Collateral Damage:
The Municipal Impact of Today's Mortgage Foreclosure Boom

by
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Preface

The recent rise in foreclosures has opened a new and costly chapter in the troubled history of America's distressed urban neighborhoods. One key aspect of the story emerging from this trend is the fact that foreclosures impose significant costs not only on borrowers and lenders, but also on municipal governments, neighboring homeowners, and others with a financial stake in nearby properties. This is particularly true of nonprime mortgage foreclosures because of their spatial concentration.

Using the City of Chicago as an example, this report documents for the first time the municipal costs of foreclosure, including both direct municipal expenditures for foreclosure related services and indirect costs linked to the blighting effect that foreclosures have on urban neighborhoods. After detailing the negative effects that foreclosures have on communities, the paper discusses steps that Chicago and other municipalities are taking to reduce the impact of foreclosures, both by engineering them out of the system and by limiting the negative spillovers that arise from foreclosures that are not preventable.

The report was prepared by William Apgar and Mark Duda. Mr. Apgar is a Senior Scholar at the Joint Center for Housing Studies of Harvard University, and a Lecturer in Public Policy at Harvard's John F. Kennedy School of Government. He previously served as the Assistant Secretary for Housing/Federal Housing Commissioner at the U.S. Department of Housing and Urban Development, and also Chaired the Federal Housing Finance Board. Mr. Apgar holds a PhD in Economics from Harvard University. Mr. Duda is a Research Fellow at the Joint Center for Housing Studies. He consults and has written widely on issues relating to single family mortgage finance in both the U.S. and China. Mr. Duda holds a PhD in Urban Geography from Clark University.

The cost estimates presented here were first described in a study entitled “The Municipal Cost of Foreclosure: A Chicago Case Study,” prepared by Mr. Apgar, Mr. Duda, and Chicago-based community development expert Rochelle Nawrocki Gorey. This longer study includes a more extensive discussion of the methodology utilized to estimate cost figures used in both reports. The earlier report is available on the Homeownership Preservation Foundation’s website at www.hpfonline.org.

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Executive Summary

The recent debate over abusive lending practices has focused squarely on damages to individual borrowers. While understandable, this view overlooks the significant costs of loan failures to municipalities that, in their role as guardians of public safety and quality of life, must foot the bill for foreclosure-related services—including remedying the many social ills that foreclosures themselves spawn. A single mortgage failure, especially one that leaves the home vacant and unsecured, can impose tens of thousands of dollars of costs on cash-strapped public agencies.

And municipal governments are just one of the many parties that pay the price for loans made to high-risk borrowers that result in foreclosures. Indeed, anyone invested in nearby homes and businesses stands to lose if a rash of foreclosures brings down property prices, accelerating the decline of an entire neighborhood. Along with local agencies, it is these area homeowners, business owners, landlords, and other investors who shoulder a burden that rightfully belongs to the parties directly involved in failed mortgages.

Overextending credit to high-risk borrowers also leads to perverse market effects. In today's competitive mortgage industry, a race to the bottom ensues when lenders lower their underwriting standards to reach ever less qualified borrowers in ever more vulnerable neighborhoods. As a result, lenders willing to underprice their products at origination gain market share while leaving others to pick up a portion of the costs generated when loans go bad.

