ECONOMIC UPDATE

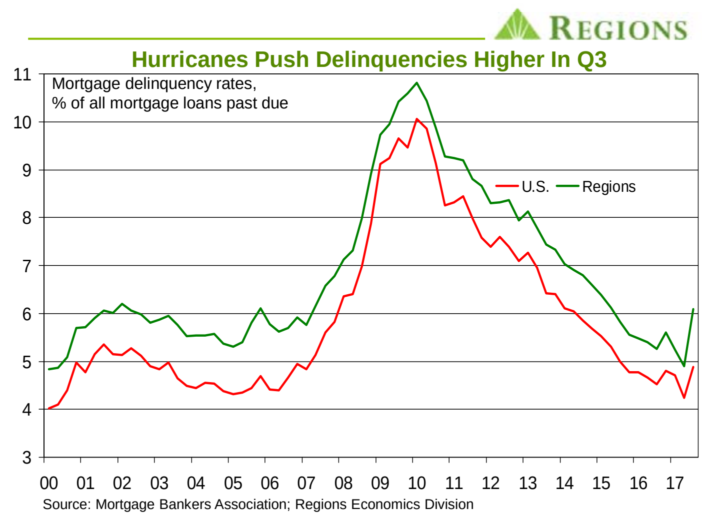
REGIONS

November 21, 2017

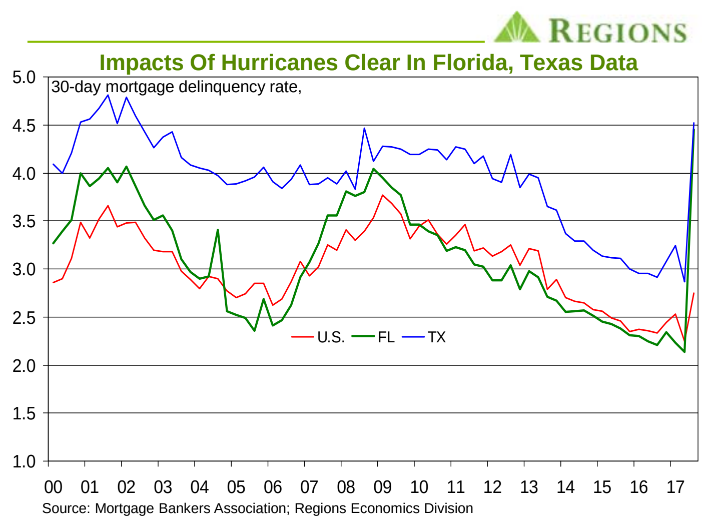
Q3 2017 Mortgage Delinquencies & Foreclosures

- For the U.S. as a whole the mortgage delinquency rate rose to 4.88 percent in Q3 2017 from 4.24 percent in Q2.
- Within the Regions footprint, the mortgage delinquency rate rose to 6.09 percent in Q3 2017 from 4.90 percent in Q2.
- Year-on-year, foreclosure starts fell by 14.8 percent for the U.S. as a whole and fell by 16.9 percent for the Regions footprint.

The Mortgage Bankers Association (MBA) recently released their data on mortgage delinquencies and foreclosures for Q3 2017. 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 4.88 percent in Q3, the highest since Q3 2015. 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 jumped to 6.09 percent in Q3 2017 from 4.90 percent in Q2. The Q3 data, however, come with a significant caveat, as delinquency rates were skewed higher in the wake of Hurricanes Harvey and Irma. That the two states most impacted by the hurricanes – Florida and Texas – are part of the Regions footprint means the impact on the delinquency rate was more pronounced for the footprint than for the U.S. as a whole, particularly given the rate we construct for the footprint is weighted by total mortgage loans. As is consistent with what prior to the hurricanes had been a steadily declining delinquency rate, foreclosure starts continue to trend lower, both for the U.S. as a whole and for the Regions footprint. As of Q3 2017, the MBA survey covers roughly 38.836 million first lien mortgage loans for the U.S. as a whole and over 14.586 million first lien mortgage loans within the Regions footprint.



