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Nonprime Loans: A View from the Local Level

by Robin Newberger and Daniel DiFranco

This article presents information on the location of subprime and Alt-A mortgages ("nonprime" loans) in the five states within the Federal Reserve Bank of Chicago's district (Illinois, Indiana, Iowa, Michigan, and Wisconsin). The purpose is to identify the zip codes and communities most affected, or at risk of being affected, by foreclosures. We present a series of maps that show the zip codes with the highest numbers and highest concentrations of subprime and Alt-A loans, as well as the past-due and foreclosure rates in these neighborhoods. For illustration purposes in the print version of this article, we present maps representing the Chicago and Detroit metropolitan areas. The full array of maps is available at the Chicago Fed's Web site, www.chicagofed.org. These maps are designed to inform policymakers, lenders, and nonprofit organizations about where to target outreach, counseling, and other resources for remediation.

The data used for this analysis comes from First American LoanPerformance, a subsidiary of First American CoreLogic, Inc. It includes first-lien subprime and Alt-A loans in securities portfolios (i.e., the segment of the subprime market that is securitized), representing about 70 percent of all subprime loans and 95 percent of Alt-A loans.[2] For this analysis, we assume that these loans are geographically representative of the total. Loans held on banks' books or portfolios sold to hedge funds or other investors without first being registered with the SEC are not included. Of note, the number of nonprime, first-lien, active loans in the five states dropped by about 25 percent between the start of 2007 and the end of 2008. The number of these loans in foreclosure rose by 33 percent during this period.

What are Subprime and Alt-A Loans?

"Subprime" is a lender-given designation for borrowers with low credit scores, little credit history, or other types of observable credit impairment. From the borrower's perspective, the primary distinguishing feature between prime and subprime loans is that the upfront and continuing costs are higher for subprime loans. Alt-A loans fall between prime and subprime loans on the risk spectrum. These loans allow some combination of low documentation, slightly subpar credit scores, and features such as interest-only or payment options. Alt-A loans carry lower interest rates than subprime loans.[1]

Table 1: Zip Codes with Nonprime Loans

	Total Number of Zip Codes in State	% Total Zip Codes in LP Dataset with >3 Subprime Loans and/or >3 Alt-A Loans	% Total Zip Codes in LP Dataset with >=50 Loans
Illinois	1584	66	27
Michigan	1170	78	44
Indiana	987	71	31
Wisconsin	897	76	24
Iowa	1058	56	9

Source: First American CoreLogic, LoanPerformance data, December 2008, and www.zip-codes.com, accessed June 2008.

The Location of Nonprime Loans

Subprime and Alt-A loans are not distributed evenly throughout each of the states in the Chicago Fed's district. As of December 2008, Illinois and Michigan had more than 150,000 subprime and Alt-A loans each, while Indiana had less than 100,000, Wisconsin fewer than

Map 1A: Illinois Past Due

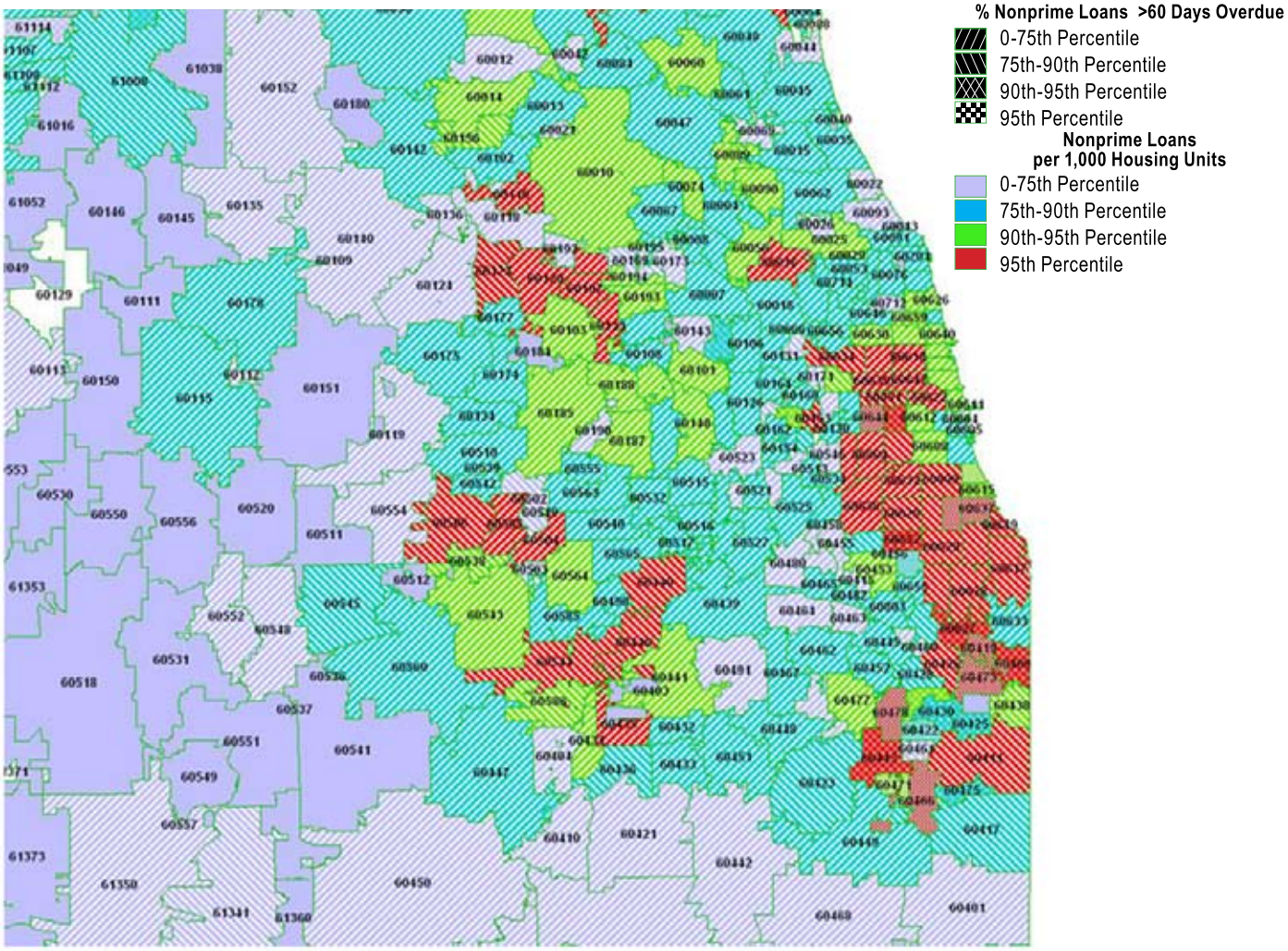


Table 2: Number of Nonprime Loans per Percentile

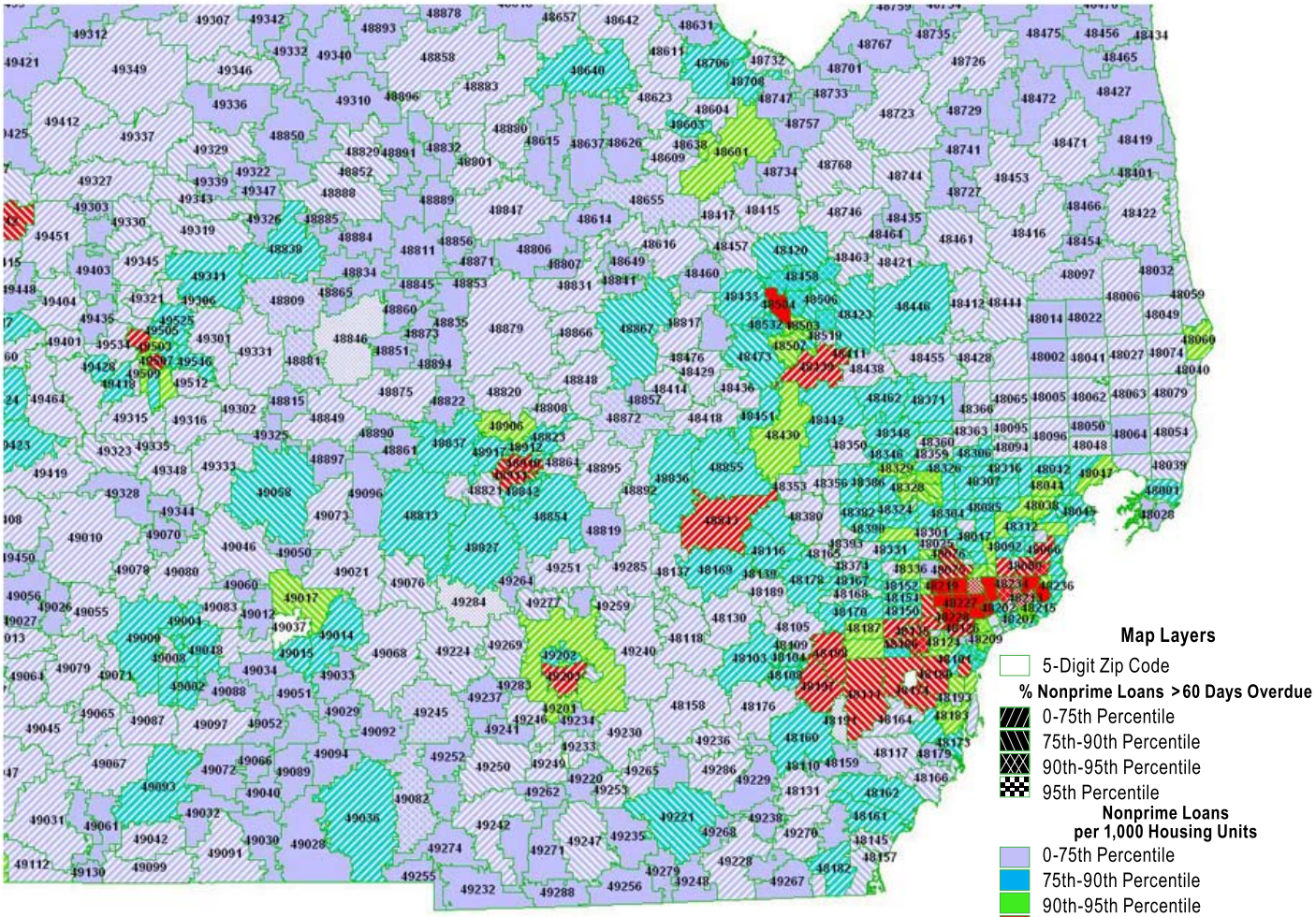
	95th Percentile	90–95th Percentile	75–90th Percentile
Illinois	917	545	218
Michigan	782	36	227
Indiana	579	406	182
Wisconsin	282	187	73
Iowa	201	75	27

