Texas Dodges Worst of Foreclosure Woes

By D'Ann Petersen and Laila Assanie

Texas bucked the national housing downturn—for a while. A strong economy and low costs of living and doing business attracted firms and new residents. The in-migration helped buoy the housing sector, and home construction, prices and sales held up in Texas even as they began to decline nationally.[1]

In time, Texas' housing market followed the nation's downward path. Home construction began plummeting in the second half of 2006—several months behind the nation. Texas existing-home sales started falling in mid-2007. The picture worsened considerably in 2008 as labor markets weakened and a troubled financial environment made mortgages more difficult to obtain.

The housing bust leaves in its wake elevated foreclosure levels in Texas and the U.S. Like other consequences of the bust, foreclosures have been less severe in Texas. While the nation's foreclosure rate has grown nearly sixfold over the last four years, Texas' has climbed only marginally.

Housing markets in Texas and the U.S. have shown signs of stabilizing in recent months. Home sales and construction starts are beginning to tick up, thanks in large part to low mortgage rates and the first-time homebuyer tax credit. Despite the improvement, segments remain weak, especially the higher-priced move-up market.

Foreclosures are likely to persist in 2010—a concern because they can add to inventories and put downward pressure on home values. However, expectations are for Texas' foreclosures to remain low compared with the nation as a whole.

Geography of Foreclosures

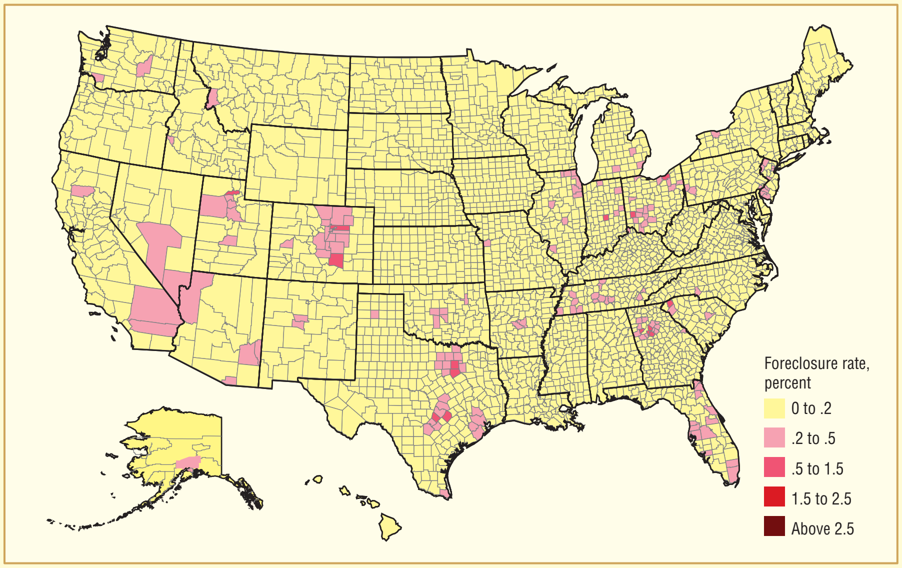
The foreclosure crisis has hit some parts of the country much harder than others. Most of the distressed housing activity is currently concentrated in just a few states. Texas isn't one of them. Its foreclosure rate ranks 28th in the nation and last among big states.

RealtyTrac data show foreclosure activity by county. We mapped foreclosures relative to the number of households in each county as of fourth quarter 2005, when the national housing crisis had yet to unfold and the foreclosure rate was a mild 0.13 percent (*Chart 1A*).

