# Million Midwest Homes at Risk in '06: The Down, Downside of the Bubble

by Paul Gallagher

As the U.S. real estate bubble breaks, the "hottest" real estate markets of the past eight years, such as the Washington, D.C. area, northern and southern California, Florida, etc., are now cooling off the fastest. But the greatest devastation of households, by foreclosure, the loss of their homes, consequent personal bankruptcies, is occurring—so far—in the globalization-devastated upper Midwest states. It is the result of lost auto and other union jobs, family over-indebtedness, and highly speculative mortgage banking. Outside of the destruction of mortgaged homes in Louisiana and Mississippi by 2005's hurricanes, the nation's worst foreclosure rates are in Indiana, Ohio, and Michigan—and they are growing fast. The foreclosure rate in Michigan, for example, in January-February 2006 was running at more than double the 2.5% rate of all of 2005. This region is where the real estate bubble has already stopped growing, as in Ohio, where the statewide median price of a home has already fallen $6,000 (about 6%) below that of one year ago.

This is where the so-called "stable" markets, and the recently "hot" markets, are headed, soon. As of April 7, the target interest rate for a one-year adjustable-rate mortgage (ARM)—the original and most widespread way to cheat your own credit rating and buy an overpriced home, though many more "exotic" home-loan products have followed it—had jumped to just about 6%, and was conservatively forecast by the FDIC to be going to about 7% in 2006. Millions of homeowners bought homes in the past few years with ARMs starting at 3% or even lower, and as they are readjusted toward 7% and higher, the difference in payments due can easily be $300-500 a month, even for a moderately priced home.

Alan Greenspan strongly promoted ARMs throughout the second decade of his chairmanship of the Federal Reserve. Since 2000, still more overextended home loans—which don't require any principal payments for five years ("interest-only"), or initially don't require any payments at all, letting the unpaid interest increase the principal owed on the house—have ballooned to 24% of all new mortgage contracts nationwide. Under certain circumstances, steadily rising Treasury-bond and mortgage interest rates—clearly in evidence now—cause explosive increases in the mortgage payments required on these hyper-extended loans. Homeowners by the thousands are evicted in sheriff's sales, or give up trying to pay, and walk away; and the repo companies suddenly have more work than they can handle. This is the situation *now* in many parts of the former industrial heartland of the country.

In many "hot markets," homeowners who have been living on the wave of real-estate bubble appreciation, believe they still have means to handle the sudden increases in interest rates and mortgage payments now coming at them. If the market price of their house or houses is still rising, or if they have other saved wealth they can throw into the deal, they believe, their bank lender will always arrange for them to switch back into a reasonable fixed-rate mortgage (Californians by the tens of thousands are doing this now), or otherwise keep the interest rate on their home loans under control. *But,* if the giddy home-price appreciation has stopped, or gone into reverse, as in Ohio; if homes have suddenly become difficult to sell without further dropping the price; if many of the households involved have lost their good-paying jobs, are facing rising local taxes and costs due to industrial collapse, are using up their savings or have none; *then* there is no way out of this speculative, overextended bank debt except foreclosure, bankruptcy, or both.

## Where the Sheriff's Sales Are

Several tracking firms have recently been reporting that mortgage foreclosures nationwide, which totalled about 880,000 in 2005, have been running at over 110,000 a month so far in 2006, with increases year-over-year variously estimated from 68-98%. These leaps in misery are concentrated in the Midwest manufacturing-loss belts.

Already in 2005, the owners of one out of 25 mortgaged homes in Indiana, one in 30 in Ohio, and one in 40 in Michigan were put into foreclosure proceedings, which generally begin when the mortgage payments are 90 days in arrears (the process does not always result in final loss of the home). The entire East North Central region of the United States, the upper Midwest states as a whole, had one out of 49 mortgaged homes in foreclosure in 2005. Ohio foreclosures statewide were 34,000 in 2000, but 64,000 in 2005.

But near the end of the first quarter of 2006, the foreclosure rates in Ohio counties were jumping about 20% a month, and the Michigan statewide foreclosure rate doubled from January to February. Indiana's 5,909 foreclosures in February were three times the number which occurred in February 2005.

The reason is that speculative lending (the driver of the national real estate bubble) has hit rapidly falling real wages and incomes. "We've lost high-paying manufacturing jobs, and replaced them with lower-paying service jobs. People were put into the wrong loans," admitted an Indianpolis mortgage banker to the *Indianapolis Star.* "The taxes kick in and the rates are rising, and now . . . they can't get enough equity out of their house to pay the bills."

