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The Illinois Institute for Rural Affairs (IIRA) works to improve the quality of life for rural residents by partnering with public and private agencies on local development and enhancement efforts.

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Impacts of the Mortgage Crisis on Rural Illinois

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The foreclosure crisis apparently had limited direct impacts on rural Illinois, but the impacts of the larger economic crisis are still being felt.

Introduction

The [home mortgage foreclosure](#) crisis in the United States played a significant role in launching the global economic downturn that began toward the end of 2007. Nationally, the total amount of subprime loans in 2001 was \$57 billion; by 2006 it had increased to \$375 billion. As the mortgage crisis began to unwind, the total of [subprime loans](#) originated dropped to \$69 billion for the first half of 2007 (Demyanyk and Van Hemert 2008).

According to RealtyTrac, 2.8 million properties received foreclosure notices in 2009, up 25 percent from 2008. More than 131,000 of those notices were in Illinois, up about 32 percent from the previous year. Illinois ranked fourth in foreclosures nationwide in 2009 (Bloomquist 2010). Generally, the combined effects of foreclosures and the weak economy have lowered home prices in Illinois. Meanwhile, some indicators point toward the possibility of increased home sales in the coming months (University of Illinois 2010), but housing construction and sales of both new and existing homes remain weak.

During much of 2008, high commodity and farmland prices buffered rural areas of the United States from the immediate effects of the economic downturn. The secondary effects of the crises began to reach rural areas late in 2008 with falling demand for agricultural products and rising unemployment in various economic sectors, such as manufacturing. Although some aspects of the recession appeared to be easing recently, we have experienced a historic economic downturn that has shaken world financial and trade markets, slowing industries, construction, energy use, and other economic activity. Gross Domestic Product and financial markets have improved recently, and housing markets appear to have stabilized somewhat, but remained weak. Foreclosures, unemployment, and falling tax revenue for state and municipal governments were taking their toll on rural areas.

This policy brief examines the subprime loan and foreclosure crisis in rural Illinois by analyzing state and county-level data. Analysis of delinquency rates, bankruptcies, and in housing sales and construction since 2005 leads us to conclude that foreclosure activity in Illinois has been concentrated mainly in metropolitan areas. The percentage of subprime mortgages originated in rural Illinois was relatively low and not as widespread as other states (Singleton et al. 2006), but the crisis has taken its toll on the state's rural and urban areas.

Recent data suggested that one in seven homeowners, or a total of about 14 million homes, had negative equity in their homes toward the end of 2009 (Illinois Association of Realtors 2009). Foreclosures create widespread [personal and community impacts](#). For example, foreclosures can lead to vacant, abandoned, and sometimes vandalized properties, leading a rise in criminal activity and discouraging reinvestment in communities and neighborhoods.

Prospects for the future remained somewhat uncertain. The Federal Reserve Bank of Chicago (Newberger and Berry 2010) hosted a conference on the foreclosure crisis in December, 2009. Panelists pointed out that the nature of the crisis had changed since 2007 and 2008. While unaffordable loan products might have triggered the problem, home foreclosures in the current phase of the recession stemmed from the larger economic crisis, including lost income because of unemployment and other factors, declining home values, and "strategic defaults" by borrowers, who, for one reason or another, choose to stop paying on their home loans. Over time, if the bad economic conditions persist, the shifting dynamics of the situation could have negative impacts on foreclosure proceedings in rural communities across Illinois.

Conditions across Illinois

Currently, Illinois is among the states with the highest mortgage loan delinquency rates in the country. While no states showed an increase in new single-family residential permits issued between 2007 and 2008, Illinois had more than a 54 percent decline year to year ([Figure 1](#)), the third highest in the country and the worst in the Federal Reserve's Seventh District (Federal Reserve Bank of Chicago 2009).

Overall, Illinois has seen a steep year-to-year decline in housing permits since 2005, well before the onset of the national economic downturn in 2007. The declines reveal just how hard the state's residential construction has been hit in both rural and urban areas. The Decatur area turned out to be a major outlier in Illinois, with a 210.3 percent increase in housing permits between 2007 and 2008. This increase was highest in the country (United States Bureau of the Census 2008).

The Federal Deposit Insurance Corporation noted an increase in Illinois mortgage delinquency rates within the subprime market during the second quarter of 2006. Rates have generally been climbing ever since. In fact, conventional subprime loan delinquencies have nearly doubled since 2006, from about 12 percent in the second quarter of 2006 to about 30 percent in the last quarter of 2009 (Federal Deposit Insurance Corporation, n.d.).

