



**A Survey of Real Estate Conditions**  
**Loyola College**  
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**The views and opinions expressed in this presentation are solely those of the author and do not necessarily represent those of the Federal Reserve Bank of Richmond or the Federal Reserve System.**





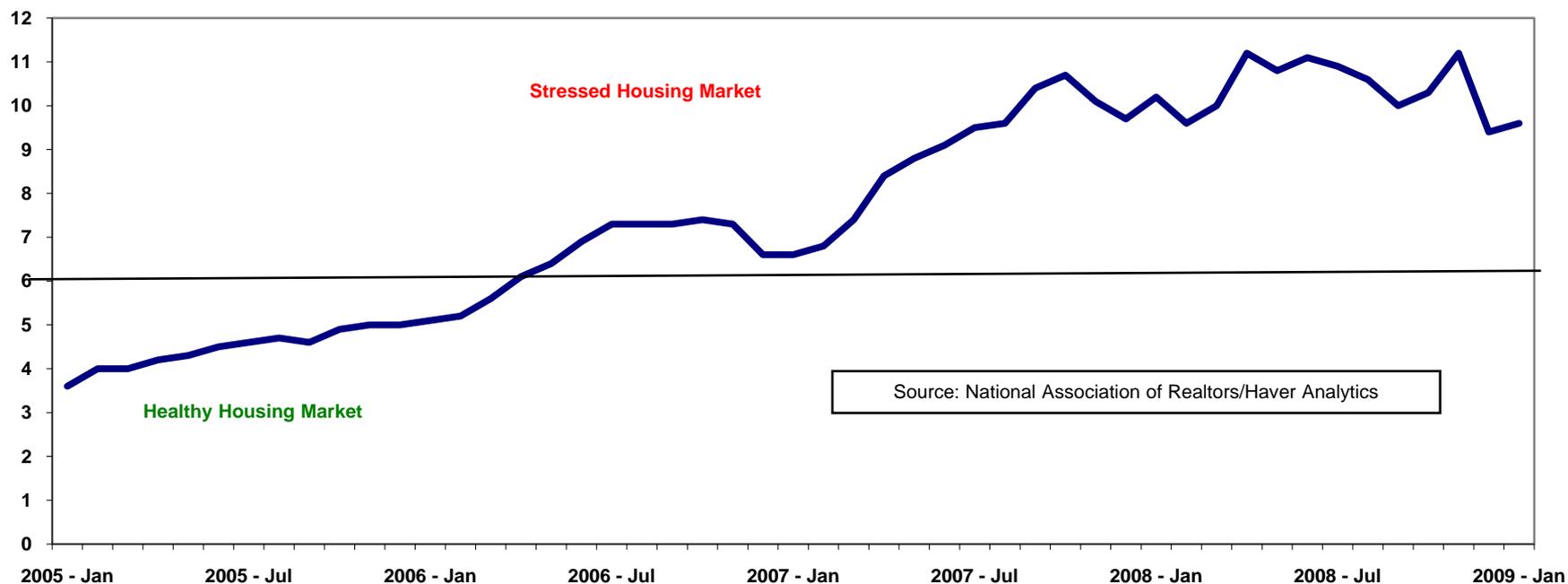
# The Story...

- Where are we?
  - The housing market – still under considerable stress
- How did we get here?
  - One underlying theme
- Where are we headed?
  - Further deterioration in housing and mortgage credit quality likely, with continued spillover into other forms of lending



# The U.S. Housing Market – Months Supply

## Months Supply of Existing Homes January 2005 – January 2009

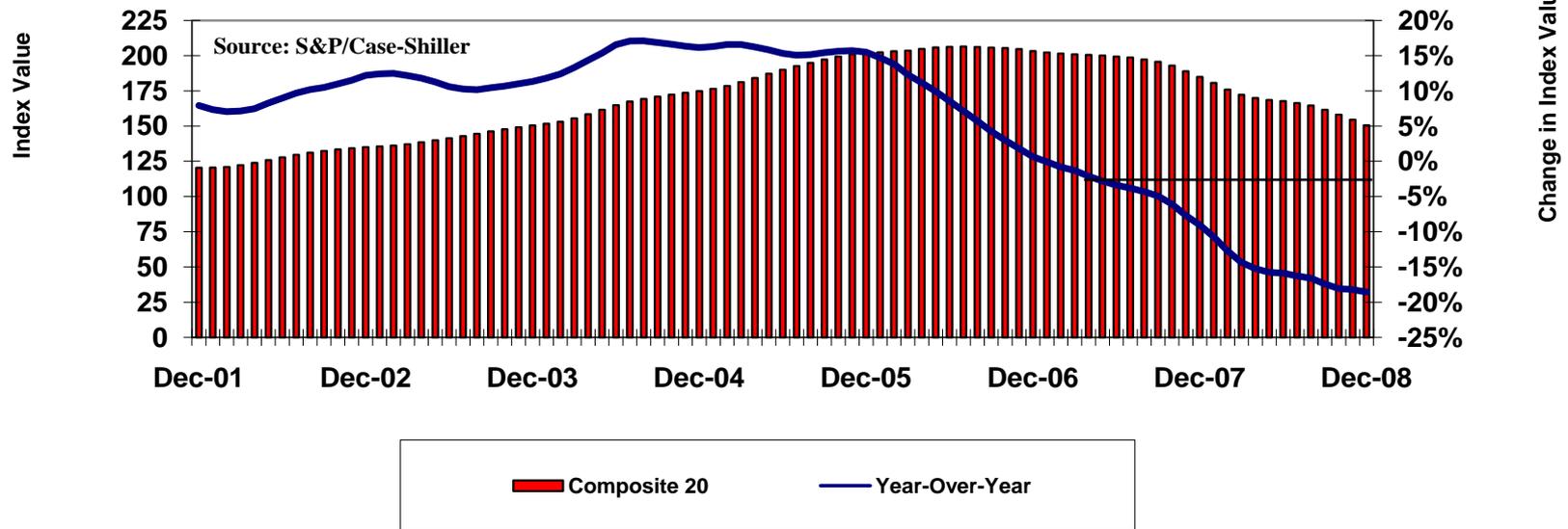


High inventories continue to weigh on the housing market.



