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Foreclosure Patterns and Impacts in the Twin Cities and Minnesota
Before the Committee on Financial Services, U.S. House of Representatives
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Introduction

Mr. Chairman and distinguished members of the Committee, I appreciate the opportunity to appear today to discuss the impact of foreclosures and abusive lending on individuals and neighborhoods in the Minneapolis-St. Paul area, and I thank Representative Ellison for bringing this hearing to Minneapolis. My duties at the Federal Reserve Bank of Minneapolis include oversight of our Community Affairs unit's efforts to foster fair and effective access to credit in low- and moderate-income communities. Thus, I am well aware that the issues we are discussing are urgent in the Twin Cities, where foreclosure rates have tripled or more in the last few years. Because you are hearing from others with direct knowledge of the resulting impacts, I will try to contribute by drawing, in part, on some pertinent research and analysis that I follow or have been involved in. I should point out, however, that my views are strictly my own, and not necessarily those of the Federal Reserve Bank of Minneapolis or the Federal Reserve System.

In the Twin Cities, the incidence of foreclosure is highest in our core cities, especially in neighborhoods where minority homeownership rose in the 1990s and a high percentage of households have subprime credit histories. Although foreclosure rates have been and remain the highest in these neighborhoods, foreclosures are occurring, and rising rapidly, throughout the metro area. Foreclosure rates may continue to climb, judging by the high percentages of risky mortgages already delinquent and the even higher percentage of risky mortgages expected to have large upward payment resets over the next two to three years. The impact of these foreclosures spreads well beyond the borrowers and lending organizations that are directly involved.

Foreclosure patterns

The topics of this hearing -- foreclosures and abusive lending – are related and yet distinct. Many foreclosures have been linked to mortgages that were disadvantageous for the borrower while very generous in lending fees and potential interest payments. However, not all abusive loans end in foreclosure, and foreclosures also happen without abusive loans, as when borrowers incur unexpected drops in income. As in other metro areas, the recent surge in Twin Cities foreclosures followed rapid growth in risky nontraditional mortgage products, such as loans with limited documentation, very low down-payments, or initially low monthly payments that escalate sharply after a few years. In some cases, these structures have been used to take advantage of borrowers, and in other cases the lenders or investors may have been the ones deceived. Sometimes the loan investors and the borrower may have jointly bet on continued housing appreciation, and when housing prices cooled, they both lost. In short, there are many abusive lending stories and many foreclosure stories, not just one.

But there are also patterns among these stories. My research with Drs. Michael Grover of the Minneapolis Fed and Laura Smith of Macalester College analyzes how foreclosure sales rates varied across census tracts in Hennepin and Ramsey counties in 2002.[1] We found that, as in other cities, foreclosures here were highly correlated with minority population share. However, when multiple factors were considered, the strongest relationship was between foreclosure rates and the percentage of adults in the neighborhood with impaired credit histories. The next most important factor in 2002 was the increase in (not the level of) of minority homeownership between 1990 and 2000. A youthful adult population also helped a bit in explaining where foreclosure rates were high. That is, foreclosures were high in low-to-moderate income areas where minority and young families, often with a history of financial stress, were trying to make the transition to homeownership. Their transitions were vulnerable, sometimes to aggressive marketers of high-priced risky loans, but also to factors such as illness or job loss.

Although we haven't repeated our earlier analysis in full, recent data indicate that the neighborhoods with the highest foreclosure rates have changed little, in location or characteristics, since 2002. In Hennepin County, where the data are most readily available, the areas with high rates of foreclosure sales changed only slightly between 2002 and 2005.[2] In addition, the location of neighborhoods where many adults have impaired credit histories changed little between 1999 and 2004.[3] Finally, very recent statistics provided by staff of the Board of Governors of the Federal Reserve System (Board) confirm many of the patterns I've mentioned. Using April 2007 data covering the majority of securitized, first-lien subprime and Alt-A mortgages, Board staff estimate that 5.5 percent of these mortgages in Hennepin County, Ramsey County, and some adjacent portions of the Fifth Congressional District are currently in foreclosure. The ZIP code areas with the highest percentages of subprime and Alt-A loans currently in foreclosure are in North Minneapolis (11 to 14 percent in foreclosure), a ring of neighborhoods surrounding downtown St. Paul (8 to 11 percent in foreclosure), and a handful of other Minneapolis-St. Paul neighborhoods (5 to 7 percent in foreclosure). Although foreclosure rates are highest in the core cities, some suburban ZIP codes with hundreds of subprime and Alt-A mortgages also have 5 to 6 percent of these mortgages in foreclosure, including parts of Brooklyn Park/Brooklyn Center; Fridley/Spring Lake Park; North Oaks/Vadnais Heights; Bloomington; Hopkins/Minnetonka, and Arden Hills/Mounds View/New Brighton/Roseville. Of course, subprime and Alt-A mortgages typically have higher foreclosure rates than other mortgages, so the foreclosure rates presented here probably overstate overall foreclosure rates, to different degrees in different neighborhoods.