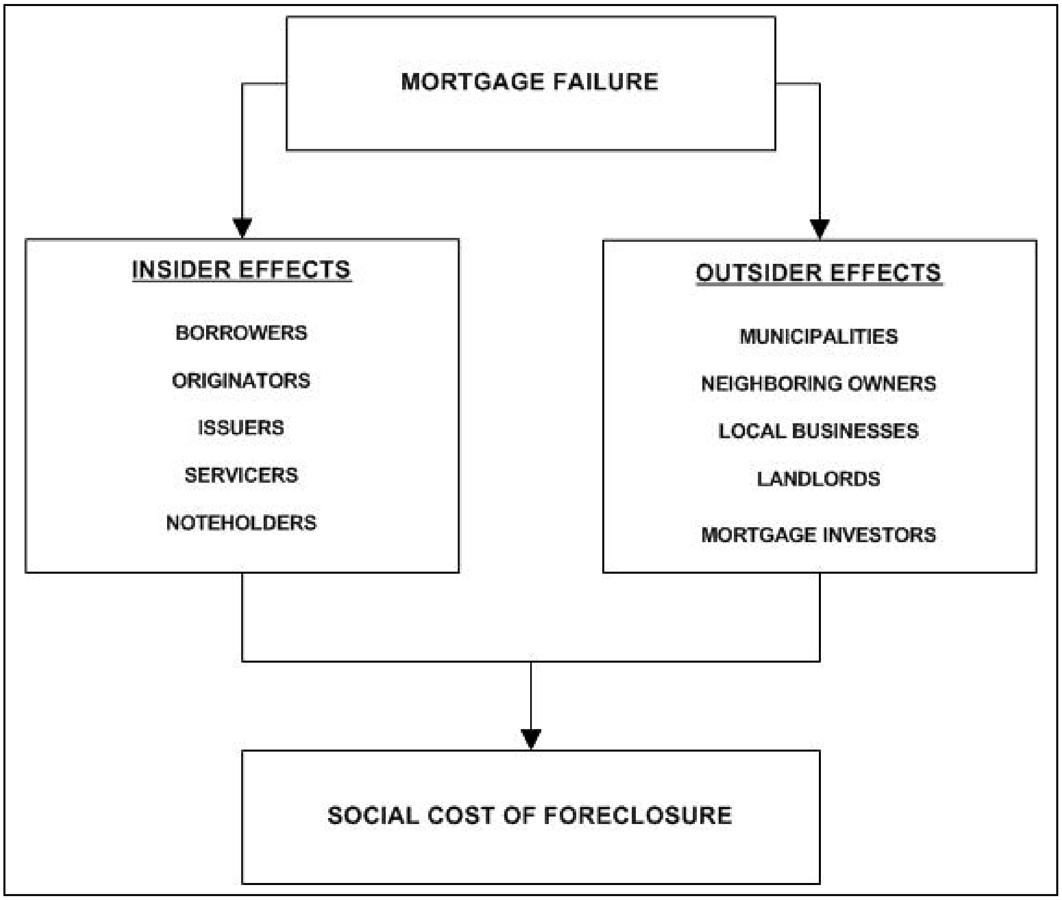
Until now, no study has examined the full social costs of foreclosures. This report begins to quantify the fallout from high-risk mortgage lending by developing a typology of these costs based on the foreclosure process in the City of Chicago. Foreclosures are not only expensive to borrowers and lenders, but they involve more than a dozen agencies and twice as many specific municipal activities, and generate direct municipal costs that in some cases exceed $30,000 per property.

Fortunately, Chicago and other municipalities are making important strides in not only limiting the fallout from poorly underwritten and/or fraudulent loans in distressed neighborhoods, but also helping borrowers resolve problems well before foreclosure becomes inevitable. Municipalities are also working to streamline the foreclosure process and ensure that lenders pay their fair share of foreclosure-related costs. These and other policies summarized in this report have been successful in combating the contagion of mortgage foreclosures.

Loan Insiders and Outsiders

The negative impacts of foreclosures extend far beyond the parties to a failed mortgage contract (Figure 1). While “insiders” (those directly involved in the transaction) incur various types of losses in the event of a default, the costs to “outsiders” (entities that are not party to the mortgage transaction) are also substantial.[1] In particular, proximity to problem buildings makes the area less desirable and slows the rate of house price appreciation, leaving nearby homeowners with much less housing wealth. Local landlords may also be forced to charge lower rents, and local businesses may see weaker sales. Even other mortgage industry participants, including noteholders for nearby properties, are likely to see the value of their investments fall as the risk of loan failure spreads.

Figure 1: The Social Impacts of Foreclosure



For municipalities, foreclosures trigger significant direct expenditures for increased policing and fire suppression, demolition contracts, building inspections, legal fees, and expenses associated with managing the foreclosure process (*e.g.*, recordkeeping/updating). Police officials interviewed for this study also cited the damage to quality of life from empty, foreclosed properties, including gang activity, drug dealing, prostitution, arson, rape, and murder. Even after the foreclosure process is completed, costs continue to accrue in cases where the municipality inherits responsibility for securing and/or demolishing the unit, clearing trash from the lot, and keeping weeds under control.

Meanwhile, borrowers in financial distress frequently stop paying property taxes. As a result, foreclosures reduce municipal tax revenues and hence the resources cities have to mitigate the negative impacts. Although authorities can issue a tax lien against the property, this process takes years to complete and, even then, does not guarantee the municipality will receive full repayment.