# The U.S. Housing Market – Price Changes

## S&P/Case-Shiller Composite 20 Index



Significant declines nationally. Prices likely to fall until inventories ease.



# Maryland Housing Market – Price Changes

Source: [www.ofheo.gov](http://www.ofheo.gov)

	<b>December 2008</b>	<b>September 2008</b>	<b>December 2007</b>	<b>December 2006</b>
<b>Maryland</b>	<b>-7.66</b>	<b>-6.26</b>	<b>0.27</b>	<b>8.51</b>
<b>Baltimore/Towson</b>	<b>-5.84</b>	<b>-4.17</b>	<b>1.73</b>	<b>8.52</b>
<b>Bethesda/Frederick/ Rockville</b>	<b>-8.76</b>	<b>-8.37</b>	<b>-3.41</b>	<b>5.00</b>
<b>Hagerstown/Martins- burg, WVa</b>	<b>-8.02</b>	<b>-6.48</b>	<b>-2.00</b>	<b>6.38</b>
<b>Washington DC/ Va/MD/WVa</b>	<b>-12.10</b>	<b>-12.30</b>	<b>-3.70</b>	<b>5.64</b>
<b>Wilmington, DE/MD/NJ</b>	<b>-4.62</b>	<b>-2.12</b>	<b>1.74</b>	<b>6.73</b>

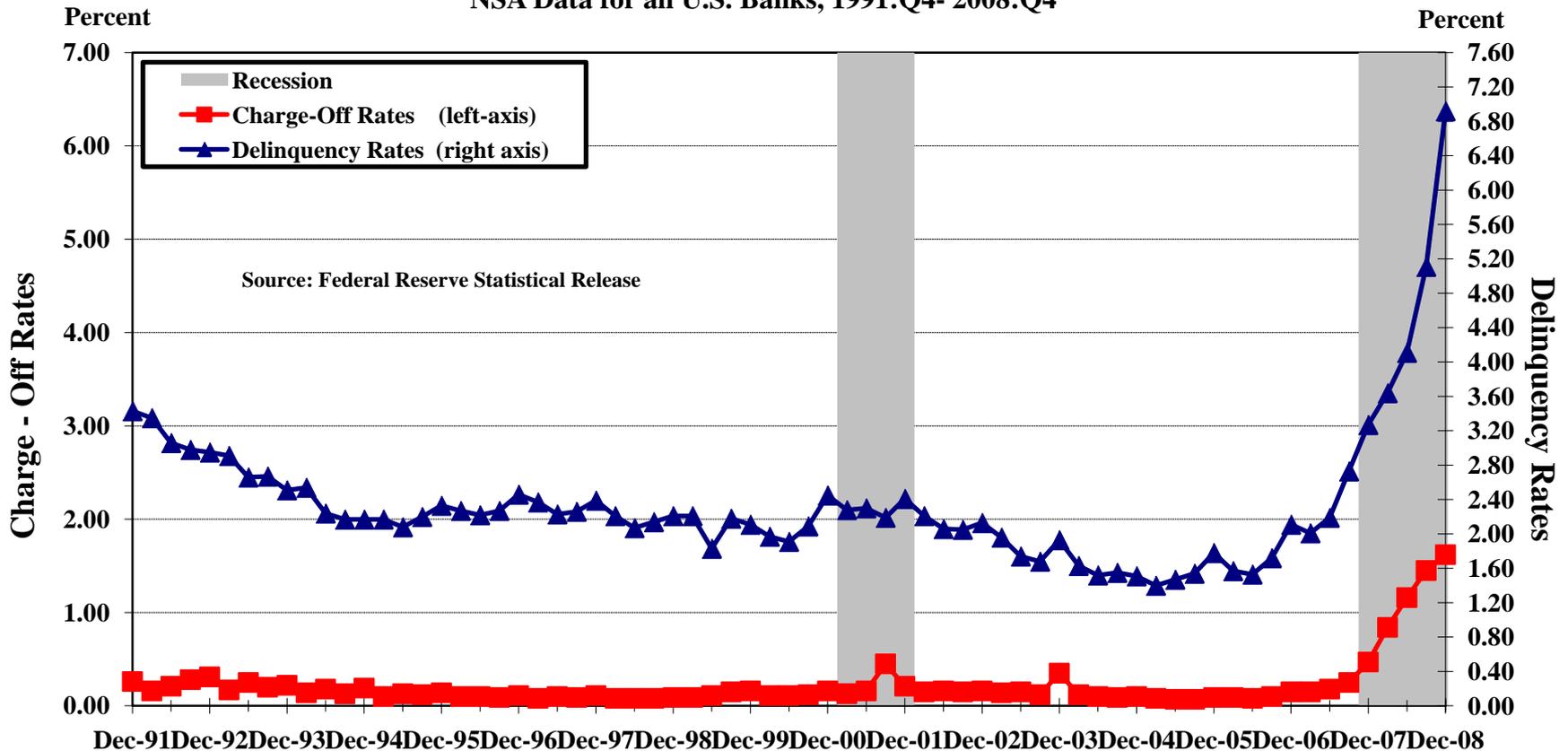
Falling prices, but still not as bad as some parts of the nation.