In our write-up of the Q2 mortgage delinquency data, which was produced after Hurricane Harvey hit Texas but before the path Irma would take was clear, we called attention to mortgage loan performance in the aftermath of Hurricane Katrina. Specifically, 30-day mortgage delinquency rates in Louisiana and Mississippi jumped in Q3 2005, and this was followed by increases in 60-day and 90-day delinquency rates in subsequent quarters. But, we noted that in neither state was the significant increase in mortgage delinquencies followed by an appreciable increase in foreclosures, with the foreclosure rate in each state remaining in line with pre-Katrina trends. We noted the same could be expected in the data for Texas, and would have made the same point had Irma's path been clear at the time. The data for Q3 2017 fall in line with this pattern, with jumps in the 30-day delinquency rate in both Florida and Texas, as seen in the chart to the side. The rate for Florida went from 2.14 percent in Q2 to 4.45 percent in Q3, with the rate in Texas going from 2.87 percent in Q2 to 4.52 percent in Q3 (these are the seasonally adjusted rates, the table on the last page shows the not seasonally adjusted data for each state in the footprint). The data over coming quarters will almost surely see follow-through increases in 60-day and 90-day delinquency rates, but in neither state do we look for material increases in foreclosures.



It is worth noting that the post-hurricane reporting structure for the mortgage delinquency data, as specified by the MBA, requests that lenders report as delinquent any loan on which the payment is not made in accordance with the original terms of the mortgage contract **regardless of any forbearance plans put in place** (our emphasis). In other words, even though forbearance plans will for the most

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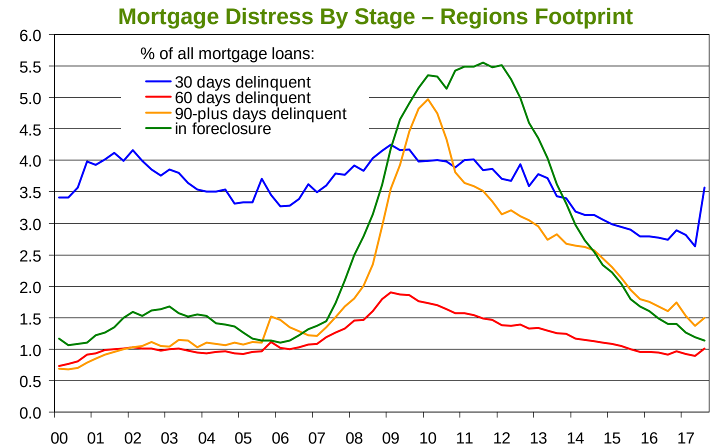
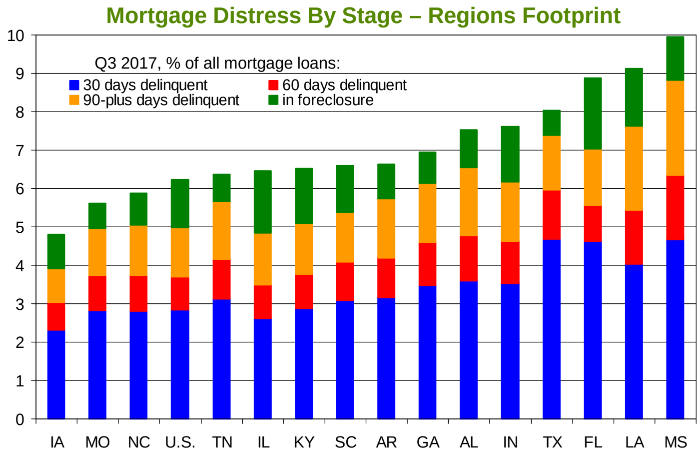
part mean there will not be high numbers of foreclosures stemming from the hurricanes, their impact will nonetheless remain visible in the delinquency data for some time to come. As such, the delinquency data will paint a misleading picture of mortgage loan performance in Florida and Texas, and to a lesser extent the U.S. as a whole, over coming quarters. What we should not lose sight of is that in each state, as for the U.S. as a whole, 30-day delinquency rates had fallen below historical norms prior to the hurricanes, which flowed through all the way to materially lower foreclosure starts. At some point the impacts of the hurricanes will drop from the data and the healthy trends in mortgage loan performance will again be apparent. It is also worth noting that a quirk of timing biased delinquency rates higher in all states in Q3 – the last day of the quarter fell on a Saturday, so processing for mortgage payments made over the weekend did not occur until Monday, October 2, so any such mortgage payments would, in accordance with MBA guidelines, be identified as delinquent and would have been captured in the 30-day delinquency rate. Though small, this effect also played a part in the higher 30-day delinquency rate in Q3 but has no longer-term implications.

