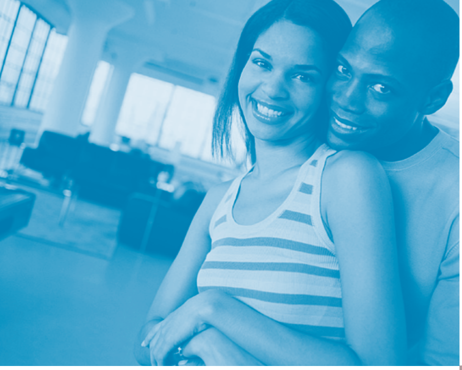
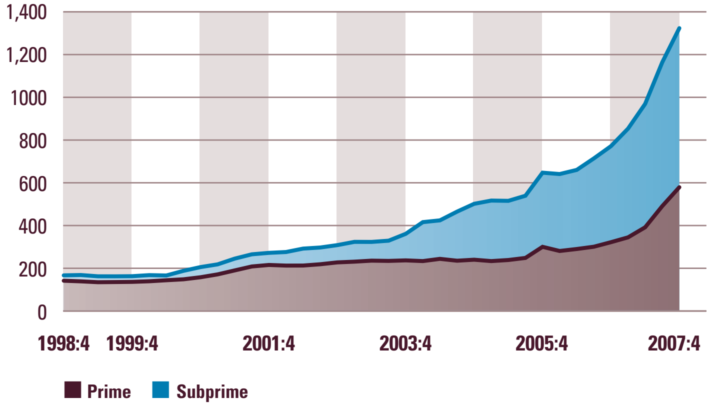


INTRODUCTION AND SUMMARY

The damage from today's mortgage foreclosure crisis reaches deep into the rental market. With affordability already a long-standing problem, the current housing debacle not only adds to the number of households competing for low-cost rentals and threatens current renters with eviction from their homes, but also increases the costs of financing rental housing construction and preservation. Moreover, because many high-risk loans now in default are concentrated in low-income and minority communities, the fallout from foreclosures is hitting the same neighborhoods where many of the nation's most economically vulnerable renters live.

FIGURE 1 **Serious Delinquencies Have Moved Up Sharply**

Loans 60+ Days Delinquent or Entering Foreclosure (Thousands)



Note: Numbers equal four-quarter moving average of non-seasonally adjusted conventional loans serviced, multiplied by the seasonally adjusted rates of delinquencies and foreclosure starts.
Source: Mortgage Bankers Association.

THE MORTGAGE MARKET MELTDOWN

Soaring foreclosure rates are one of the unintended side effects of extending homeownership opportunities to higher-risk households with limited incomes and wealth. Designed to expand access to mortgage capital for these borrowers, subprime lending helped to fuel the decade-long homebuying boom. But as early as 2004, the number of subprime loans that were seriously delinquent (with payments 60 days or more late, and/or just entering into foreclosure) had jumped to over 260,000, devastating many low-income and minority communities—particularly in the industrial Midwest. But because the performance of prime loans remained relatively stable, the uptick in troubled subprime mortgages had little impact on national mortgage markets.

But as more and more households struggled to buy in the face of rapidly rising home prices, the number of seriously delinquent conventional mortgages continued to climb—more than doubling from 2004 to 2007 to well over 1.3 million (Figure 1). Various forms of nontraditional and higher-priced subprime loans were particularly vulnerable. The Mortgage Bankers Association estimates that over 12 percent (or some 750,000) of all subprime loans were seriously delinquent by the end of 2007. Although the share of troubled prime mortgages was only 1.67 percent at year end, this translates into nearly 580,000 seriously delinquent loans—an increase of 143 percent from the 2004 figure.

Aggressive marketing by many mortgage industry participants helped to spark the meteoric rise in high-risk products. Reinforcing this trend was the structure of the mortgage industry itself—in particular Wall Street's seemingly insatiable appetite for mortgage-backed securities and the widespread use of incentives for brokers and loan officers to push risky, higher-priced products. The surge in foreclosures suggests that many borrowers who took on subprime loans and other forms of high-priced debt had little or no capacity to repay.

The plentiful supply of mortgage capital also fed a substantial rise in high-risk lending to absentee owners of one- to four-unit rental properties. The Mortgage Bankers Association reports that, by the end of 2007, one out of every five new foreclosure actions nationwide involved absentee owners of such properties. While varying from one state to the next, the foreclosure process generally overrides existing rental lease provisions. As a result, even tenants with strong payment histories may be forced to move from their homes with little or no notice.