Note: These are the minimum number of loans in each percentile, based on zip codes in the dataset. **Source:** First American CoreLogic, LoanPerformance data, December 2008.

60,000, and Iowa about 22,000.[3] On a per-capita basis, Michigan had about 17 loans per 1,000 people, and Iowa about seven loans per 1,000 people. There was also a disparity in the proportion of zip codes with high numbers of nonprime loans between states. While more than half of the zip codes in each state contained at least four nonprime mortgages, far fewer zip codes were the site of at least 50 such loans. In Michigan, for example, about 45 percent of all zip codes had more than 50 nonprime loans, whereas the rate was 9 percent of all zip codes in Iowa (see Table 1). Our analysis of nonprime loan performance (past-due and foreclosure rates) examines only those places with a minimum of 50 nonprime loans.

The maps and accompanying analysis focus on loan performance in the communities in which these loans are the most prevalent. Maps 1A–5A (not all shown) categorize zip codes (by percentile) according to the number of subprime and Alt-A loans in each. Maps 1A and 2A, representing the Chicago and Detroit metro areas, respectively, are included here. Maps of other District 7 states can be viewed at www.chicagofed.org/community_development/foreclosure_maps.cfm. The zip codes colored in red represent those at the 95th percentile among zip codes (in the

Map 2A: Michigan Past Due



dataset) with at least four nonprime loans. For example, the top five percent of zip codes in the dataset for Illinois have a minimum of 917 nonprime loans (Table 2). The zip codes colored in green represent zip codes between the 90th and 95th percentile in terms of their number of loans, and those in blue are between the 75th and 90th percentile. Zip codes colored in purple represent the 0-75th percentile of the distribution.

Maps 1B–5B (1B and 2B shown) employ an alternative method to calculate the "highest-loan" zip codes. These maps identify zip codes with high concentrations of nonprime loans; i.e., the number of nonprime loans per 1,000 units of housing units in the zip code. For example, the Michigan zip codes with a minimum of 68 nonprime loans per 1,000 units of housing fall within the top 5 percent of the distribution in that state (Table 3).

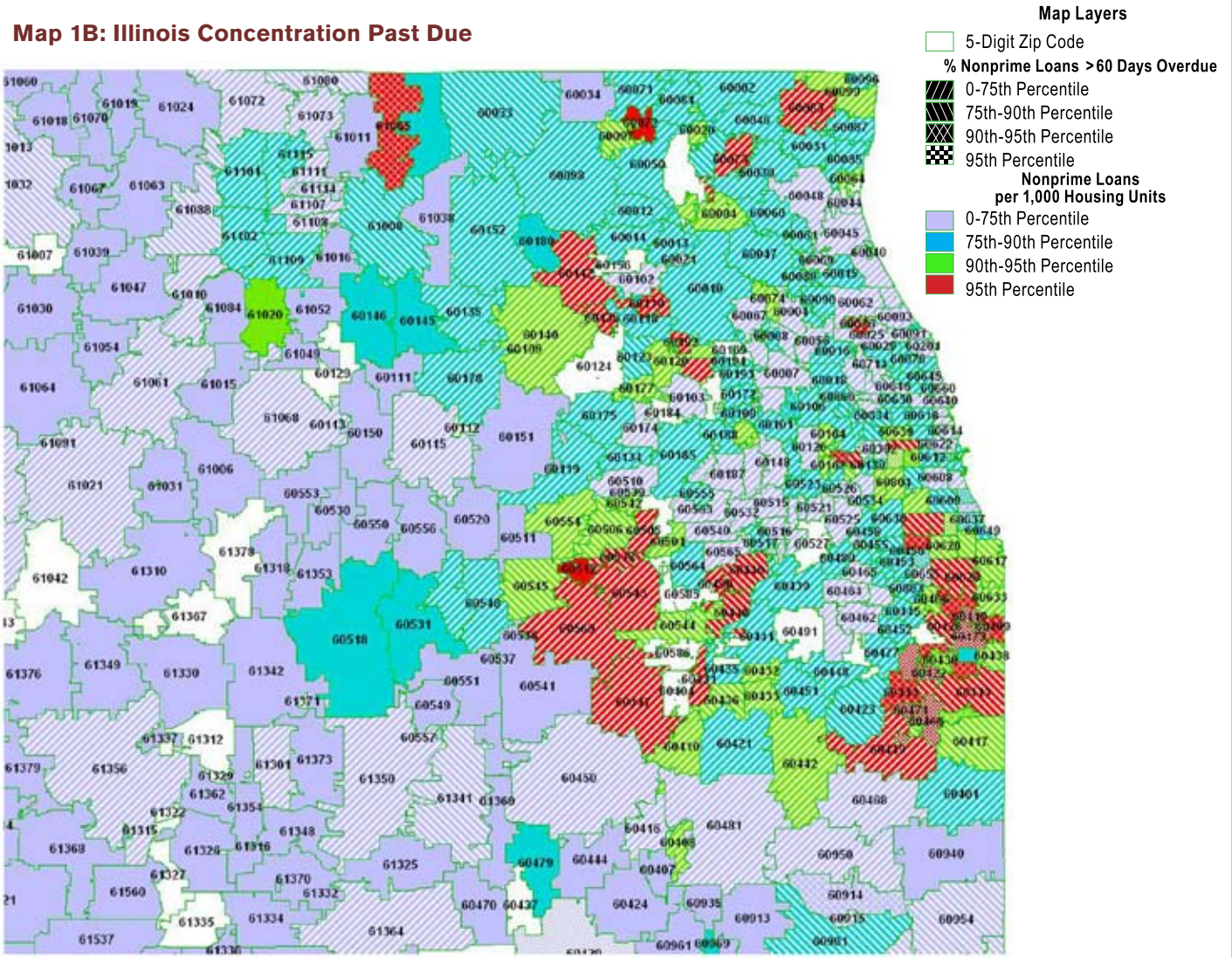
Table 3: Nonprime Loans per 1,000 Housing Units

	95th Percentile	90–95th Percentile	75–90th Percentile
Illinois	88	60	34
Michigan	68	57	41
Indiana	65	55	39
Wisconsin	45	31	28
Iowa	35	29	21

Note: These are the minimum number of loans per thousand housing units in each percentile, based on zip codes in the dataset. **Source:** First American CoreLogic, LoanPerformance data, December 2008, and Census 2000.

According to the first method, the neighborhoods with the most nonprime loans tend to be those located in and around the largest cities: in Michigan, Detroit; in Illinois, Chicago; in Wisconsin, Milwaukee and cities to the south; in Indiana, Indianapolis and Gary; and in Iowa,

Map 1B: Illinois Concentration Past Due



Des Moines, Cedar Rapids, and the Quad Cities. In Chicago, high numbers of nonprime loans are found in both the northern and southern parts of the city. In Detroit, high numbers of nonprime loans cover all but the eastern most zip codes, as well as zip codes in Dearborn and farther south of the city limits in Ypsilanti and Belleville. In Indianapolis, the affected zip codes form a ring around the center of the city (Indianapolis central, north, east, northeast, south, and southwest). In the northwestern part of the state, high-nonprime zip codes extend from East Chicago to Elkhart. In Milwaukee, the footprint of the city shows high numbers of nonprime loans, as do the cities of Racine and Kenosha to the south. In Des Moines, the most affected neighborhoods form an arc around the north and east sides of the city.

The second method produces a slight shift in geographic pattern. In Illinois, the zip codes in the 95th percentile (with 88 or more nonprime loans per 1,000 housing units) tend to be located on the south side of Chicago and in the south and southwest suburbs, and to a lesser degree on the north side. In Michigan, Detroit still shows a high concentration of loans, though in somewhat fewer regions. In Indiana, the most affected zip codes are located around the perimeter of Indianapolis and in cities in the northwest of the state. In Wisconsin, the 95th percentile includes fewer Milwaukee neighborhoods in the south of the city, and captures more towns in St. Croix and Polk counties on the western side of the state. Iowa shows fewer places overall affected by high concentrations of nonprime loans: these include a cluster of zip codes on the east side of Des Moines, zip codes to the north and south of the city, and smaller towns, such as Oakland and Pacific Junction near the western border.