The Reinvestment Fund, which has studied homeowner groups and locales at risk for mass foreclosures, reports that about 2 million homeowning households nationally are at high risk for foreclosure in 2006—about 2.5% of the national total. By comparison, 1.6% of homeowner households of *all* kinds were foreclosed in 2005. Well over a million of these at-risk-in-'06 households are in the upper Midwest. They are concentrated among the holders of ARMs, says the Reinvestment Fund, and particularly the borrowers of "sub-prime" loans: those whose credit and income did not justify the size of the mortgage, but were sold "exotic products" by real estate and mortgage bankers. "Subprime" mortgage loan payments go up faster when interest rates are rising. And as the Reinvestment Fund found in a 2004 study of low- and moderate-income new homeowners in Pennsylvania, these mortgage *principal amounts* are often more than the house is worth, because these home buyers often have to combine two or more mortgage loans to get the house.

According to the Mortgage Bankers Association on April 11: In Michigan, Missouri, Tennessee, and West Virginia, one-fifth of all homeowners with sub-prime ARMs were in mortgage arrears by at least three months—i.e., in foreclosure—in March 2006. In Michigan, the Association reported, these sub-prime ARM loans were 14.7% of all mortgages. Thus, this hyper-extended loan type alone, now has nearly 3% of Michigan's mortgaged homeowners in foreclosure proceedings—more than the total 2.5% foreclosure rate for all mortgages in the state last year.

In March, Wayne County, Mich. (including Detroit) alone had 3,300 homes in foreclosure proceedings, two and a half times the number in March 2004. Wayne County had lost a net 76,000 jobs from 2001-05, and was forecast to lose 12,000 more in 2006. Oakland and Macomb, the neighboring (also industry-based) counties, both have double the number of foreclosures they saw two years ago.

Or, take St. Joseph County, Ind. (including South Bend) as an example. There were 1,000 sheriff's sales in the county in 2002; some 1,600 in 2005; and 550 in the first quarter of 2006. Sheriff's Lt. Arthur Pletcher commented to the St. Joseph local newspaper on April 2, "You'll see a $30-40,000 house with a $60,000 mortgage. Somebody is lending somebody too much money." A union leader in Lafayette, Ind. reported, "There are sheriff's sales going on now all over this [Tippecanoe] county." Indiana had lost 100,000 manufacturing jobs from December 1999 to December 2005.

In Linn County (including Cedar Rapids), Iowa, there were 58 sheriff's sales in January 2006, and 48 in February, compared to a total of 212 in all of 2005. Capt. John Steulke of the county sheriff's department told the *Sioux City Journal,* "The adjustable-rate mortgages are starting to kick in. Somebody takes out an adjustable-rate mortgage three or four years ago at 4%, and now all of a sudden, they're up at 7%; and that's a big difference."

## Fearful Forecasts

The big Federal mortgage company Freddie Mac forecast, in a report issued April 11, that all home sales in the United States will drop by 8% in 2006, from 2005's level. The National Association of Realtors current forecast is that new home construction will drop by 10.9%. This makes a strange picture with the following figures: Even as new home sales fell 5% in January, the unsold new homes inventory reached an eight-year high, and mortgage applications fell, housing starts and new building permits were *up* 4% from a year ago. In other words, by the sheer momentum of speculative investments into the now-ending bubble, builders were still building homes that they are not going to be able to sell. In Midwest states like Ohio, they were already heavily discounting those homes to try to sell them, accentuating the downward pressure on home prices. Even in Central Ohio around the state capital area of Columbus, big builders such as Centex Homes now have $50,000 discounts on the average new home. The median home price in Central Ohio dropped from $170,000 in February 2006 to $161,000 in March 2006, and there were 30% more unsold homes on the market. Ohio lost another 9,200 jobs, net, in January and February.

In Washtenaw County (including Ann Arbor), Mich., the median home price dropped from $218,000 in February 2005 to 205,000 in February 2006. Unsold homes were a third more numerous than a year ago. "It's a buyer's market, if you can find a buyer," one city councilman told the *Ann Arbor News.*

In other regions of the country, whose real estate markets are not—yet—in such distress, the prevalence of ARMs, subprime ARMs, and other forms of household debt hyperextension is just as great, or greater than in the Midwest. So far, nationally, only 3% of these "most vulnerable" mortgage loans were 90 days or more in arrears (in foreclosure) in February, compared to the 20% cited above for Michigan, Missouri, West Virginia, and Tennessee in March. Once housing prices start to fall in the "stable" and "hot" markets, and interest rates keep rising, the zooming foreclosure rates now seen in parts of the Midwest, especially, will spread around the country.

For an example, take a look at one recently "hot market." In Boston (where home prices are now faltering after meteoric rises), 27.1% of all homeowning households with a mortgage, spent *half or more of their 2005 gross income* on housing costs, according to the Census Bureau.