THE RENTAL AFFORDABILITY CRISIS

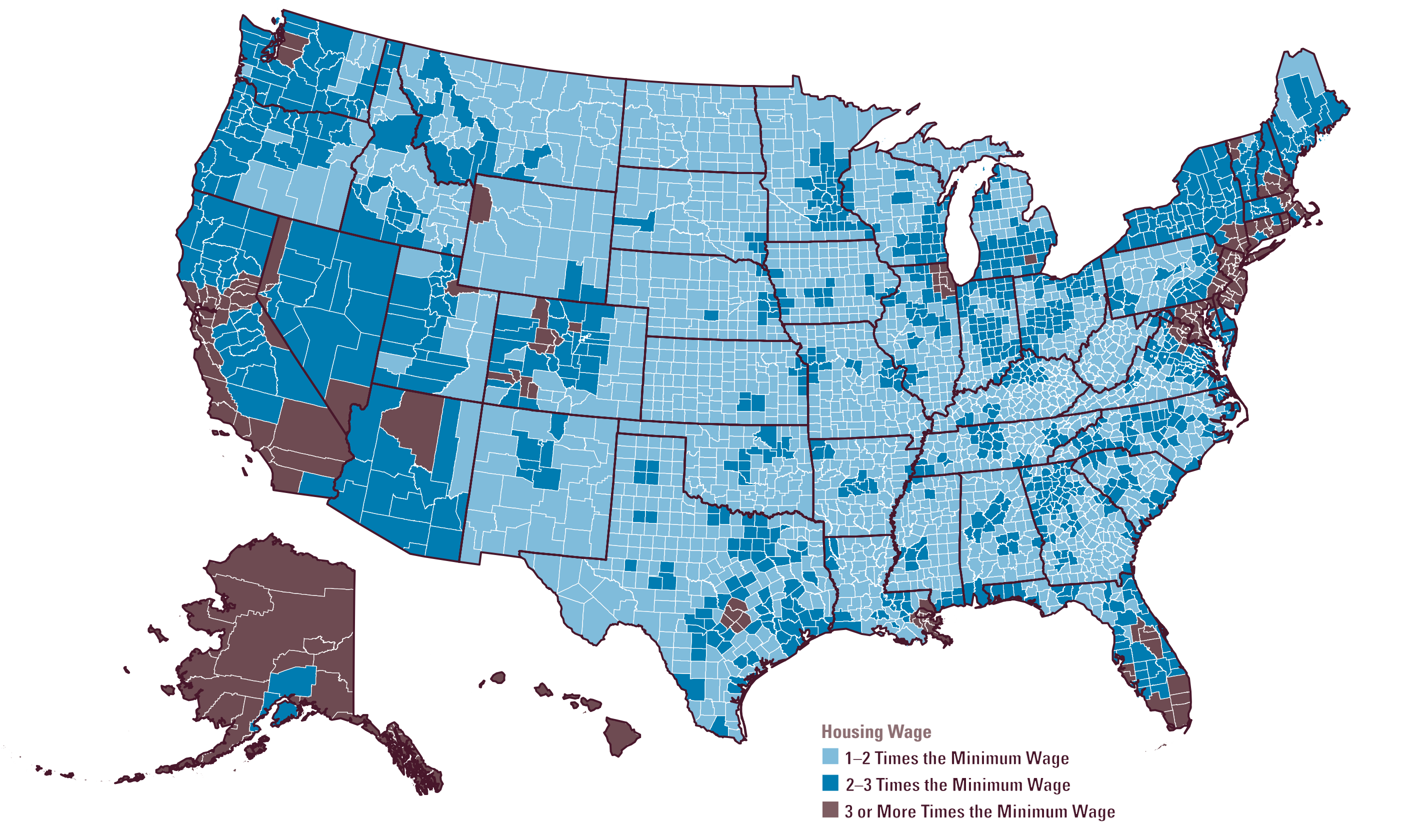
While some owners who have lost their homes will quickly buy another unit and others will move in with family and friends, many will become renters. Indeed, after averaging just 0.7 percent annual growth from 2003 to 2006, the number of renter households jumped by 2.8 percent or nearly one million in 2007.

The growing numbers of renters must now compete for the limited supply of affordable housing, adding to the long-standing pressures in markets across the country. Each year the National Low Income Housing Coalition (NLIHC) calculates the current "housing wage," or the amount it takes to afford a modest two-bedroom apartment at 30 percent of income. In 2007, that figure stood at $16.31 an hour, nearly three times today's minimum wage of $5.85 and over twice the $7.25 level scheduled to go into effect in 2009.