# Commercial Bank Mortgage Performance

## Residential Mortgage Charge-Off and Delinquency Rates

NSA Data for all U.S. Banks, 1991:Q4- 2008:Q4



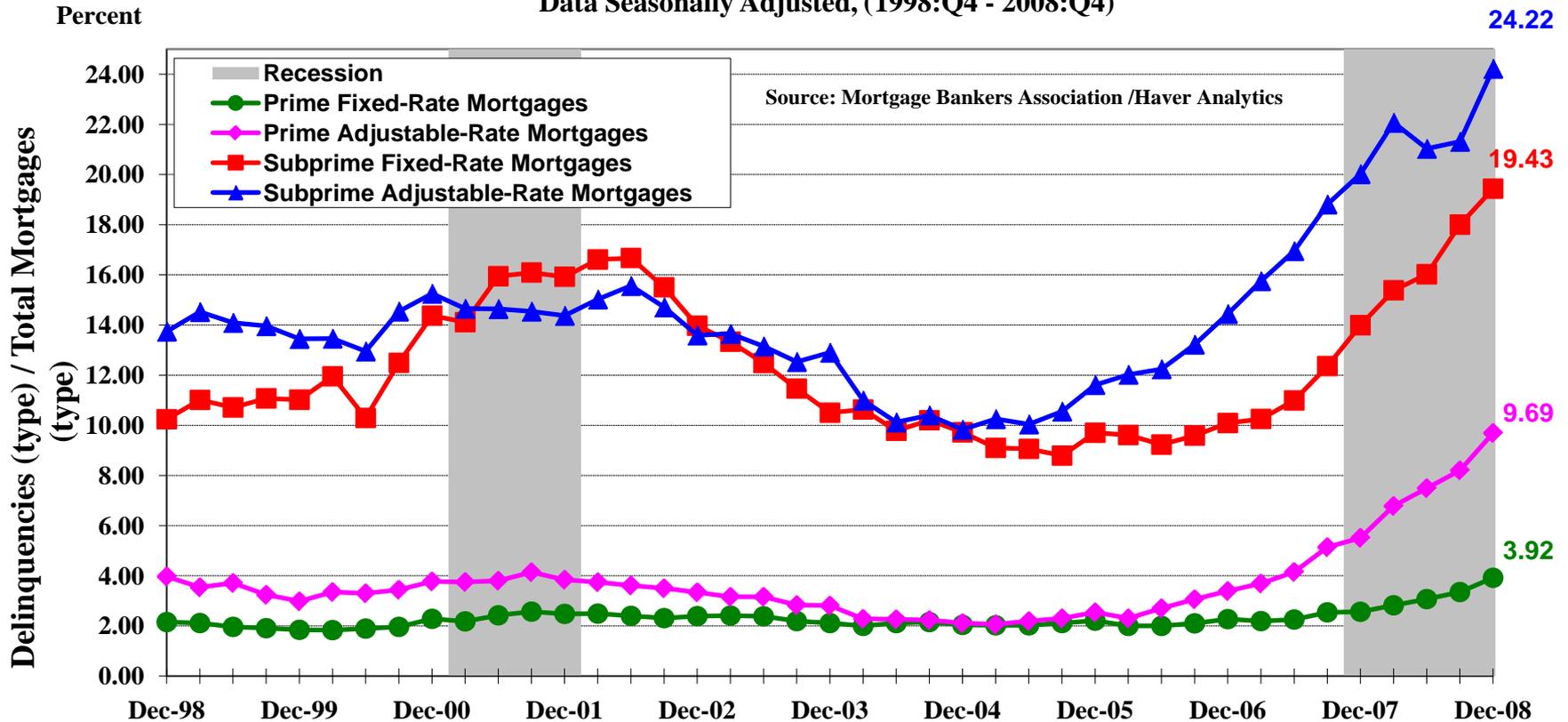
Significant deterioration with performance well above last two recessions.



# U.S. Mortgage Quality – Delinquencies

## U.S. Residential Mortgage Delinquency Rates

Data Seasonally Adjusted, (1998:Q4 - 2008:Q4)