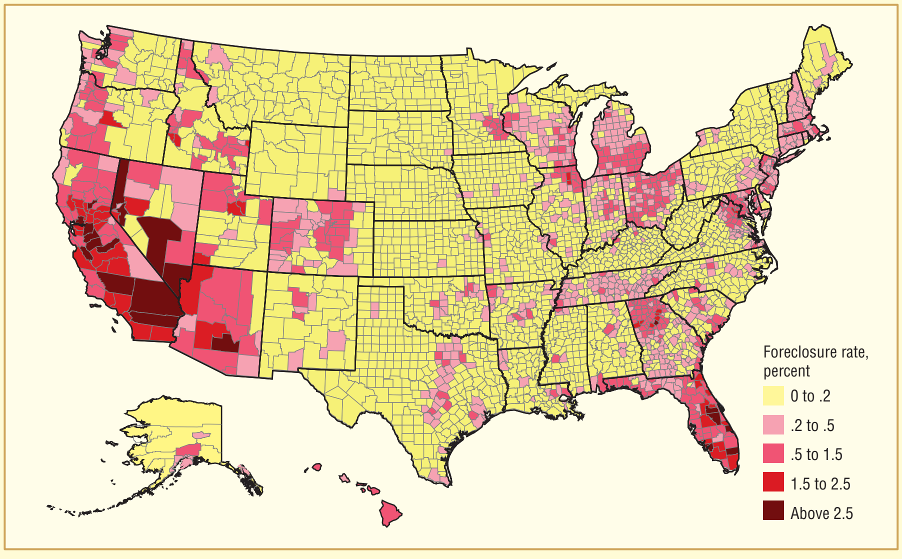
At that time, only a few states showed clusters of counties with somewhat high foreclosure rates. These included California, Florida and Colorado—states that had a high incidence of risky, high-cost loans. According to the Mortgage Bankers Association, the three states' share of subprime adjustable-rate mortgage (ARM) loans was above 8 percent

Chart 1
Foreclosure Rates by County—Before Housing Crisis and Now

A. Fourth Quarter 2005



B. Third Quarter 2009



NOTE: The foreclosure rate is the number of foreclosure filings divided by the number of households in each county times 100.

SOURCE: RealtyTrac.

in fourth quarter 2005, compared with 6.7 percent for the nation.

In Texas, foreclosure rates were elevated in several parts of the state in 2005, even though the economy was expanding and the housing market was still on an upswing. As a result, Texas' foreclosure rate of 0.26 percent was double the national average. Several areas of the state, especially counties within the Dallas–Fort Worth and Austin metropolitan areas, were still feeling the aftereffects of a high-tech bust that persisted for several years after 2001 and left a significant share of white-collar workers without jobs. In fact, some counties in the two metro areas were among the top 25 in the U.S. for foreclosure rates in fourth quarter 2005.

Fast-forwarding to third quarter 2009, Texas looks pretty much the same (*Chart 1B*). Overall, the state's foreclosure rate edged up to 0.32 percent, and a few more counties saw foreclosures rise.

But the picture looks strikingly different elsewhere. Falling home prices, rising unemployment and resets on risky loans spread and intensified the foreclosure crisis. By the third quarter of this year, the nation's foreclosure rate had hit 0.73 percent, up from 0.13 percent in fourth quarter 2005.

Many areas are showing signs of distress, including the manufacturing belt, as the downturn in the auto industry feeds high unemployment. While foreclosure-rate increases are widespread, Nevada, Arizona, California and Florida account for most of the foreclosure activity. More than 40 percent of the counties with rates above the U.S. average are in these four states.

Texas is now faring better in the foreclosure crisis in part because of a healthier economy. The state outperformed the nation in job growth in 2006 and 2007. Even as the U.S. economy was mired in recession in 2008, Texas saw modest job growth. This year, the pace of job losses steepened in Texas, closely matching the U.S. rate.

Another key for the state is a housing market that didn't see the price escalation other big states did during the boom years. As a result, Texas didn't experience a price-bubble bust. In fact, home values have held up relatively well.

The purchase-only home price index, issued by the Federal Housing Finance Agency (FHFA), shows that home values appreciated 4.6 percent in Texas from the end of 2006 to second quarter 2009 while they fell 10.3 percent nationwide (*Chart 2*).[2] Among the hardest hit states were Nevada, Arizona, California and Florida—those with the highest third-quarter foreclosure activity. Several metropolitan areas in these states saw prices plummet more than 40 percent.

A large share of borrowers had little or no equity at origination, so the rampant depreciation left many of them owing more than their home's value and unable to sell or refinance without taking a loss. These so-called underwater mortgages began to increase, putting even more downward pressure on home prices. Because of its more stable home values, Texas has had a relatively low share of homeowners with negative equity, ranking 35th among states.[3]

Moreover, Texans didn't rely on risky loans as heavily as borrowers in other states during the boom years. Fewer interest-only and negatively amortized loans were taken out in the state, according to a Dallas Fed study.[4] And only 43.1 percent of Texas subprime borrowers used cash-out refinancing, compared with 57.3 percent for the nation.[5] More equity has made Texas homeowners less vulnerable to default in cases of economic or personal adversity.

