

THE REAL DEAL

NEW YORK REAL ESTATE NEWS

For banks, foreclosed homes pile up

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By Alex Ulam

Bedford-Stuyvesant is a neighborhood being pulled in two directions: Burned-out houses sit next to newly built brick townhouses. A block of well-kept brownstones is followed by a block with foreclosed houses, some of which have boarded-up windows and others of which are inhabited by squatters.

Outside 185 Madison Street, a bleary-eyed man wearing a dirty T-shirt, who identifies himself as the property manager for the recent owner, said he has just been served with an eviction notice to leave in 10 days. The two-family house he is standing in front of is listed as having been acquired at a foreclosure auction in November 2007 by Fremont Investment and Loan, a California-based bank.

The two-family is one of the growing numbers of REO properties — Real Estate Owned by investors and banks — popping up throughout predominantly low-income and minority New York City neighborhoods. In the last year, banks and investors have started building up large inventories of REOs, largely because they are having trouble unloading them in a stagnating market where property values are no longer appreciating and where credit for mortgages is harder to come by.

According to the data provider Property Shark, the percentage of foreclosed properties that went through foreclosure auctions in Queens and then ended up as REOs spiked to 91.6 percent in April 2008 from 24.4 percent in April 2006. During that same time, the percentage of foreclosed properties that became REOs in Brooklyn jumped to 81.8 percent from 24.3 percent.

Meanwhile, banks are having an increasingly hard time unloading the properties that didn't sell at foreclosure auction. They generally farm out those properties to brokers and property managers. But unloading REOs at steep discounts could mean major losses for banks and investors in real estate trusts — which invested in mortgage-backed securities and therefore own many of the properties. So while many banks don't like holding REOs, especially in depreciating markets, the lenders have ended up with large inventories of them because they are not yet prepared to slash prices.

Brian Silvestry, whose self-named Long Island City-based company specializes in

marketing REO properties for mortgage servicers, said servicers are now discounting REO properties a bit more than they have in the past at foreclosure auctions.

"Once it is an REO, and if it is a decent house, which is pretty rare, you are going to see a discount of about 10 percent," he said.

"But the ones that need a lot of work are going to be discounted a little more, percentage-wise, for the people who are handy themselves or who are a general contractor — those are very good bargains," said Silvestry.

In raw numbers, Queens had 629 REOs in March 2007, which jumped to a stunning 2,391 in May 2008, while Brooklyn saw a spike from 285 to 737 during the same period, according to Property Shark.

The problem is only expected to intensify as more homes throughout the city go into foreclosure.

Furthermore, foreclosed homes that become REO properties are widely viewed as having a potentially devastating effect on neighborhoods.

According to New York University's Furman Center for Real Estate and Urban Policy, properties adjacent to vacant or abandoned buildings typically sell for 28 percent less than comparable properties located farther away, and the negative associations are still significant on buildings located at distances of up to 2,000 feet from a vacant home.

Many houses that go into foreclosure, the argument runs, are already in bad shape because homeowners in default on their mortgages often don't have the resources to maintain them. After foreclosure, when a property becomes vacant, it is often subjected to further neglect and turns into a magnet for crime and vandalism. Worse still, according to new numbers by Furman, there are 2,411 households facing foreclosure proceedings in Bed-Stuy alone.

"Even in very strong neighborhoods where you have one vacant home, you can see the impact — the graffiti, the neglect," said Sarah Gerecke, chief executive of Neighborhood Housing Services, an affordable housing organization that serves low-income communities. "In hard-hit neighborhoods, you can see two properties vacant on a block and another three with 'for sale' or 'for rent' signs — there is danger from vermin, and a big problem we are seeing is the theft of copper pipes in these vacant properties."

The overvaluation of properties in some neighborhoods also appears to be a major factor behind the slowing business at the foreclosure auctions. Generally, at the foreclosure auctions, the starting price, also known as the upset price, is the amount of the mortgage. But now that property values are no longer appreciating in many low-income neighborhoods, there is generally little or no money to be made purchasing a home for the amount of the outstanding mortgage.

"You can only inflate property values so long before the bubble pops," said Lionel Ouellette, executive director of Changer NYC, a homeowner organization that works with low- and moderate-income communities. "And now that it has popped, you have such large outstanding balances on these homes that nobody is going to buy them at the auction — not an individual coming in to look for a deal, not the well-established investor."

Josh Zinner, co-director of the Neighborhood Economic Development Advocacy Project, an advocacy group that works with low-income communities, said it would make more sense for the banks and investors to modify mortgages than to foreclose. Although foreclosure actions can end up costing the trusts and banks, which own the mortgages, significantly more money than it would to modify the loan in a depreciating market, Zinner said mortgage servicers are more inclined to foreclose.

"The problem is that the servicers make a lot more money from the fees they get for doing foreclosures than they do from modifying mortgages," Zinner said. "So you have these backwards incentives — when what they should be doing is modifying these loans as much as possible — especially when there is more due on the property than the property is worth."

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