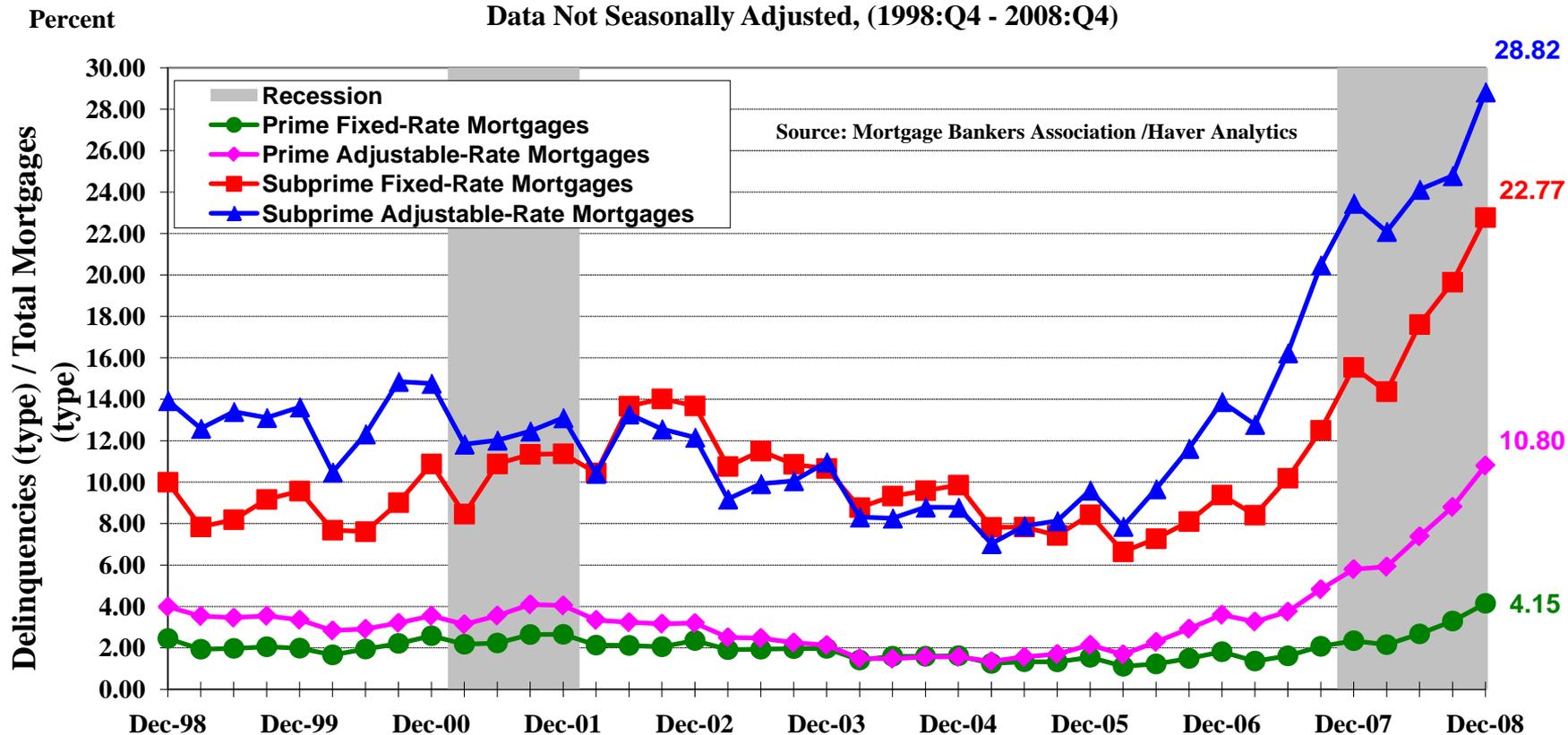
Unprecedented subprime problems, prime has also deteriorated significantly.



# Maryland Mortgage Quality – Delinquencies

## Maryland Residential Mortgage Delinquency Rates

Data Not Seasonally Adjusted, (1998:Q4 - 2008:Q4)



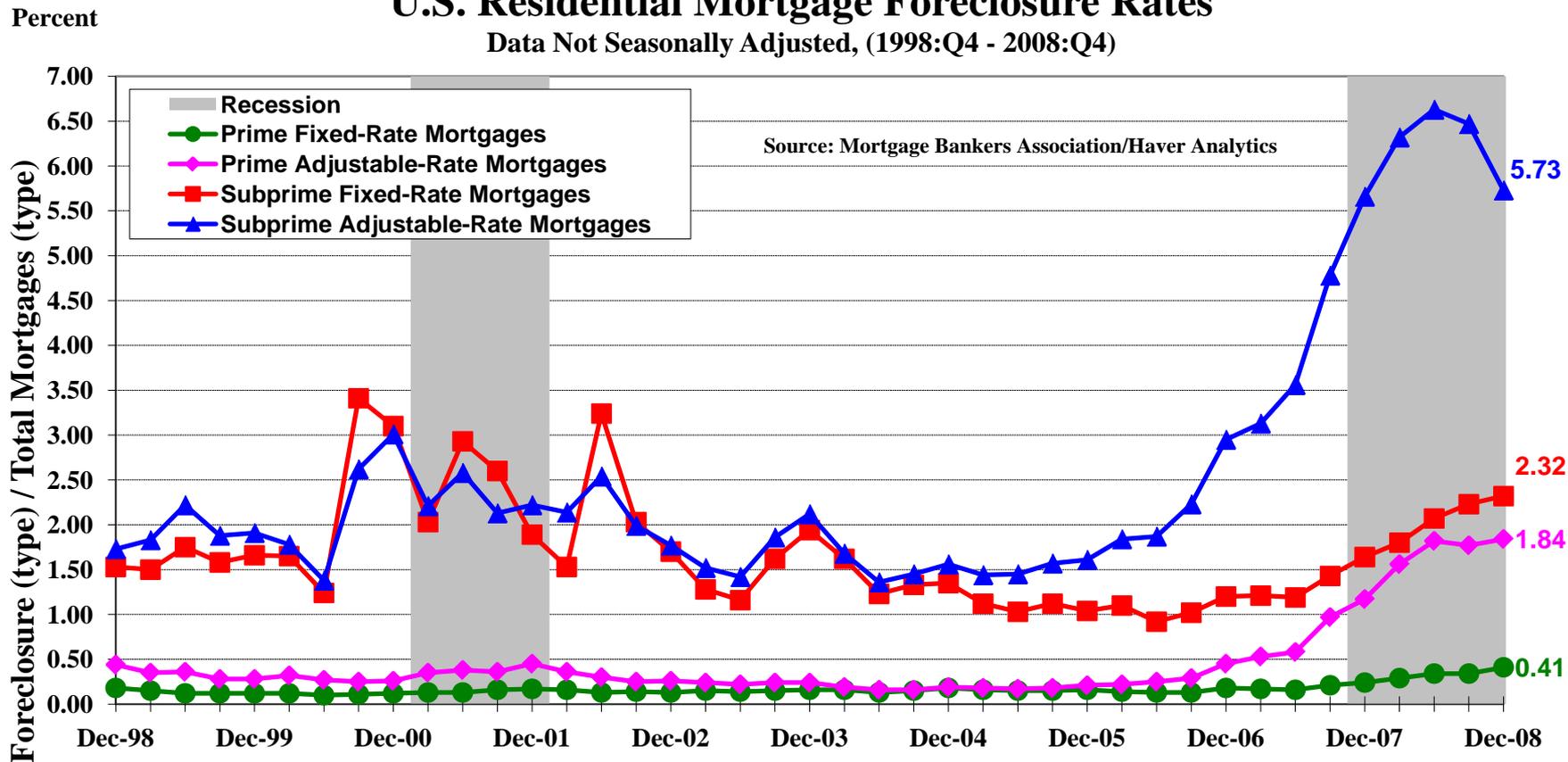
Maryland's mortgage delinquencies are higher than the nation.