Texas Hot Spots

Many factors influence foreclosure rates. Recent research shows that differences in U.S. counties' foreclosure rates are associated with unemployment, housing affordability, changes in home prices and the share of minority homeowners with high-cost loans. This also holds true in Texas.[6]

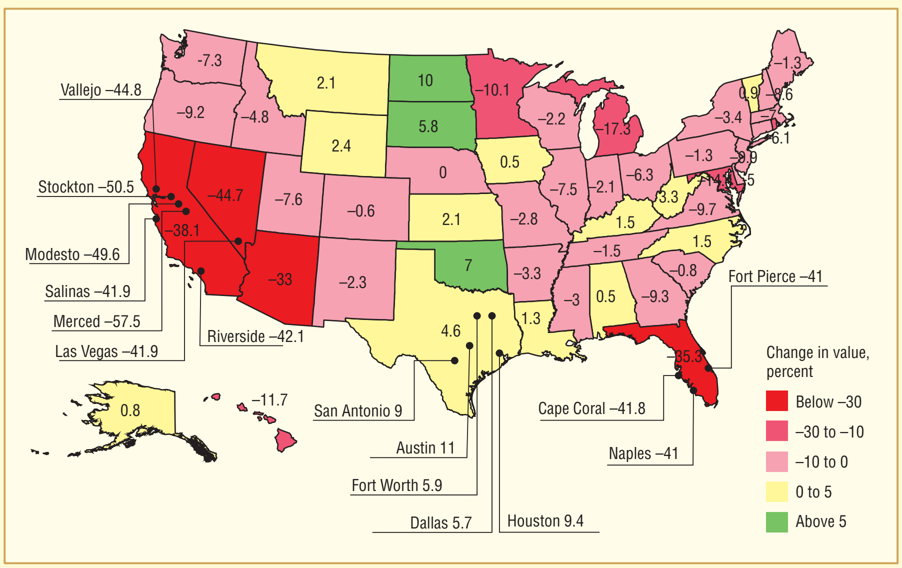
Of the 254 counties in Texas, only four had foreclosure rates exceeding the national average in third quarter 2009. Twenty-six reported rates higher than the state average (*Table 1*). Economic and demographic characteristics common to these hot spots help explain why their foreclosure rates are somewhat higher:

Unemployment. A weak economy can make it difficult for households to keep up with mortgage payments. One-earner and low-income households are particularly vulnerable to economic or financial shocks.

While Texas' unemployment rate has remained well below the nation's, most hot-spot counties saw joblessness increase by more than the state average between December 2006 and September 2009. Johnson County, which has the third-highest foreclosure rate in Texas, saw the largest increase in unemployment, probably because of the sharp fall in Barnett Shale natural gas drilling activity in the area.

Galveston saw its unemployment rate rise significantly as devastation from Hurricane Ike in September 2008 forced businesses to close. Along the Mexican border, Cameron and Hidalgo counties also saw above-average increases in unemployment.

Chart 2
Home Values Holding Up Better in Texas than Nation
(House price index, fourth quarter 2006 to second quarter 2009)



NOTE: Metro data are from the House Price Index (HPI), which includes refinances, while state data are from the purchase-only HPI.

SOURCE: Federal Housing Finance Agency.