As Table 4 shows, the places identified as "high-loan" zip codes share some common features regardless of the method that is used to identify them. The median income in these zip codes is around 80 percent or less of the county median, signifying that a large share represents low- or moderate-income households. The largest group of residents in most zip codes tends to describe themselves (demographically) as "White only," although more than 40 percent of the nonprime high-loan zip codes in Illinois and Michigan have Black majority populations.

The two methods of identifying high-loan zip codes result in some demographic differences as well. For example, in Illinois, the zip codes with the highest numbers of nonprime loans tend to have a higher percentage of Hispanics and foreign-born residents than the zip codes with the highest concentrations of nonprime loans. In Wisconsin, the zip codes with the highest numbers of nonprime loans tend to have a greater percentage of Blacks than zip codes with the highest concentrations of these loans. In Iowa, the zip codes with the highest numbers of nonprime loans are located in predominately urban areas, whereas the zip codes with the highest concentration of nonprime loans are likely to be in rural areas.

Past-due Rates

Maps of past-due loans, 6A–10A and 6B–10B, depict the percentage of past-due loans in a given zip code for a principal metropolitan area.[4] Once again, for illustration purposes, we include here the relevant maps for Chicago and Detroit metro areas, 6A, 6B, 7A, and 7B. Identifying the neighborhoods with high rates of past-due loans is useful for anticipating the areas at risk for foreclosures. It is also a way to identify the places where residents might benefit from financial counseling or modification of loan terms, since interventions are more successful the earlier they take place. The zip codes with the highest percentile of past-due loans are illustrated with a checkered pattern (see Table 5); the zip codes in the 90th percentile are illustrated with a diamond lattice pattern; and the zip codes in the 75th percentile are illustrated with diagonal lines going from top left to bottom right.[5]

Maps of past-due loans 6A–10A, based on the count of subprime and Alt-A loans, show some overlap between places with very high numbers of loans and very high delinquency rates. Maps 6B–10B,

Table 4: Characteristics of High-nonprime-loan Zip Codes

	% Black (Median Zip Code)	% White (Median Zip Code)	% Hispanic (Median Zip Code)	% Foreign-Born (Median Zip Code)	% Urban (Median Zip Code)	Zip Code Median Income/ County Median Income
Illinois – High Count	35.8	44.8	15.4	11.2	100.0	63.6
Illinois – *High Concentration*	23.5	59.6	5.2	5.9	100.0	87.6
Illinois – All Zip Codes	0.2	97.7	1.0	0.9	0.0	n.a.
Michigan – High Count	35.1	55.7	1.8	3.9	100.0	67.2
Michigan – *High Concentration*	27.8	57.3	1.7	3.6	100.0	67.9
Michigan – All Zip Codes	0.3	96.1	1.5	1.6	0.0	n.a.
Indiana – High Count	10.9	84.1	3.4	2.8	99.3	73.4
Indiana – *High Concentration*	2.0	93.1	1.0	2.1	85.5	86.6
Indiana – All Zip Codes	0.1	98.0	0.8	0.8	0.0	n.a.
Wisconsin – High Count	7.1	84.8	4.8	4.2	100.0	71.2
Wisconsin – *High Concentration*	0.6	96.1	2.1	2.0	76.7	77.5
Wisconsin – All Zip Codes	0.1	97.9	0.9	1.2	0.0	n.a.
Iowa – High Count	2.5	93.2	2.6	3.0	95.8	82.1
Iowa – *High Concentration*	0.1	97.0	1.9	1.4	26.0	90.9
Iowa – All Zip Codes	0.0	98.8	0.5	0.7	0.0	n.a.

Note: This table includes only zip codes in the 95th percentile of nonprime loan counts and concentrations, based on zip codes in the dataset. The percent median income across zip codes represents the median of the median incomes. **Source:** First American CoreLogic LoanPerformance data, December 2008, and Census 2000.

Map 2B: Michigan Concentration Past Due

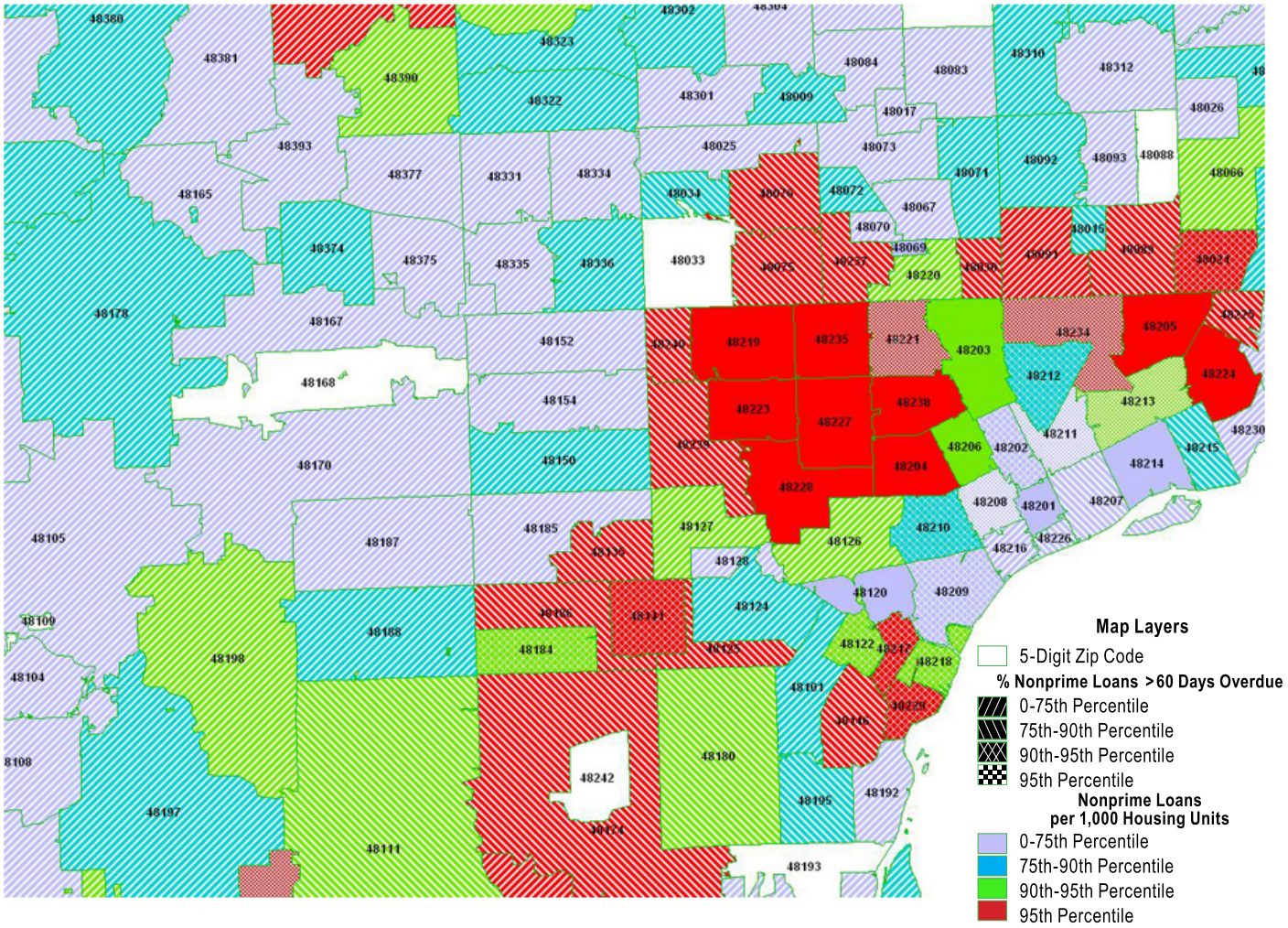


Table 5: Percent Nonprime Loans at least 60 Days Past Due

	95th Percentile	90–95th Percentile	75–90th Percentile
Illinois	24.7	22.9	19.3
Michigan	28.8	25.0	21.2
Indiana	23.2	21.8	18.8
Wisconsin	26.6	22.4	19.1
Iowa	20.8	18.3	16.3

Note: These numbers represent the minimum percent of delinquencies in each percentile, based on zip codes with a minimum of 50 loans. **Source:** First American CoreLogic LoanPerformance data, December 2008.

based on the concentration of nonprime loans, show more overlap.

- **In Illinois,** the places with high numbers of loans and high past-due rates are found in south-side neighborhoods of Chicago and the southern suburbs. In Chicago, these include Englewood (60621); East Garfield Park, Humboldt Park, and Lawndale (60624); Austin (60644); Ashburn (60652); and Woodlawn (60637). In the suburbs, they include South Holland, Country Club Hills, Park Forest, Calumet City, and Riverdale.

The places with high past-due rates and high concentration of loans are the south suburban towns of South Holland, Dolton, Hazel Crest, Matteson, Richton Park, Country Club Hills, Flossmoor, Glenwood, and Olympia Fields. The town of Poplar Grove (Boone County) has a high concentration of loans and high past-due rates as well.

- **In Michigan,** several areas of Detroit have both high numbers of nonprime loans and high past-due rates. These include: Hamtramck (48212); Conner, the Airport, and Chandler Park (48213); Bagley (48221); and Grant

(48234). These neighborhoods are more than 85 percent Black and have median incomes of around 60 percent of the county median. Eastpointe, to the north of Detroit, also has a high number of loans and high past-due rates, as does Inkster, to the south.