According to the Federal Deposit Insurance Corporation (2010), the percentage of mortgages in Illinois with foreclosures hovered at or below 1.5 percent throughout the 1990s. In 2000, foreclosures moved up to around 2 percent, staying at this level until 2006. In 2007 and 2008, the percentage of mortgages facing foreclosure jumped to about 4.25 percent. By

the end of 2009, the figure had climbed to about 5.5 percent.

Then the number of foreclosures statewide climbed from 8,157 in June, 2008, to a peak of 15,398 in March, 2009. By May, 2009, the number of foreclosures had declined to 10,942, a significant drop, but still about 35 percent above the June, 2008, figure. In Cook County alone, one in every 221 housing units was in foreclosure in March, 2010, according to RealtyTrac Inc. (2010).

Illinois had 99,488 foreclosure filings in 2008, less than 5 percent of the national total of about 2.3 million. The state was in the top 10 of the nation's foreclosure ranking throughout 2008 and 2009. Four Illinois metro counties with approximately 59 percent of the state's population accounted for almost three-fourths of the foreclosures statewide in 2008. Cook County reported the most foreclosures with 54,588, about 55 percent of the state's total. Will County had 6,612 foreclosures, about 6.6 percent of the total; Lake County was third with 6,323 foreclosure filings, about 6.3 percent of the total. DuPage County was fourth with 6,184 foreclosure filings, about 6.2 percent of the total (RealtyTrac Inc 2009). [Figure 2](#) shows foreclosures as of April 29, 2009. The shaded counties, all of which are metropolitan, accounted for almost 92 percent of the foreclosures in Illinois while containing approximately 73 percent of the state's population (RealtyTrac Inc 2009).

Throughout the housing boom, housing prices in Illinois' metropolitan areas appreciated faster than in rural areas. Figures show that from about 2000 to 2005, urban housing prices in Illinois gained 43.2 percent, compared with 29 percent in rural Illinois. There were several reasons for this. First, rural homes tend to be

less expensive. Second, rural areas tend to have fewer housing transactions than urban areas since population density is very different (Office of Federal Housing Enterprise Oversight 2009). Chad Wilkerson, Vice President of the Federal Reserve Bank of Kansas City, suggested additional reasons for the lower appreciation rate in rural areas: greater availability of rural land and perhaps better credit underwriting standards by rural lenders (Wilkerson 2008).

Rural Illinois and the Larger Downturn

Implications of the larger downturn on rural Illinois have become clearer over time. Statewide, unemployment bottomed out at 4.3 percent in October and November of 2006 and has climbed steadily since. Statewide seasonally adjusted unemployment in January, 2010, was 11.3 percent, the highest since the major recession of the 1980s, which peaked at 12.9 percent in February, 1983, according to the United States Department of Labor Statistics (2010). The Illinois Department of Employment Security (2010) noted that by January, Illinois had lost 407,000 jobs since the official start of the recession in December, 2007, and there is evidence that the rate of jobs lost slowed during 2009 (Recovery.Illinois.Gov 2010).

Meanwhile, in May, 2009, rural unemployment in Illinois (8.2%) was increasing, but was actually below metropolitan rates (10.2%), according to Murphy and Bishop (2009). This ran counter to historic trends where rural unemployment rates have tended to be higher than urban. It also illustrated the serious early impacts of the downturn on urban areas. By October, 2009, however, the extended effects of the recession showed up in Illinois rural unemployment (10.7%), compared with 9.0 percent in urban areas (Bishop and

Gallardo 2009). From May to October, urban areas actually showed a decline in joblessness, while unemployment increased in rural areas. Illinois appears to be running counter to national trends, where rural unemployment still tends to be running below urban unemployment.

Meanwhile, single family home construction in Illinois' rural counties has slowed. While the pace of home construction across Illinois increased from 2004 to 2006, rural home construction rates did not increase as rapidly as in metro areas. Building permits for new single family homes have decreased more in urban areas than in rural areas, but were down across the state in 2008. [Figure 3](#) shows the widespread decline in permits, with the vast majority of rural and urban counties showing a percentage decline from the four-year average in 2008.¹

Like most of the rest of the country, home sales in Illinois also have slowed. [Figure 4](#) shows that based on a four-year running average, sales were down in almost all counties, according to the Illinois Association of Realtors (Illinois Association of Realtor n.d.). Where sales appeared to have increased in some rural counties, the gains were marginal in most cases. Only a few metropolitan and micropolitan counties showed gains.