Table 1
Economic and Demographic Characteristics of Texas Hot Spots

County	Foreclosure rate, 2009:Q3 (%)	Change in unemployment rate, Dec. 2006 to Sept. 2009 (pct.pts.)	Home purchase loan-to-income ratio, 2006	Home price appreciation, 2006:Q4 to 2009:Q2 (%)	Change in housing units, 2000 to 2008 (%)	Higher-priced loans, blacks, 2006 (% of all home-purchase loans)	Higher-priced loans, Hispanics, 2006 (% of all home-purchase loans)
Kaufman	.90	4.3	2.0	5.7	21.1	70.2	45.1
Bastrop	.84	4.2	2.0	11.0	12.5	82.1	46.5
Johnson	.82	5.2	1.9	5.9	16.0	57.1	47.4
Rockwall	.76	4.0	2.3	5.7	66.0	63.6	31.4
Comal	.57	3.1	2.2	9.0	40.2	35.3	28.7
Williamson	.56	4.5	2.2	11.0	48.3	33.9	31.9
Parker	.53	4.5	2.0	5.9	13.4	75.0	34.7
Fort Bend	.52	4.5	2.0	9.4	33.9	60.2	41.5
Collin	.50	4.2	2.2	5.7	45.0	47.3	39.6
Kendall	.48	2.7	2.2	9.0	40.1	0.0	14.0
Ellis	.46	4.6	2.1	5.7	30.9	38.3	42.3
Montgomery	.45	4.3	2.0	9.4	43.3	60.9	39.8
Tarrant	.44	4.1	2.1	5.9	20.5	61.3	43.5
Dallas	.43	4.3	2.1	5.7	10.4	67.7	55.6
Hays	.43	3.4	2.2	11.0	42.0	40.4	33.8
Cameron	.43	5.0	2.0	7.0	20.8	42.9	55.3
Denton	.42	4.1	2.1	5.7	32.6	50.1	41.2
Bell	.41	2.8	2.0	8.5	24.6	59.6	42.8
Hidalgo	.40	4.7	2.0	.2	30.4	39.3	57.6
Harris	.39	4.4	2.1	9.4	21.4	69.6	51.7
Burnet	.38	3.0	2.0	10.7	26.1	50.0	57.9
Galveston	.38	4.2	1.9	9.4	18.8	64.3	46.5
Guadalupe	.37	3.1	2.1	9.0	26.6	36.9	30.0
Bexar	.37	3.3	2.1	9.0	16.9	39.9	41.6
Travis	.35	3.7	2.3	11.0	26.9	43.2	33.2
Brazoria	.33	4.7	2.1	9.4	27.3	55.4	39.5
Texas avg.	.32	3.6	1.6	7.8	17.1	36.5	48.3
U.S. avg.	.73	5.4	2.2	–5.6	11.0	31.8	30.7

NOTES: The loan-to-income ratios and the higher-priced-loans data are simple averages for Texas and the U.S. Home price appreciation reflects combined metro/nonmetro series.

SOURCES: RealtyTrac; Bureau of Labor Statistics; Pew Hispanic Research Center; Federal Housing Finance Agency; Census Bureau.

The border region often sees higher unemployment during economic downturns because average households are younger and less educated than in other parts of the state.

Housing affordability. Loan-to-income ratios are a good proxy for determining owners' ability to repay mortgages. The higher the ratio, the more likely the borrower is to default in cases of sudden change in financial or economic circumstances. The average loan-to-income ratio for Texas counties is 1.6, compared with 2.2 for U.S counties—an indication that affordability is high in the state.[7]

All hot-spot counties have loan-to-income ratios above the state average, however, suggesting relatively high household spending on mortgages. Nonetheless, ratios for most Texas counties are below the national average and much lower than the more expensive areas of the country, such as California's Santa Clara County at 3.5 and San Francisco County at 3.3.

Home prices. County-level home-price data are difficult to come by, so we assigned each county the FHFA's house-price index value for its metro area.[8] Using this proxy, three of the four counties with the highest foreclosure rates are in the DFW area, where home-price appreciation was the slowest among major Texas metros. Indeed, county-level Realtor data for DFW show prices fell over the past year in these three counties—Kaufman, Johnson and Rockwall—and existing-home inventories are higher than the state average.

Deteriorating prices are a significant reason for high foreclosures in other parts of the country but are a less-important factor in Texas. Average Texas home prices have been relatively stable, despite declines in some pockets. The state's modest appreciation, however, hasn't led to significant equity gains for homeowners, either.

New construction activity. The 26 hot-spot counties have posted significant new construction since 2000. The number of housing units grew an average of 22.7 percent from 2000 to 2008, compared with 17.1 percent for Texas and 11 percent for the U.S.

The biggest increases were in the suburbs—for example, Rockwall County saw a 66 percent gain. Its foreclosure rate is the state's fourth highest. Six other hot-spot counties recorded construction increases of 40 percent or more.

Because of a strong pullback in construction in the past two years, new-home inventories have recently come down in Texas, which should mitigate the impact of higher foreclosures.

Ethnicity and loan cost. Ethnicity plays a role in the likelihood of foreclosure partly because minority homeowners on average are younger, have lower incomes and have fewer years of schooling than non-Hispanic white homeowners. These factors make job losses more likely in economic downturns. The same factors make qualifying for a mortgage more difficult, often raising the cost of home loans for minorities.

