The Accumulation of Bank-Owned Homes

Dan Immergluck

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Moderator: *Welcome to the Federal Reserve Bank of Atlanta's Foreclosure Response podcast series. I'm Karen Leone de Nie with the Federal Reserve Bank of Atlanta. Today we're talking with Dan Immergluck, an associate professor of city and regional planning at the Georgia Institute of Technology in Atlanta. Dan conducts research on housing markets, fair lending, community development finance, neighborhood change and segregation, and related public policies. At Georgia Tech he teaches courses in housing policy, real estate finance, and research methods.*

Across the country increasing numbers of homeowners are facing foreclosure. While some will be able to maintain homeownership by refinancing, loan modifications, or other strategies, some others will not. What happens with these homes, and what is being done to return them to a productive use, is the subject of today's discussion. We're talking to Dan about his research on bank-owned, also known as real estate–owned properties, or REO, in the United States. Dan, thanks for joining us.

**Dan Immergluck:** Thank you, Karen.

Moderator: *Dan, can you explain what is meant by REO?*

Immergluck: Sure, Karen. REO (real estate–owned) properties are the properties, the homes, that banks take back at foreclosure. So, basically, someone goes through the foreclosure process. It's possible for someone else to buy that home at the foreclosure auction, but nine out of ten times, especially nowadays, the bank ends up taking the home back, and then it becomes owned by the lender, and then they try to market it and sell it.

Moderator: *Why is this important to be looking at these bank-owned properties?*

Immergluck: Well, REO properties, especially one- to four-unit (what are called single-family) homes are typically vacant. And if they're on the market for a long time (typically they're on the market for at least three or four months, but it can be a year or longer) then they basically create a drag on the local housing market. They do this in a number of ways. First, a surge in REO properties in a neighborhood basically is creating an excess supply of housing in that neighborhood. And when you have a sudden surge in supply of housing, that means property values in the neighborhood drop, so that becomes a problem for everybody in the neighborhood. A second way is that, especially when they stay on the market longer and especially in markets that are already weak and have some issues, the vacant properties can become vandalized, they can have the copper stripped out of them, and so the properties are devalued in that way, and they create blight, you get boarded-up properties in a neighborhood. And then finally, in some cases, vacant and abandoned properties, especially that are boarded up, that are stripped of their value, can become basically havens for crime—spots where violent and property crime are kind of drawn into the neighborhood.

Moderator: *I know that your research has looked at the accumulation of REO properties. Can you explain how the inventory of these properties varies by different types of metropolitan areas?*

Immergluck: Sure. Basically, what my research over the last year or so has shown is that at a metropolitan level there are three types of metropolitan regions in terms of REO. First, there are a lot of cities, a lot of metropolitan areas, where there's been increases in REO properties but the foreclosure rates have not gone up a tremendous amount. Property values have been relatively stable—of course most metros have seen some property value decline. And I call these Type 1 metros.

Then there are mostly larger, older metropolitan areas, some of these that have had weak housing markets for a while, losing population, that I call Type 2 metros. And many of these cities had relatively high levels of REO even before the national foreclosure crisis—their foreclosures hit sooner [and] they had other kinds of vacant property problems. Most of these cities, as I said, are what folks call weak market cities. But also cities like Atlanta had high levels of REO even before the national crisis. Cities like Chicago, but also cities like Cleveland and Detroit, fall into this category.

And then the third category of metropolitan areas are what people think of as, sometimes, the bubble markets, the "boom-bust" metros—the California metros, the Florida metros, Phoenix, Las Vegas, some East Coast metros—and these areas saw a real housing boom, rapid price appreciation during the high-risk lending boom and then sudden and rapid price declines...At the beginning of the national crisis in 2006, [they] really had no foreclosures because people would be able to sell their house very easily. But then [they] saw very rapid increases to the extent that by late 2008 those metros had really much higher REO levels and REO inventories than the Type 2 cities (the Chicagos, Clevelands, Atlantas, cities like Riverside, California, Las Vegas, Phoenix). So those cities kind of surpassed and became the real foreclosure hotspots in the area—REO hotspots nationally.

Moderator: *So you're talking about metro areas throughout the country. And it makes me wonder: How do state laws affect the volume of REO inventories?*

Immergluck: In particular, state foreclosure policy can really affect how fast REOs accumulate in a metro and how much they accumulate. And there's a couple of different ways they do this. One is, states have widely varying what are called preforeclosure periods, and that's the time between when you get the foreclosure notice in the mail, or it's in the newspaper and it says you're in foreclosure, and the time … your house actually goes to auction at the courthouse steps or in the court there is what's called a sheriff sale. That period can vary from a month or month-and-a-half to a year, depending on state law. So if it takes a long time to go through that process, kind of obviously, then in some states that accumulation of REO is going to be slowed down. So we see a slower accumulation of REO in places like Florida than we do in Georgia, where the foreclosure process is very fast. The other thing that that foreclosure period can do is give people the longer periods—can give people more time to find alternatives to foreclosure. So there's some evidence that, actually, longer foreclosure periods reduce the foreclosure rate in a state.