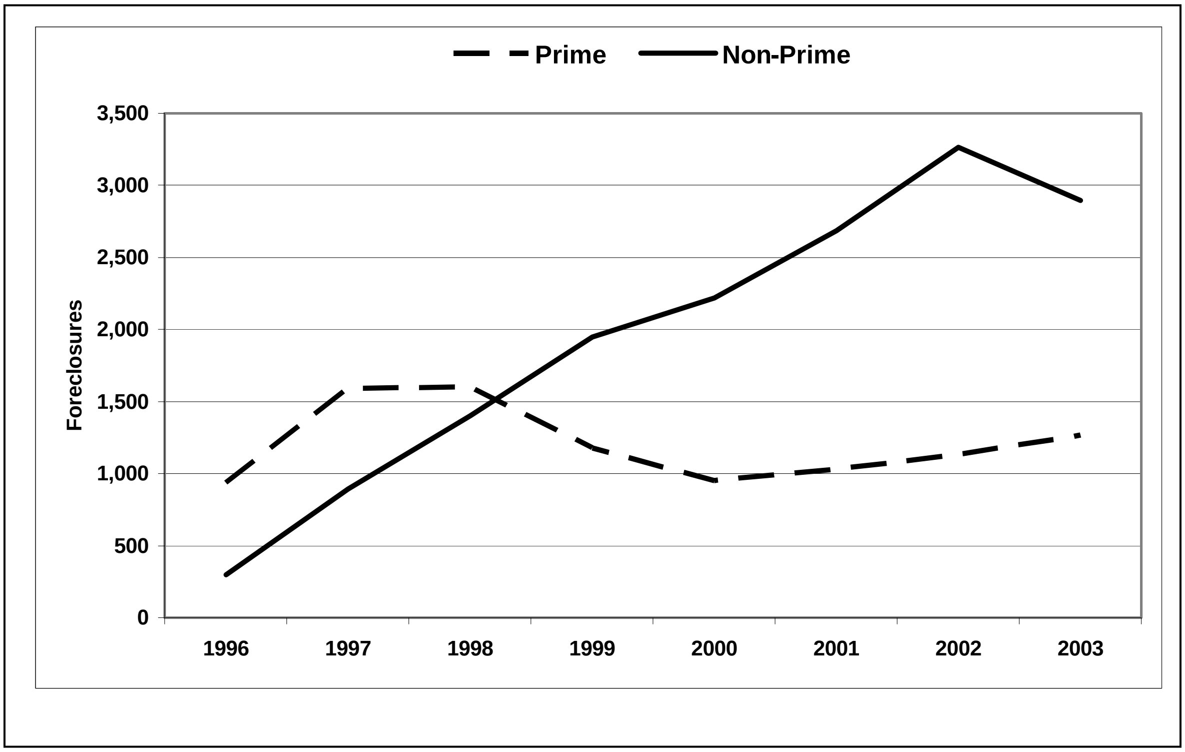
When foreclosure leads to demolition, the municipality faces additional property tax losses because it must remove the assessed value of the structure from its tax roles. Municipal revenues are also reduced by delayed and uncollected taxes and unpaid service fees for water, gas, and electricity. More generally, to the extent that foreclosures make urban neighborhoods less attractive to households and businesses, municipal sales and income tax receipts also suffer.

The first step in addressing these concerns and ensuring the efficient functioning of the nonprime mortgage market is to assess the true social cost of foreclosures. Using the City of Chicago as a case study, the following sections begin this analysis.

Nonprime Foreclosures on the Rise

From almost nothing a decade ago, nonprime loans now capture an astounding 20 percent share of the home loan market. Although this long-awaited mortgage capital has benefited many underserved neighborhoods, higher-risk lending has also sparked a substantial increase in foreclosures. The City of Chicago has seen the total number of foreclosures double since 1996, despite relative stability on the prime loan side (Figure 2). Serious delinquencies and foreclosures for nonprime loans can easily be ten times higher than for prime loans.[2]

Figure 2: Nonprime Lending Has Driven up Chicago Foreclosures



Source: D. Rose, *Preying on Neighborhoods: Community Partners Turn the Tide against Predatory Lending*, 2004 (www.nticus.org/currentevents/press/pdf/preyingonneighborhoods2.pdf)

Complicating matters is the fact that nonprime foreclosures tend to cluster in ways that generate significant spillover effects as vacant properties become magnets for crime and other social ills. [3] In fact, extreme rates of loan failure suggest that foreclosures are “contagious,” with one loan failure increasing the likelihood of another. Take the case of a single block in Chicago’s Auburn–Gresham neighborhood, where 14 foreclosures occurred among the block’s 37 properties in just a decade. The one vacant and subsequently demolished home on this block also destroyed approximately $220,000 in housing wealth for 13 neighboring homeowners (see Appendix A).

The fact that foreclosures on failed nonprime loans impose un-recovered costs on entities outside the mortgage transaction means that higher-risk lending practices impose a greater burden on society than prime lending. Given that foreclosures tend to cluster in low-income and/or minority neighborhoods, many of the outsider effects are concentrated among the nation’s most vulnerable households.[4]

Five Common Foreclosure Scenarios

The complex foreclosure process in Chicago involves the coordination of more than a dozen city and county agencies. The depth of local government involvement depends on whether the foreclosure action is contested, if the house is vacant and open, visibly deteriorates, and/or becomes a public nuisance during the foreclosure process.

