We All Pay A Price For the Foreclosure Crisis

Foreclosures don’t just hurt the family who loses their home – they damage the neighborhood, the community, and the larger economy. That’s why economic forecasts almost always highlight the state of the housing market and the impact of foreclosures. As Federal Reserve governor Joseph Tracy recently put it in his economic outlook for 2011¹:

“The growing inventory of defaulted mortgages continues to weigh down any recovery in the housing market….Problems in housing markets can impact economic growth. Housing directly effects growth through incentives for builders to build new houses…Falling house prices can also negatively impact consumption growth to the extent that homeowners increase their savings in an effort to offset declines in their housing wealth…the protracted process of resolving the overhang of negative equity resulting from the overvaluation of housing during the boom will remain a headwind restraining economic growth for years to come.”

Numerous peer-reviewed research studies have measured the impact of foreclosures and demonstrated the ways their spillover effects harm local neighborhoods and economies.

**Foreclosures Harm Housing Values:** Multiple studies have demonstrated that foreclosures have a negative impact on local property values, particularly during periods of recession. Each foreclosure leads to a drop of about 1 percent in the value of nearby homes.² Using these estimates, the Center for Responsible Lending has calculated that over the 2009-2012 period foreclosures will cut house values by some $1.9 trillion in total. Each foreclosure leads to total home value losses of about $70,000 across the surrounding neighborhood.³ Some of the reasons for these effects include “distress sales” of foreclosed properties, the blight effect of abandoned homes, vandalism, and increases in crime.

**Foreclosures Harm the Broader Economy:** The negative economic effect of foreclosures doesn’t end with declines in home values. Falling home prices have strong negative effects on both consumer spending and investment in new construction.⁴ Declines in consumer spending and declines in construction spending are both major drivers of job loss and unemployment. This increase in unemployment in turn drives further declines in foreclosures, as well as further independent declines in spending and investment. This cycle creates a large “multiplier effect” for the negative economic impacts of foreclosures. [See Figure 1].

Economists have begun to quantify the actual impacts of foreclosures on spending and investment in the current economic recession. By comparing economic outcomes in states which require a judge to make a ruling to approve a foreclosure sale (“judicial states”) vs. those that do
not require judicial approval for foreclosures (“non-judicial states”), economists from the University of Chicago and the University of California at Berkely were able to estimate the effects of foreclosure on the broader economy. Non-judicial states had significantly higher levels of foreclosure than judicial states, and also had greater declines in housing prices and lower levels of consumer spending. These impacts were closely correlated with changes in foreclosures and were dramatic. In fact, the economists estimated that some 15 to 30 percent of the decline in new home construction since 2007 and 20 to 40 percent of the decline in auto sales over the same period is traceable to increases in foreclosures.5

**Foreclosures Create Direct Costs For Local Governments:** The negative economic impacts of foreclosures already have major effects on local governments, as they drive declines in tax revenues. At least two thirds of local government revenues come from the property tax, which is directly impacted by declines in home prices and by foreclosures.6 In addition, sales taxes, the other major source of local revenues, are also very sensitive to the slowdown in consumer spending linked to foreclosures.

But foreclosures also lead to direct costs for local governments at a time when the economic downturn has already stressed their budgets. Harvard economist William Apgar carefully tracked the direct municipal costs incurred by the city of Chicago in executing a foreclosure and then maintaining the home to make sure it was not damaged or vandalized.7 He found that it cost the city about $5,400 to secure and conserve a foreclosed property that had not been abandoned by the owner. If the owner had abandoned the property prior to the foreclosure, which often meant the home had been damaged or vandalized, then costs jumped to over $19,000.

In 2010 there were 2.9 million foreclosure filings.8 If these filings lead to foreclosures, and just 25 percent of the foreclosures result in an abandoned property, then Apgar’s research implies that this creates over $25 billion in direct foreclosure-related costs for local governments.


Rockefeller Institute State Revenue Report, October 2010.


FIGURE 1: THE FORECLOSURE CYCLE

FORECLOSURES

Lower Home Values

Lower Construction Investment + Lower Consumer Spending

Rise In Unemployment