The delayed effects of the large economic downturn are a cause for considerable concern in rural Illinois, but will take some time to sort out. Some trends that bear watching include:

¹ In rural counties, the number of housing permits can fluctuate widely from year to year, so the four-year average was used to dampen those fluctuations. (United States Bureau of the Census 2008).

- **Commodity Prices.** According to the World Bank (2008). " . . . sharp declines in oil and food prices [during 2008] mark[ed] the end of what has been the most historic commodity price boom of the past century. Like earlier booms, this one was driven by strong global economic growth and has come to an end with the abrupt slowdown in the global economy precipitated by the financial crisis." According to the Federal Reserve Bank in Kansas City, the sharp economic decline triggered tumbling demand for agricultural products as consumers changed their eating habits (Henderson 2009). While the price drop for corn and soybeans last year did not take them back to 2006 levels, prices have remained relatively weak since the initial drop in 2008. Continued low prices, coupled with volatile food and energy markets, could have a negative impacts on rural economies. Much depends on how national and global markets, including foodstuffs and energy, recover from the current downturn.²
- **Farmland Prices.** So far, Illinois farmland prices have held up relatively well during this economic cycle. According to the Illinois Society of Professional Farm Managers and Rural Appraisers, during 2009, farmland prices in the state tended to be down in the north,

² Research from the Agricultural Marketing Resource Center (http://www.agmrc.org/renewable_energy/ethanol/fuel_and_grain_price_historic_comparisons.cfm), accessed July 14, 2009) shows long-run relationships between soybeans and corn and various fuels. They indicate, with some exceptions, a tendency for fuel and grain prices to follow each other up and down.

up in the west, and mixed in the south (Landis 2010). The Farm Crisis of the 1980s, as part of the larger downturn then, had a far more serious impact on land prices, which dropped 19 percent in 1982, 16 percent in 1984, and 21 percent in 1985. Henderson and Akers (2009) noted that the prospects for farmland prices, after significant run ups in recent years, now seem to be more closely related to volatile agricultural markets, prospects for farm income, and fluctuations in capitalization rates.

- **Credit Conditions.** Credit for businesses and farms remained tight, according to recent Federal Reserve *Beige Books* (2009 and 2010). Many banks continue to be cautious, and some have made their credit requirements even tougher in recent months. Meanwhile, demand for loans also has been weak. As the Federal Reserve Bank of Kansas City noted recently, “With rising default rates, farmers and rural business owners should be prepared to bear some additional risks to receive credit” (Briggeman 2009, p 5). Coupled with low commodity prices and the potential for declining land values, farmers, in particular, may continue to have difficulty obtaining operating funds if the overall economy does not improve as expected. In addition, tight credit has a negative impact on all forms of construction, bringing a slowdown to this industry in rural areas.
- **Job Losses.** The Midwest has undergone a significant transition over the past generation, and rural areas have struggled to adapt with the

movement of jobs and capital across the country and around the world. As already noted, unemployment in rural Illinois increased quickly during the recession and recently exceeded urban joblessness. The pace of job losses across the state has slowed as economic news has continued to send mixed messages. Protracted unemployment and slow job creation may well impede widespread recovery in the near term at least. The pacing and timing of job losses and job creation will play an important role in the health of rural labor markets in the coming months.

The American Recovery and Renewal Act (ARRA), State, and Local Governments. The ARRA was a complex undertaking, and a full analysis of its impacts probably will not be known for several years. An initial assessment of the act’s impacts by the Congressional Budget office (2010) suggested increased Gross Domestic Product and job creation and retention. The ARRA will continue to have impacts through 2010, but its effects will diminish after that.

As of December 31, 2009, Illinois had received about \$7.26 billion in ARRA funds that were used for education; transportation; workforce development; unemployment insurance; health and human services; energy and the environment; public safety and housing. Illinois. Recovery.Gov (2010) reported that about 6,700 jobs were created as a result of the stimulus funding.

ARRA grants to state governments, including Illinois, helped stave off some financial difficulties in the short run, but did not resolve the state's entrenched fiscal difficulties. Fiscal conditions for state and local governments in Illinois have been volatile as a result of the larger downturn and the state's increasingly precarious debt situation. Layoffs of employees who work for government agencies would have a significant impacts on rural areas where government employment in schools and other agencies is a dominant factor in the economy.

