WOODSTOCK INSTITUTE
Advancing Economic Security and Community Prosperity

Assisting Underwater Homeowners:

Written Testimony of Tom Feltner
Vice President | Woodstock Institute

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About Woodstock Institute

My name is Tom Feltner, vice president of public policy at Woodstock Institute. I would like to thank Chairman Burke, Chairman Suarez and members of the joint committee for the opportunity to express Woodstock Institute's recommendations for assisting homeowners with underwater mortgages in Chicago.

Woodstock Institute is a leading nonprofit research and policy organization in the areas of fair lending, wealth creation, and financial systems reform. Woodstock Institute works locally and nationally to create a financial system in which lower-wealth persons and communities of color can safely borrow, save, and build wealth so that they can achieve economic security and community prosperity. We conduct research on financial products and practices, promote effective state and federal policies, convene a coalition of community investment stakeholders working to improve access to credit, and help people use our work to understand the issues and develop and implement solutions.

Impact of Negative Equity on Chicago Communities

In Cook County in the fourth quarter of 2011, 245,486, or 26 percent, of mortgaged properties were underwater. Underwater mortgages were far more likely to be concentrated in communities of color. In predominantly white communities, only 12 percent of mortgages were underwater, while in predominantly African American communities, 40 percent were underwater. In predominantly Latino communities, 38 percent of mortgages were underwater.

Table: Loan-to-Value Ratios of Cook County Mortgaged Properties, 2Q2011

Cook County ZIP codes	Mortgaged Properties with Some Equity	Underwater Mortgaged Properties			Percent Under-water	All Mortgaged Properties
		LTV100-124	LTV≥125	Total		
10 Percent or less Minority	56,250	4,939	2,614	7,553	12%	63,803
10-19.9 Percent Minority	179,787	22,635	9,656	32,291	15%	212,078
20-49.9 Percent Minority	297,754	67,405	31,264	98,669	25%	396,423
50-79.9 Percent Minority	79,305	28,677	18,011	46,688	37%	125,993
≥ 80 Percent African American	42,609	16,862	11,709	28,571	40%	71,180
≥ 50 Percent Latino	51,950	18,500	13,214	31,714	38%	83,664
Grand Total	707,655	159,018	86,468	245,486	26%	953,141

Source: Proprietary data on negative equity; 2010 Decennial Census

Homes with negative equity are more likely to go into foreclosure than are homes that have equity. Negative equity can create a cycle in which a growing number of concentrated foreclosures drive down property values, which further weakens the economic security of neighboring homeowners, which then leads to additional foreclosures. Research indicates that homeowners with outstanding mortgage debt that exceeds the value of their home are more likely to default on their loans than are homeowners with some equity in their home.[1] And the farther underwater a home is, the higher the likelihood of default. One report found that homeowners with loan-to-value (LTV) ratios higher than 150 percent are seven times more likely to go into foreclosure than are homeowners with some equity in their homes.[2] Breaking that cycle of declining property values and foreclosures must be our top housing policy priority.

In addition to contributing to more foreclosures, negative equity threatens the success of existing programs designed to prevent foreclosures. Loan modifications that do not include a principal reduction component are more likely to go into foreclosure, or re-default, than are modifications that address negative equity through principal reduction. Underwater homeowners with subprime mortgages who received loan modifications without principal reductions are four times more likely to re-default than are homeowners whose modifications include principal write-down.[3] Options to refinance underwater loans are often limited as well, though policymakers have recently expanded programs designed to facilitate refinancing of loans with negative equity.

Recommendations

Woodstock Institute supports further consideration of seizing underwater mortgages through eminent domain and restructuring those mortgages to ensure long-term affordability. During these considerations, Woodstock Institute strongly encourages the Joint Committee to consider the public benefit of stabilizing communities through principal reductions. Woodstock research has demonstrated that for every new foreclosure filing, the property values of surrounding properties on that block are reduced by one percent, draining approximately $159,000 in home equity from the neighborhood for every property entering foreclosure.[5] Our research also shows that, in cases where foreclosure cannot be avoided through existing loss mitigation programs, there is a significant loss of value once the property is sold post-foreclosure out of real-estate-owned (REO) status.[6] Additionally, research indicates that homeowners with underwater mortgages are less inclined to invest in the maintenance of their property than are other homeowners, which contributes to neighborhood destabilization.[7] Without question, the public good and economic security of Chicago's communities is improved when foreclosure can be avoided through a principal reduction.

[1] Neil Bhutta, Jane Dokko, and Hui Shan. *The Depth of Negative Equity and Mortgage Default Decisions*. Washington, D.C.: Federal Reserve Board, 2010. Print.

[2] *Troubled Asset Relief Fund: Further Actions Needed to Fully and Equitably Implement Foreclosure Mitigation Programs*. Washington, D.C.: United States Government Accountability Office, 2010.

[3] Andrew Haughwout, Ebiere Okah, and Joseph Tracy. *Second Chances: Subprime Mortgage Modification and Re-Default*. Washington, D.C.: Federal Reserve Bank of New York, 2010.

[5] Dan Immergluck, and Geoff Smith. *Risky Business: An Econometric Analysis of the Relationship between Subprime Lending and Neighborhood Foreclosures*. Chicago, IL: Woodstock Institute, 2004.

[6] Geoff Smith, and Sarah Duda. *Roadblock to Recovery: Examining the Disparate Impact of Vacant Lender-owned Properties in Chicago*. Chicago, IL: Woodstock Institute, 2009.

[7] Brian T. Melzer. *Mortgage Debt Overhang: Reduced Investment by Homeowners with Negative Equity*. Evanston, Illinois: Northwestern University Kellogg School of Business, 2010. Print.

Woodstock Institute encourages the Joint Committee to consider proposals that target those underwater mortgages that are most difficult to modify. We are now four years into the ongoing economic and foreclosure crisis and it is clear that the existing loss mitigation strategies have not reached the majority of homeowners facing economic insecurity. The national mortgage settlement reached by state Attorneys General in response to concerns over robo-signing foreclosure documents has resulted in an increase in the number of principal reductions carried out by the five major mortgage servicers that were party to the settlement. At the same time, stabilizing housing values in many communities and a change in loss mitigation policies are driving an increase in short sales, in which the property is sold for less than the value of the current mortgage. However, the vast majority of homeowners in foreclosure still face significant challenges to meaningful loan modifications or "graceful exits" such as a short sale or a deed-in-lieu of foreclosure. Eminent domain should be considered only in circumstances where existing, successful loss mitigation strategies are not available.

Eminent domain should be used to seize and restructure underwater mortgages only if meaningful community participation in both the program design and implementation can be assured. Eminent domain is an important tool that local governments can use to facilitate economic development or promote public health, safety, and welfare. When property is acquired through eminent domain, there must be safeguards, including public input, to ensure that economic development priorities are met and that public health, safety, and welfare are improved. While seizing mortgages does not force a change in the ownership of the property, we believe that public input, due process, and transparency remain critical to the equitable execution of any program that makes use of eminent domain.

I appreciate the opportunity to express Woodstock Institute's recommendations and look forward to working with you as you consider this and similar proposals going forward.

For more information, please contact Tom Feltner, Woodstock Institute Vice President at (312) 368-0310 or tfeltner@woodstockinst.org.