The places with the highest rates of past-due loans and the highest concentration of nonprime loans include some of the Detroit neighborhoods listed above. These include Bagley (48221), Boynton (48217), and Grant (48234). They also include areas around Detroit like Eastpointe and New Haven to the north, and Wills and Inkster to the south. Pontiac (48340) has a high loan delinquency and loan concentration as well.

- **In Indiana,** Merrillville and South Bend both show very high numbers of loans and high percentages of past-due rates. In Indianapolis, Indy Central (46218) has a particularly high rate of past-due loans and a high number of nonprime loans.

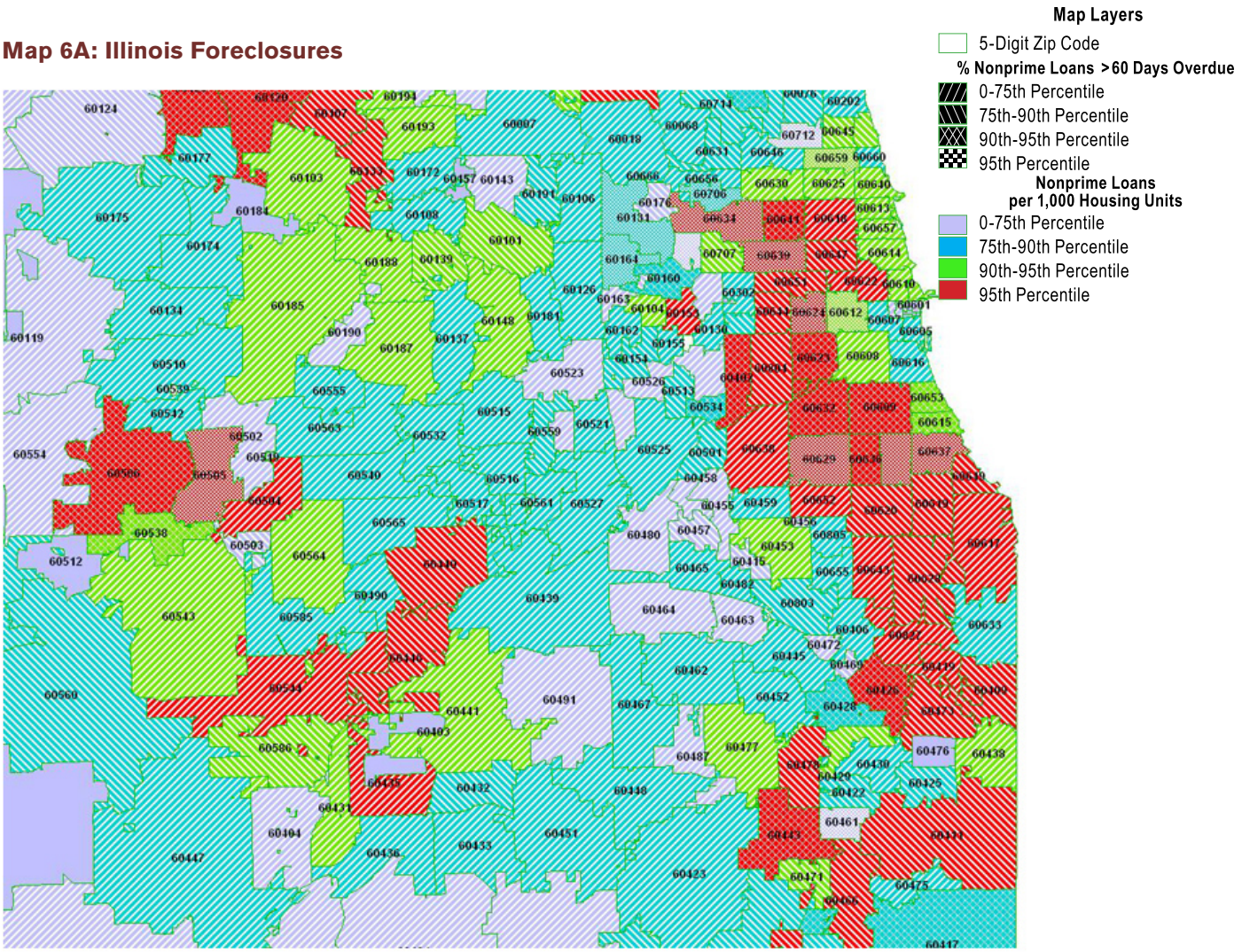
The places with the highest concentrations of nonprime loans and

Table 6: Percent of Nonprime Loans in Foreclosure

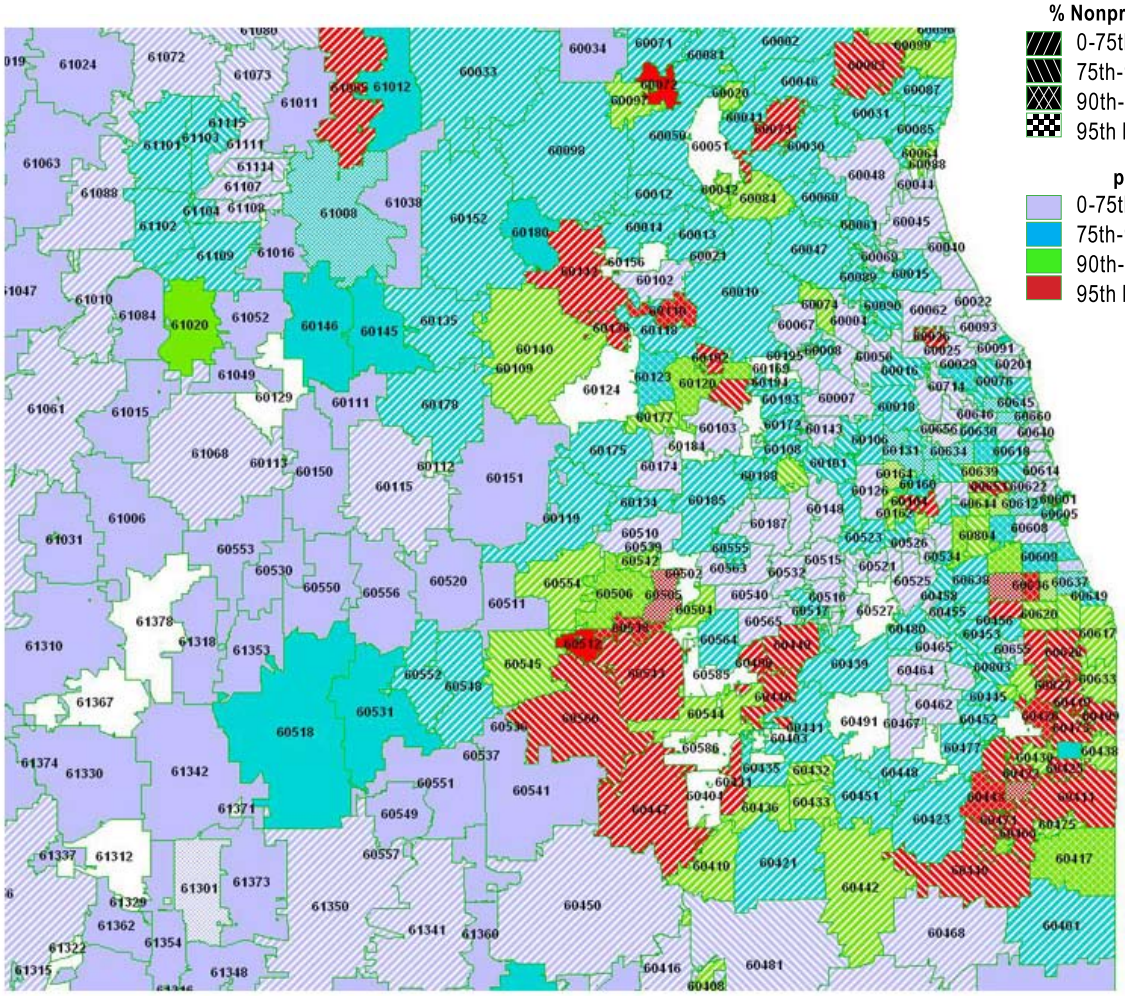
	95th Percentile	90–95th Percentile	75–90th Percentile
Illinois	17.5	15.9	13.5
Michigan	8.2	7.3	5.9
Indiana	15.7	14.0	11.4
Wisconsin	15.9	14.8	13.3
Iowa	15.0	14.2	11.8

Note: These numbers represent the minimum percent of delinquencies in each percentile, based on zip codes with a minimum of 50 loans. **Source:** First American CoreLogic LoanPerformance data, December 2008.

Map 6A: Illinois Foreclosures



Map 6B: Illinois Concentration Foreclosures



Map Layers

5-Digit Zip Code

% Nonprime Loans >60 Days Overdue

0-75th Percentile
75th-90th Percentile
90th-95th Percentile
95th Percentile

Nonprime Loans per 1,000 Housing Units

0-75th Percentile
75th-90th Percentile
90th-95th Percentile
95th Percentile

the highest rates of past-due loans are in the northwest part of the state, including Gary, Merrillville, and South Bend. They are also in southeast and central Indianapolis (46239 and 46218).

