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Can New York Avoid a Foreclosure Crisis?

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A decade ago, the Queens Supreme Court handled about 300 or 400 foreclosures a year. In 2007, that number soared to more than 7,500 foreclosures, and the court is on track to see 10,000 foreclosures before this year ends, according to an official.

In the next few years, one out of every 32 homeowners in New York state is projected to enter foreclosure, according to a report issued by the Pew Charitable Trusts.

In New York City, neighborhoods in Queens, Brooklyn, as well as parts of the Bronx and Staten Island, will be the hardest hit: In 2007, for example, foreclosures in Queens and Brooklyn accounted for 40 percent of the state's total. (Co-op foreclosures, which are governed by a different set of rules, are not processed by the court system and are not included in projected foreclosure totals.)

What media outlets call the mortgage meltdown is receiving more and more local and national attention, most of which is centered on the often tragic and personal financial consequences foreclosure presents for individual homeowners. It takes a trip to a foreclosure auction, held every Friday morning in Queens, to see another dimension of the problem: The properties aren't selling.

When the market was hot, eager speculators crowded the auctions looking for a bargain. Today, the overwhelming majority of properties are "bought" back by the bank that made the original loan. The bank must then try to recoup what it can by reselling the property, a dicey proposition in today's market. The result is a growing glut of vacant and unsold property.

The Costs of Foreclosure

The consequences of this foreclosure gridlock can be seen only a few short miles away from the courthouse in South Jamaica, Queens, where a reporter from the Daily News recently counted 32 foreclosed homes in a five-block area. None of them has fared well. A squatter moved into one abandoned property, smashed the front window and scattered trash in the yard. Another home became a crack house. "You see drugs, you see young kids coming through, adults passing through. It's a disaster," one South Jamaica resident told the reporter.

Situations like these have led some housing experts to make grim predictions about the years ahead. "Abandonment of the 1970s, where entire blocks are stripped ... is what this will look like" Sarah Gerecke of Neighborhood Housing Services told the Daily News.

No one benefits from housing foreclosure. For borrowers, it means, at minimum, a lost home and badly damaged credit. Foreclosure is also a losing proposition for lenders. According to the Pew report, the average cost of a foreclosure is $58,759 in foregone interest, court costs and other fees, or between 20 and 60 cents on the dollar.

Yet the highest costs of foreclosure may be borne by the public, in the form of falling property values, higher crime rates and other costs to government. Researcher www.coa.gatech.edu/crp/facstaff/immergluck.htm Dan Immergluck of the Georgia Institute of Technology estimates that property values decline by 1 percent for every foreclosure within one eighth of a mile of a single-family home, meaning that even homeowners who pay their mortgages regularly are hurt by foreclosed house on nearby blocks.

Government takes a big hit as well, in the form of reduced tax receipts, including sale, transfer and property taxes. All told, the Pew report estimates that New York's property tax base will be reduced by $65 billion in the coming years as a result of what they call the "foreclosure effect". And the bill doesn't end there: Researchers at the Harvard Joint Center for Housing Studies identified 26 separate costs borne by government in "foreclosure related services," such as increased police patrols and trash removal, which cost $7,000 on average and as much as $34,199 per property.

The Challenge of Foreclosure Prevention

While these hefty costs mount up, there is some evidence that foreclosure prevention programs save money for everyone. According to the housing agency Freddie Mac, every dollar spent on a foreclosure prevention program based in the Twin Cities in the mid-1990s saved lenders $3 in direct costs, even though after two years only 224 of the 800 homeowners helped by the program remained in their homes.

Yet a number of obstacles stand in the way to preventing foreclosure. One is financial: Many home loans simply cannot be salvaged. A number of homeowners owe more money on their home than the property is worth or have monthly payments that exceed their income. It's difficult to imagine a scenario where these "bad" loans can be renegotiated, because they should have never been made in the first place.

As housing prices continue to fall, the problem could get much worse: One financial analyst told the International Herald Tribune that an additional 10 percent drop in home prices would lead to 20 million households nationwide that owe more on the mortgage than the value of their home. In that scenario, millions of homeowners could walk away from their homes.

Another obstacle relates to the nature of the loans themselves. About two thirds of mortgage funding is provided by institutional investors who buy mortgage backed securities, and contract out the task of foreclosure to third-party agents, known as "loss mitigators," who, in some cases, are barred from renegotiating with borrowers.

The result is paralysis. "In a healthy market, foreclosure would be rare, because it pays for a lender to forgive, say, 20 percent of a loan rather than booting the homeowner out and seeing 30 percent of the property value evaporate in the process of eviction," wrote Sebastian Mallaby in the Washington Post. "But because mortgages have been sliced up and distributed among far-flung investors, it's difficult to get their consent for partial forgiveness."

Still, there are signs that the foreclosure game is changing: In March, the Wall Street Journal reported that out-of-work mortgage lenders, fueled in part by $180 million in funding for mortgage counseling provided by Congress, are finding work counseling homeowners on ways to hold on to their homes.

The Role of the Courts

New York is one of 10 so-called judicial foreclosure states where courts manage the sad journey to foreclosure and so are struggling to catch up with the rising numbers. Along with Queens, the Bronx is experiencing caseload growth, albeit at a slower rate: 1,247 filings in 2007, compared to 881 in 2006. The increase has led to delays, as court officials are only now getting around to cases filed in December.