Federal and State Remedies

The federal government and the State of Illinois have taken steps to mitigate housing problems caused by the crisis. For example, the Illinois Housing Development Authority (2010) provides foreclosure assistance to help homeowners and communities improve their living conditions including:

- The National Foreclosure Mitigation Counseling Program (NFMC), administered by the Illinois Housing Development Authority (IDHA), provides free foreclosure counseling and legal assistance to homeowners facing foreclosure or at risk of foreclosure.
- The Illinois governor set up a Mortgage Fraud Task Force to help those who might have been victims of illegal or unethical mortgage practices.
- The Illinois Homeowner Protection Act of 2009 (SB-2513) gives homeowners who have fallen more than 30 days behind on their mortgage payments more time to work with their lender to

develop a plan to let them to remain in their homes. Lenders and loan servicers are required to notify homeowners/borrowers when a loan is past due and provide an opportunity for the homeowner to seek housing counselling.

- The federal Neighborhood Stabilization Program (NSP), administered by IHDA, provides funding to projects in areas of greatest need to acquire, rehabilitate, and redevelop foreclosed properties that might become sources of community blight. NSP's initial funding is authorized under Title III of the Housing and Economic Recovery Act of 2008.

Conclusion

The direct effects of the foreclosure crisis on rural Illinois have been minimal, nowhere near the impacts in urban Illinois, especially the Chicago area. Taking into account the number of foreclosed homes in rural areas, building permits, and single-family housing sales, it is clear that the foreclosure activity has been centered in metropolitan counties.

The housing price bubble was much larger in metro areas, as was the foreclosure problem. Still, the rapid overall economic decline in the wake of the foreclosure crises has affected rural Illinois. These impacts will require adjustments in rural areas over time and will be related to the pace and nature of the national and global recovery.

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Roots of the Foreclosure Crisis

According to Global Insight (The United States Conference of Mayors 2007), foreclosure activity in the United States first intensified in 2006 in slower growth states such as Indiana, Ohio, and Michigan. Then, metropolitan areas in Florida and California began to experience a dramatic increase in loan delinquencies and foreclosures. As the foreclosure crisis spread in metropolitan areas, it created a ripple effect in other economic sectors. As the extent of the bad debt became evident, financial institutions worldwide began to suffer from economic stress that eroded not only their profits, but also the reserves required to keep them solvent. Massive government intervention since late 2008 has helped staunch some of the financial hemorrhaging, but national and global markets remain weak.

Historically low interest rates helped fuel a housing boom after 2000. The low rates, plus a newly deregulated financial and banking industry, led to new and revised loan instruments that were highly profitable in the short run, but in hindsight, were misapplied because loans were given to borrowers who might not have been qualified under normal circumstances. The paper for these loans was bundled in with other loans, resulting in “toxic” loan packages that were sold to financial institutions around the world.

The mortgage crisis started in part because some lenders’ failed to follow underwriting standards and gave loans to those who could not keep up with their payments. Many of these risky loans were made through subprime, adjustable rate mortgage (ARM) loans in 2004 and 2005 (The United States Conference of Mayors 2007). The loans were offered with little or no down payment, and borrowers, who seemed to have been counting on constantly increasing home prices, might have been unaware of the terms of their mortgages. As the adjustable rates conformed to market rates after a two-year period, monthly mortgage payments increased, leaving many borrowers unable to pay their mortgages.

After market rates automatically reset for the first wave of adjustable rate mortgages in 2006 and 2007, delinquency rates increased, foreclosures rose, especially in urban and suburban areas. The number of foreclosures increased, eventually forcing housing prices to decline and ending the run up that began in the early part of the decade. The price decline was precipitous enough to greatly decrease homeowners’ equity after the inflated prices earlier in the decade. Borrowers found themselves with a higher loan-to-value ratio, so they were unable to refinance their loans to get a better interest rate. This began a spiral which led to even more foreclosures, triggering problems for many banks and other investors.

In some cases borrowers had no mortgage holder to renegotiate with; their mortgages had been sold to the secondary markets and most likely resold after that, spreading the impacts of the bad loans around the world (The United States Conference of Mayors 2007). Research indicates that the mortgage crisis had been developing for six years before it detonated in 2007 (Demyanyk 2008). Lenders became more skeptical about making loans, and investors—including many banks, investment companies, and some insurance firms—tried selling off their dubious holdings.

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Prime and Subprime Mortgages

Usually, lenders require much documentation from borrowers to determine whether to proceed with a home mortgage loan. The borrower's recent employment records and credit history provide two basic forms of information that the lender uses to make a sound decision (Federal Reserve Bank of New York 2009). If borrowers do not qualify for a prime rate loan, they may be eligible for an Alt-A loan or a subprime loan.

Under normal conditions, lenders separate prime and subprime borrowers by considering the borrower's history, including mortgage or rent payment behavior, previous bankruptcy filings, debt-to-income ratios, and the documentation provided for verifying the borrower's income. The mortgage amount is also based on the down payment and the borrower's credit risk using the Fair, Issac, and Company (FICO) score (Agarwal and Ho 2007).