- **In Wisconsin**, the highest numbers of loans and the highest rates of past-due loans are found in the Milwaukee neighborhoods of Silver Spring, Havenwoods, McGovern Park, Hampton Heights, and Wahl Park (53218); Grasslyn Manor, Sunset Heights, and Dineen Park (53216); Florist Highlands, Little Menomonee Parkway, Parkway Hills, Silver Swan, and Timmerman Airport (53225); Lenox Heights, Saint Joseph, Uptown, and Metcalfe Park (53210); Brown Deer Park, Tripoli Park, Fairfield, and Thurston Woods (53209); and Cold Spring Park, West Side, Far West Side, and Near South Side (53208).

The places with both the highest concentration of nonprime loans and the highest rates of past-due loans are in northern Milwaukee (53216, 53225, 53218, 53209), as well as in Racine to the south.

- **In Iowa,** the Des Moines neighborhoods (50316 and 50320) show the highest rates of past-due nonprime loans. Cedar Rapids (52405) has both a high rate of nonprime loans and high delinquency rates. In addition, Bondurant, which is east of Des Moines, Adel, which is west of Des Moines, and Missouri Valley, in the western part of the state, are towns with high delinquency rates and fall within the 75th to 90th percentile in terms of the number of nonprime loans.

The places with the highest rates of past-due loans and the highest concentration of nonprime loans are clustered near Des Moines (50314, 503316, 50320). Towns with high rates of past-due loans but fewer loans (75th to 90th percentile) are Missouri Valley (Harrison County) and Cedar Rapids (52405).

Foreclosure Rates[6]

Maps 11A,B – 15A,B (not shown) follow a similar design, but substitute past-due rates with foreclosure rates. High foreclosure rates impact property values, crime rates, and the overall economic well-being of community.[7] In

four of the five states, the average foreclosure rate on nonprime loans (across all zip codes in a state in the dataset) was about 10 percent as of December 2008. In Michigan, it was lower at about 5 percent. Table 6 presents foreclosure rates across zip codes at the top end of the distribution in each state, based on zip codes with a minimum of 50 subprime loans.[8]

The zip codes with the highest rates of foreclosures are not necessarily the places with the highest numbers or concentrations of nonprime loans. A few places stand out for having both high numbers of nonprime loans and high rates of foreclosures.

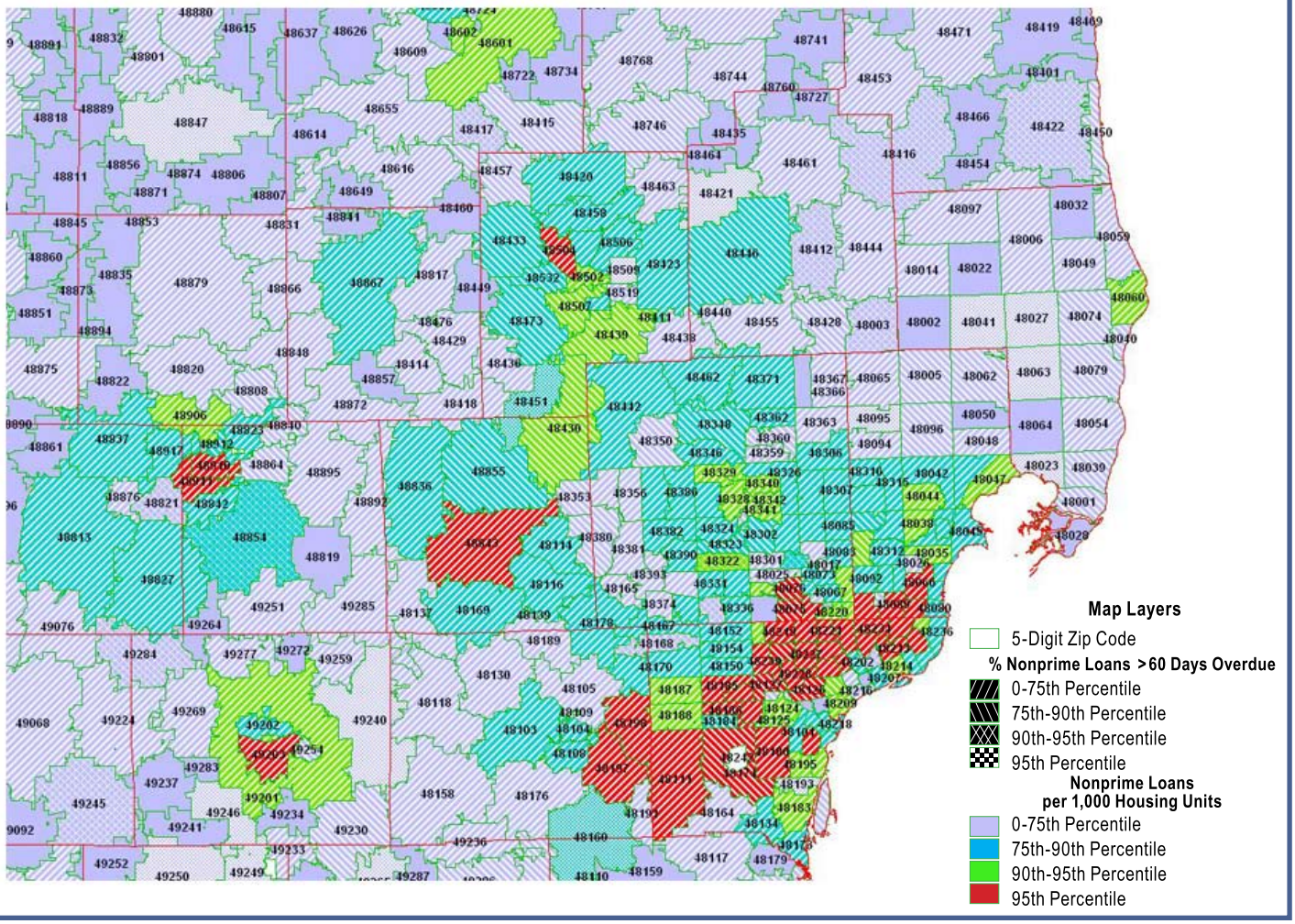
- **In Illinois,** the high number, high foreclosure zip codes are located in the south side Chicago neighborhoods of Englewood, West Elsdon, Gage Park, Lawndale, South Austin, and Bridgeport. They are also in the north side neighborhoods of Belmont Cragin and Logan Square. In addition, high loan and high foreclosure rates are in the south suburbs of Matteson and Harvey, and the west suburbs of Aurora, Elgin, and Carpentersville.

The places with the highest concentration of nonprime loans and the highest foreclosure rates include south and southwest suburbs, such as Matteson, Olympia Fields, and Harvey. They are in the western suburbs of Carpentersville and Aurora. In the city, high foreclosure rates characterize the neighborhoods of Englewood, West Lawn, Gage Park, and Garfield Ridge.

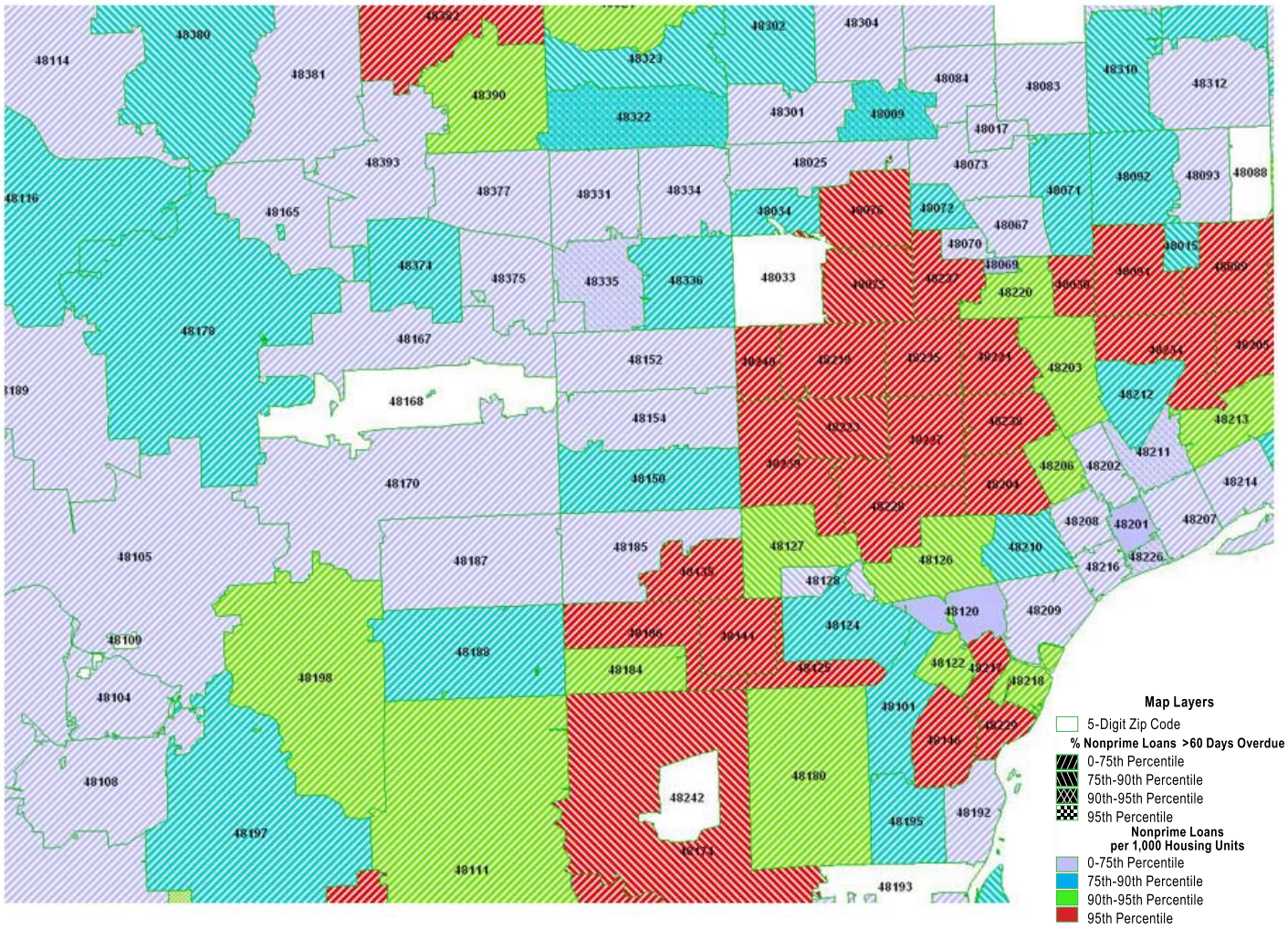
- **In Michigan,** the highest foreclosure rates are not found in the zip codes with the most nonprime loans. They are outside of Detroit, in West Bloomfield (48322), Mason (Ingham County), and Linden (Genesee County). The neighborhoods with the most number of nonprime loans and foreclosure rates in the 75th to 90th percentile are Romulus (48174), Dearborn (48126), and Southfield (48075 and 48076).

