WOODSTOCK INSTITUTE
Advancing Economic Security and Community Prosperity

Struggling to Stay Afloat:

Negative Equity in Communities of Color in the Chicago Six County Region

About negative equity and community stability

The prevalence of homes with negative equity—in which homeowners owe more than their homes are currently worth—prolongs the foreclosure crisis and delays economic recovery. Homeowners with negative equity are often referred to as being underwater.

Negative equity contributes to community decline by potentially leading to increased foreclosure activity, threatening the success of foreclosure prevention programs, and draining neighborhood wealth. In addition, the destruction of assets caused by negative home equity may disproportionately threaten the economic security of people of color because home equity is a larger proportion of their net worth than it is for white people.

The following analysis examines patterns of negative equity in communities of different racial and ethnic compositions in the Chicago six county region in 2011. It finds that negative equity is disproportionately concentrated in the Chicago region's African American, Latino, and majority minority neighborhoods, and that borrowers in communities of color have much lower equity than do borrowers in predominantly white communities. This report concludes with recommendations to reduce the impact of declining property values and the number of homeowners with negative equity, including broader use of principal reduction loan modifications and short sales.

Findings

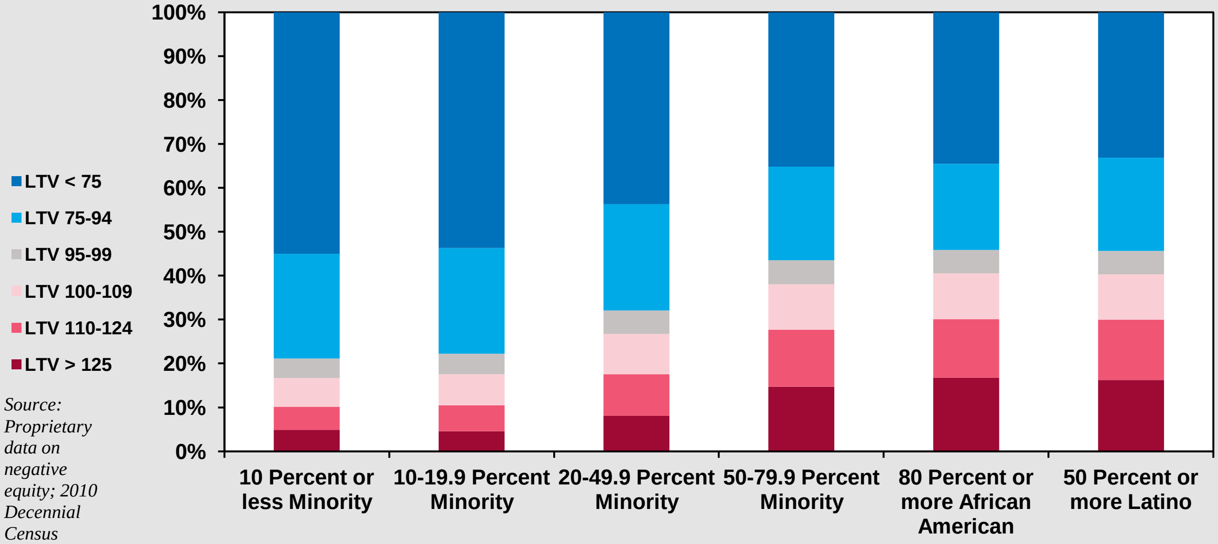
Nearly one in four residential properties in the Chicago six county region is underwater, with just under $25 billion of negative equity. Of the 1,649,389 residential properties with mortgages in the Chicago six county region in the fourth quarter of 2011, 405,413 are underwater. There is a total of $24.7 billion of negative equity in the Chicago six county region, for an average of $60,987 of negative equity per property. The average underwater property has 31.8 percent more outstanding mortgage debt than the property is worth.

Almost half of the properties in communities of color are underwater or nearly underwater. In highly African American communities in the Chicago six county region, 40.5 percent of borrowers are underwater, while another 5.4 percent are nearly underwater (see Fig. 1). Similarly, 40.3 percent of properties are underwater in predominantly Latino communities and 5.3 percent are nearly underwater. In communities where people of color comprise between 50 and 79.9 percent of the total population, 38.1 percent of properties are underwater and 5.4 percent of properties are nearly underwater. In contrast, only 16.7 percent of properties in predominantly white communities are underwater, with another 4.4 percent nearly underwater. Borrowers in communities of color are more than twice as likely as are borrowers in white communities to have little to no equity in their homes.

Almost one-third of the loans in communities of color are severely underwater. Research suggests that once the loan-to-value (LTV) ratio is greater than 110 percent, a borrower is more likely to default on his or her loan. In predominantly African American communities, 30.1 percent of properties have LTVs exceeding 110 percent, while that figure is 30 percent in predominantly Latino communities and 27.7 percent in majority minority communities. In contrast, just 10.1 percent of the properties in predominantly white communities have LTVs exceeding 110 percent. Almost three times as many properties in communities of color are severely underwater compared to properties in white communities.

Only about one-third of homeowners in communities of color have significant equity in their homes. In predominantly African American communities, 34.5 percent of borrowers have LTVs less than 75 percent, while 35.2 percent of borrowers in majority minority communities and 33.1 percent of borrowers in Latino communities have more than 25 percent equity in their homes. Fifty-five percent of borrowers in predominantly white communities have more than 25 percent equity, meaning that borrowers in white communities are more than one and one-half times more likely to have significant equity in their homes than are borrowers in communities of color.

Figure 1. Loan-to-value ratios of properties with mortgages in Chicago six county region, fourth quarter of 2011



Source: Proprietary data on negative equity; 2010 Decennial Census

Recommendations

- **Servicers should use principal reduction as a foreclosure prevention tool more broadly.** While reducing interest rates and extending loan terms may be appropriate for borrowers experiencing problems with affordability, they do not adequately address the factors that contribute to default for underwater homeowners. Servicers should use principal reduction loan modifications more often when they reduce the likelihood of default on underwater loans.
- **The Federal Housing Finance Authority (FHFA) should permit loans backed by Fannie Mae and Freddie Mac to be eligible for principal reductions.** The Federal Housing Finance Authority does not permit principal writedowns on loans backed by Fannie Mae and Freddie Mac, the Government Supported Entities. This means that a large percentage of underwater borrowers do not have access to a principal reduction loan modification, even if it could prevent foreclosure. The FHFA should explore ways to make principal reduction an option for GSE-backed loans.
- **Servicers should streamline processes for short sales.** Negative equity poses challenges when a homeowner wants to sell his or her home, since it is unlikely that the homeowner will be able to sell the home at a price that will cover the outstanding mortgage debt. A short sale allows the homeowner to sell at a price lower than the outstanding debt, but often take longer to complete than conventional sales, which can deter potential buyers. Servicers should continue initiatives to streamline the short sale process.

More information

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