Prevailing prime mortgage rates are given to those with lower credit risk, while subprime borrowers pay a rate that tends to be 200 to 300 basis points (2% to 3%) higher than the prime mortgage rates. Subprime borrowers also pay higher origination fees such as higher application fees and prepayment penalties (Agarwal and Ho 2007). The higher costs compensate lenders for the risk associated with the borrowers who may fail to repay the loan (Singleton et al. 2006). Alt-A loans are considered less risky than subprime loans. They are given to those with good credit scores but who may have a high debt-to-income ratio or do not provide sufficient documentation necessary for verifying their income (Federal Reserve Bank of New York 2009). Adjustable rate mortgage loans have been very popular as well. ARMs carry low initial rates which adjust through time based on the prime rate.

Some forms of subprime loans especially have faced criticisms for a number of years. A study conducted by seven state and regional research organizations concluded that high-risk lenders were primarily concentrated in minority neighborhoods during 2006 (Woodstock Institute 2008). According to a study by the Carsey Institute, these predatory loans have been widely used by rural minorities and women and for the purchase of manufactured housing, which is prevalent in rural areas. Predatory subprime loans contain consumer unfriendly terms such as penalties for early payment, excessive points and fees when the mortgage is issued, and a disregard for the borrower's ability to repay (Singleton et. al 2006).

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Impacts of Foreclosures

The effects of foreclosures are felt by individuals, neighborhoods, local governments, and across the community. Foreclosures drive down the property values of neighbors. It becomes more difficult to sell a home in a neighborhood that has devalued and vacant homes. Local governments receive less revenue from property taxes and are forced to reduce funding to community programs and services.

Taxing districts base their expenditure projections on the difference between the non-tax revenue and the total amount needed to carry out project functions. This difference is the amount that needs to be raised from property taxes (Illinois Department of Revenue 2009). As foreclosures rise, revenues from property taxes decrease, forcing counties, cities, school districts and other agencies funded by property taxes to operate with less funding.

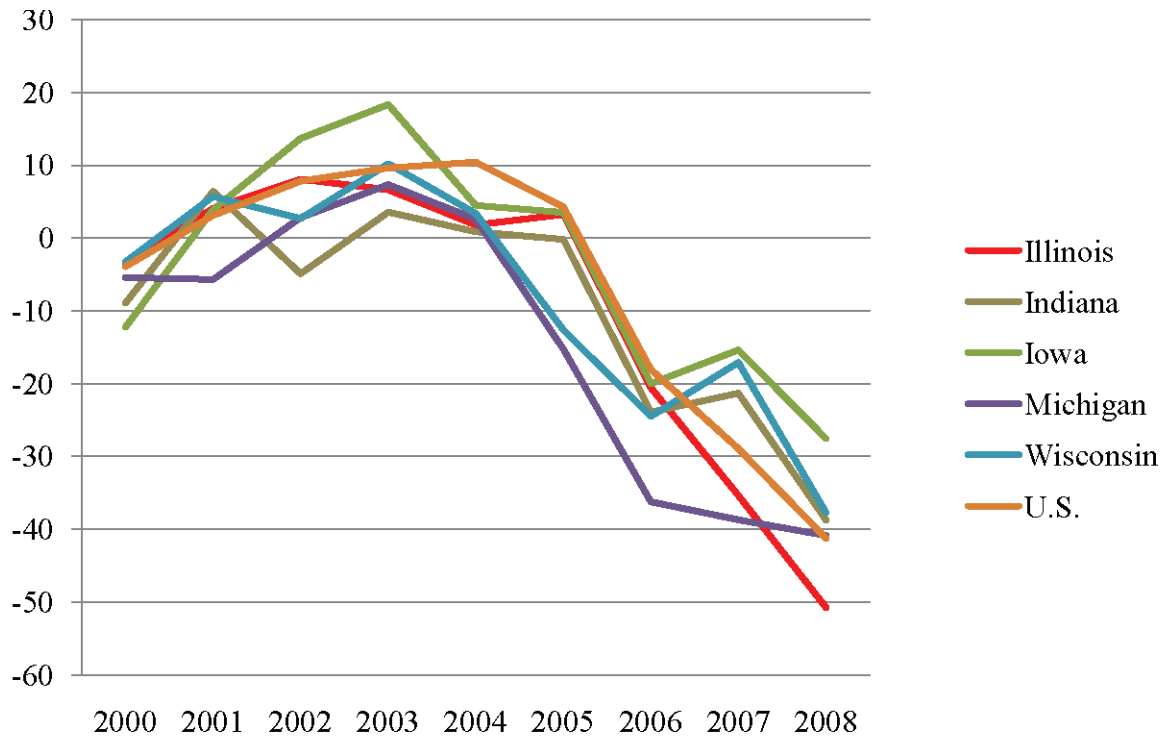
As a result of lower property values, the Woodstock Institute estimated that state and local governments nationwide would lose \$917 million in property revenue taxes in 2009. Foreclosures become a burden to local governments; costs to service a property can add up to \$30,000 per property, including legal fees, fire suppression, building inspection, and handling the foreclosure procedures (Woodstock Institute 2008). Immergluck and Smith found that for the borrower, foreclosure entails a loss of stability and a damaged credit rating that also affects the person's standing in the labor, insurance, and rental housing markets (2005).