The places with the highest foreclosure rates are in zip codes in the 90th to 95th percentile in terms of the concentration of nonprime loans. These are in towns such as Milan (Monroe County), Columbiaville (Lapeer County), and Linden and Burton (Genesee County).

Map 7A: Michigan Foreclosures



Map 7B: Michigan Concentration Foreclosures



- **In Indiana**, the zip codes that show both high rates of nonprime loans and high foreclosure rates are mainly in the northeast part of the state, in Gary (46408, 46404) and South Bend (46628).

  The highest nonprime-loan foreclosure rates are found around Gary (46404, 46409, 46408) and South Bend (46613). High foreclosure rates are also found in Indianapolis central (46201).

- **In Wisconsin**, they are found mainly in the city of Milwaukee, in the Washington Heights, Washington Park, Walnut Hill, and Hawthorne Glen neighborhoods (53208); in the Williamsburg, Harambee, River West, and Brewer's Hill neighborhoods (53212); in Metcalfe Park, Saint Joseph, Sherman Park, Uptown, and West Side (53210); and in Arlington Heights, Borchert Field, and North Division neighborhoods (53206). High foreclosure rates are also found in smaller cities in the north of the state, including Somerset (Saint Croix County) and Green Bay (Brown), where each fall within the 75th percentile in terms of numbers of loans.

  The highest rates of foreclosures are found in Milwaukee, as well as in the western part of the state, in Houlton and Somerset (St. Croix County), and Osceola (Polk County). Several zip codes in the 75th percentile in terms of loan concentration also have high rates of foreclosure, including Kewaskum (Washington County), Watertown (Dodge County), and Columbus (Columbus County).

- **In Iowa,** the zip codes with both high numbers of nonprime loans and high rates of foreclosure are in Des Moines (50317, 50310, 50313, 50315 [90th percentile in loans and foreclosures]), Cedar Rapids (52403), and Dubuque (52001). They are also in smaller towns like Altoona (Polk), Newton (Jasper), and Bouton (Dallas).

  The places with the highest concentration of nonprime loans and the highest foreclosure rates are found in Bondurant and Altoona (Polk County); Des Moines, in the Douglas Acres, Gray's Woods, and Laurel Hill neighborhoods (50317); and in the Chautauqua Park, Cheatom Park, King Irving, and Sherman Hill neighborhoods.

Conclusion

This article identifies the zip codes (and communities) where nonprime loans are the most prevalent, and focuses attention on the places with the most delinquencies and foreclosures. We find that a handful of zip codes have the most nonprime loans and large percentages of poorly performing loans. In Illinois, these tend to be in the south suburbs and a few south-side Chicago neighborhoods. In Michigan, they include neighborhoods of Detroit and the suburb of Eastpointe. In Indiana, they cover the cities in the northwestern region of the state and neighborhoods in Indianapolis. In Wisconsin, they are mainly in north Milwaukee. In Iowa, they are in Des Moines and Bondurant. The places with the most nonprime loans as of December 2008 are roughly the same places where high numbers of nonprime loans were prevalent at least six months earlier.

In general, however, the results of this exercise show that pinpointing the most at-risk zip codes (and communities) is largely a matter of judgment. A range of criteria dictates where interventions should take place, and prioritizing these criteria can be a matter of personal perspective. At a regional level, an argument can be made to focus on home owners in Michigan, Illinois, and Indiana, since these states have the higher per capita rates of nonprime loans. On the other hand, the proportion of nonprime loans in foreclosure is currently highest in Illinois, Wisconsin, and Indiana, arguing for greater attention in these states. Similarly, within a given state, the case can be made (as it is in this article) that the zip codes with the most nonprime loans should receive attention. Focusing on the 95th percentile is admittedly a narrow range, however, and zip codes at lower percentiles may deserve more attention. In addition, the argument can be made to focus on places with high delinquency rates, since these may be places where loan work-outs and other interventions have the greatest chance of succeeding. At the opposite extreme, it can be argued that the most economically challenged neighborhoods, the places that face many other stresses, including high unemployment and high poverty rates, in addition to foreclosures, are the most deserving of attention and resources.

While the accompanying maps do not definitively identify the subprime "hot spots," they give a clearer appreciation of the extent to which the impact of nonprime lending differs within a metropolitan area, a county, and even a city. The data presented here shows that many neighborhoods in central cities face high rates of delinquencies and foreclosures, but many suburban and rural areas are affected as well. This granular examination of nonprime loan location may be a necessary component of designing effective remediation for home owners and neighborhoods.

Loan Resets

Interest rate resets and conversions from an interest-only payment (IO) to a fully amortizing one can affect loan performance as well. However, it appears unlikely that either of these two potential sources of payment shock will account for widespread delinquencies in the near term. One reason is that many of the loans undergoing their first reset this year may actually result in payment decreases due to this year's low LIBOR rates. Of the 52.4 percent of nonprime loans which are ARMs, 10.3 percent will change from fixed rate to a floating rate this year. Further, assuming the LIBOR remains at about 1.75 percent through the remainder of the year, over 75 percent of these mortgagors will experience a decrease in their monthly payment. (We estimate that LIBOR could rise to about 3 percent before the number of ARM borrowers whose payments would increase will exceed the number of borrowers whose payments would decrease). With respect to the payment shock from interest-only loans to fully-amortizing mortgages, these types of loans are relatively rare in the dataset. Only 9.5 percent of loans with a fixed interest rate and 17.9 percent of ARMs that are currently active are structured to include an IO period. The expirations of interest-only periods among these loans are spread out over the next eight years, with only 5.1 percent of IO loans switching to fully amortizing payments in 2009. Overall, this accounts for less than 1 percent of the total loan population.

Notes

1 See www.frbsf.org/publications/federalreserve/annual/2007/subprime.pdf and www.chicagofed.org/community_development/files/12_2006_pnv_nontraditional_mortgages.pdf, accessed April 16, 2009.

2 Loans include owner- and nonowner-occupied nonprime loans made for purchases, refinances, and "loans for other purposes."

3 These counts underestimate the total number of active, first-lien, nonprime loans, counting only those in the First American CoreLogic LoanPerformance dataset.

4 The past-due rates represent nonprime loans at least 60 days past due as of December 2008. LoanPerformance also collects data on loans 30 to 59 days past due.

5 The calculation of percentiles for past-due loans is based on zip codes with a minimum of 50 loans so as not to include zip codes that have high percentages of nonprime foreclosures, but relatively few nonprime loans overall.

6 Foreclosure rates are defined as the share of nonprime loans in foreclosure. This rate does not include Real Estate Owned (REO) properties.

7 See Woodstock Institute, "There Goes the Neighborhood: The Effect of Single-Family Mortgage Foreclosures on Property Values," June 2005.

8 The data reflects the subprime and Alt-A loans in foreclosure as of December 2008, and therefore may differ from sources that calculate state foreclosure rates based on a cumulative tally over a number of months.

Bankruptcy: Three Years After the Bankruptcy Reform Act of 2005

by Helen Mirza

Background

On October 17, 2005, a major U.S. federal bankruptcy reform law took effect. This change (the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, a.k.a. the Bankruptcy Reform Act of 2005) had been over 10 years in the making and represented the culmination of years of effort on the part of both consumer advocates and lenders, as well as regulators and others. This act amended the 1978 bankruptcy code, and was the most significant and sweeping change since that date. We summarized this seminal change in bankruptcy, focusing on nonbusiness filing ramifications, in the April 2006 edition of *Profitwise News and Views* (*PNV*). Also summarized were opinions of what the new law would mean for both consumers and creditors. The following article is a brief overview of trends in filings, and views regarding what has transpired in the interim. The article addresses the following questions:

- Has the new law met expectations?
- Has the new law made it easier or harder to obtain Chapter 7 discharge?
- Have certain practices previously deemed abusive been alleviated?