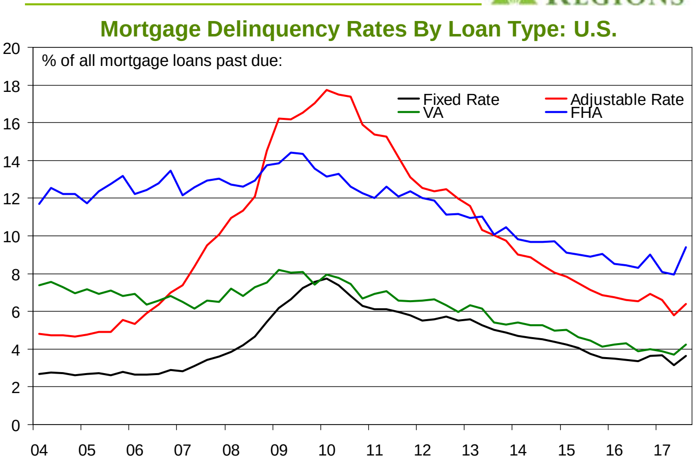


Source: Mortgage Bankers Association; Regions Economics Division



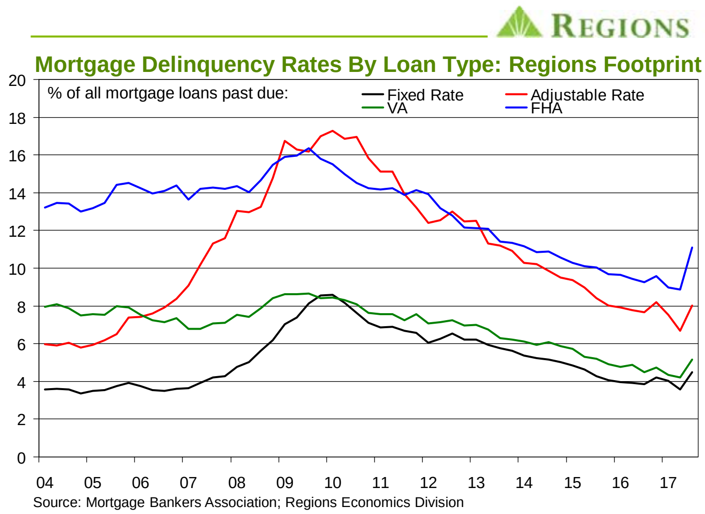
Source: Mortgage Bankers Association; Regions Economics Division

