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# The Foreclosure Crisis, Foreclosed Properties, and Federal Policy: Some Implications for Housing and Community Development Planning

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## Abstract

Problem: Foreclosures surged during the 2007 to 2009 national foreclosure crisis and federal policymakers failed to respond quickly and forcefully to the problem. The large numbers and geographic concentration of foreclosed properties have posed a particular problem for many planners.

Purpose: I aim to describe the intrametropolitan distribution of foreclosed properties at the zip code level, the often anemic or delayed federal policy response to rising foreclosures, and the potential effects of likely changes in federal policy and housing finance for metropolitan housing, development patterns, and local housing and community development planning.

Methods: I used archival research and secondary and media resources to document the federal response to the foreclosure crisis. I analyzed a proprietary data set to describe the problem of the accumulation of foreclosed properties across and within metropolitan areas.

Results and conclusions: Foreclosed properties were already accumulating in metropolitan areas with weak housing markets by 2006, but formerly hot markets such as Riverside, CA, Las Vegas, NV, and Phoenix, AZ, had many more by mid-2008. Within metropolitan areas, foreclosed properties were disproportionately concentrated in central city neighborhoods, although suburban zip codes with long commute times also had relatively high levels. The federal response to rapidly worsening foreclosures was faltering and timid. More conservative finance following the crisis will put downward pressure on housing consumption, potentially shifting demand to smaller homes. However, financing may be difficult or expensive to obtain for condominium buildings, and lenders and investors may shy away from less conventional projects, due partly to higher risk premiums.

Takeaway for practice: In the short run, local governments must confront the problems of foreclosed properties, especially when they are highly concentrated in certain neighborhoods. More conservative mortgage markets are likely to persist for some time, with potential impacts on housing demand. Planners should strive to diversify tax bases by promoting more diverse land use and housing patterns to make their communities more resilient in future crises. Federal policymakers may move toward greater mortgage market regulation, but this will be vigorously debated. Policymakers will also consider the ongoing federal role in secondary markets, without which long term stability is unlikely. Finally, Congress may extend the Community Reinvestment Act to nonbank financial institutions given the federal support they have received during the crisis.

Research support: None.

Keywords:

foreclosure mortgage crisis housing finance

# Notes

1. These include two key laws effectively preempting many state lending regulations: the Depository Institutions Deregulation and Monetary Control Act and the Alternative Mortgage Transaction Parity Act. See McCoy and Renuart (2008) and Immergluck (2009).

2. Alt-A loans are loans for which the borrower pays a premium in exchange for not having to provide the usual documents to verify his or her income.

3. Delinquency rates are from the Mortgage Bankers Association's National Delinquency Survey (Mortgage Bankers Association, 2009).

4. See Immergluck (2008) for a more extensive description of the LPS Applied Analytics data.

5. The four categories of REO density are: low, containing zip codes in the bottom quartile of REO density; moderate, containing zip codes from the 25th percentile to the 75th percentile; high, containing zip codes in the 75th to the 90th percentile of REO density; and very high, containing zip codes above the 90th percentile.

6. Researchers have only recently examined the evidence on cramdowns' effects on interest rates. Lending industry representatives argued that the proposal would raise interest rates on owner-occupied home loans by 1.5 percentage points because, without cramdown protection, lenders would require higher interest rates to compensate for potentially greater losses. They have cited the higher interest rates for investment property mortgages as evidence of such an effect (Mortgage Bankers Association, 2008). But such loans likely cost more to finance because investor property mortgages involve other forms of increased risk, including higher default risk. Levitin and Goodman (2008) measured the impact of cramdowns on interest rates using longitudinal historical data from federal judicial districts, which varied in the degree to which they allowed mortgage cramdowns on principal residences from 1979 to 1993. They found that mortgage cramdowns resulted in increases in interest rates of only 0.05 to 0.15 percentage points, far less than the 1.5 percentage points claimed by the Mortgage Bankers Association.

7. A thrift is a financial institution that accepts deposits like a bank. However, thrifts evolved from savings and loans, which were formed primarily to originate and service home loans. Thrifts operate under different charters than state or federally chartered banks, and are regulated by the federal Office of Thrift Supervision. Banks are

regulated by state banking departments and by the Federal Deposit Insurance Corporation, the Federal Reserve, or the Office of the Comptroller of the Currency, depending on their charters. Nondepository financial institutions, which include mortgage and finance companies, are not directly regulated by any of these agencies, but are subject primarily to state regulators and the Federal Trade Commission for compliance with consumer protection laws.

8. For example, the proportion of senior mortgages with associated junior mortgages increased in Massachusetts from 26% in the second quarter of 2003 to 65% in the third quarter of 2005 (Rosengren, 2008).

9. While HERA provided some direction for allocating the funds, there are no consistent, small-area data on foreclosures or foreclosed properties that are publicly available. HUD used free or very low cost data and a regression approach to predict foreclosures at the census tract level, and then allocated funds according to these estimated foreclosures. The census tract values of the resulting indicator of what HUD called foreclosure risk was then made available for states and localities to use in allocating funds within their own jurisdictions.

10. Condominium associations often limit or restrict leasing of individual units, and converting entire buildings of individually owned units to rental is also challenging.

11. This is a broad and complex area, and there are many other issues. I emphasize three key issues that are fundamental to the entire structure of mortgage market regulation. See Immergluck (2009) for a broader discussion of regulatory issues that have been raised by the crisis.

12. Another alternative is to define a default loan product, which would have minimal potential legal liabilities for lenders, like a 30-year, fixed-rate mortgage. Variations from this product, like adjustable rates, would trigger potentially higher liabilities, thus encouraging lenders to market the safer default product more heavily. Barr, Mullainathan, and Shafir (2008) propose such an alternative.

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