To assess the range of costs that arise from the foreclosure process, this study calculated the costs of five typical scenarios using Chicago and Cook County budget and administrative data for 2003 and 2004. The estimated prices for each of 26 individual foreclosure-related activities are listed in Figure 3.

Figure 3. Foreclosure-Related Municipal Costs

Activity	Agency	Cost
1. Lis Pendens Filing	Recorder of Deeds	$ (13)
2. Operate Chancery Court	Multiple County Agencies	$ (43)
3. Register Sale and New Owner	Recorder of Deeds	$ (13)
4. Delegate Agency Foreclosure Prevention Funding	Dept. of Administrative Hearings (DOAH)	$ 96
5. Vacancy Intake	Department of Buildings (DOB) and Others	$ 3
6. Building Inspections	DOB	$ 364
7. Maintain Vacant Building Registry	DOB	$ 36
8. Serving Notice to Secure	Department of Law (DOL) and Sheriff	$ 715
9. Boarding, Lien Issuance	DOB, DOL	$ 1,445
10. Prepare Case for Administrative Hearing	DOL	$ 2,690
11. Administer DOAH	DOAH	$ 78
12. Prepare Housing Court Case	DOL	$ 4,203
13. Administer Housing Court	Multiple County Agencies	$ 228
14. Police Call	Police Department	$ 315
15. Police Make Arrests	Police Department	$ 180
16. Initial Notice of Demolition	DOB	$ 165
17. Notice of Impending Demolition	DOB	$ 75
18. Demolition by Contractor, Lien Issued	DOB, DOL	$ 6,000
19. Property Tax Losses from Demolition	n/a	$ 4,307
20. Prepare and Try Demo Case	DOL, DOB	$ 5,884
21. Administer Demo Court	Multiple County Agencies	$ 228
22. Unpaid Property Tax Losses	n/a	$ 506
23. Unpaid Utility Tax Losses	n/a	$ 51
24. Unpaid Water Usage	Water Department	$ 162
25. Mow Lawn/Remove Trash	Department of Streets and Sanitation	$ 5,000
26. Fire Suppression	Fire Department	$ 14,020

It is important to note that the costs presented here are net of any funds recovered for foreclosure-related services. While municipalities can and do recover some share of the cost, the amount is often modest. For example, fees charged by the Cook County Recorder of Deeds for filing documents appear to cover the County's administrative costs. In contrast, the $15 fee that the Department of Buildings is currently authorized to charge for serving an initial notice of demolition is well below the average $180 cost of this service to the city.

Of course, not all foreclosures generate substantial municipal or other third-party costs. In the simplest cases, the unit transfers smoothly from the borrower into the portfolio of the noteholder or to a foreclosure investor. Such transfers involve no vacancy, no additional policing, demolition, boarding, or other foreclosure support services from the City or County. In these instances, the municipal loss per foreclosure net of fees recovered is just $27. If the unit becomes vacant, however, the City's foreclosure costs mount rapidly.

Scenario A: Vacant and Secured Properties
Municipal Cost = $430

The basic foreclosure process for vacant properties involves seven agencies. Reports of vacant foreclosed properties to the Department of Buildings (DOB) typically come from aldermen, the mayor's office, the 311 information system (the city's non-emergency call system), concerned neighbors, community groups, police and fire officials, or building inspectors in the field. DOB responds by sending inspectors out to confirm the structure's vacant status and to document code violations for which the city issues fines. Cook County departments incur expenses for administering Chancery Court and for maintaining the foreclosure-reporting infrastructure.

Scenario B: Vacant and Unsecured Properties

Municipal Cost = $5,358

When the unit is unsecured and the building inspector's report favors conservation over demolition, DOB contacts the owner regarding failure to comply with regulations for vacant and open buildings and issues fines for the code violations to encourage compliance. If the owner responds by properly securing the unit, registering it as vacant, and posting an official notice, the property can remain in this state until it is sold or becomes a threat to public safety. If the owner fails to comply, however, the case goes to the Department of Administrative Hearings (DOAH) or to Housing Court, either of which incur the costs of legal notification, securing the vacant unit, and issuing and collecting on liens. Legal expenses alone exceed $2,500 in a straightforward case and can easily go much higher. A typical case of this type adjudicated in DOAH involves nine municipal agencies and expenses of more than $5,000 per problem property.