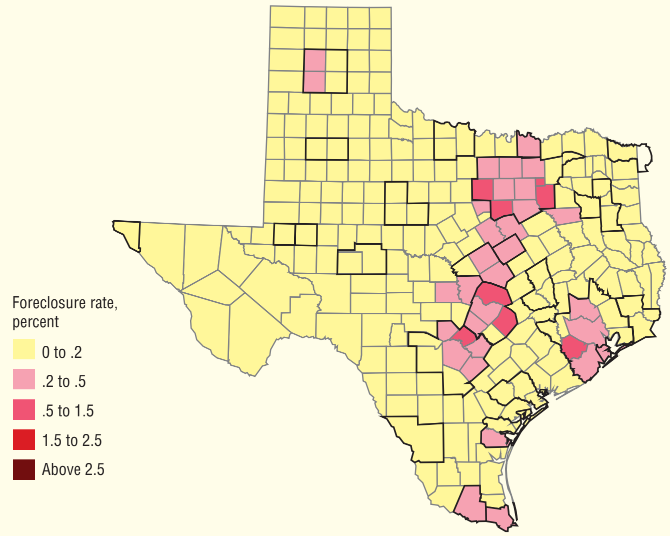
In the U.S. and Texas, minorities have been hit hardest by the current recession. National unemployment rates stand at 15.6 percent for blacks and 12.7 percent for Hispanics, compared with 9.3 percent for non-Hispanic whites. In the U.S., 31 percent of both black and Hispanic households have higher-cost loans, compared with 26 percent of non-Hispanic white households.[9]

Texas has a large Hispanic population. For this demographic group, pricey loans are common in most Texas counties, not just in the hot spots. Statewide, the share of higher-cost loans among Hispanics is 48.3 percent. The share of costly loans among black Texans is more than 60 percent in many hot-spot counties, compared with the state average of 36.5 percent and national average of 31.8 percent.

Overall, the analysis shows that Texas counties with high foreclosure rates generally have sharp jumps in unemployment, high

Foreclosures will likely be a headwind for the housing sector and overall U.S. economy well into 2010.

Chart 3
Texas Foreclosure Hot Spots
(Third quarter 2009)



NOTE: The foreclosure rate is the number of foreclosure filings divided by the number of households in each county times 100.

SOURCE: RealtyTrac.

loan-to-income ratios, slower home-price appreciation, significant new construction and a greater prevalence of high-priced lending to minorities. By and large, most counties with these characteristics are found within the state's four most heavily populated metro areas (*Chart 3*).

A Look Ahead

Most homeowners are current on their mortgage payments, but a rising share have seen their finances shaken as home values have fallen, mortgage interest rates have reset upward and job losses have reduced family income. Foreclosures will likely be a headwind for the housing sector and overall U.S. economy well into 2010.

Indeed, several factors suggest the national foreclosure situation may worsen before it gets better.

First, the U.S. economy remains weak and the unemployment rate is high.

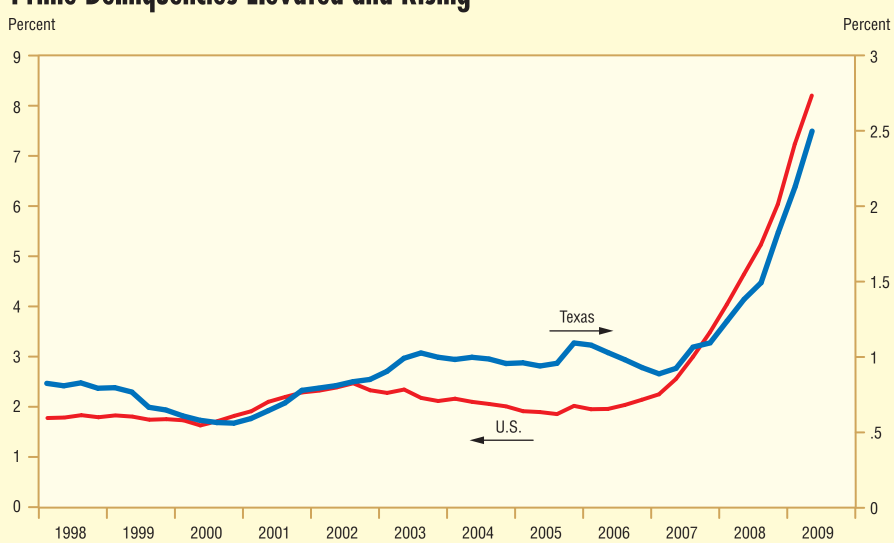
Second, mortgage delinquencies are increasing. While the worst of the subprime troubles are behind us, a wave of alt-A and option ARM resets in 2010 will hit hard in states with high shares of those riskier mortgages.[10] Delinquency rates on even "safe" prime loans—the lion's share of outstanding mortgages—are climbing (*Chart 4*).

