: Virginia Association of Realtors

# The following factors will contribute to how quickly markets rebound

- An upturn in home sales will mark the bottom of the market—as unsold inventory declines, prices will stabilize and foreclosures ease.
- Current data show most Virginia markets still experiencing declining home sales. However, in Northern Virginia steep price cuts are now contributing to a rebound in sales activity.
- The quicker that prices fall, the sooner that home sales and appreciation rates are likely to turn positive—more modest short-term price declines may contribute to prolonged price stagnation as occurred in Northern Virginia during the 1990's.

# What further risks lie ahead?

1. First, the length and severity of the recession is a major unknown. A layering of traditional economic foreclosure drivers on top of the current factors impacting the market will compound current weakness.
2. A second risk is bank-owned homes. This inventory is quickly building now that the June seasonal peak in sales is past. A continued build-up will reinforce current price cuts in Northern Virginia and could stimulate significant price declines in other markets as well.
3. Finally, there is the ongoing risk of further trauma in the credit markets that would significantly reduce the availability of affordable home financing. It is essential that an adequate supply of affordable mortgage funds remain available to enable the market to recover.

# Market implications of the current situation

- The short-term revival in homes sales is being driven by investors
- Longer-term market recovery is tied to a revival of first-time home buying
- Minority households comprise nearly half the households age 25-44 in Virginia's major metro markets
- Sustainable minority home buying is key to the vitality of the single-family market

# Linkage between homeownership and rental housing policies

- Over emphasis on home buying has led to reduced public support for affordable rental housing, which has reduced rental choices
- Lack of adequate rental opportunities, coupled with changing attitudes toward debt and leverage, led many to make poor home purchase choices
- Consumers need help in better understanding housing options and the financial obligations and consequences they entail