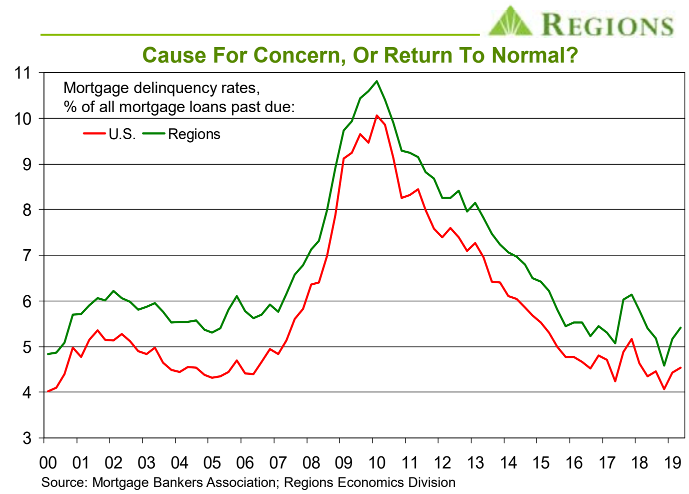
ECONOMIC UPDATE
REGIONS
August 21, 2019

Q2 2019 Mortgage Delinquencies & Foreclosures: Regions Footprint

- For the U.S. as a whole the mortgage delinquency rate rose to 4.53 percent in Q2 2019 from 4.42 percent in Q1
- Within the Regions footprint, the mortgage delinquency rate rose to 5.41 percent in Q1 2019 from 5.16 percent in Q1
- Foreclosure starts were up 5.1 percent year-on-year for the U.S. as a whole, and down 2.0 percent for the Regions footprint

The Mortgage Bankers Association (MBA) recently released their data on mortgage delinquencies and foreclosures for Q2 2019. For the U.S. as a whole the mortgage delinquency rate, which encompasses all stages of delinquency but not those loans in some stage of foreclosure, rose to 4.53 percent in Q2 2019 from 4.42 percent in Q1. Utilizing the MBA data, we calculate a comparable delinquency rate for the 15-state Regions footprint, which is a weighted average (based on the number of total mortgage loans serviced in each state) of the delinquency rates reported for the individual states. The delinquency rate for the Regions footprint rose to 5.41 percent in Q2 2019 from 5.16 percent in Q1. As of Q1 2019, the MBA survey covers roughly 38.661 million first lien mortgage loans for the U.S. as a whole and roughly 14.539 million first lien mortgage loans within the Regions footprint.



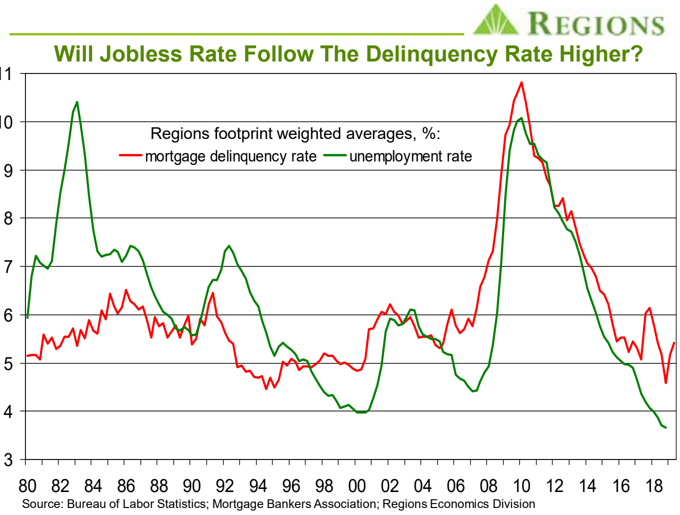
For a second consecutive quarter, we are left to explain an increase in the mortgage delinquency rate, with the rate also having risen in Q1 2019. With the exception of the post-hurricane spike in late-2017, the first two quarters of 2019 mark the first back-to-back increases in the mortgage delinquency rate since 2009, i.e., the height of the housing market bust. The obvious question is whether this marks the end of a prolonged period in which the mortgage delinquency rate had steadily trended lower (again, with the notable exception of the post-hurricane spike in Q3-Q4 2017). Indeed, one could argue that, by year-end 2018, there was nowhere for delinquency rates to go but up. As we've noted in the past few editions of this write-up, early-stage (i.e., 30-day and 60-day) delinquency rates had fallen below long-term norms, so it could be that the increase seen over the first half of 2019 simply reflects a movement back towards those longer-term norms – rising early-stage delinquency rates pushed the overall delinquency rate up over 1H 2019. That lending standards on mortgage loans have been easing over the past several quarters (as indicated in the Federal Reserve's quarterly surveys of senior loan officers) may also be contributing to higher delinquency rates.