As a home goes into foreclosure, it has severe effects on neighboring homes and entire communities. Up to 2.5 million homes across Illinois could have been affected during 2008 and 2009, leading to an average decrease in home value of about \$10,760 (Center for Responsible Lending 2008).

According to research by Immergluck and Smith, a house within an eighth of a mile of a foreclosed property decreases in value by about 0.9 percent with a similar loss for each additional foreclosure on the block. The effect was found to be even higher for lower-income neighborhoods where values dropped by about 1.44 percent (Immergluck and Smith 2005).

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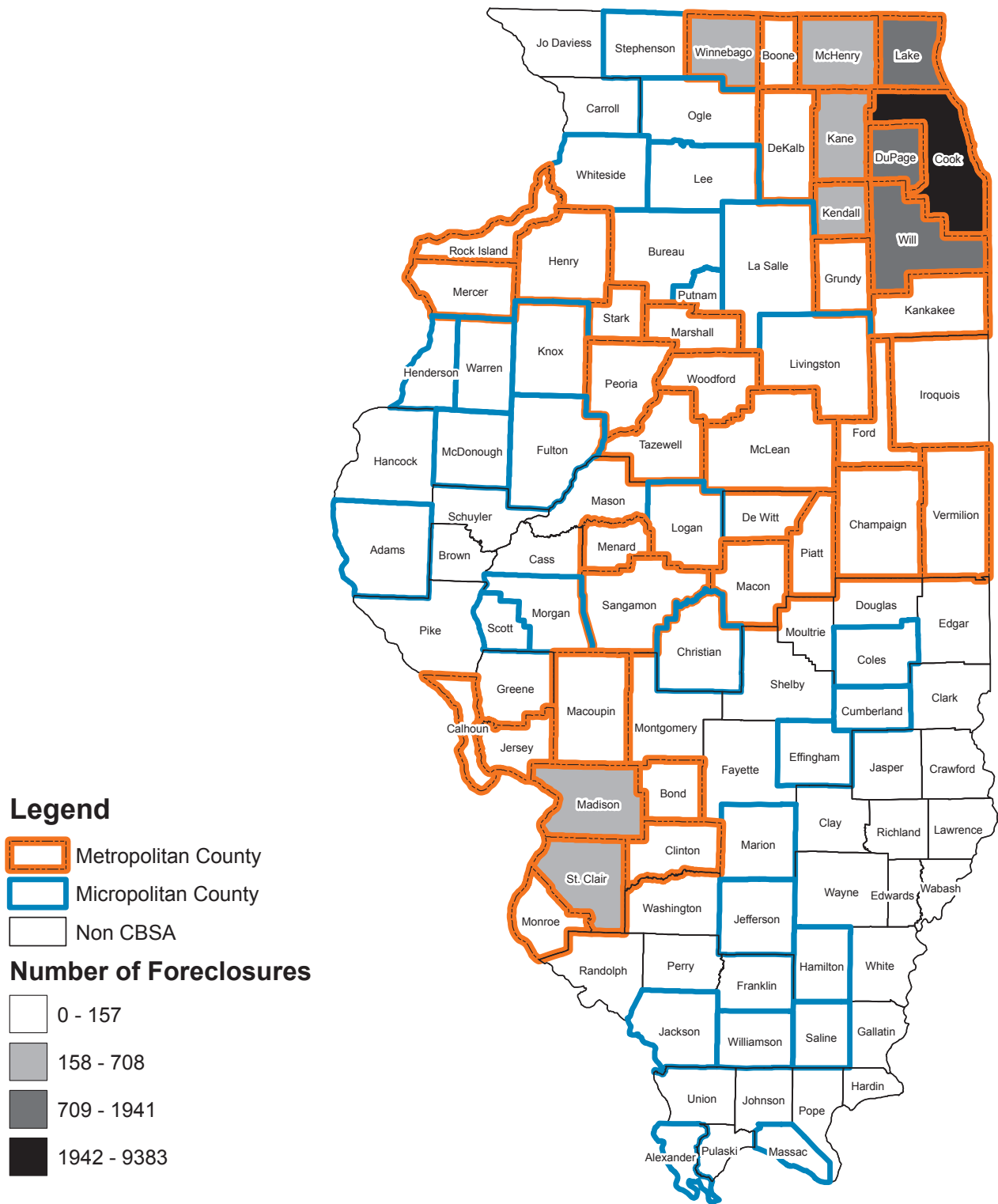
Figure 1, Year-to-Year Percentage Changes in Single-family Housing Permits Issued in the Midwest, 2000-2008.