What has changed a lot since 2002 is the number of foreclosures. Professor Prentiss Cox of the University of Minnesota Law School has tabulated sheriff's foreclosure sales in Hennepin County since 1988.[4] The annual number of sales cycled between about 800 and 1,500 from 1998 through 2004. In 2005 the number climbed above 1,600, and in 2006 it jumped 80 percent to more than 3,000. Similar 2005-2006 increases occurred in the rest of the seven-county core metropolitan

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[1] "Targeting Foreclosure Interventions: An Analysis of Neighborhood Characteristics Associated with High Foreclosure Rates in Two Minnesota Counties." Available at www.minneapolisfed.org/community/pubs/foreclosureinterventions.pdf

[2] See the analyses of Hennepin County foreclosure sales in 2002-2005 by Dr. Laura Smith's Macalester College urban geography students, at www.macalester.edu/geography/projects/courses/geog365/index.htm.

[3] See "Credit risk data may help target foreclosure mitigation" in *fedgazette*, September 2007, Federal Reserve Bank of Minneapolis (forthcoming).

[4] For charts depicting Professor Cox's and other local foreclosure sales data, see "Residential Foreclosure: A Wake Up Call for Real Estate Lawyers," a presentation by Elizabeth Ryan and Melissa Manderschied to the Hennepin County Bar Association, April 26, 2007. Available at www.ci.minneapolis.mn.us/cped/docs/foreclosure_presentation.pdf.

area. Based on data through May, it looks as if the number of sales in these seven counties will increase by 50 percent or more in 2007. Put another way, current trends suggest that seven-county foreclosure sales may reach 11,000 to 12,000 in 2007, as compared to about 2,100 in 2003 or 2002. Outside the seven-county core metro area, Greater Minnesota's foreclosure sales rose by almost 50 percent in 2006 and are projected to nearly double in 2007.[5]

Additional statistics provided by Board staff support the view that foreclosures may rise further. Using the data described above, Board staff examined 40,120 subprime and Alt-A first-lien mortgages in Hennepin County, Ramsey County, and nearby portions of the Fifth Congressional District. In addition to the 2,200 loans already in foreclosure, 1,580 (3.9 percent) are seriously delinquent (90 days or more) and another 3,652 (9.1 percent) are 30 to 89 days delinquent. Furthermore, monthly payments on about 15,000 of these loans (37 percent of the total) are scheduled to reset to significantly higher values by the end of 2009, including over 4,500 in the second half of 2007 and another 7,700 in 2008.

Foreclosure impacts

The impact of foreclosures can vary a great deal depending on the circumstances of the foreclosure. I will make two points related to work that the Federal Reserve Bank has been involved with. First, as shown in the accompanying map based on statistics provided by Dr. Laura Smith of Macalester College, the number of owner-occupied dwellings (those that are homesteaded for Minnesota property tax purposes) fell between 2005 and 2007 in many of the Minneapolis neighborhoods where foreclosure rates have been especially high. This undercuts one of Minnesota's key social policy efforts, the Emerging Markets Homeownership Initiative (EMHI).[6] My colleague, Minneapolis Fed Community Affairs Officer Jacqueline King, chairs the board of EMHI, whose objective is to close Minnesota's racial and ethnic homeownership gaps by significantly raising minority homeownership rates by 2012. To meet that objective, we need to do more than help minority households buy a home. We also have to prepare and support them to succeed as homeowners.[7] Until we do, EMHI will be swimming against a strong and rising tide of foreclosure in many of our most affordable neighborhoods.

Second, the neighborhood impact of investor-related foreclosures is often just as severe as foreclosures involving owner-occupants, but this significant category of foreclosures seems to get much less attention. Records from Ramsey and Hennepin counties suggest that 40 percent or more of sheriff's sales involve properties that are not owner-occupied. An analysis of Hennepin County Home Mortgage Disclosure Act (HMDA) data by my colleague Dr. Grover (attached below) shows that the percentage of Minneapolis mortgagors not planning to occupy their property began to escalate in about the year 2000 and more than doubled, to 19.5 percent, by 2005. In North Minneapolis, which has seen some of the highest rates of foreclosures in the state, the trend

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[5] See "Foreclosures in Greater Minnesota: A Report Based on County Sheriff's Sale Data," available from the Greater Minnesota Housing Fund at www.gmhf.com/foreclosure.pdf.