# U.S. Mortgage Credit Quality – Unprecedented Foreclosures

## U.S. Residential Mortgage Foreclosure Rates

Data Not Seasonally Adjusted, (1998:Q4 - 2008:Q4)



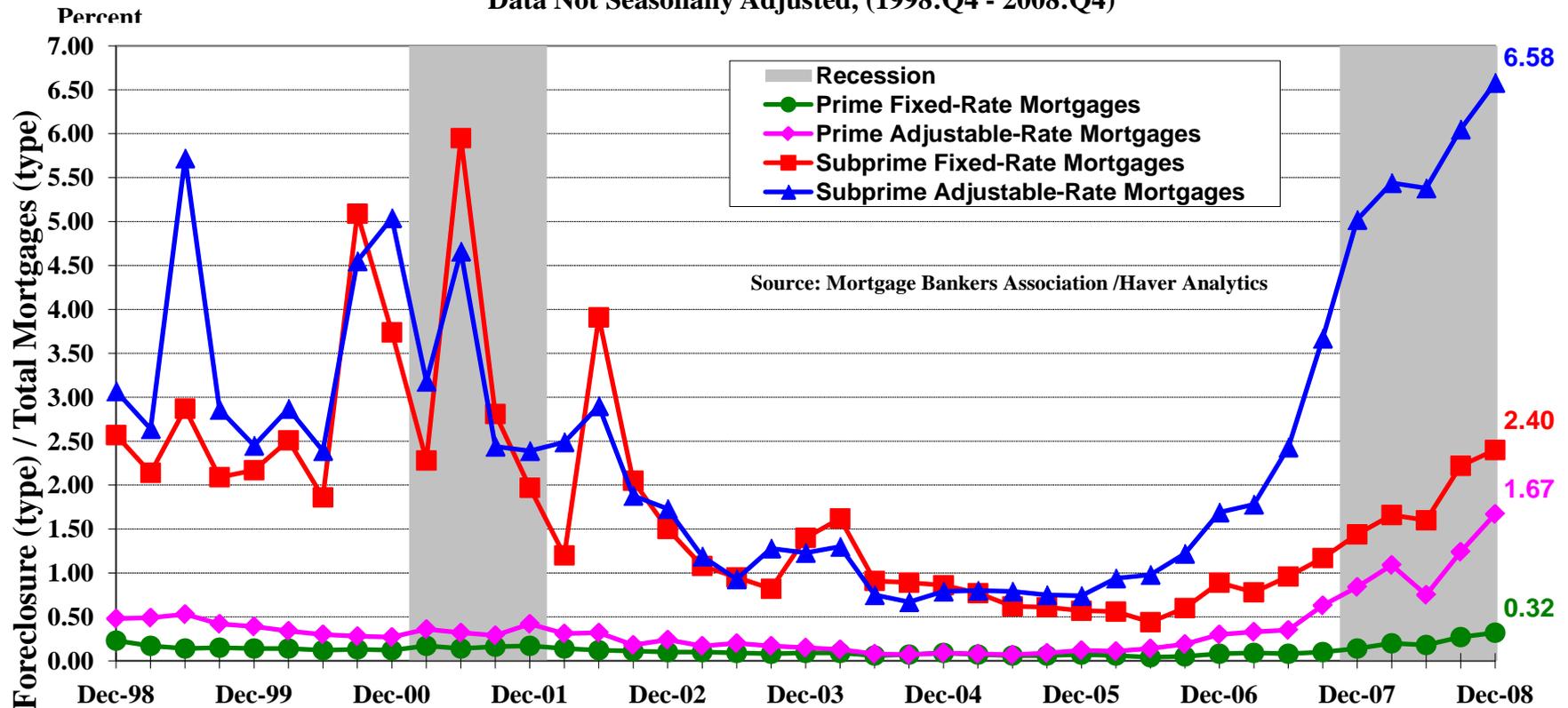
Record foreclosures with subprime leading the way.