Source: Federal Reserve Bank of Chicago 2009.

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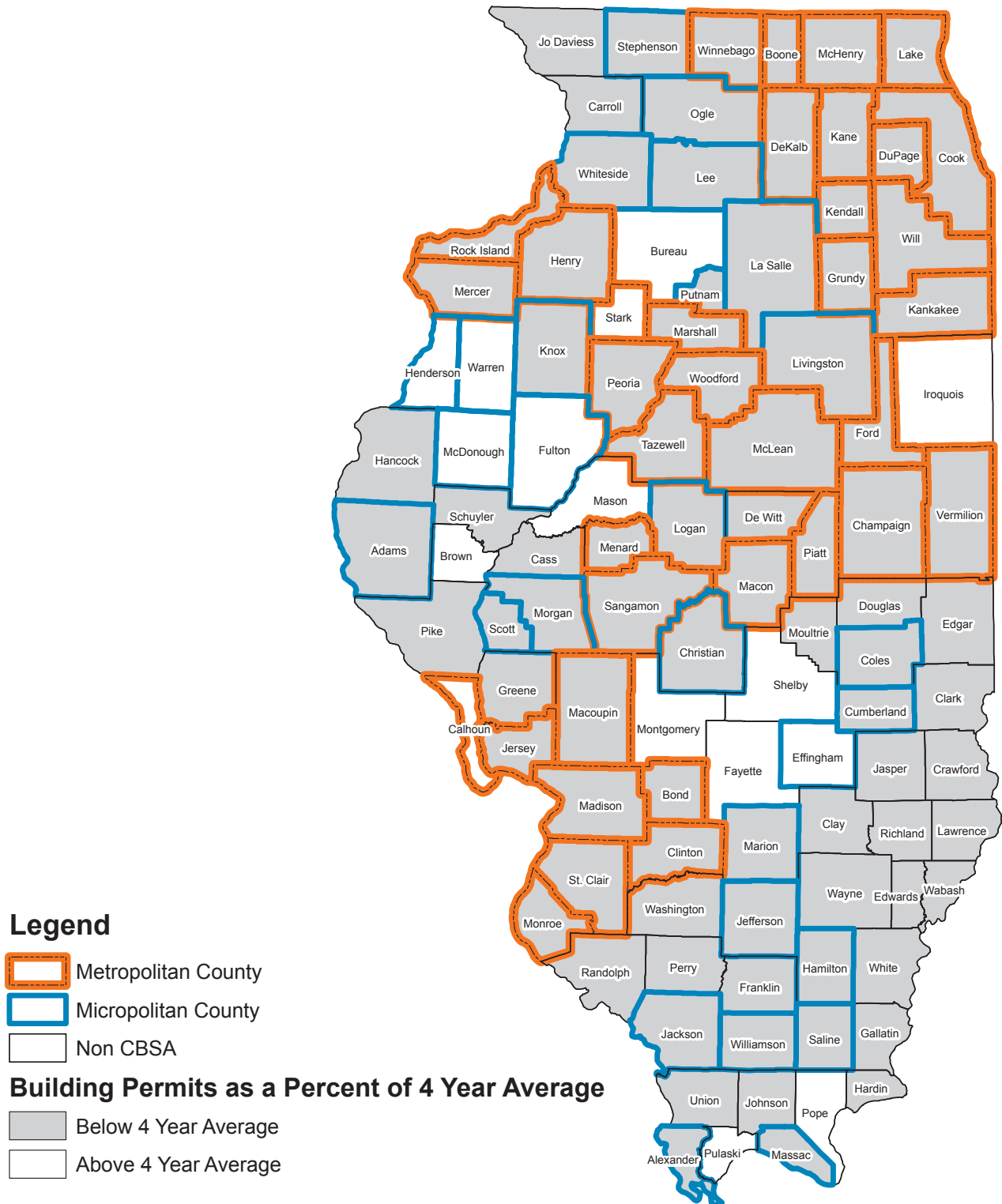
Figure 2. Foreclosures in Illinois by County, April 29, 2009.



