Concerns that a wave of foreclosures would crash upon the housing market once pandemic protections like foreclosure moratoriums and forbearance programs ended did not materialize, and foreclosures remain near historic lows.

Will Foreclosures Rise as the Markets Cool?

JAN 2023 — **Now, the Federal Reserve is raising interest rates to tame inflation and, as a result, the housing market is rapidly cooling.** Some wonder if foreclosures will accelerate as house price appreciation decelerates.

“Foreclosure is the result of two simultaneous triggers: the lack of ability to pay (delinquency) and the lack of equity in a home,” First American Economist Ksenia Potapov said. “But not every delinquency will become a foreclosure. With enough equity, a homeowner has the option of selling the home or tapping into that equity to weather a temporary financial setback.

“The inverse — a lack of equity in the home without a financial setback that leads to delinquency — will again not end in a foreclosure,” she said. “Alone, economic hardship or a lack of equity are each necessary, but not sufficient to trigger a foreclosure. Both triggers need to be present to create the conditions for a foreclosure.”

While thoughts of foreclosure bring up memories of the great financial crisis of a decade ago, the housing market is very different today, Potapov said. Nationally, household equity reached 70 percent in the second quarter of 2022, the highest level in over 35 years. And the labor market continues to show strength, with the unemployment rate near pre-pandemic lows.

“However, the housing market has cooled considerably amid the affordability shock driven by rapidly rising mortgage rates, and signs of a labor market slowdown are emerging,” Potapov said. “Both trends threaten to increase the risk of foreclosures over the near term.”

House price appreciation is slowing in all major markets, she said, and prices are poised to fall further as the sellers’ market of 2021 and early 2022 turns toward buyers, which could chip away at some of the equity that homeowners have built up.

“Price growth will inevitably continue to decelerate to reflect the reality of higher mortgage rates,” Potapov said. “The double-digit house price appreciation of the past two years was not sustainable in the long run and was far outside the historical norm – average annual house price appreciation nationally since 1990, not including the pandemic, is 3.6 percent.”

“But, even if house prices turn negative, the decline would have to be substantial to eat away at all the equity that many homeowners have accumulated over the last few years,” she added. “For example, for the average national homeowner who bought a home in July 2020, house prices would need to decline 27 percent to wipe out all of their equity gains from appreciation.”

Homeowners have high levels of tappable home equity, providing a cushion for potential price declines and to prevent housing distress from turning into a foreclosure.

“In fact, if distressed homeowners are required to resolve delinquency, given their equity buffers, involuntary sales are much more likely than foreclosures,” Potapov said. “Foreclosures in the third quarter of 2022 increased, but remained below pre-pandemic levels. While we can expect the number to drift higher as the labor market slows and house prices fall from their peak, **the result will likely be more of a foreclosure ‘trickle’ than a ‘tsunami.’”**

SOURCE: The Title Report https://bit.ly/3UPSGGJ