[6] For more information about EMHI, see "Update on Minnesota minority homeownership initiative," *Community Dividend* Issue 4, 2006, Federal Reserve Bank of Minneapolis, www.minneapolisfed.org/pubs/cd/06-4/initiative.cfm; or visit the EMHI web site at www.emhimn.org.

[7] For more on the importance of post-purchase success among vulnerable homeowners, see "Post-purchase counseling: An EMHI strategy to close homeownership gaps," *Community Dividend* Issue 4, 2005, Federal Reserve Bank of Minneapolis, www.minneapolisfed.org/pubs/cd/05-4/counseling.cfm.

toward non-occupying borrowers was even more pronounced. The percentage of North Minneapolis mortgages to such borrowers rose from an already elevated 13.6 percent in 2000 to over 31.3 percent in 2005. Allan Malkis and his colleagues at Northway Community Trust are currently conducting further analysis of the effects of investor-related foreclosures in North Minneapolis, and I look forward to seeing the results.

Conclusion

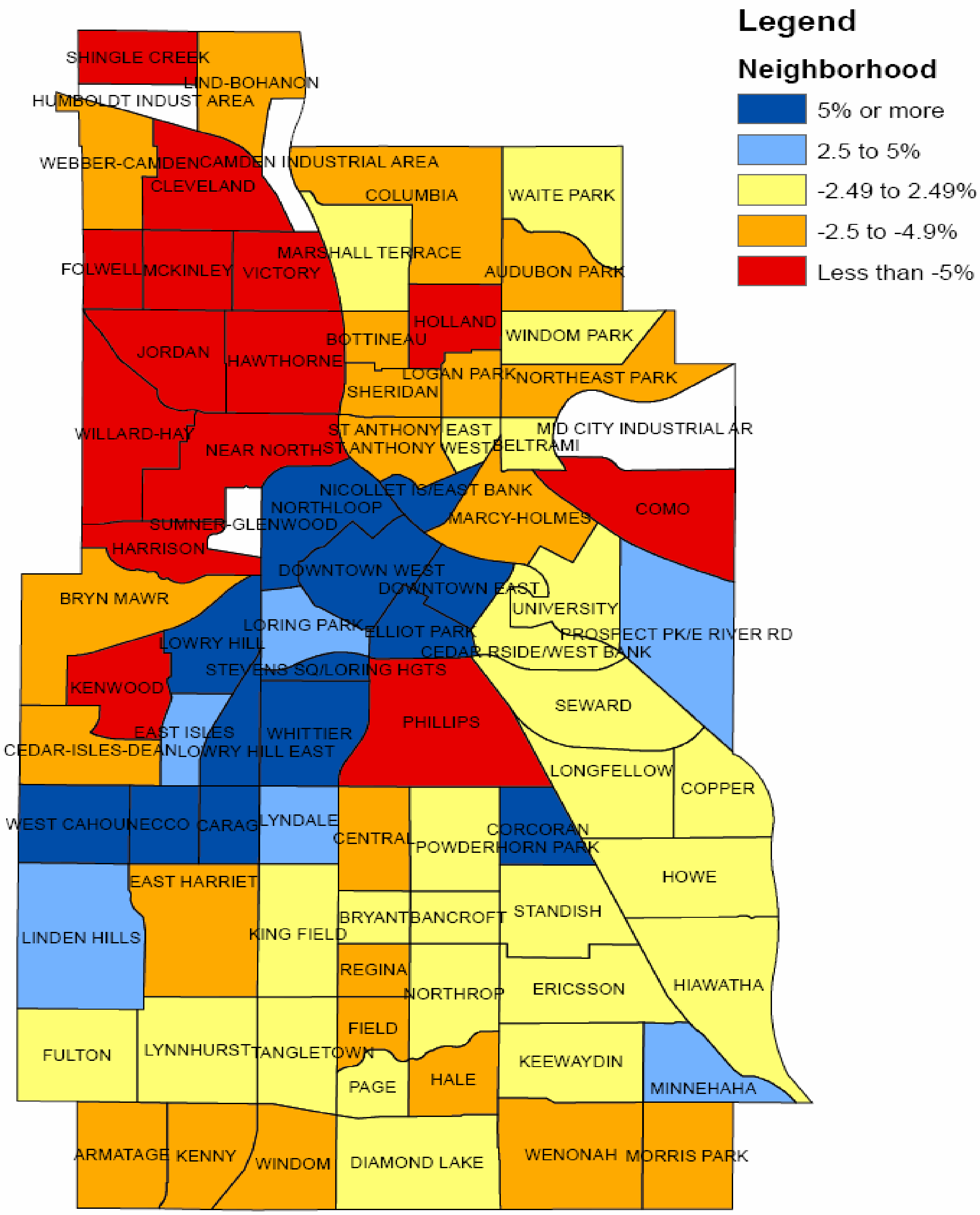
Foreclosures are a serious and rapidly escalating problem in Minnesota. The Federal Reserve Bank of Minneapolis is devoting significant resources to the issue. As we have in the past, members of the Community Affairs unit at the Federal Reserve Bank of Minneapolis are providing technical assistance and support to local foreclosure mitigation initiatives. We will continue to play that role and look for other ways to help.