Moreover, as we frequently note in our discussions of the mortgage delinquency data, there are clear seasonal patterns in the raw data. As such, if the raw, or, not seasonally adjusted, data in any given quarter do not conform to typical seasonal patterns, the seasonally adjusted data for that quarter will be biased, i.e., made to look better/worse than is actually the case, depending on the deviation in the raw data. For instance, the not seasonally adjusted early stage delinquency rate tends to fall in Q1 and rise in Q2 of any given year. But, as we noted in our last write-up, the decline in the 30-day delinquency rate in Q1 2019 (14 basis points) was smaller than the historical average (56 basis points), which led to the reported seasonally adjusted rate looking worse than is actually the case. That Q1's decline was smaller than normal goes to our point that there simply may have been limited scope for further improvement in the 30-day delinquency rate after such a prolonged decline left it below historical norms. By the same token, the increase in the unadjusted 30-day delinquency rate in Q2 2019 (32 basis points) was larger than the historical average (20 basis points), so seasonal adjustment would not have fully compensated, thus pushing the seasonally adjusted rate higher (there are similar patterns in the data on the 60-day delinquency rate).

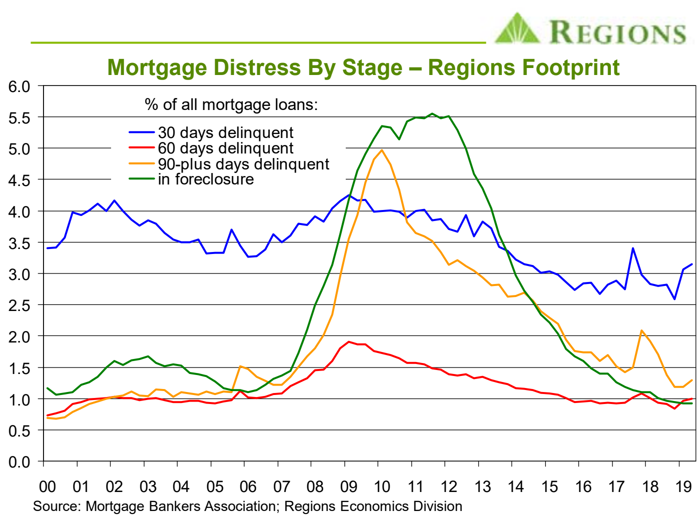
In addition to atypical seasonal patterns in the raw data, higher early-stage delinquency rates could also reflect severe flooding in parts of the broad South and Midwest regions, as MBA pointed out in their release of the Q2 data. As we discussed in the wake of Hurricanes Harvey and Irma, MBA reporting standards dictate that any delinquencies stemming from natural disasters are reported in the data even when forbearance agreements are in place, but at the same time spikes in early-stage delinquencies in such instances are not typically followed by subsequent spikes in late-stage delinquencies and foreclosures. Though weather effects cannot account for some of the broader based (geographically) increases in early-stage delinquencies reflected in the recent data, they can and likely do account for at least some of the increases seen in parts of the Region footprint.