The court procedure has not been set up to prevent foreclosures. Officials say it's very rare to see a homeowner show up in court at any point during the process. Most never respond to the initial summons informing them of the court action.

Housing advocates believe that the judicial foreclosure process is fundamentally flawed. "People get overwhelmed when they get served papers, and there's no one they can turn to for help" said Josh Zinner, co-director of the Neighborhood Economic Development Advocacy Project. The result, according to Zinner, is a "pro forma foreclosure mill" where more than 90 percent of borrowers served with foreclosure notices default.

Ohio is one judicial foreclosure state that is trying to rewrite the rules of how courts respond. Hit by 85,000 foreclosures in 2007 --Ohio has 3 percent of all nationwide home loans, but 6 percent of foreclosures -- the state created an ambitious program, called "Save the Dream," that recruited 1,100 attorneys to provide voluntary legal counsel to homeowners facing foreclosure. Free legal assistance is available to anyone making less than $54,000 a year.

Judges also have the authority to order mediation in cases where they believe a settlement is possible. Summit County, which includes the city of Akron, has been aggressive about using mediation to settle foreclosure cases. In the first three months of 2008, mediators handled 37 foreclosure cases, which resulted in 26 settlements, according to Frank Motz, chief mediator of the Summit County Court of Common Pleas. In some cases, lenders agreed to sharply reduce interest rates on a loan; in others, they've added the unpaid balance and other fees to the end of a mortgage to help a borrower get back on track.

Mediation can even help in cases where loan modification is not an option. In what is known as a deed in lieu of foreclosure resolution, Servicers agree to forgive some debt if a homeowner agrees to an immediate transfer of the property. This has the effect of saving the servicer time and money, while letting homeowners walk away with their credit intact. Not incidentally, it also removes a burden on the court by taking a case off the books.

Motz expects the number of court-ordered mediations to triple in the months ahead. "Lenders are more and more interested in working out settlements," he said. Still, there are limits to this approach, as Motz freely admits. Even in a best-case scenario, according to Motz, more than half of all foreclosures would still proceed over the traditional court path.

What New York Can Do

Encouraging mediation is just part of what Ohio is doing to stem the foreclosure process. In early April, Gov. Ted Strickland announced a nonbinding agreement with nine large loan servicers to encourage modifications on a large scale, according to the Cleveland Plain-Dealer.

New York is experimenting with a variety of approaches. As Michelle Chen reported in Gotham Gazette, New York City recently launched the Center for New York City Neighborhoods to provide mortgage counseling and legal assistance to at-risk homeowners.

State government has also tried to address the problem, albeit with mixed results. In July 2007, New York committed $100 million to an emergency loan fund, with the goal of helping 500 to 700 families refinance at-risk loans. The program is aimed at converting interest only, adjustable rate mortgages into fixed rate 40-year mortgages. According to the Washington Post, however, only three families have signed up, leading to calls to expand eligibility criteria.

Most states can afford to help only a limited number of homeowners - and only if lenders are willing to take steep price cuts. "The numbers don't add up," said Sarah Gerecke of Neighborhood Housing Services of New York City. "The prices are too high and the conditions of the properties aren't good," she said.

A third, and more controversial, solution involves creating a one-year moratorium on foreclosures in New York. Such legislation already has 60 Assembly co-signers, according to the New York Times, and advocates believe the bill has a good chance of passing this summer. Although the Times reported that the moratorium would apply to all court-ordered foreclosures, the language of the bill seems to suggest that it would apply only to owner-occupied homes where the homeowner does not own any other property. Industry representatives have argued that, by making it harder to foreclose on a property, the moratorium would raise borrowing costs for all homeowners.

In New York, court-ordered foreclosure already takes 12 to 18 months to complete, which presumably gives borrowers time to work out a solution. And a moratorium alone is not a panacea, as officials in Philadelphia discovered after they introduced a one-month moratorium on foreclosures in March. "A moratorium just causes a freeze -- and then what," Judge Annette Rizzo told the Philadelphia Inquirer.

Many experts believe that, if anything, the foreclosure process is too long, particularly for homes that are not owner occupied. Ohio is considering creating a separate track for investor-owned properties that will allow foreclosure proceedings to occur more quickly, which, they hope will reduce the time that many properties stay vacant.

A More Comprehensive Approach

Advocates want the federal government to take a more comprehensive approach to the foreclosure problem. "[States] don't have the resources or the regulatory authority or leverage with the industry," Bill Faith, Executive director of the Coalition on Homelessness and Housing in Ohio, told the New York Times. "Much more serious progress is only going to be achieved if the feds take appropriate action."

The Senate and the House has each passed different measures to address the foreclosure crisis by providing money for pre-foreclosure counseling. The House bill includes $15 billion in loans and grants for local government and nonprofits to buy and renovate vacant foreclosed homes. The Senate bill has a $7,000 tax credit for purchasers of foreclosed homes, while the House version dedicates its tax credit to first-time homeowners.

Both the House and the Senate are considering creating a $300 billion to $400 billion loan fund to encourage the pre-foreclosure refinancing of 1 million at-risk home loans. The loans would be guaranteed by the federal government and would be rewritten by lenders at no more than 90 percent of their current value.

Competing proposals in Congress will set off a major political struggle, as Americans debate whether the fund amounts to an unfair bailout for troubled homeowners and lenders. For New Yorkers, it may represent the only means available to hold off a wave of foreclosures with negative effects for everyone.