# Maryland Mortgage Quality – Foreclosures

## Maryland Residential Mortgage Foreclosure Rates

Data Not Seasonally Adjusted, (1998:Q4 - 2008:Q4)



High foreclosure levels, with subprime performing worse than nation.



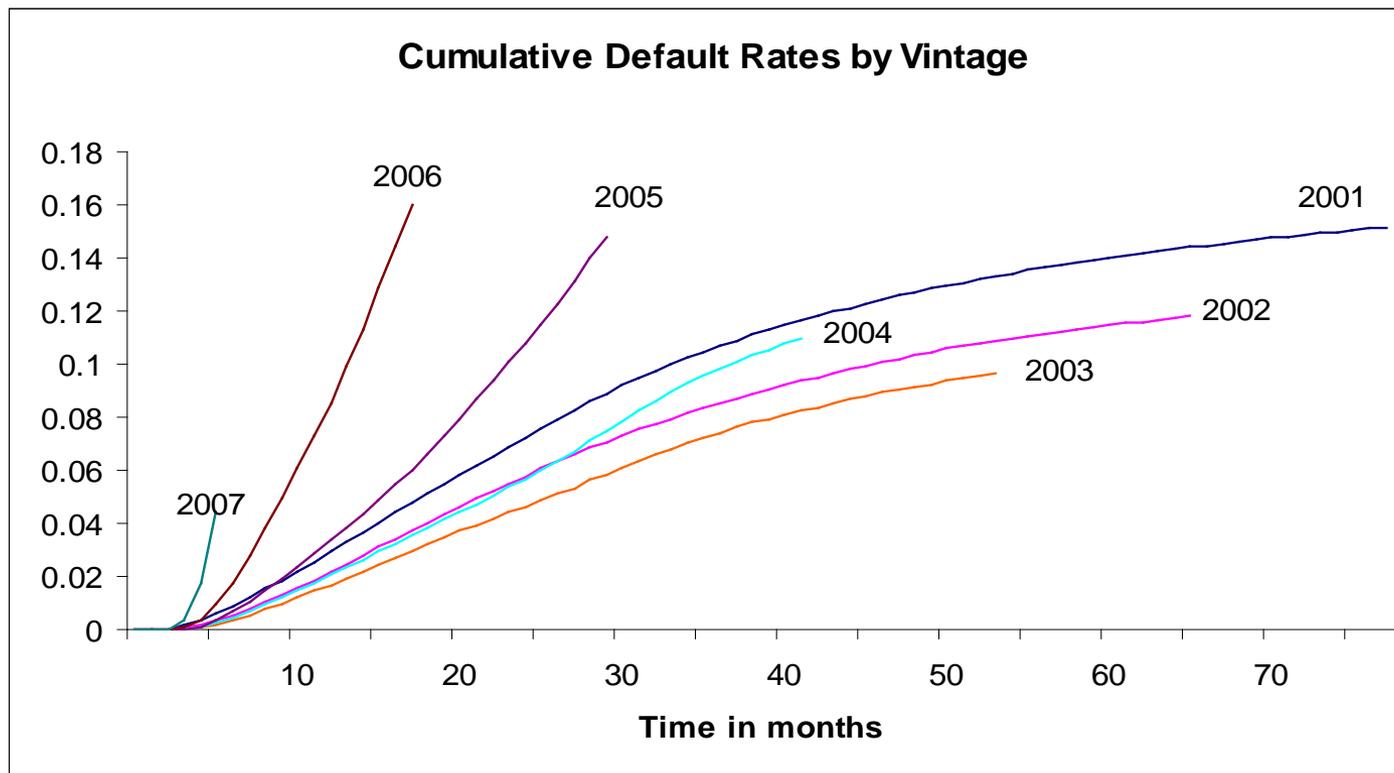


# What Was Different this time?

- Unprecedented subprime growth and a shift in the composition of originations (variable vs. fixed).
- Technological and product innovations:
  - Modeling approaches allowed lenders to more finely differentiate and pool riskier borrowers...borrowers who had trouble getting credit in the past.
  - Existing and new mortgage products marketed and used in ways not previously seen.
  - But, their performance had not been tested in a down market and the probability of a significant housing shock was likely underestimated.
- Shift in the composition of originators (growth outside the traditional commercial banking system).
- Significant capital markets demand for mortgage-related assets.



