BRIEFING PAPER

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Foreclosures and the Inner City

The Current Mortgage Crisis and its Inner City Implications

The Initiative for a Competitive Inner City (ICIC) is a national, not-for-profit organization founded in 1994 by Harvard Business School Professor Michael E. Porter. ICIC's Mission is to promote economic prosperity in America's inner cities through private sector engagement that lead to jobs, income and wealth creation for local residents. ICIC brings together businesses and civic leaders to drive innovation and action, transform thinking and accelerate inner city business growth and investment.

In 2007, 0.37% of the estimated national housing stock became the property of lending institutions.[1] That is, for every 1,000 homes in United States, in 2007 almost four became "real-estate owned," industry shorthand for residential properties whose ownership reverts back to banks or other mortgage holders. Real-estate owned ("REO") properties are of particular concern because they often end up being sold at auction prices or worse, abandoned buildings that create blight, drive down property values, and undercut the local tax base. In a setting where the magnitude and contours of the foreclosure crisis are still taking shape, REO data provide an unambiguous measure of foreclosure activity and its impact on different types of communities.

Table 1. Foreclosure Statistics by Location

	% of Housing Units in REO	% of owner occupied Housing Units in REO	REO per square mile
Inner City	.63%	1.52%	9.2
Rest of Central City	.41%	.71%	2.3
Rest of United States	.31%	.48%	.2
Entire U.S.	.37%	.61%	.3
IC/Rest of City	1.5	2.1	4.0
IC/Rest of U.S.	2.0	3.0	38.4

Unfortunately, these data paint a troubling picture of the incidence of foreclosures in America's inner cities.[2] Data from the 100 largest US cities show that in 2007, the REO rate in inner city neighborhoods was twice as high (0.63% versus 0.31%) as in the r est of the United States. (See Table 1.) These data underscore two important aspects of the current crisis. The first is that urban areas have been disproportionately affected by the crisis: REO rates even in higher -income central city neighborhoods are 30% higher than in the rest of the United States (0.41% vs. 0.31%). Second, within urban areas, lower-income neighborhoods (i.e., inner city neighborhoods) have suffered much higher foreclosure rates than their higher-income counterparts: inner cities foreclosure rates are a full 50% higher than those in the rest of the city. The data suggest, then, that there is an urban component to the foreclosure crisis, but that within urban areas, there is a sharp demarcation between inner city and higher-income neighborhoods.

[1] ICIC thanks RealtyTrac, which provided the foreclosure data used in this analysis, and Fannie Mae, which provided housing price data used in this analysis. A description of data sources and methods is outlined in a technical memorandum, "Foreclosures and the Inner City: Data Evaluation and Methodology." ICIC Research, March, 2008.

[2] ICIC defines inner cities as core urban census tracts with 20% or higher poverty rates or that meet two of the following three criteria: poverty rate of 1.5 times or more that of their Metropolitan Statistical Areas; median household income of 1/2 or less that of their Metropolitan Statistical Areas; and unemployment rate of 1.5 or more that of their Metropolitan Statistical Areas.

Even these numbers, however, underestimate the full impact of foreclosures on inner city neighborhoods. A better measure of the extent of the crisis is foreclosures as a percent of owner-occupied properties, a measure that excludes public housing units, which do not have residential mortgages, and multi-family rental properties with five or more units, which will carry commercial rather than residential mortgages. Using this measure, foreclosure rates per unit are two times higher in inner cities than in the rest of central cities and three times higher than elsewhere in the United States.

Although the foreclosure problem is fairly widespread across US inner cities – 70% have REO rates that are higher than in the rest of their central city – the problem is particularly acute in some areas. Table 2 lists the inner cities with the highest 2007 foreclosure rates. Detroit and Cleveland had the highest 2007 REO rates, 3.7% and 3.0% respectively, and joined by five other Midwestern cities: Indianapolis, Akron, St. Louis, Toledo, and Kansas City. These inner cities are likely plagued by two factors that are contributing to REO rates: high foreclosure activity and low demand for housing, which will reduce the chance to sell homes at auctions, thus ensuring that they revert back to the mortgage owner. Atlanta, Stockton, and Sacramento are also among the worst inner cities in terms of 2007 REO rates. However, based on the number of properties in early stages of foreclosure in the last months of 2007, we expect that in 2008, California inner cities will figure much more prominently in the foreclosure crisis than they did in 2007.