National figures of course mask sharp differences in affordability across states. Nevertheless, no single minimum-wage earner working 40 hours a week, 52 weeks a year, earns enough to cover the cost of a modest rental anywhere in the country (Figure 2). Even in rural counties where rents may be as low as $500, a full-time worker would have to earn up to two times the minimum wage to afford a basic two-bedroom unit. Meanwhile, in some of the highest-cost areas where rents exceed $1,500 per month, a household would have to include more than five full-time minimum-wage workers to cover the cost of a modest apartment.

FIGURE 2 **One Minimum-Wage Earner Cannot Afford a Modest Rental Unit Anywhere in the Country**

Housing Wage Needed to Afford a Two-Bedroom Apartment



Notes: The housing wage is the income required to afford a modest two-bedroom apartment at the local fair market rent, assuming the household pays 30% of income for housing and works 40 hours a week for 52 weeks. The federal minimum wage in February 2008 was $5.85 per hour. Analysis is based on methodology developed by Cushing N. Dolbeare and the National Low Income Housing Coalition.
Source: US Department of Housing and Urban Development, Fiscal Year 2008 Fair Market Rents.

FIGURE 3 Foreclosures Have Added Significantly to the Vacant Inventory

Thousands

	2003	2006	2007	Average Annual Percent Change 2003–06	Average Annual Percent Change 2006–07
Occupied	**105,560**	**109,575**	**110,306**	**1.3**	**0.7**
Own	72,054	75,380	75,159	1.5	-0.3
Rent	33,506	34,195	35,147	0.7	2.8
Year-Round Vacant	**11,631**	**12,459**	**13,276**	**2.3**	**6.6**
For Rent	3,676	3,737	3,848	0.5	3.0
For Sale	1,308	1,836	2,117	12.0	15.3
Held Off Market	5,672	5,778	6,181	0.6	7.0
Seasonal Vacant	**3,643**	**3,978**	**4,376**	**3.0**	**10.0**

Source: US Census Bureau, 2003–2007 Housing Vacancy Survey.

SUPPLY PRESSURES

Rising foreclosures and the resulting turmoil in credit markets threaten to undermine the already weak multifamily construction sector. Last year, completions of multifamily units for rent fell to 169,000 units—just two-thirds of the 2002 figure and only one-third of the 1986 record high (Table A-1). Today, with the cost of capital to fund new multifamily construction on the rise and a possible recession in the offing, the near-term prospects for this sector remain bleak.

In the short run, it also appears that mortgage foreclosures are adding to the number of units held off the market—in part because of the long foreclosure disposition process, and in part because some new owners of foreclosed properties are waiting for conditions to improve before putting their units back on the market (Figure 3). At the same time, the weak homebuying market is also helping to expand the supply of higher-priced rentals as owners attempt to rent out their newly vacant condominiums and single-family homes. But because most renters do not have adequate income to take advantage of these opportunities, the market has limited ability to absorb the current excess supply.

With these large, unprecedented shifts on both the demand and supply sides of the rental market, the direction of rents is impossible to predict. On the one hand, rent levels were still climbing through the end of 2007. Indeed, monthly gross rents (payments to property owners plus utility costs) stood at a record high of $775 last year in inflation-adjusted terms (Table A-2). While former homeowners with good income-earning prospects may be able to manage rents of this magnitude, over 15 million lowest-income renters cannot. With incomes of less than $24,200, these households would have to spend at least 38 percent of their incomes to afford rents of $775 a month, and many would have to spend a much higher percentage.

On the other hand, just as the foreclosure crisis is pushing down home prices, rising rental vacancy rates could trigger a decline in rents. Indeed, the excess supply could eventually filter down to lowest-income renters. This would, however, provide a temporary fix at best. When property owners are unable to collect rents sufficient to cover basic maintenance and operating costs, they are likely to leave their properties vacant for long periods—the first step toward abandonment and demolition.