# The Bottom Line: Weakened Underwriting

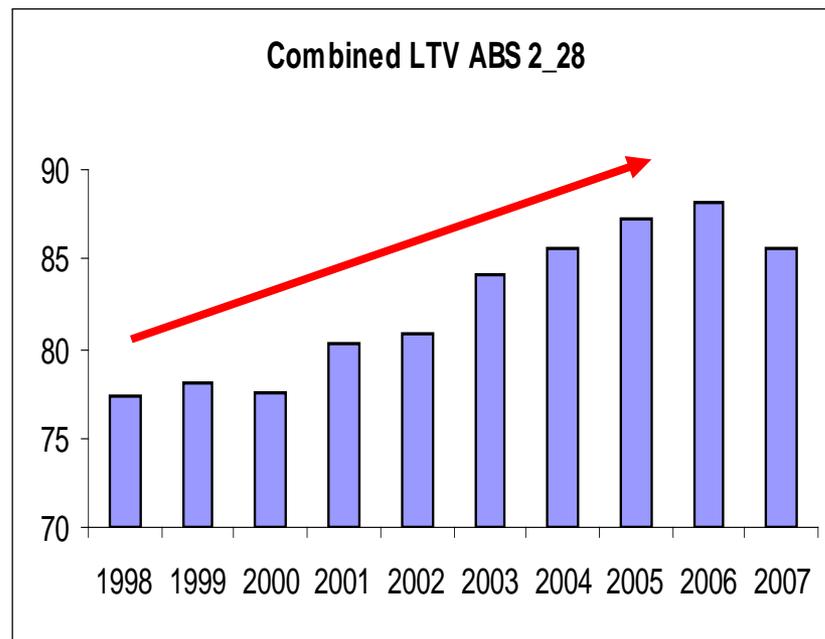
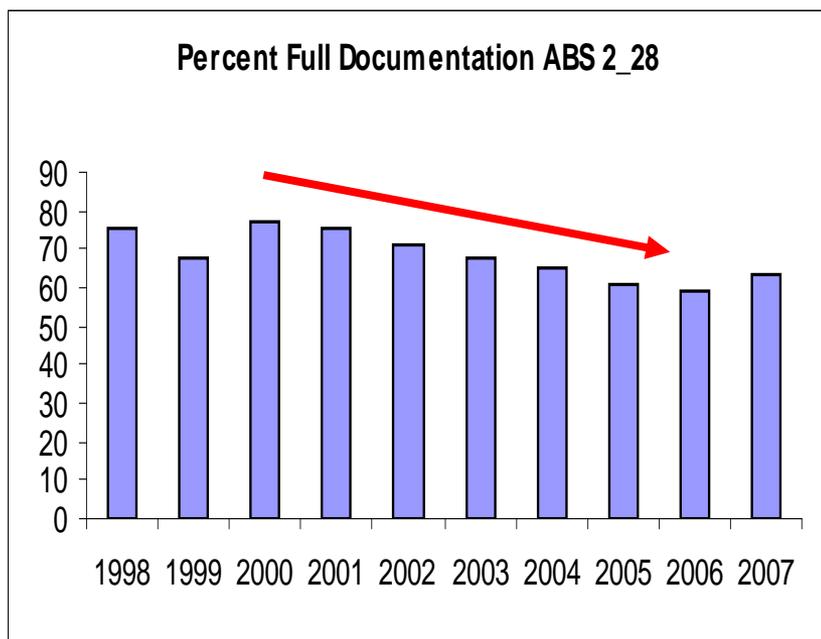


Source: Federal Reserve Board calculations using Loan Performance data

Weaker performance at the peak of the housing boom: Underwriting.



# Underwriting: Documentation and Loan-to-Value



Source: Federal Reserve Board calculations using Loan Performance data

Documentation requirements went down at the same time LTV's went up.





# Underwriting - Where did the “C’s” go wrong?

- **Character**

- ✓ “Willingness to pay.” A strong credit history demonstrates prudent financial management.

- **Capacity**

- ✓ “Ability to pay.” Income verification and monthly cash flow establish a basis for sustainable home ownership.

- **Collateral**

- ✓ Honest, not aggressive, appraisals provide a foundation for home ownership.

- **Capital**

- ✓ Even a small down payment helps.





# Where Are We Headed - House Prices

## Positives:

- Favorable interest rate environment
- Tax incentives
- Buyer's market - lots of inventory and sellers willing to negotiate
- Affordability has improved

## Negatives:

- Economy
- Lending standards have tightened
- Distressed sales and inventory
- Uncertainty



# Where Are We Headed – Foreclosures

Source: Bloomberg



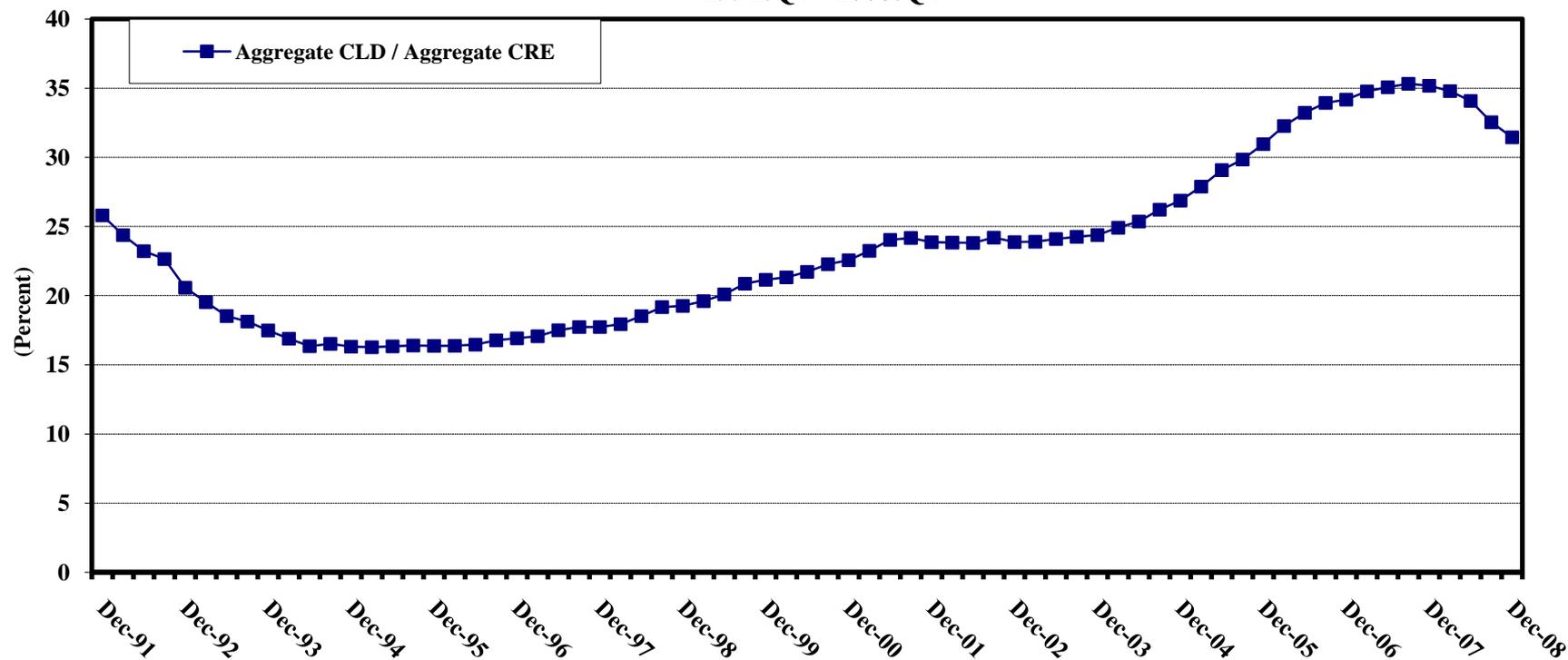
Such deterioration would likely involve more prime loans.