Scenario C: Vacant, Unsecured Properties Tracked for Demolition

Municipal Cost = $13,452

If the inspector determines the building is "vacant, open, and constitutes a hazard to the community," the City moves toward demolition. Under Fast Track Demolition (FTD), the City notifies legally interested parties that they must secure, repair, or demolish the structure or else it will be razed at City expense. The DOB issues a lien, which is enforced by the Department of Law (DOL), to cover the City's costs and can either leave the ultimately vacant lot in the owner's possession or acquire it by foreclosing on the demolition lien.

Non-FTD cases are tried in Demolition Court, which is part of the Housing Court section of the Circuit Court of Cook County. Based on the building inspector's report, the DOL drafts a formal complaint and issues summons to all interested parties. If the City can prove the structure is a threat to public safety and beyond reasonable repair, DOB hires a contractor to demolish the building and DOL issues and enforces a lien to cover the cost. If the owners contest demolition, they are given a time-limited opportunity to bring the building up to code.

In the meantime, vacant, unsecured buildings are a magnet for intruders. Police are called upon to evict squatters, chase away vandals, and arrest drug dealers. Depending on the severity of the problems and the frequency with which they must be addressed, increased policing can easily add between $300 and $1,100 to the municipal foreclosure bill.

Regardless of whether they go through Fast Track Demolition or through Demolition Court, these cases impose similarly large costs that often go un-recovered. In FTD cases, the City is not always able to collect the full amount on demolition liens. In Demolition Court cases, preparing and trying these relatively complex proceedings is expensive. In either situation, the City's property tax base decreases when the value of the demolished structure is removed from the tax roles. The estimated cost presented here is based on Fast Track Demolition and only modest need for additional policing at the property before demolition.

Scenario D: Properties Abandoned Before Foreclosure Is Completed
Municipal Cost = $19,227

Situations where the noteholder or noteholder's agent does not complete the foreclosure process—often because the cost of restoring the property to minimally adequate standards exceeds its value—are called "walkaways." Because the original mortgage borrower has long since left and the noteholder is not required to take possession of the unit, the structure ends up vacant and in legal limbo. Not surprisingly, walkaways cause immense problems for nearby residents, businesses, and neighborhoods.

For municipalities, these cases involve property tax losses because unpaid bills technically remain the responsibility of the homeowners, who clearly have no ability to pay. Uncollected taxes are ultimately put through a tax sale, which allows the City to recoup some share of the outstanding balance. Meanwhile, the City also loses revenue from unpaid water bills and overdue utility payments (which carry municipal taxes). And because the deteriorating properties are untended, they often require periodic maintenance such as garbage removal and mowing weeds.[5] Because of the extended period of vacancy, the lack of oversight from any party with the resources to address problems, and the legal ambiguity in which these properties are left, walkaways can push municipal expenditures up by thousands of dollars more than in cases where the noteholder completes the foreclosure process.

Scenario E: Abandoned Properties Damaged by Fire
Municipal Cost = $34,199

In long vacant buildings, a host of problems can arise or intensify and push foreclosure-related costs even higher. For example, the likelihood of serious criminal activity, higher trash removal costs, and illegal reconnection of utilities all increase dramatically. The risk of fire damage—whether at the hands of vandals, squatters, or owners seeking to make insurance claims—also rises sharply.

These fires often decimate the structure because no one calls the Fire Department while the blaze is still small enough to be suppressed. Once firefighters are called in, a fire in an abandoned building imposes not only significant costs on the City ($14,000 on average), but also risks to the health and welfare of these public employees. Burned buildings often constitute a threat to public safety, requiring immediate demolition. Given a long period of vacant/open status, a fire, and eventual demolition of the remaining structure, the total cost to the municipality is more than $34,000.

What Public-Private Partnerships Can Do

With foreclosures on the rise in communities across the country, it is essential to find ways to minimize the potential fallout on all stakeholders. As an important first step, municipalities must work with responsible mortgage industry and community leaders to reduce the incidence of poorly underwritten and/or fraudulent high-risk loans in distressed neighborhoods. This must be reinforced with efforts to improve financial literacy by providing access to counseling for distressed borrowers. Municipalities should also simplify the foreclosure process and work to ensure that lenders pay their fair share of foreclosure-related costs. The following recommendations cite measures that the City of Chicago and other municipalities have taken, or are considering, to meet the foreclosure challenge.

1. Support Foreclosure Prevention Initiatives

Since some municipal expenditures are unavoidable once the process begins, investing resources to avoid foreclosures should be a priority. Clearly, the savings from heading off future foreclosure costs and the spillover effects on distressed neighborhoods are substantial. Chicago's Department of Housing now spends nearly $1 million of its Community Development Block Grant funds working with community-based nonprofit organizations on preventative programs. Innovative programs now in place in cities across the country demonstrate that partnering with the mortgage industry and community-based organizations is an effective way to stem the problems from foreclosures, in particular by:

- **Connecting borrowers to credit counseling.**
  Many distressed borrowers could save their loans, homes, and credit standing if they knew where to turn for help. Effective counseling can make the difference between saving and losing their homes.