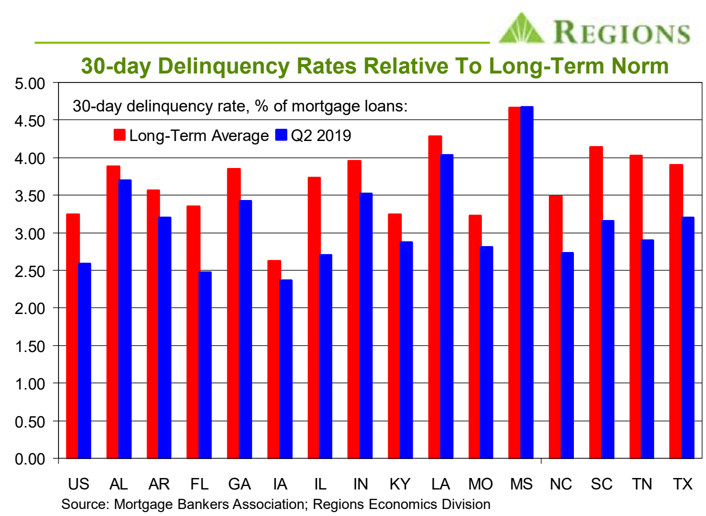
Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com

So, between seasonal adjustment issues, reversion back towards historical norms, and weather effects, it may seem as though the recent upturn in early-stage mortgage delinquency rates can be explained away, leaving few reasons to worry about it. Lest you think that we have suddenly taken up residence in Lake Wobegone where, much like the children, all of the economic data are above average, even allowing for the factors we discuss above, we're not quite willing to simply brush aside the recent upturn in early-stage mortgage delinquencies. The chart to the side helps account for why this is the case. Over time, the total mortgage delinquency rate, which covers all stages of delinquency, and the jobless rate have been closely linked. While the relationship between the two may seem obvious, what may be surprising is that in most instances, the mortgage delinquency rate has moved, either up or down, before the unemployment rate has moved.



One possible explanation is that at turns in the business cycle, firms tend to alter the number of hours worked by their current workforces before actually changing the number of employees, as doing so gives them time to assess whether they are seeing a genuine turn in the cycle or simply a transitory increase/decrease in demand. But, these changes in hours worked clearly impact total labor earnings, i.e., fewer/more hours worked translate into less/more take-home pay, which in turn impacts consumer spending and debt service payments. A timely, but likely not isolated, example of this effect is playing out in the Elkhart-Goshen IN metro area, the heart of domestic RV manufacturing. With demand for RVs having slowed and inventories building, manufacturers have begun cutting back on production, including some producers cutting workweeks to four days from five. As such, workers are still employed, but are taking home less pay and, as such, could face growing financial stress even before there is any impact on the headline jobless rate. To be sure, we're not saying this is widespread, but it does help account for why the delinquency rate tends to move before the jobless rate. This helps account for why we find the recent upturn in the mortgage delinquency rate to be at least a bit unsettling, and we think the behavior of delinquency rates certainly merits extra attention over coming months in light of growing concerns that we are nearing a cyclical turning point. Moreover, with a heavy exposure to motor vehicle manufacturing across the Regions footprint and the pace of motor vehicle sales slowing, it is not unreasonable to think that the scenario now playing out amongst RV manufacturers could start playing out amongst motor vehicle manufacturers, which is a potential source of upward pressure on early-stage delinquency rates across the footprint in the months ahead.



