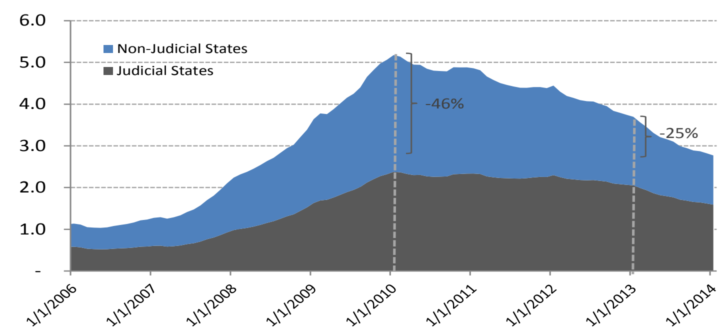
Shadow Inventory

Judicial vs. Non-Judicial States

April 25, 2014

The size of the shadow inventory[1] rose rapidly during the U.S. housing market crash, reached its peak of 5.2 million (10.3% of all outstanding mortgage loans) in January 2010, and has since been on a steady decline. As of January 2014, the national level shadow inventory stood at 2.8 million, representing a 25% drop year-over-year and a 46% drop from its peak. The overall reduction has been substantial, due in large part to strong demand for distressed properties from private and institutional investors, increasing modification activity, as well as recovering housing environment. It is important to note however, that the magnitude of the decline has varied greatly across individual states. The uneven improvement can be clearly seen when comparing the level of distressed properties in judicial vs. non-judicial states.

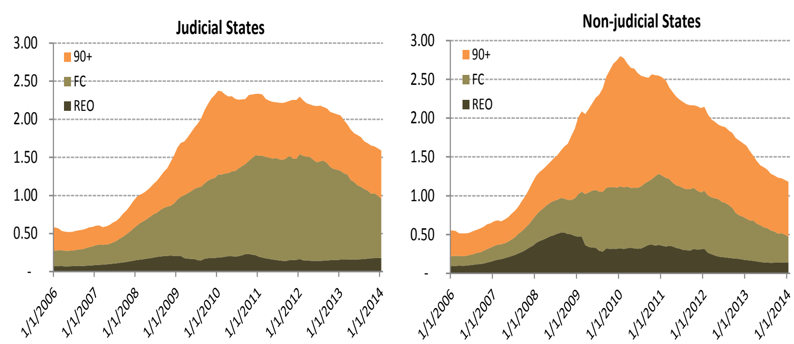
Figure 1. Trends in Shadow Inventory (in million)



As depicted in Figure 1, judicial states experienced a much slower decline in the size of the shadow inventory than non-judicial states. As of January 2014,

- There were roughly 1.2 million distressed properties in non-judicial states, a 28% drop year-over-year and an impressive 58% drop from the peak of 2.8 million,
- While the level of the shadow inventory in judicial states was assessed at 1.6 million, a 22% drop year-over-year and a 33% drop from the peak of 2.4 million.

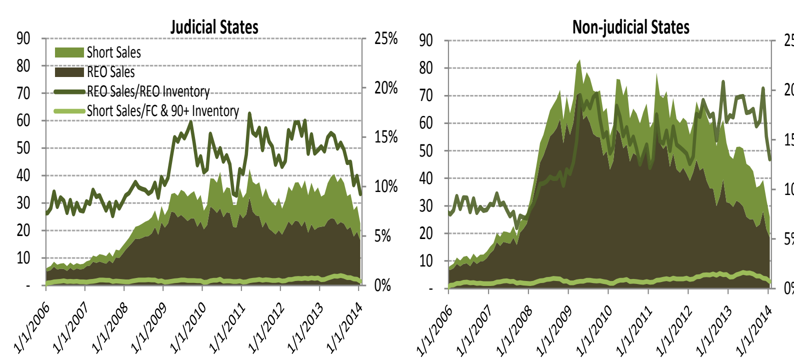
Figure 2. Trends in Shadow Inventory Components (in million)



A further analysis demonstrates that all three components of the shadow inventory (REO, foreclosure and 90+delinquencies) have declined at a faster pace in non-judicial states (Figure 2). Comparing year-over-year changes:

- REO inventory declined 17% in non-judicial states vs. a 13% increase in judicial states,
- Foreclosure inventory declined 38% in non-judicial states vs. a 33% decrease in judicial states, and
- 90+ (seriously delinquent loans) declined 25% in non-judicial states vs. a 13% decrease in judicial states.