Some of that assistance comes in the form of research and data analysis, an area where the Federal Reserve has some skill. From my experience with this work, I have concluded that access to mortgage- and foreclosure-related data like those discussed above has already been valuable in addressing foreclosure problems, and that better access could help more. As discussed in my paper with Drs. Grover and Smith and in an article by Dr. Grover,[8] foreclosure data and neighborhood credit score data can be used to target outreach, education, and counseling that aim to help mortgage borrowers succeed. With more complete and accessible public records, we might do more, such as monitor whether certain loan originators or mortgage brokers are associated with unaccountably high levels of foreclosures.

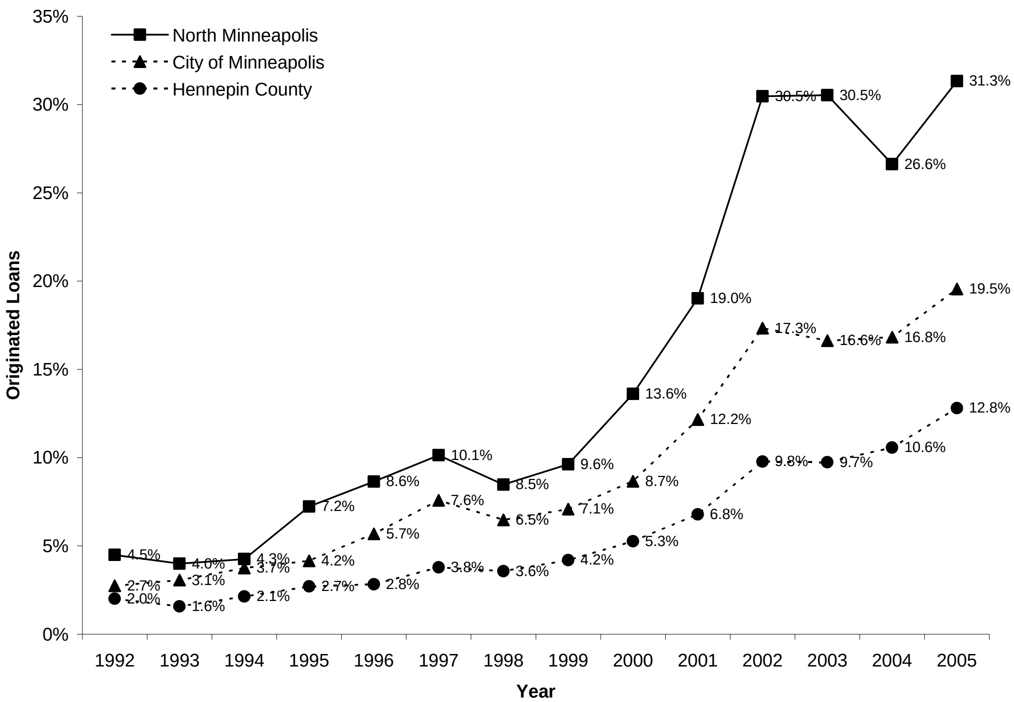
Data access is just one aspect of a broader issue: Are our foreclosure laws and practices well designed to cope with the twenty-first century mortgage market? To explore that question, our Community Affairs unit is organizing a workshop called "Fixing the Foreclosure System," to be held October 4 at the Federal Reserve Bank of Minneapolis. I welcome suggestions for issues we should consider, and I hope I will have an opportunity to share some useful outcomes from the event. Thank you.

[8] "Fed-led research reveals need for better Twin Cities foreclosure data," *Community Dividend* Issue 4, 2006, Federal Reserve Bank of Minneapolis, www.minneapolisfed.org/pubs/cd/06-4/foreclosure.cfm.

Change in the Number of Homesteaded Properties, 2005 to 2007 by Minneapolis Neighborhood



Number of Originated Conventional Home Purchase Loans Where the Borrower Does Not Intend to Occupy the Property



Source: Analysis of HMDA data by Dr. Michael Grover, Federal Reserve Bank of Minneapolis.