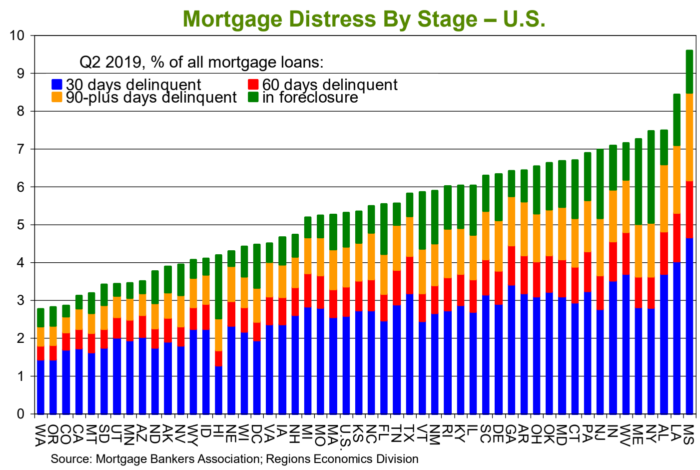


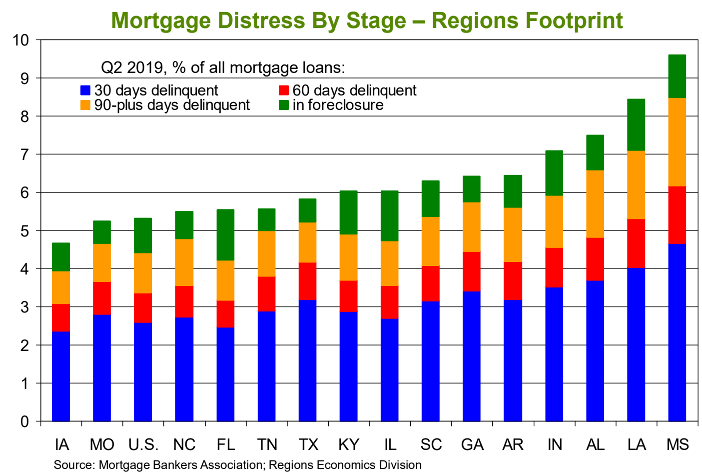
The first chart above shows mortgage distress by stage for the Regions footprint as a whole. The recent upturn in the 30-day delinquency rate does stand out. All 15 states saw their 30-day delinquency rate rise over the first two quarters of 2019; the 80 basis point increase in Louisiana is the largest two-quarter increase, followed by increases of 69 basis points in Mississippi and 65 basis points in Georgia. The two-quarter increase of 39 basis points in North Caroline is the smallest in the footprint, with Iowa seeing a 41 basis point increase. Still, to our earlier point, with the exception of Mississippi, despite the increase over the first half of 2019, the 30-day delinquency rate as of Q2 is below the longer-term (1980 through 2006) average, in many cases comfortably so. Our takeaway is that while mortgage loan performance remains strong, the recent upturn in early-stage delinquencies is a caution against getting complacent.

As of Q2 2019, Mississippi has the highest incidence of total mortgage distress – the sum of 30-day, 60-day, and 90-day delinquency rates and the foreclosure inventory rate – in the nation, at 9.59 percent, with the highest 30-day, 60-day, and 90-day delinquency rates.

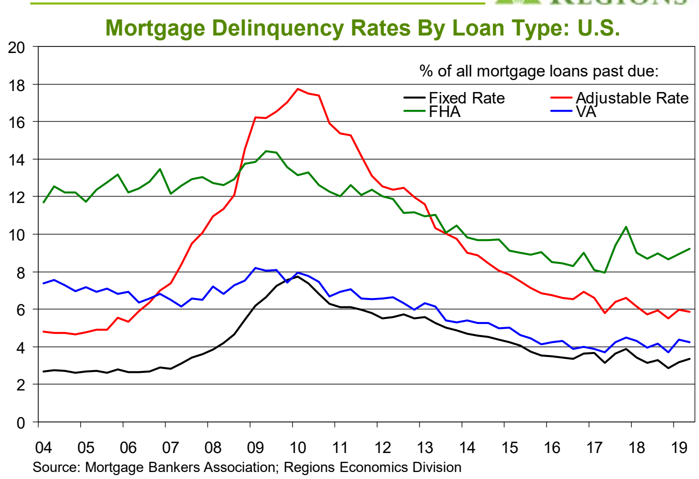
Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com