Figure 3. Trends in Distressed Sales (in 000s)



The differences in the shadow inventory trends can be mainly attributed to judicial foreclosure processes and resultant longer liquidation timelines prevalent in judicial states. Additionally, the share of the distressed sales relative to the distressed inventory levels has been higher in non-judicial states, as shown in Figure 3. Over the last 12 months, averagely 13% of the REO inventory is liquidated through REO sales on a monthly basis in judicial states. This number is much higher, at 18%, in non-judicial states.

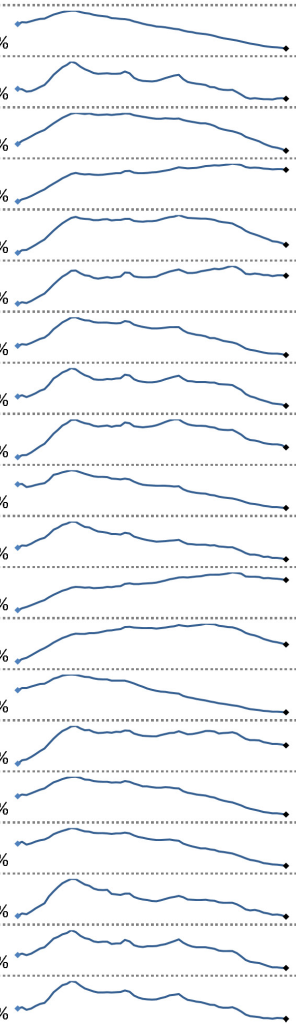
[1] Shadow inventory consists of foreclosed homes and mortgages delinquent for 90 days or more.

In the following chart (Figure 4), we illustrate trends in distressed properties across the top 20 states, which comprise approximately 80% of the national shadow inventory. As discussed in the above sections, most areas show significant improvements, while certain judicial states (New York, Pennsylvania, and New Jersey) experience persistently high levels of pending distressed inventory.

Figure 4. Shadow Inventory Trends of Top 20 States

As of January 2014

	Rank	Loan Count	State	Shadow Inventory	1/1/2009	Shadow Inventory as % of mortgage loans	1/1/2014
	1	5,923,060	California	187,695	9.9%		3.2%
	2	3,298,461	Texas	138,208	4.9%		4.2%
*	3	3,171,371	Florida	422,199	15.0%		13.3%
*	4	2,093,526	New York	195,587	5.3%		9.3%
*	5	2,066,892	Illinois	164,217	7.0%		7.9%
*	6	1,641,205	Pennsylvania	110,465	4.8%		6.7%
	7	1,609,025	Georgia	96,843	7.3%		6.0%
*	8	1,589,916	Ohio	103,731	7.2%		6.5%
*	9	1,578,101	North Carolina	79,250	4.3%		5.0%
	10	1,502,168	Michigan	70,056	8.7%		4.7%
	11	1,491,234	Virginia	53,062	4.4%		3.6%
*	12	1,379,600	New Jersey	170,811	6.3%		12.4%
	13	1,282,342	Washington	69,448	3.4%		5.4%
	14	1,164,760	Arizona	35,757	9.8%		3.1%
	15	1,147,701	Maryland	95,836	6.5%		8.4%
	16	1,017,872	Colorado	26,089	4.3%		2.6%
	17	988,213	Minnesota	32,637	5.5%		3.3%
	18	983,559	Massachusetts	54,218	5.6%		5.5%
*	19	952,996	Indiana	57,219	7.0%		6.0%
	20	879,549	Missouri	36,962	4.9%		4.2%



* Judicial State

Sources: CoreLogic, FBC

In the years ahead, we anticipate the levels of shadow inventory to continue trending down, albeit at a slower pace. The majority of the seriously delinquent loans (57%) is located in judicial states and therefore will follow lengthy liquidation timelines. Additionally, we expect the demand from investors to decline going forward amid recent home price increases. Overall, dropping volume of distressed properties, along with low inventories of existing and new homes, should support modest home price appreciation. It's important to remember that the performance of the local housing markets will depend on the areas' individual factors and may not follow the national trends.

For questions or additional information, please contact:

Guey-Mei You, Ph.D.	Aga Brazil
gyou@falconbridgecapital.com	abrazil@falconbridgecapital.com
(925) 979-4257	(925) 979-4291