What the Filing Numbers Tell Us

In the eight-year period, 2000 through 2008, total nonbusiness bankruptcy filings increased every year with the exception of a modest decline (4 percent) from 2003 to 2004, and a huge decline of over 70 percent from 2005 to 2006.[1] After the signing by the president of the Bankruptcy Reform Act of 2005 (Reform Act) in April of that year, there was concern that the new law would make it more difficult to file and provide less protection than the old law. As a consequence, there was a 30 percent increase in filings in 2005 over the prior year, mostly from late spring through the summer and early fall of 2005, with most filers attempting to beat the October deadline when the new law was to take effect. Some in the legal community predicted a rush of filings prior to the date the new law took effect. In the prior article on bankruptcy in the April 2006 edition of *PNV*, we pointed out that, "Thousands of debtors rushed into court hoping to get their case filed before the law changed. During the final two weeks before the new law took effect, over 600,000 debtors filed for bankruptcy protection, compared with approximately 30,000 filings per week on average previously, and only 3,600 per week immediately following the effective date of the new law."[2] The

Table 1: Seventh District Nonbusiness Filings 2000–2008[3]

	2000	2001	2002	2003	2004	2005	2006	2007	2008*	9 Year Total
Illinois	59,892	73,036	81,091	84,520	79,320	105,964	29,774	40,416	54,049	608,062
Indiana	37,126	47,462	52,859	55,155	53,941	78,201	21,858	30,514	38,597	415,713
Iowa	8,079	10,787	11,454	12,259	12,722	18,254	4,683	6,793	7,730	92,761
Michigan	35,835	46,138	54,805	62,070	63,531	88,402	32,746	44,996	53,353	481,876
Wisconsin	17,164	21,347	24,439	27,524	24,439	37,420	11,010	15,439	20,994	199,776
District Total Per Year	158,096	198,770	224,648	241,528	233,953	328,241	100,071	138,158	174,723*	1,798,188

NOTE:*3 Quarters Average X 4 **SOURCE:** American Bankruptcy Institute.

increase in 2005 of total nonbusiness filers over 2004 was 31 percent (from 1,560,339 to 2,039,214).[4]

In 2006, filings fell to a 15-year low of 597,965 – a 71 percent decline over 2005.[5] Shortly after the October 2005 effective date of the new law, and possibly due to the dramatic decrease in filings and related fees, many attorneys began advertising campaigns to alert consumers that the 2005 change in the law did not preclude filing for bankruptcy, nor for the vast majority of individuals did it change practical outcomes with respect to what debts are discharged and what personal and real property filers may keep. The filings for 2007 increased by 38 percent over 2006, and the first three quarters of 2008 (data are not yet available for the fourth quarter) suggest a 32 percent increase in filings over 2007.[6]

In the District

The Seventh Federal Reserve District (Illinois, Indiana, Iowa, Michigan, and Wisconsin) experienced similar fluctuations in filing rates.

The changes in the Seventh District largely reflect national trends.

Review of Major Changes in the 2005 Legislation

Essentially, the 2005 reforms created a "means test" in order to file for Chapter 7 relief in which all nonpriority debt is discharged. The new law forces individuals with sufficient income (based on a formula) to file for Chapter 13 relief as opposed to Chapter 7, so that a filer with sufficient income would have to repay some, if not all, of his debt. Debt under Chapter 13 can be reduced or restructured with possible relief from penalties, interest, and other adverse consequences of untimely payment.

Other changes include required prefiling counseling in order to determine whether an individual is eligible for Chapter 7. Filers must also fully disclose all assets and debts, and complete an approved financial management course in order to obtain the final discharge, whether in Chapter 7 or 13.

State homestead exemptions (the ability to retain an equity interest in real property used as a principal residence) were also revised under the Reform Act. Under the revisions, debtors must have lived for two years in a given state before being able to take advantage of that state's homestead exemption. Some states had extremely lenient exemptions, which may have encouraged individuals anticipating filing bankruptcy to transfer large portions of their wealth into homes in states where the exemption was high or virtually unlimited, thereby sheltering from creditors' assets that would otherwise have to be liquidated to satisfy debt. Further, under the new law, property acquired less than 3.3 years prior to the bankruptcy filing is limited to $125,000 in homestead exemption regardless of the state's exemption limit.

One of the major changes sought and incorporated in the new law by lenders was to eliminate the so-called "cram down" provisions of the prior law. This means that secured lenders with collateral other than real estate (mainly automobiles) had to settle for collateral value at the time of filing and were not entitled to "deficiency judgments." Deficiency judgments represent an amount owed to lenders after subtracting the monies obtained from sale of collateral. In bankruptcy, the judge could declare that the total debt was extinguished by the current market value of the collateral at the time of filing (or the value realized at a later sale). This practice was considered an "abuse" of the system by many lenders, who claimed it was impossible to fully assess the risk of lending on personalty as collateral in the event of bankruptcy or to value it accurately.

The Bankruptcy Horizon

The current economic crisis has negatively impacted the financial health of individuals and families in the United States. As more and more industries and businesses seek government assistance to keep their businesses afloat, many employers, large and small, appear to be in jeopardy, creating the potential for higher levels of unemployment.

Table 2: Chapter 7 and 13 Nonbusiness Filings by Year

	Total* Filings	Chapter 7	Chapter 13	Chapter 13 Filings as % of Total
2002	1,537,730	1,086,459	450,217	29%
2003	1,624,677	1,155,081	467,908	29%
2004	1,562,621	1,117,304	444,352	28%
2005	2,039,214	1,631,011	407,322	20%
2006	597,965	349,012	248,430	42%
2007	822,590	500,613	321,359	39%
2008**	1,046,548	693,497	351,674	34%

NOTES: *Includes Chapter 11 de minimus filings – therefore, Chapter 7 and 13 do not foot exactly to total. **2008 totals annualized for fourth quarter data unavailable.
SOURCE: American Bankrupcy Institute.

Individuals and families with high debt levels may ultimately find it difficult, if not impossible, to avoid bankruptcy. The discharge of debt will further exacerbate lender losses. Pressure will also be put on state budgets for food stamps, child care, and other state funded programs as more and more individuals and families experience unemployment and erode financial resources.

Debtors in the past were often stigmatized by bankruptcy, and it was difficult to obtain credit for a considerable period of time after the discharge. However, in recent years, there has been an increasing willingness on the part of many lenders to extend credit to recent bankrupts. As a result, some people emerging from bankruptcy have been able to obtain credit and rebuild their credit worthiness and credit scores—some have not. This willingness to extend credit, however, may undergo a change if many bankrupts are unable to find and keep jobs. Katherine Porter, associate professor at the University of Iowa College of Law, testifying before the U.S. House Subcommittee on Financial Institutions and Consumer Credit in March 2008 stated that, "In my research, I found that in the first year after filing Chapter 7 bankruptcy, 96 percent of debtors received credit card offers."[7]

The 2005 bankruptcy changes did meet certain expectations. The perceived abuse of extremely high state homestead exemptions has been curbed. Furthermore, the vast majority of individuals filing for bankruptcy have been able to meet the income formula test (based upon being above the median state income level—individuals with incomes under that median do not have to meet the test under the formula and can proceed to file directly under Chapter 7).

Bankruptcy Reform's Role in the Foreclosure Crisis

Recently, news sources have begun to report on a new trend, where people have despaired of saving their home and make credit card debt a priority in order to maintain a source of cash flow and purchase power. One media report suggested that the 2005 Bankruptcy Reform Act, "…was a major reason for the foreclosure crisis and the falling housing prices that have affected virtually every home owner in the country."[8]

The data in Table 2, excerpted from the American Bankruptcy Institute Web site[9], show the breakdown of bankruptcy filings in the years leading up to and since the reforms of 2005.

A big increase in Chapter 7 and (somewhat less) significant decrease in Chapter 13 filings occurred in 2005 (date of Reform Act). Since 2005, both Chapters 7 and 13 filings have trended upward sharply, but the proportion of 13 filings, after a (predictably) sharp proportionate increase in 2006, has trended back down toward pre-2005 levels. Since no data are available regarding the number of Chapter 7 filers that were forced into Chapter 13 via the means test or otherwise, nor is the breakdown home owners versus renters among filers, it is difficult to infer any effect on foreclosure rates as a result of the 2005 reforms, since both chapters require repayment of secured debt (in Chapter 7 only if the filer wishes to take advantage of his homestead exemption). Accordingly, even if a significant portion of Chapter 13 filers were the result of failing the means test, the impact of reform on foreclosure filings remains an open question.

Congress has asked the National Bankruptcy Research Center to research and respond to a series of related questions submitted to it recently.[10] Once these questions have been answered and data gathered and published, it may be possible to determine with more certainty the role the Reform Act has had on the foreclosure crisis.