And then the other part of the foreclosure process that's a bit less common, meaning not all states even have this, is what's called the postsale redemption period. So in some states, after the foreclosure sale happens, you have as owner of the house maybe a month, maybe as much as six months or a year even, to stay in the house and have the potential to get the house back, although that potential is very limited. It's very hard to get the house back after that foreclosure sale. But what it means is the property is technically in REO—it's not completely owned by the bank, but it's functionally owned by the bank, yet they can't sell it. So it's in this kind of limbo. And what we see in states like Michigan, Minnesota, and some others with fairly long postsale redemption periods is metros in those states tend to have very high levels of REO. And it would be one thing if people were actually living in the properties, and in some cases they are during that period; then you might not really think it's a problem because the vacancy problem doesn't occur. But, in fact, anecdotally at least, in many places folks on the ground tell me and others that people tend to leave their houses during that period, often early in that period, because they know they can't get the house back. So then you basically have a house in limbo for six months, and that really doesn't serve anybody's purposes.

Moderator: *You know, we're talking about vacant properties, and I know that people tend to think of vacant properties as a distinctly urban issue. But in your research on REO accumulation, I wonder what you're seeing in terms of this problem in urban areas versus suburban areas?*

Immergluck: Good question. The problem is disproportionately urban/central city, meaning there are, on average, if you take a neighborhood or a ZIP code that's in a central city versus a suburb, on average across all neighborhoods in the country you will tend to see a higher level of REO per property—a higher fraction of properties will be in REO in cities versus suburbs. On the other hand, the notion that it's an entirely central city or urban problem is really not correct at all because there are so many suburbs. And because there are so many suburbs—and the 75 percent of metropolitan areas, on average, are suburban—we see more neighborhoods (in this case I have measured them by ZIP codes) that have very high levels of REO, that are suburban [rather] than urban. In fact, the number of what I call high-REO ZIP codes that are suburban outnumbers the urban ones by about two-and-a-half to one. And in fact when I talked about the different types of metropolitan areas, what we also see is—in the boom-bust, what I called Type 3, metros that have really seen very large increases in REO volumes and inventories—in those it is more suburban than it is in the Type 2 metros. So in the Type 2, the older cities, it tends to be more urban—the Clevelands, the Chicagos, the Detroits. But in the Riversides, the San Diegos, and in Las Vegas, it's either both central city and suburban or a majority suburban problem.

Moderator: *And so you've been talking about a lot of different cities dealing with these issues, and so, what are they doing to respond to the foreclosure crisis and, specifically, these REO properties?*

Immergluck: There's been a lot going on, and it's interesting because some of these metros really didn't have a foreclosure problem before 2008, and certainly not before 2007, especially the Type 3 metros, the boom-bust areas. But a lot of other cities, especially the Type 2 metros, had REO problems earlier, not at the scale that they have today, so especially in those places, and especially in their central cities, there had been on the ground a variety of work going on for quite a while to respond to the foreclosure problems. And there's both a kind of a front-end and a back-end part of the response. On the front end, it's about counseling and working on loan modifications, and on the back end it's dealing with the REO problems and issues around homelessness caused by foreclosures. Some communities have geared up fairly rapidly, but I would say that the communities where there was a problem before 2007 have an advantage. Chicago's the city that comes to mind a lot, as well as Cleveland. Neighborhood housing services in Chicago had a really quite successful foreclosure (both loan modification and foreclosure counseling and property reclamation) REO reclamation program starting as early 2002–2003. But then the second wave of foreclosures hit during the national crisis, and it was very hard for them to keep up with that scale of the problem.

Moderator: *So, in conclusion, what are local governments doing going forward to deal with the foreclosure challenges?*

Immergluck: Good question. On the front end there's still a lot of work trying to get people loan modifications to reduce the continuing stream of foreclosures. The nature of the foreclosure problem has shifted some from a subprime problem to a broader problem that's being really accelerated by unemployment and a variety of just general economic distress. So folks are having to reach out. The problem is definitely more suburbanized everywhere because of the nature of the loans that are going into foreclosure; so the problems are spreading. And, again, it's partly about suburban governments not having history of dealing with these problems before.

On the back end, on the REO side, local governments are starting to pull down funds from the federal government through the Neighborhood Stabilization Program. And this is a roughly $6 billion program now ($4 billion in Phase 1, $2 billion in Phase 2), and they're pulling down the Phase 1 monies to be able to buy properties and reclaim them for different uses, primarily housing uses. So they might be buying vacant houses that need a lot of work, working with nonprofits and for-profits to rehab those. Some of those will become, again, owner-occupied housing, some will become rental housing. But the main focus is to reduce the negative affects I talked about earlier from vacant properties in a neighborhood, to get those properties reoccupied and, in some cases, to demolish some properties. But that's really what local governments are focusing on—and also just getting credit markets working so people who really should be homeowners or can be homeowners can get access to loans and to buy those homes and to keep markets more stable.

Moderator: *Well, Dan, thank you so much for joining us today.*

Immergluck: Thank you.

Moderator: *For more information on foreclosure and REO, see the "Community Development" section on the Federal Reserve Bank of Atlanta's Web site at frbatlanta.org. We've been speaking with Dan Immergluck of the Georgia Institute of Technology. This concludes our Foreclosure Response podcast on bank-owned properties. Thanks for listening. If you have comments or questions, please e-mail podcast@frbatlanta.org.*