THREATS TO LOW-INCOME COMMUNITIES

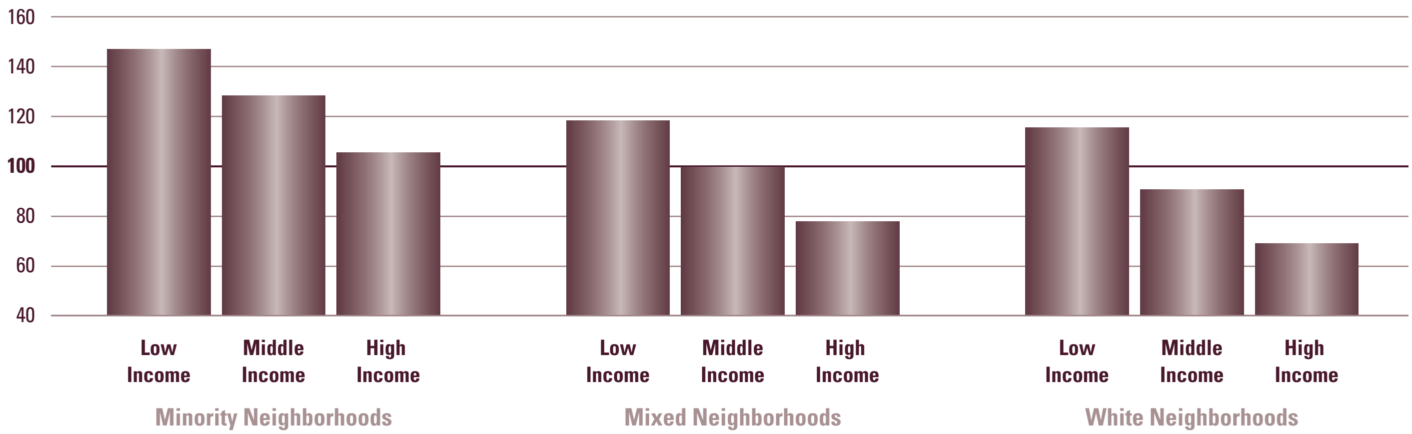
The foreclosure crisis is hitting the nation's low-income and minority neighborhoods particularly hard. According to the most recent Home Mortgage Disclosure Act (HMDA) data, higher-cost subprime loans accounted for 27 percent of all home loan originations in 2006, but nearly 45 percent of those in low-income, predominantly minority communities. By comparison, higher-priced subprime loans represented just 15 percent of all home mortgages in high-income, predominantly white areas (Table A-8).

Little wonder, then, that foreclosures are also concentrated in low-income and minority communities. Assuming that a higher-priced subprime loan is 10 times more likely than a lower-priced prime loan to end in foreclosure (a fairly conservative ratio), loans on homes in low-income minority neighborhoods are 48 percent more likely to be foreclosed than loans on average, and two times more likely than loans in high-income white areas (Figure 4).

High levels of foreclosures produce collateral damage that can easily destabilize already vulnerable communities. In particular, the concentration of foreclosures in lower-income, densely populated neighborhoods works to depress property values, lower local property tax revenue, and impose additional costs on cash-strapped public agencies that must pay for police, fire, and other municipal services to prevent the blighting effect of vacant properties.

FIGURE 4 **Foreclosures Hit Hardest in Minority and Low-Income Neighborhoods**

Index of Foreclosure Probabilities for Loans Originated in 2006 (100=National Average)



Notes: Loans are first lien mortgages originated for owner-occupied, one- to four-unit properties. Low- (middle-/high-) income neighborhoods are defined as census tracts with less than 80% (80–120%/more than 120%) of the MSA/MD median income. Minority neighborhoods are more than 50% minority; mixed neighborhoods are 10–50% minority; and white neighborhoods are less than 10% minority.
Source: JCHS tabulations of 2000 Decennial Census and 2006 Home Mortgage Disclosure Act data.

NEW DIRECTIONS FOR POLICY

Rates of early payment delinquencies are a widely used indicator of how a set of loans is likely to perform over time. Based on an analysis of loans that are currently 60 days or more late, most industry experts predict loans originated in 2006 and 2007 will be the most foreclosure-prone in history.

Of course, quick and aggressive policy action could limit future growth in foreclosures and help financially distressed homeowners pull back from the brink. Yet even as mortgage industry executives, government officials, and nonprofit and community leaders work to find remedies to the mortgage market meltdown, the number of foreclosures continues to climb. Left unchecked, loan foreclosures are likely to continue to rise well into 2009.

While crafting appropriate solutions to assist homeowners facing foreclosure is an important national goal, the mortgage market crisis should not divert attention from the urgent housing problems that low-income renters confront. As the mortgage market turmoil continues, many holders of foreclosed assets will be forced to sell at deep discounts. Rather than allow foreclosed properties be sold off to the highest bidder, what is needed is a mission-driven entity, such as a community preservation fund, that could participate in this market with the goal of expanding the supply of affordable rental housing.

Crafting such a program could be the centerpiece of the next generation of affordable housing programs—a balanced set of national housing policy initiatives that expand access to sustainable and affordable housing opportunities to meet the needs of owners and renters alike.