The City of Chicago provides this information through its 311 call center. To help build public trust in the 311 approach, Chicago Mayor Richard Daley led a highly visible campaign to introduce the system and encourage distressed borrowers to seek help before it becomes too late. Callers have the opportunity to receive counseling from the Credit Counseling Resource Center (CCRC), a national alliance of HUD Certified Housing Counseling agencies operated by the Homeownership Preservation Foundation, and then be put in contact with the loan servicer to explore a potential workout or be referred to other available local resources or assistance if appropriate.[6] Funded by both the City and its lender-partners, the counseling service is free to borrowers.

- **Helping servicers contact distressed borrowers.**
  Despite great efforts, mortgage servicers are often unable to reach delinquent borrowers. In fact, it is not uncommon for delinquent nonprime loans to go to foreclosure without the borrower ever speaking to a servicer or learning that workout opportunities are available.

  To address this problem, GMAC-RFC's Homecomings Financial Network now works with Neighborhood Housing Services of Chicago (NHSC) in an effort to contact unresponsive borrowers and offer them access both to their servicer and to free credit counseling. The organizations work together to arrive at appropriate workout solutions, and provide borrowers a trusted advisor to guide them through a difficult and potentially intimidating process. Initial results suggest that as many as half of program participants achieve successful outcomes (*i.e.*, any resolution that does not result in the property becoming vacant and abandoned).

2. Reform the Foreclosure Process

The increase in nonprime foreclosures has tested local governments' ability to efficiently provide foreclosure-related services. The process needs to be simpler and better coordinated, particularly in the following areas.

- **Streamline legal procedures.**
  While borrowers must have every reasonable opportunity to cure defaults, foreclosure should be a speedy and predictable process once failure is inevitable. Regulatory reform should focus on standardizing and updating the legal process, with an eye to eliminating provisions that delay foreclosures even as the negative impacts on neighborhoods continue to mount.[7]

- **Coordinate foreclosure service provision.**
  Better coordination among municipal service providers is also essential to minimize the spillover effects of mortgage failures. Chicago's Troubled Building Initiatives (TBI) provides a model of what can be achieved by coordinating city resources and activities across all agencies involved in problem buildings. Once a property is identified, staff from the agencies involved in TBI assess available resources (*e.g.*, laws, fines/fees, coercive mechanisms, and other signals) and outline an action plan. These plans include tactics such as foreclosing on an existing municipal lien or bringing administrative or judicial action against the lender and/or property owner. The goal is first and foremost to get the attention of interested parties and reach resolution quickly.

- **Close the walkaway loophole.**
  No outcome of the foreclosure process deserves more attention than walkaways. When both the borrower and lender abandon their interests in

the property, they leave municipalities and other local stakeholders with a problem building whose title status may take years to resolve.

Neighborhood Housing Services of Chicago is now working with the City and responsible lender partners to accelerate the transfer of potential walkaway properties to either the City or a designated nonprofit. Such a solution reduces municipal costs and safety problems from vacant properties languishing in legal limbo. Early intervention—before the arrival of squatters or illegal activities—is a high priority.

- **Develop a foreclosure hotspot protocol**.
  In neighborhoods where foreclosures concentrate, a protocol should guide remediation efforts and minimize the adverse effects on outside parties. For example, municipal tax collection agencies might refrain from foreclosing on tax liens against owner-occupants in foreclosure hotspots if this would help borrowers and lenders resolve the delinquency. Alternatively, if the owner of a hotspot home has already vacated the property, is not contesting the foreclosure, and/or lacks the financial stability to remain in the home, the municipality could work with lenders to accelerate the foreclosure and the transfer to a new owner. Again, while it is important to protect the interests of low-income homeowners, streamlining the foreclosure process in many cases can help stabilize a distressed area and reduce foreclosure-related costs for insiders and outsiders alike.[8]

3. Allocate Service Costs More Fairly

Many of the social costs of foreclosures fall on taxpayers who must foot the bill for delivery of foreclosure-related municipal services. To relieve the public burden associated with the municipal costs of foreclosures, and re-establish efficient pricing in this segment of the mortgage market, municipalities might:

- **Raise the fees on foreclosure-related services.**

  As municipalities reevaluate how to set fees for their services, they must honor the principle that taxpayers should not subsidize services that largely benefit specific, identifiable private parties. Providing foreclosure infrastructure and remediation services violates this principle. Despite the fundamental lack of information on the specific activities involved in the foreclosure process and on their individual costs, current pricing policies can clearly be improved.