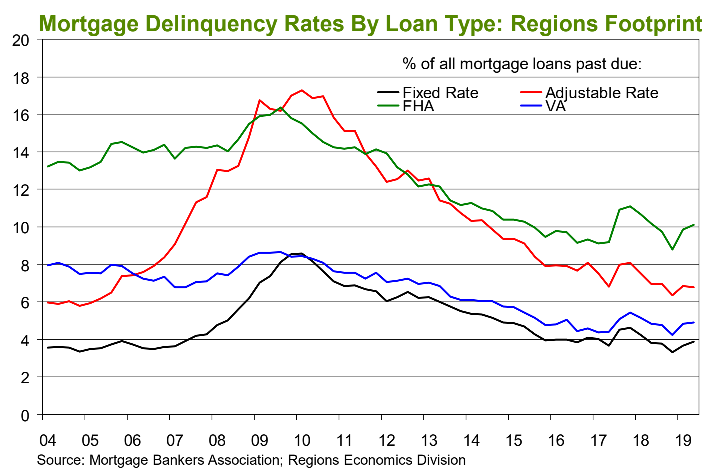
That said, at 1.10 percent, Mississippi's foreclosure rate is nowhere near being the highest in either the U.S. or the Regions footprint. New York posted the nation's highest foreclosure rate in Q2 (2.43 percent), with Louisiana (1.34 percent) and Florida (1.32 percent) posting the highest foreclosure rates in the Regions footprint. Louisiana, Alabama, and Indiana are also amongst the ten states with the highest rates of total mortgage distress as of Q2. With a rate of 2.77 percent, Washington posted the lowest rate of total mortgage distress in Q2, followed by Oregon (2.83 percent) and Colorado (2.86 percent). Within the Regions footprint, Iowa had the lowest rate of total mortgage distress, at 4.67 percent, which was up from 4.24 percent as of Q1 2019.