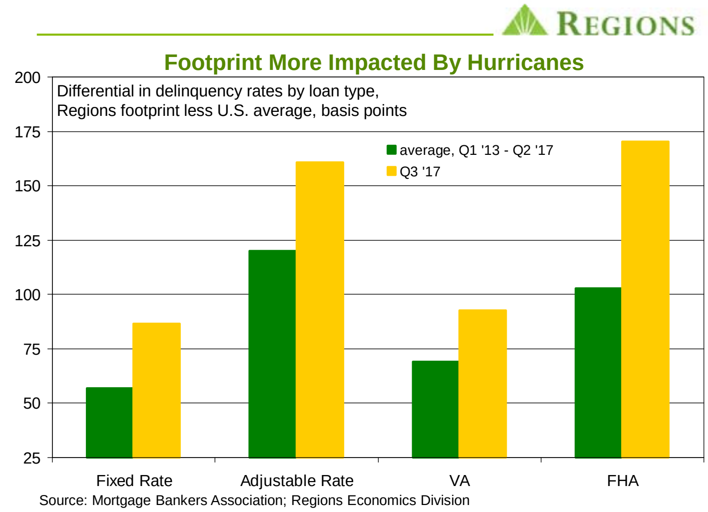
The overall incidence of mortgage distress, which includes both delinquency and foreclosure, for the Regions footprint as a whole rose to 7.21 percent in Q3 from 6.08 percent in Q2. The jump in the 30-day delinquency rate discussed above is apparent in the first chart above, but aside from that what we find notable is the steadily declining incidence of foreclosure. The inventory of loans in some stage of foreclosure edged down to 1.14 percent in Q3 from 1.19 percent in Q2. Again, even though we expect delinquency rates to move higher over the coming few quarters, we do not look for a similar increase in the foreclosure rate. The second chart above shows mortgage distress for each state in the Regions footprint broken out by stages. At 9.95 percent, Mississippi had not only the highest incidence of mortgage distress in the footprint in Q3 but also the highest in the U.S., while at 9.13 percent Louisiana had the nation's third-highest incidence. As we routinely note, Mississippi has long been characterized by having a high incidence of mortgage distress comprised of high early-stage delinquency rates (i.e., loans delinquent for less than 90 days) but relatively low rates of late-stage delinquencies (90 days or more delinquent) and foreclosure, as many loans repeatedly migrate between current and delinquent. Though not nearly to the extent as Texas, Hurricane Harvey did impact Louisiana and this is likely a large factor behind the jump in Louisiana's 30 day delinquency rate in Q3. Note that with the jump in their 30-day delinquency rates, Florida and Texas show significantly higher rates of mortgage distress for Q3 than had been the case in prior quarters. It is worth noting that, at 0.65 percent, Texas had the footprint's lowest foreclosure rate in Q3 2017.



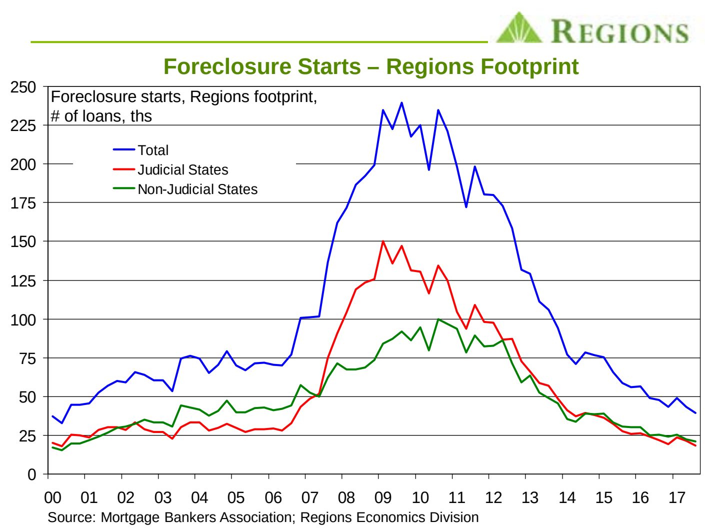
Source: Mortgage Bankers Association; Regions Economics Division

As seen in the chart to the side, delinquency rates jumped across all loan types in Q3, which would be expected if indeed the primary driver of higher defaults is disruption in payment activity stemming from the hurricanes. With delinquency rates rising across each of the four broad loan types, the relative order of delinquency rates across loan types has not changed, i.e., FHA loans have the highest incidence of delinquency while conventional fixed rate loans have the lowest incidence. We'll reiterate a point we made in our write-up of the Q2 data – the cuts shown in the chart to the side reflect the new reporting convention adopted by the MBA as of the Q1 2017 data. This is when the MBA discontinued their previous practice of reporting data on "prime" and "subprime" loans. Under that convention, however, the bulk of what were reported as subprime loans were adjustable rate loans, which helps account for the patterns in delinquency rates on adjustable rate mortgage loans seen in the chart to the side.