Third, moratoriums put in place in late 2008 and early 2009 have slowed the foreclosure process and pushed activity into late 2009 and early 2010.

Counteracting these factors are falling prices and the first-time homebuyer tax credit, which are boosting sales in most areas of the country. In addition, government agencies have launched efforts such as the Home Affordable Modification Program that may resolve some of the pending foreclosures. Unfortunately, the share of

(*Continued on back page*)

Chart 4
Prime Delinquencies Elevated and Rising



SOURCES: Mortgage Bankers Association; seasonal adjustments by the Dallas Fed.

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homeowners who have taken advantage of such programs is small, and redefault rates on modified mortgages remain high.[11]

In Texas, foreclosure trends will bear watching. Many Texans have lost their jobs during the current recession—a development showing up in rising delinquencies on prime loans.

On the bright side, the foreclosure landscape looks better in Texas than in most other states. Home values have held up, and foreclosure inventories are lower than the national average. According to the Mortgage Bankers Association, 2 percent of Texas mortgages were in the foreclosure process in third quarter 2009, compared with the national share of 4.5 percent. In addition, fewer risky loans were made in Texas.

While Dallas Fed forecasts call for only a slow rebound in employment, Texas businesses are growing more optimistic and signs are pointing to a recovery in economic activity.

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Notes

The authors thank RealtyTrac for foreclosure data and Michael Nicholson for research assistance.

[1] See "Hot Housing Market Catching Cold in Texas," by D'Ann Petersen, Federal Reserve Bank of Dallas *Southwest Economy*, no. 1, 2008, http://dallasfed.org/research/swe/2008/swe0801c.cfm.

[2] Other indexes, such as Case-Shiller, suggest even more deterioration nationally. Case-Shiller is a value-based index that reflects movements in higher-priced homes more accurately but, unlike the Federal Housing Finance Agency (FHFA) index, is not available at the state or metro level.

[3] Data are from Equifax and Moody's Economy.com. See the *Wall Street Journal* blog Developments, Aug. 11, 2009, http://blogs.wsj.com/developments/2009/08/05/more-homeowners-upside-down-on-mortgages.

[4] See "Why Texas Feels Less Subprime Stress than U.S.," by Anil Kumar, Federal Reserve Bank of Dallas *Southwest Economy*, no. 6, 2008, http://dallasfed.org/research/swe/2008/swe0806b.cfm.

[5] Data are from First American CoreLogic, LoanPerformance and the Federal Reserve Bank of New York, June 2009.

[6] See "Through Boom and Bust: Minorities, Immigrants and Homeownership," by Rakesh Kochhar, Ana Gonzalez-Barrera and Daniel Dockterman, Pew Research Center report, May 2009.

[7] U.S. and Texas loan-to-income figures are simple averages of all counties in each.

[8] The metro house price index includes refinanced properties as well as purchases, thus its values may overstate appreciation (or underestimate depreciation) compared with the FHFA's state purchase-only index.

[9] See note 6. U.S. figures are simple averages of all counties.

[10] Alt-A mortgages are loans for which the risk profile of the borrower falls between prime and subprime. The borrowers have inadequate documentation and high loan-to-value and debt-to-income ratios. An option ARM is an adjustable-rate mortgage that offers borrowers the flexibility of four monthly payment options to help with cash flow. Options include a specified minimum payment, an interest-only payment and 15- and 30-year fully amortizing payments.

[11] See "Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization," by Manuel Adelino, Kristopher Gerardi and Paul S. Willen, Federal Reserve Bank of Boston, Public Policy Discussion Papers no. 09-4, July 2009.