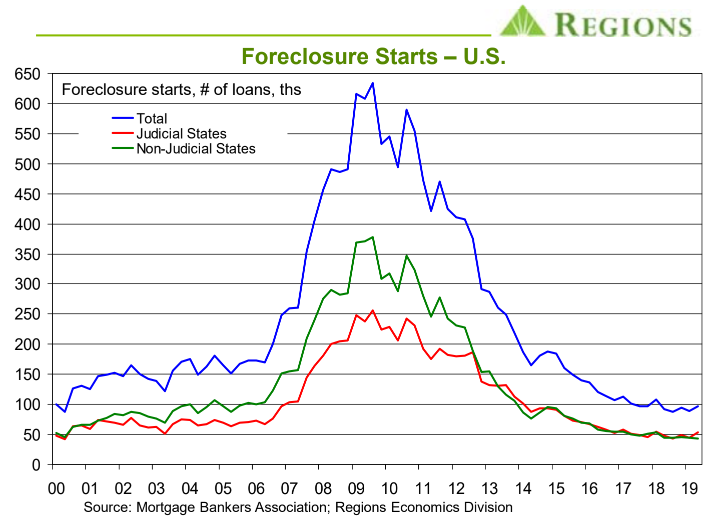


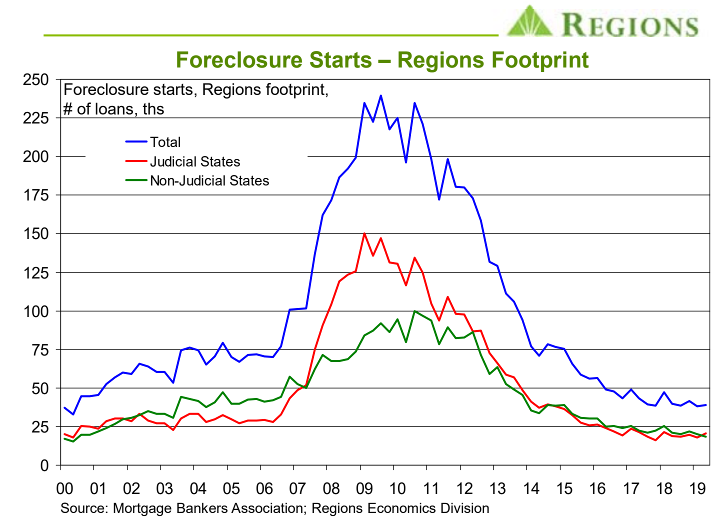
Of the four broad loan categories on which the MBA now reports data – fixed rate, adjustable rate, FHA, and VA – loan performance deteriorated in each over the first half of 2019, which is the case nationally and within the Regions footprint. As a side point, though MBA no longer reports on the basis of "prime" and "subprime" mortgage loans, they have noted that most of what were in the past reported as "prime" mortgage loans now fall into the "fixed rate" category, while most of what in the past were reported as "subprime" mortgage loans now fall into the "adjustable rate" category. Over the first half of 2019, the deterioration in loan performance was the most pronounced in the FHA and VA buckets. Nationally, the delinquency rate on FHA loans rose by 57 basis points over the first half of 2019 and stands at 9.22 percent as of Q2, while the delinquency rate on VA loans rose by 53 basis points and now stands at 4.24 percent. Within the Regions footprint, the delinquency rate on FHA loans rose by 130 basis points over the first half of 2019, and stands at 10.10 percent as of Q2, while the delinquency rate on VA loans rose by 65 basis points and now stands at 4.90 percent.