Source: foreclosure.com 2009.

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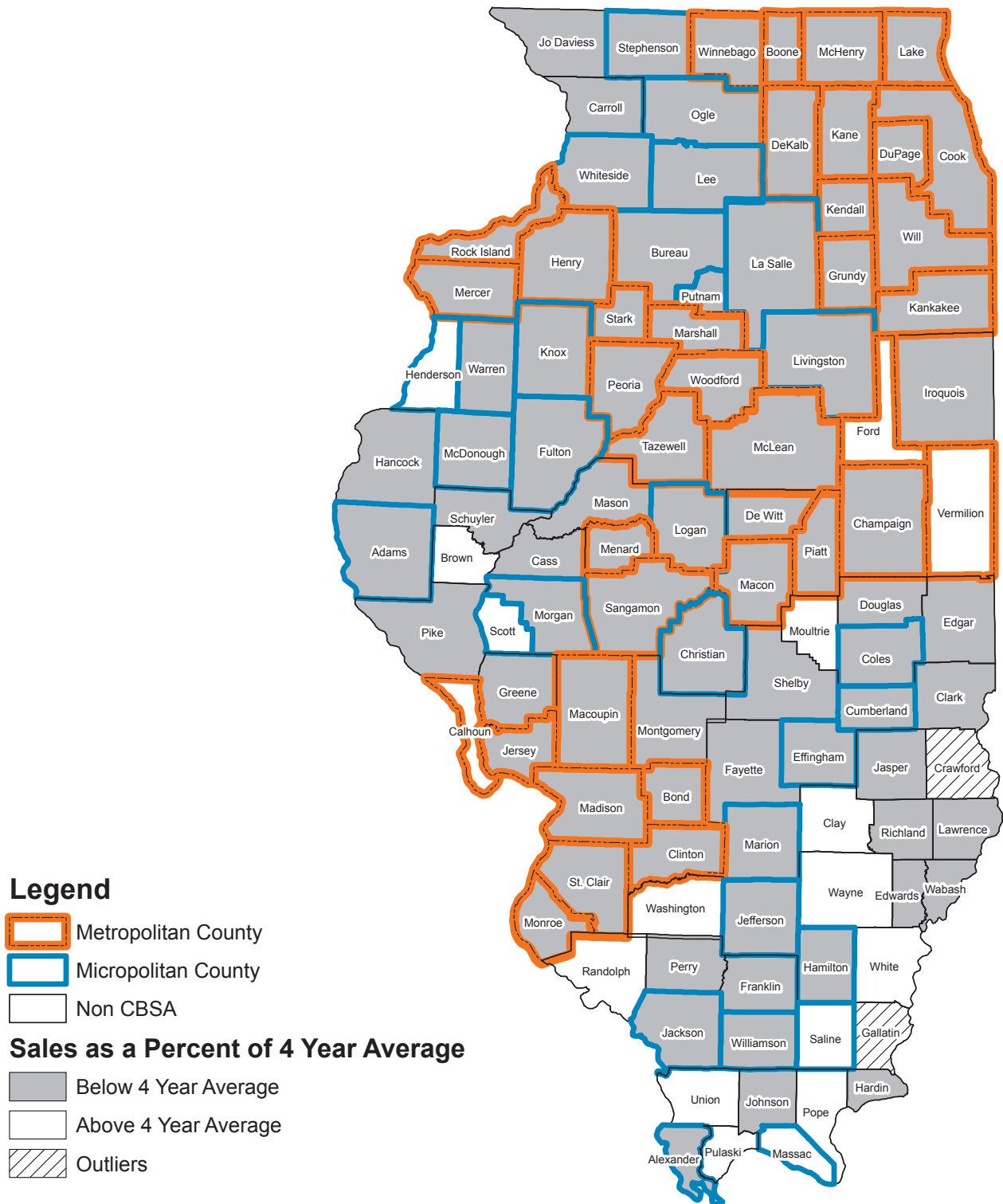
Figure 3. 2008 Building Permits as a Percent of the 4-Year Average



Source: United States Bureau of the Census

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Figure 4. Four-year Running Average of Single-family Home Sales in Illinois Counties.



Source: Illinois Association of Realtors

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