Table 2. Inner Cities with the Highest REO Rates, 2007

Inner City	2007 REO Rate
Detroit	3.7%
Cleveland	3.0%
Atlanta	2.6%
Indianapolis	1.9%
Akron	1.8%
Stockton	1.7%
St. Louis	1.6%
Toledo	1.6%
Sacramento	1.6%
Kansas City	1.6%

Some analyses of the foreclosure crisis identify the expansion of home ownership opportunities for low-income persons as a driver of the current crisis. In this view, increases in home ownership rates among low-income groups is responsible for rising foreclosure rates, a claim that if true, could explain high foreclosure rates in the inner city, where income levels are significantly lower than in the rest of the United States. However, our analysis calls into question the accuracy and completeness of this argument: even after controlling for median income, a owner-occupied housing unit in an inner city zip code was twice as likely to have gone into foreclosure in 2007 as a unit elsewhere in the country. This finding is particularly difficult to explain in light of evidence that housing price increases, which usually correlate negatively with foreclosures, actually grew faster in inner city neighborhoods than other areas in the years leading up to the crisis.

We believe that the root causes of these trends are not the financial behavior of residents but the unique characteristics of the physical environment in inner cities, especially the high density of housing. As was recently pointed out by Federal Reserve Chairman Ben Bernanke, neighborhoods with high concentrations of foreclosures suffer additional fallout in terms of financing options, home sales, prices, and abandoned properties.[3] Where these effects have been quantified, the numbers are sobering. A 2005 study in Chicago found that every foreclosure reduces the value of single family homes within 1/8th of a mile by 1.0-1.4 percent.[4] These impacts increase closer to the foreclosed property: a study of foreclosures in Philadelphia found that being within 150 feet of an abandoned property decreased housing values by $7,600.[5] Utilizing research for the Fannie Mae Foundation,[6] the Center for Responsible Lending estimates that having a foreclosed property in the neighborhood decreases a home's value by an average of $5,000.[7]

Price decline along with other products of foreclosures in a neighborhood in one time period will act as causes of additional foreclosures in that neighborhood in the next time period. These feedbacks effects are likely to be felt most acutely in inner cities, where housing density (housing units/square mile) is 2.5 times higher than in other urban neighborhoods and almost twenty times higher than in the rest of the United States. In 2007, the combination of high foreclosure rates and dense

[3] Bernanke, Ben S. (Speaker). (2007). "Subprime Mortgage Lending and Mitigating Foreclosures." Washington, DC: Committee on Financial Services, U.S. House of Representatives.

[4] Temple University Center for Public Policy and Eastern Pennsylvania Organizing Project. (2001). Blight Free *Philadelphia: A Public-Private Strategy to Create and Enhance Neighborhood Value.*

[5] Apgar, William, and Mark Duda. (2005). *Collateral Damage: The Municipal Impact of Today's Mortgage Foreclosure Boom.* Washington, DC: Homeownership Preservation Foundation.

[6] Immergluck, Dan and Geoff Smith. (2006). *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values* Fannie Mae Foundation.

[7] The Center for Responsible Lending. (2008). "Subprime Spillover: Foreclosures Cost Neighbors $223 billion; 44.5 Million Homes Lose $5,000 on Average." Durham, North Carolina.

housing stock created foreclosures per square mile that were almost forty times higher in the inner city than in the rest of the country.

The distribution of foreclosures within inner cities is also troubling. Within inner cities, the highest incidence of foreclosures is not in higher-income neighborhoods where gentrification lead to price appreciation and speculation, nor in the lowest-income neighborhoods, where residents might struggle most financially. When ranked by median income, neighborhoods in the middle of the range suffered higher average foreclosure rates (0.67% of housing stock) than either the poorest neighborhoods (0.62%) or the highest-income inner city neighborhoods (0.44%). These patterns suggest that those neighborhoods that were improving in terms of livability and stability are at greatest risk of widespread foreclosures and the attendant problems. This raises fears that the current crisis could undermine decades of hard-won gains in inner city neighborhoods across the country.

Our data do show that foreclosures are likely to increase in 2008 in the inner cities and across the United States. Still, much is unknown about the nature and velocity of the current foreclosure crisis. Some factors that have been identified as contributing to foreclosures across the country are more important in inner city neighborhoods. For example, Latinos and African- Americans, who account for a large portion of the inner city population, are far more likely to have sub-prime loans than white homeowners with similar incomes.[8] The prevalence of these loans, which are six times more likely to enter foreclosure than prime loans, is certainly an important part of the inner city foreclosure story. For other factors, such as changes in housing prices, our first cut suggests that its relationship to foreclosures might be different in inner cities than in other parts of the country. A thorough, systematic look at the causes and consequences of the foreclosure crisis must be undertaken in order to develop short-term intervention strategy and a longer-term policy approach to replace the wealth that has been so quickly drained from the inner city.

ICIC

For more information please contact
Teresa Lynch, SVP of Research
tlynch@icic.org or 617-292-2363 x 103

ICIC
727 Atlantic Avenue, Ste 600
Boston, MA 02111
www.icic.org

[8] Association of Community Organizations for Reform Now (ACORN). 2004. *Separate and Unequal: Predatory Lending in America.* ACORN: Washington, DC.