# Spillover - The CRE/RRE Link

## Construction and Land Development (CLD) a Portion of CRE

1991:Q4 - 2008:Q4



Source: Consolidated Reports of Condition and Income

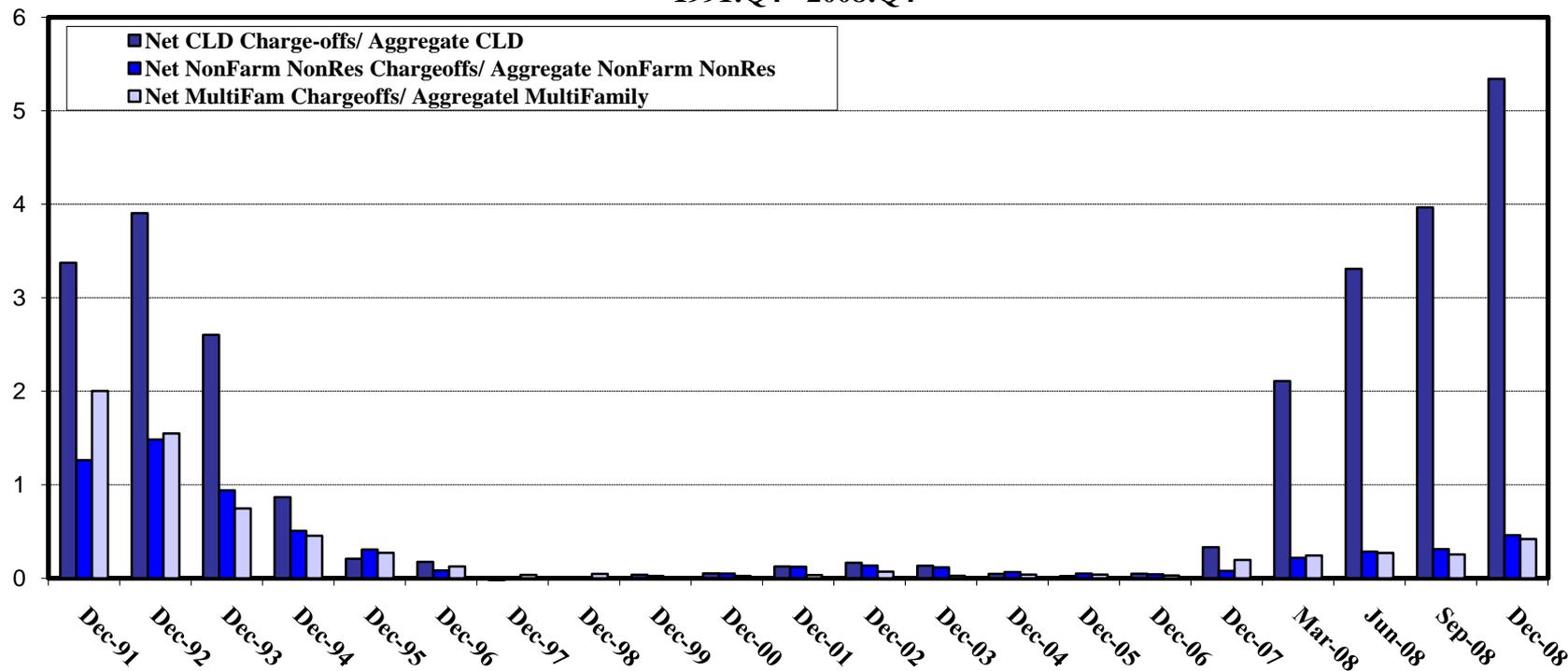
CLD loan concentrations topped out higher than the early 1990's.



# Deteriorating CRE Performance

## National Commercial Real Estate (CRE) Charge-offs

1991:Q4 - 2008:Q4



Source: Consolidated Reports of Condition and Income

CLD fared the worst previously and has deteriorated significantly again.





## Recap

- The housing market is characterized by oversupply and falling prices.
- U.S. mortgage loan performance has deteriorated significantly and now has surpassed levels seen at the last recession.
- Maryland's performance is generally weaker than the nation.
- Weakened underwriting standards were a major factor.
- Spillover into commercial real estate (construction and land development) and home equity evident.
- Still not out of the woods yet.



# Questions?



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