  Some may worry that raising lender fees will push the costs of nonprime credit even higher, making housing even less affordable. Although this concern has merit, it suggests two counter-arguments. First, if costs are tied to risk level, they fall primarily on the most problematic, foreclosure-prone loans. If this eliminates the market for highly default-prone lending, then borrowers, investors, and many outside the mortgage transaction all benefit. Second, implicitly subsidizing mortgage prices—which is what municipalities now do by undercharging for foreclosure-related services—is a poor substitute for explicitly designing policies to increase ownership opportunities and sustainability among targeted groups of low-income borrowers.

- **Establish an industry fund to help offset municipal costs.**

  In theory, correctly pricing municipal services should promote efficient resource allocation. In practice, however, the cost of collection may be higher than the fees generated. One solution to this problem builds on a proposal by the Coalition for Fair and Affordable Lending, a national organization representing nonprime lenders. Under this approach, Congress would require that nonprime lenders pay a reasonable fee into a central fund when they originate a mortgage.[9] This fund could then be used to defray the municipal costs associated with foreclosure, support state and local efforts to streamline the foreclosure process, and expand local foreclosure avoidance initiatives.

Summary

As the City of Chicago's example demonstrates, the high costs of foreclosures make it imperative that municipal, mortgage industry, and community leaders join the effort to stop the problem where it starts—poorly underwritten and/or fraudulent high-risk loans. Because even legitimate nonprime loans are more failure-prone, however, these groups must also support foreclosure avoidance programs that educate distressed borrowers about loan restructuring options.

Municipalities themselves have numerous opportunities to make delivery of foreclosure-related services more efficient and to reevaluate laws and regulations that may unintentionally add to the overall social cost of foreclosures. Recognizing that they will inevitably bear some of the costs, however, municipalities must be prepared to use their own community development resources to advance foreclosure avoidance efforts, both to reduce their own exposure and to help families in distress.

In addition, municipalities should carefully review the costs of providing foreclosure-related services and, when appropriate, ask the mortgage industry to share the burden of paying these costs. Municipalities can work with mortgage industry leaders to ensure that they recover a greater share of outlays from user fees or proceeds from the foreclosure sale. In combination, all of these initiatives will limit the disproportionate burden municipalities now carry for the rising rate of foreclosures, while also helping to preserve the homeownership gains achieved by extending credit to higher-risk borrowers.

Appendix A. Brief Note on Methodology

The following section summarizes the methodology used to estimate the direct municipal costs and the indirect costs to property owners from foreclosures. A full discussion is available in the background report entitled “The Municipal Cost of Foreclosures: A Chicago Case Study,” prepared by William C. Apgar, Mark Duda, and Rochelle Nawrocki Gorey, and available on the Housing Policy Foundation’s website (www.hpfonline.org).

Direct Municipal Costs

The report estimates the municipal costs of providing 26 distinct foreclosure-related services provided by 15 separate agencies. Individual cost estimates are then combined to compute the direct municipal costs associated with five increasingly complex foreclosure scenarios. These estimates are based on a detailed examination of City of Chicago and Cook County budgets for 2003 and 2004, and on a series of interviews with key informants in various municipal departments between August and November 2004.

Specific estimates were derived in one of four ways:

(1) Respondents directly provided costs.

(2) Respondents provided hourly wages, which were then multiplied by the number of hours necessary to complete the task (also provided by the respondents).

(3) Per-event costs were calculated by dividing budget numbers by the share of a department or section’s activity involved in a foreclosure-related service, and then dividing by the number of times the activity was performed.

(4) Hourly wages were derived from budget information and combined with respondent data on the number of hours required to perform each task.

Indirect Costs on Neighboring Property Owners

Although difficult to measure, indirect costs to neighboring property owners add significantly to the overall social costs of foreclosure. This is particularly true in the case of vacant units, making the area less desirable to prospective homebuyers and thereby bringing down home price appreciation.

In the only published effort to measure the magnitude of these effects, a Temple University study found that Philadelphia properties located within 150 feet of an abandoned unit sold for $7,627 less than those not located near abandoned units, with the effect tapering off to $3,543 at distances of 300-450 feet and becoming negligible beyond 450 feet (the length of a typical block).[10] These findings are consistent with the general literature on the impact of so-called negative externalities on house price appreciation, which suggest that the presence of a deteriorated structure can reduce area property values by as much as 10 percent, and that the largest impacts are on homes located closest to the blighted property.[11]

Applying the same logic to the sample block in Chicago mentioned in this report, the negative spillover from the vacant foreclosed unit affected 13 homeowners within 150 feet of the property. Assuming that loss rates as a share of house value are the same in both cities and given that Chicago's median house price is 2.2 times higher than Philadelphia's, the average property value loss in the Chicago case is $16,915. This figure, when multiplied by 13, yields $219,893.