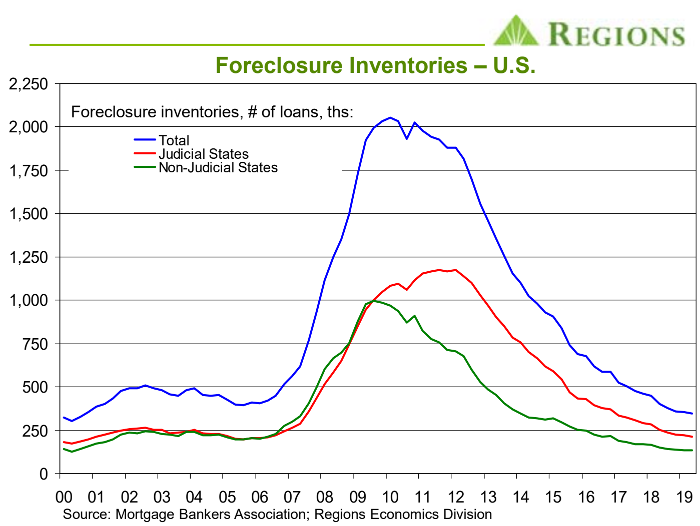


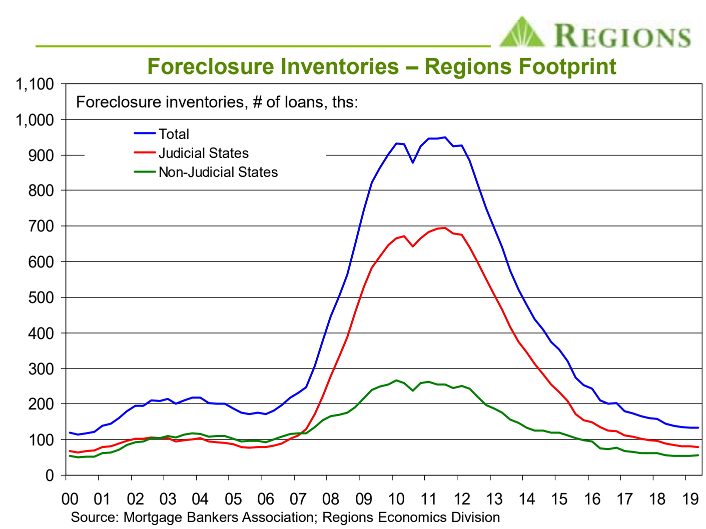
Nationally, there were a total of 96,654 foreclosure starts during Q2, the most in any quarter since Q1 2018 and a year-on-year increase of 5.05 percent. This marks the first year-on-year increase in foreclosure starts since Q4 2010. New York saw a jump in foreclosure starts in Q2, with the 9,852 foreclosure starts the highest in the nation and the highest in New York state since Q2 2015. Florida also saw a notable jump in foreclosure starts in Q2, with the 9,105 foreclosure starts the highest quarterly total since Q2 2017. This triggered an increase in foreclosure starts for the Regions footprint as a whole, with a total of 38,968 foreclosure starts across the 15 states. This still leaves total foreclosure starts down 2.01 percent year-on-year for the footprint as a whole. Though we're still at least a few quarters from finding out the answer, one way to know whether the recent upturn in early-stage delinquencies has been more noise than signal will be to track foreclosure starts. For instance, to the extent seasonal adjustment noise and weather related issues drove reported increases in early-stage delinquency rates, there is no reason to expect this to map into increased foreclosure starts another few quarters down the road. More broadly, we can make the same point about foreclosure starts that we made about early-stage delinquency rates, i.e., despite the recent upturn, the number of foreclosure starts remains low by historical standards, both nationally and within the Regions footprint, as the following two charts show.





Foreclosure inventories have also fallen dramatically, and while the number of loans is still modestly above pre-crisis norms, when expressed as a percentage of outstanding first lien mortgage loans, foreclosure inventories are indeed below pre-crisis norms. The share of total home sales accounted for by distress properties, which mainly consist of REO sales and short sales, has fallen sharply and remains just above pre-crisis norms, both nationally and within the Regions footprint. Earlier in this cycle, the paring down of the large backlog of distress inventories helped hold down the pace of house price appreciation, but as that backlog has all but been cleared, inventory constraints in the for-sale segment of the housing market have become more pressing, thus helping fuel a faster pace of house price appreciation.





Mortgage Distress, Regions Footprint

as of Q2 2019

STATE	30-day delinquency rate	60-day delinquency rate	90-day delinquency rate	foreclosure inventory	total mortgage distress rate	"early stage" delinquency rate	"serious" delinquency rate
Alabama	3.70	1.13	1.76	0.91	7.50	4.83	2.67
Arkansas	3.20	0.99	1.42	0.82	6.43	4.19	2.24
Florida	2.47	0.71	1.05	1.32	5.55	3.18	2.37
Georgia	3.42	1.03	1.31	0.66	6.42	4.45	1.97
Iowa	2.37	0.72	0.85	0.73	4.67	3.09	1.58
Illinois	2.70	0.86	1.18	1.30	6.04	3.56	2.48
Indiana	3.52	1.05	1.36	1.16	7.09	4.57	2.52
Kentucky	2.87	0.84	1.20	1.12	6.03	3.71	2.32
Louisiana	4.03	1.28	1.79	1.34	8.44	5.31	3.13
Missouri	2.81	0.86	1.00	0.57	5.24	3.67	1.57
Mississippi	4.67	1.51	2.31	1.10	9.59	6.18	3.41
North Carolina	2.73	0.83	1.23	0.71	5.50	3.56	1.94
South Carolina	3.16	0.93	1.28	0.92	6.29	4.09	2.20
Tennessee	2.90	0.91	1.19	0.57	5.57	3.81	1.76
Texas	3.20	0.97	1.05	0.61	5.83	4.17	1.66
U.S.	2.59	0.78	1.05	0.90	5.32	3.37	1.95

NOTE: all rates expressed as a percentage of outstanding mortgage loans, not seasonally adjusted

Source: Mortgage Bankers Association; Regions Economics Division

Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com