Conclusion

Many economists and researchers predict a continued rise in bankruptcy filings due to economic conditions. Our bankruptcy laws were imported and refined from similar laws in England prior to our nation's independence. The British system had revealed the trauma and limited effectiveness of prison and punishment for unpaid debt. In both Britain and the U.S., a more enlightened approach has been to allow those who simply cannot pay their accumulated debt to find a legal and safe means by which to begin anew financially. Safeguards are built into our system of bankruptcy (including how often one

A Practitioner's Viewpoint

Attorney Catherine Molnar-Boncela, from the law firm of Goveia and Associates of Merrillville, Indiana, has practiced bankruptcy law for over 20 years. The firm itself has specialized almost exclusively in bankruptcy for over 30 years. Ms. Molnar-Boncela stated that, *"In my experience and practice, the use of the means test has not had a material effect on the recommendation of a chapter 13 over a chapter 7 filing. The chapter choice process was already built in, to some degree, in the prior bankruptcy code in Section 707B, in that the attorney was expected to ascertain which chapter was appropriate for an applicant before filing and not just make a filing based on the applicant's preference."*

Since the formula for determining "means" considers actual income and expenses to reach a net capacity to repay, *"…a major and perhaps unintended consequence in its application is that the applicant with income that exceeds the state median income must also include the effect of any larger mortgage and car payments on disposable income. These higher income filers, as a result, then usually have limited disposable income to contribute to a chapter 13 plan and to unsecured creditors. Therefore, many higher income applicants nevertheless qualify for Chapter 7 as a result of higher expenses."* Many observers assumed that the means test would force the majority of higher income filers into Chapter 13, but given the nature of the means test, the effect of higher income is tempered when the filer also has extensive debt obligations and high payments.

From a different standpoint, Ms. Molnar-Boncela also observed, *"The vast majority of individuals seeking to file a bankruptcy petition that I have represented exhaust their exempt assets to pay secured and unsecured debt before they come to me. These exempt assets often include the equity in their homes, IRA, and 401(k) accounts. They do everything they can in an attempt to avoid financial ruin."*

Molnar-Boncela takes a very practical approach to helping those facing bankruptcy: *"I do my best to influence my clients to refrain from filing a bankruptcy petition while they have no income from a job or pension. A bankruptcy petition provides relief only when my clients have something to protect from garnishment or exemptions. As one of the bankruptcy judges I worked for liked to remind attorneys, 'A discharge is a terrible thing to waste.' A bankruptcy petition that is filed before a client returns to work will, of necessity, exclude subsequent medical bills and other dischargeable debt resulting from the period of unemployment."*

can file) to protect also the interests of creditors from irresponsible debt management. The bankruptcy laws in the U.S. will likely continue to be revised from time to time to adjust for economic, social, and behavioral conditions, and to provide creditors with greater certainty of outcomes, as well as relief for debtors. Pending policy proposals may fundamentally alter the treatment of secured (specifically mortgage) debt in bankruptcy cases. However, further research, when appropriate data are available, is required to determine with certainty the impact of the 2005 reforms on the current mortgage foreclosure crisis.

NOTES

1 See www.abiworld.org.

2 Ibid.

3 Ibid.

4 Ibid.

5 Ibid.

6 Ibid.

7 Testimony of Katherine Porter, associate professor, University of Iowa College of Law before the U.S. House Subcommittee on Financial Institutions and Consumer Credit, March 13, 2008. Accessed at www.house.gov./apps/list/hearing/financialsvcs-dem/porter031308,PartIC.,secondparagraph on January 15, 2009.

8 Dan Margolies, The Kansas City Star (1/12/2009) paraphrasing Donald P. Morgan, research officer at the New York Fed (article entitled "U.S. mortgage meltdown linked to 2005 bankruptcy law).

9 Accessed at www.abiworld.org/AM/AMTemplate.cfm?Section=Home&TEMPLATE=/CM/ContentDis on January 15, 2009.

10 Karen Redmond, National Bankruptcy Research Center.

Around the District

Illinois

Illinois Launches Recovery Web Site

Governor Pat Quinn launched a Web site that was created to help ensure that Illinois takes full advantage of the American Recovery and Reinvestment Act (ARRA). The Illinois Recovery Web Site is a tool for every taxpayer, business, and government official interested in the efforts to rebuild and restore Illinois.

The new Web site is the portal to Illinois' implementation of the federal stimulus plan and will:

- Allow Illinoisans to suggest a project that is eligible for federal stimulus funds;
- Connect to agency sites where proposed project lists will be posted as they become available;
- Keep track of projects, spending, and job creation; and
- List state run programs receiving supplemental funding including vocational rehabilitation, unemployment benefits, food stamps, and other services.

This site was created to share information about the ARRA of 2009, so that every qualified project in Illinois can capture and use its fair share of federal stimulus funds.

Illinois has created a Stimulus Team to work with every community to:

- Coordinate projects that will create long-term investment in Illinois;
- Help potential stimulus projects meet implementation and reporting requirements; and
- Keep people informed about progress toward shared goals of job creation, twenty-first century infrastructure improvement, and economic growth.

The State of Illinois is committed to working with elected officials, at every level, to ensure no deserving project goes unnoticed, and every potential public-private partnership is built. With this Web site, the state will pursue every stimulus opportunity it can, and direct you to the best available information. All of the state's citizens are invited to "Suggest a Project" (www.recovery.illinois.gov/projectideas.cfm).

For additional information, visit www.recovery.illinois.gov.

Indiana

Indianapolis Forum on Tax Reform

On April 2, 2009, Larry DeBoer, professor of agricultural economics at Purdue University, gave a presentation on "Indiana's Property Tax Reforms, 2008–2011." DeBoer consults with the Indiana Legislative Services Agency about tax and finance issues, including the annual state revenue forecasts. The legislature uses his model of the Indiana property tax to analyze the effects of policy changes. The model was used extensively during the 2002–2003 reassessments and tax restructuring.

Professor DeBoer noted that, in 2009 and 2010, while home owners are expected to receive a new 35 percent homestead deduction in property tax payments, the impact on nonresidential properties, commercial apartments, and agricultural real estate will be significantly less. In addition, he provided a breakdown, by county, of the expected future losses in income for local government due to circuit breaker credits, which limit property taxes to a percentage of a property's gross assessed value.

To learn more about Indiana property tax legislation, Professor DeBoer maintains a local government information Web site, which can be

accessed at www.agecon.purdue.edu/crd/localgov.

Iowa

Iowa Attorney General Leads 15 State Foreclosure Mitigation Effort

In late 2007, Iowa's Attorney General Tom Miller spearheaded a coalition of 11 (now 15) state's attorneys general to attack the rising tide of mortgage foreclosures. "The group was formed to help avoid preventable foreclosures wherein modification was in the best interest of both the borrower and the servicer and his secondary market investor," said Patrick Madigan, Iowa's assistant attorney general and the lead attorney of the task force under Attorney General Tom Miller.

The Consumer and Community Affairs division of the Federal Reserve Bank of Chicago has collaborated with the Iowa attorney general's office on several occasions to showcase the work of this group through conferences, roundtables, and other venues during 2008 and continuing in 2009. The attorney general's office was instrumental in helping to form the Iowa Mediation Services, a group of individuals who assist home owners in Iowa who are in foreclosure (or threatened with foreclosure) to determine if modification or other assistance can help prevent loss of the home.

The Group, whose official title is "The State Foreclosure Prevention Working Group (Working Group)" has issued three status reports, the last of which was published in September 2008. In that report, the Group concluded that, "Eight out of ten seriously delinquent home owners are not on track for any loss-mitigation outcome." In spite of the attorney general's efforts in working with the top 20 or so subprime servicers in the U.S., the attorney general concluded that servicers are, "…not developing effective approaches to address the bulk of subprime loans, which are in default before interest rate resets."

In February 2009, the Working Group issued a statement urging the OCC and the OTS to push for affordable mortgage modifications. In a letter directed to the agencies (OCC and OTS), the group questioned the re-default rate reported by the agencies (55 percent re-default within six months) and asked for more "transparent and robust reporting" The Working Group reported default rates of only 25.8 percent in loan modification activity with 13 major nonbank subprime servicers.

Michigan

Property Tax Crisis

The recent wave of mortgage foreclosures has affected cities and neighborhoods throughout Michigan. With almost 150,000 foreclosures recorded in the first nine months of 2008 alone, the problems of abandoned housing and collapsing housing markets have spread and made the problems of distressed communities even worse. On March 12, 2009, a "Property Tax Workshop: Michigan Local Governments in Fiscal Crisis" was held. The primary objective of this workshop was to serve as a catalyst for an important and difficult public discussion. David Sjoquist, professor at the Andrew Young School of Public Policy, Georgia State University, provided an overview of national property tax issues. Mark Skidmore, Morris Chair in State and Local Government Finance and Policy at Michigan State University, provided a more in-depth look at how existing property tax policies result in distortions that favor specific groups, in particular, long-time property owners. Dan Kildee, treasurer of Genesee County, provided some valuable insights regarding the impacts of mortgage and property tax foreclosures on local governments.

On April 1, 2009, Mark Skidmore was the guest speaker at the Community and Economic Development Forum at the Federal Reserve Bank of Chicago Detroit Branch. He discussed the looming effects of the property tax crisis effecting Detroit and Michigan.

Wisconsin

Priority Recovery and Reinvestment Aid for High-poverty Communities

On February 26, Alan Berube, Senior Fellow and research director of the Brookings Institution's Metropolitan Policy Program, presented an overview of "The Enduring Challenge of Concentrated Poverty in America: Case Studies from Communities Across the U.S." – a joint project of the Brookings Institution and the Federal Reserve System's Community Affairs offices.

Mr. Berube included a brief look at high, medium, and low-priority items in the American Recovery and Reinvestment Act from the perspective of high-poverty neighborhoods. High-priority aid to individuals would include increased tax credits and food stamp benefits and expanded unemployment insurance. High-priority aid to governments, firms, and nonprofits would include capital for public housing and expansion of head start.

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