Appendix B. Municipal Costs for Specific Foreclosure Scenarios

Activity	Scenario A: Vacant & Secured	Scenario B: Vacant & Unsecured	Scenario C: Demolished	Scenario D: Abandon-ment	Scenario E: Fire Damage
1. Lis Pendens Filing	X	X	X	X	X
2. Operate Chancery Court	X	X	X		
3. Register Sale and New Owner	X	X	X		
4. Delegate Agency Fcl. Prevention Funding	X	X	X	X	X
5. Vacancy Intake	X	X	X	X	X
6. Building Inspections	X	X	X	X	X
7. Maintain Vacant Building Registry	X	X	X	X	X
8. Serving Notice to Secure		X	X	X	X
9. Boarding, Lien Issuance		X			
10. Prepare Case for Administrative Hearing		X			
11. Administer DOAH		X			
12. Prepare Housing Court Case					
13. Administer Housing Court					
14. Police Call			X	X	X
15. Police Make Arrests					X
16. Initial Notice of Demolition			X	X	
17. Notice of Impending Demolition			X	X	
18. Demolition by Contractor, Lien Issued			X	X	
19. Property Tax Losses from Demolition			X	X	X
20. Prepare and Try Demo Case					X
21. Administer Demo Court					X
22. Unpaid Property Tax Losses				X	X
23. Unpaid Utility Tax Losses				X	X
24. Unpaid Water Usage				X	X
25. Mow Lawn/Remove Trash				X	X
26. Fire Suppression					X

End Notes

1 Economists typically refer to these effects as external costs or externalities. The social cost is the combination of these external costs and the costs incurred by the borrower and lender in the private transaction of securing a mortgage loan.

2 A. Cutts, R. Van Order, and P. Zorn, *On the Economics of Subprime Lending*, Freddie Mac Working Paper 04-01, 2004. http://www.freddiemac.com/news/pdf/subprime_012704.pdf.

3 See D. Immergluck and G. Smith, "The Impact of Single-Family Mortgage Foreclosures on Neighborhood Crime," (manuscript version dated January 31, 2005) for a discussion of the relationship between mortgage foreclosures and criminal activity.

4 See M. Duda and W. Apgar, *Mortgage Foreclosure Trends in Los Angeles: Patterns and Policy Issues.* Report prepared for Los Angeles Neighborhood Housing Services, July 2004.

5 The cost of these activities is significant, as evidenced by a study in Buffalo that puts the municipal cost of trash removal alone at $5,000 per lot. For further discussion of the Buffalo study see B. Anderson, "New Jersey Fights Blight," *Affordable Housing Finance*, June 2004: 78-79.

6 CCRC was founded in 2002 to provide point-of-sale counseling for borrowers at risk and, along with its partners, has counseled more than 40,000 homeowners since that time. For additional information and links to participating counseling agencies see http://www.hpfonline.org/processPrograms/ccrc.html.

7 For a discussion of how recent reforms in Michigan are enabling the City of Flint to address issues relating its growing inventory of vacant and abandoned homes, see D. Kildee, "Reusing Forgotten Urban Land: The Genesee County Urban Land Redevelopment Initiative," *Housing Facts and Findings,* Volume 6, Number 2, June 2004: 1-3.

8 For a discussion of these issues, see W. Apgar and M. Duda, *Preserving Homeownership: Community Development Implications of the New Mortgage Market,* a report prepared for Neighborhood Housing Services of Chicago, March 2004. http://www.nw.org/network/pubs/studies/documents/preservingHomeownershipRpt2004_000.pdf.

9 See point 12 of CFAL's "Twelve Key Proposals for Reasonable Compromise" in *National Standards for Mortgage Lending Gain Momentum; Industry Outline 'Reasonable Compromise' Proposals*, press release dated November 17, 2003. http://www.cfal.ws/Directory/CFAL-Materials/CFAL%20Press%20Release%2011-18-03.pdf.

10 A. Shlay and G. Whitman, *Research for Democracy: Linking Community Organizing and Research to Leverage Blight Policy*, University of Toledo COMM-ORG working paper, 2004. http://commorg.utoledo.edu/papers2004/shlay/shlay.htm.

11 For a summary of the literature on the housing spillover effects, see A. Schwartz, I. Ellen, I. Voicu, and M. Schill, *Estimating the External Effects of Subsidized Housing Investments on Property Values*, paper prepared for the Federal Reserve System Conference on Sustainable Community Development, 2003.