The first chart above shows the same breakdown of delinquency rates by loan type for the Regions footprint as a whole. The same jump in delinquency rates across loan types seen nationally in Q3 is apparent in the data for the footprint, and the relative order of delinquency rates across loan types is the same. The second chart above reiterates a point we made at the outset, i.e., the Regions footprint saw loan performance adversely impacted by Hurricanes Harvey and Irma to a much greater degree than was the case nationally. The green bars show the average differential, in basis points, in delinquency rates between the Regions footprint and the U.S. average over the Q1 2013 through Q2 2017 period. For instance, the delinquency rate on conventional fixed rate mortgage loans for the footprint as a whole was on average 57 basis points above the national average over the Q1 2013 through Q2 2017 period, but as of Q3 2017 stood 87 basis points above the national average. The biggest differential between Q3 2017 and the longer-term average is in delinquency rates on FHA loans; as of Q3 the delinquency rate on FHA loans for the footprint as a whole stood 170 basis points above the national average, compared to the longer-term average differential of 103 basis points.



As we also noted at the outset, the noise in the mortgage performance data will persist for a few quarters but should have little lasting impact on the longer-term trends. It is important to keep that in mind, and also important to not let the jump in delinquency rates seen in the Q3 data deflect attention from what has been steadily improving mortgage loan performance over the past several years. While this improvement is readily seen in the downward drift in delinquency rates, it can also be seen in foreclosure starts, as shown in the chart to the side. In Q3 2017 there were 39,498 foreclosure starts across the Regions footprint, the fewest since Q2 2000. Similarly, the 97,020 starts nationally marks the lowest quarterly total since Q2 2000. Data on foreclosure inventories show the same pattern, i.e., a steady decline after a massive wave that crested after the end of the 2007-09 recession.

The steady decline in foreclosure starts is a combination of more stringent mortgage underwriting standards, a prolonged period of steady job and income growth accompanied by significant house price appreciation that has restored equity for large numbers of homeowners across much of the U.S. It is worth noting that while performance on other types of consumer debt, such as auto loans and credit cards, has deteriorated over recent quarters, performance on mortgage loans had steadily improved prior to the jump in Q3 that reflects the impact of Hurricanes Harvey and Irma far more so than any other factor(s). This of course is not to say mortgage loan performance is immune to the deterioration seen in other forms of consumer debt – it is not. One trait that is apparent in the historical data is that mortgage delinquency rates tend to move hand-in-hand with unemployment rates, nationally and also on the state and metro area levels. In other words, the end of the current economic expansion, now in its ninth year, will ultimately come, and when it does it will bring with it higher delinquency rates that will, unlike the spike seen in the Q3 data, be more reflective of underlying economic and financial conditions. That said, the current expansion has seen very little of the excesses in mortgage lending practices and the unsustainable rates of house price appreciation seen in the build up to the 2007-09 recession. As such, it is perfectly reasonable to expect that, whenever the next downturn comes, the consequences will not be nearly as severe as was the case the last time around.

Mortgage Distress, Regions Footprint

as of Q3 2017

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	3.59	1.18	1.77	0.98	7.52	4.77	2.75
Arkansas	3.16	1.03	1.54	0.91	6.64	4.19	2.45
Florida	4.64	0.93	1.46	1.85	8.88	5.57	3.31
Georgia	3.48	1.11	1.55	0.81	6.95	4.59	2.36
Iowa	2.31	0.72	0.88	0.89	4.80	3.03	1.77
Illinois	2.61	0.88	1.36	1.61	6.46	3.49	2.97
Indiana	3.52	1.12	1.54	1.43	7.61	4.64	2.97
Kentucky	2.88	0.90	1.31	1.43	6.52	3.78	2.74
Louisiana	4.04	1.40	2.20	1.49	9.13	5.44	3.69
Missouri	2.83	0.91	1.22	0.66	5.62	3.74	1.88
Mississippi	4.67	1.68	2.48	1.12	9.95	6.35	3.60
North Carolina	2.81	0.93	1.32	0.82	5.88	3.74	2.14
South Carolina	3.08	1.00	1.30	1.21	6.59	4.08	2.51
Tennessee	3.12	1.03	1.52	0.69	6.36	4.15	2.21
Texas	4.68	1.29	1.41	0.65	8.03	5.97	2.06
U.S.	2.84	0.86	1.29	1.23	6.22	3.70	2.52

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

Source: Mortgage Bankers Association; Regions Economics Division

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