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# Housing submarkets and the impacts of foreclosures on property prices

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## ABSTRACT

The dramatic rise in the number of foreclosed properties since 2006 has come to assume the proportions of a national crisis. It is widely acknowledged that foreclosures hurt neighborhoods by devaluing the nearby properties through various channels. This paper offers a new way of conceptualizing and then estimating the potential effects of foreclosures on property values. Housing stock heterogeneity in the central city old neighborhood allows for the possibility that the impacts of nearby foreclosures may differ across types of housing. This study uses a dataset that covers twenty years of housing values from the City of Worcester (MA), and finds evidence that foreclosures of multi-family houses in close proximity influence the sales price of surrounding single-family properties after controlling for impact from foreclosure of nearby single-family houses. The most preferred estimate suggests that each multi-family foreclosure that occurs between 660 and 1320 feet away from the sale lowers the predicted sales price by approximately 3%. Nearby multi-family spillover impacts also persist over time. In addition, a new approach advocating for an alternative definition of housing submarket suggests that a distant foreclosure within the same submarket also lower sales price of a single-family home by 0.1%.

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## 1. Introduction

The dramatic rise in the number of foreclosures since 2006 has come to assume the proportions of a national crisis. Foreclosure allows a lender to claim legal rights to the amount owed on a defaulted loan by selling or taking ownership (repossession) of the property securing the loan. Foreclosed properties are likely to sell at discount, both because they may have been physically damaged during the foreclosure process, and because lenders have an incentive to sell them quickly to reduce their holding costs. However, there is a widespread concern that foreclosures may negatively affect neighborhoods by lowering the prices of nearby properties. In the event of foreclosure, properties may sit vacant, reducing the visual appeal and more likely to be attracting vandalism and crime (Immergluck and Smith, 2006; Schuetz et al., 2008; Rogers and Winter, 2009; Campbell et al., 2011). Even the crime-free well maintained

vacant properties may depress nearby property values by adding to the local supply of available units. Foreclosures could also affect the price of “comparables” used to estimate neighboring property values (Lin et al., 2009).

This study offers a new way of conceptualizing and then estimating the potential impacts of foreclosures on non-foreclosed property sales price. It examines how definitions of housing submarkets may influence the estimated impacts of foreclosures on non-foreclosed property sales prices. The traditional approach implicitly assumes homogeneous housing stocks, and narrowly defines submarkets spatially. It typically uses spatial proximity view to measure such spillover effects. In contrast, this study introduces a new approach, which accounts for housing stock heterogeneity (especially in the context of central city neighborhoods). This in turn firstly allows for the possibility that the impacts of nearby foreclosures may differ across types of housing. For example, multi-family foreclosures can affect nearby single-family properties. Secondly, it suggests that an alternative definition of a non-localized

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**Table 1**  
Demographic comparisons across cities.

City	Worcester (MA)	Springfield (MA)	Cincinnati (OH)	Providence (RI)	New Haven (CT)
Population density (per square mile)	4592	4738	4239	9385	6541
(%) White population	77	56	53	55	44
(%) Black population	7	21	43	14	37
Per capita income in 1999 dollars	18,614	15,232	19,962	15,525	16,393
(%) Below poverty level	18	23	22	29	24
Housing density (per square mile)	1881	1906	2128	3671	2801
(%) Occupied housing unit	95	93	89	92	89
(%) Owner-occupied housing unit	43	50	39	35	30
(%) Single-family unit	37	49	39	26	25
(%) Multi-family unit	45	35	35	59	50
Median block group level multi-family house (%)	37	24	49	51	24
(%) Built before 1960	66	67	69	70	62
Median year structure was built	1946	1951	1948	1943	1951
Median gross rent as a % of household income in 1999 dollars	25	28	25	28	30
Owner-occupied housing units: Median value	118,400	86,500	93,200	101,700	104,300

Notes: Above information is based on the data from U.S. Census (2000). Multi-family units consider up to 19 units only. The median block group level measure is based on an adjustment made towards transforming housing units to number of houses. This measure represents the percentage of multi-family houses at the census block group level.

submarket may also be appropriate in terms of estimating the impacts of foreclosures. It allows for the possibility that houses that are not close by could be viewed as substitutes and those spatially separated foreclosed properties may exert downward pressure on the prices of non-foreclosed properties by adding to the supply of already available dwelling units in the entire submarket.

This study is based on the housing market in the City of Worcester, Massachusetts, a mid-sized New England city. Worcester can be used as an example of a large number of middle-sized cities that have a spatial mix of housing rather than homogenous neighborhoods of one type or the other.<sup>1</sup> Table 1 indicates that Worcester is indeed similar to other older cities based on a set of demographic characteristics. Especially, the median block group level measure reveals that half of the census block groups in each of these cities contain at least 25% of multi-family houses. This in turn gives an overall idea of housing stock heterogeneity in these older neighborhoods. The city had also experienced a faster rise in home prices followed by a more rapid fall in recent years and has been hit the hardest by foreclosure fallout, which is evident from the Fig. 2. It also shows that the incidence of multi-family foreclosure is a serious issue, and generally higher than that of the single-family foreclosures.

In an effort to detect spillover effects of foreclosures, this study distinguishes between foreclosures on single- and multi-family dwellings that take place within 660 feet (one-eighth of a mile) and within 1320 feet (one-quarter of a mile) of each single-family transaction in the dataset. The coverage of the dataset is the period from 1991 to February 2008. There is evidence that properties in close proximity to foreclosures sell at a discount. The most preferred estimate suggests that within a 660 foot radius of the subject property, each single-family foreclosure reduces the value

of nearby single-family properties by approximately 1%. That result is consistent with the current literature. Immergluck and Smith (2006) find that each additional single-family foreclosure within one-eighth of a mile is associated with roughly a 1% decline in single-family property value in Chicago. Leonard and Murdoch (2009) report a similar price discount from every additional foreclosure within 250 feet of a sale of a single-family home in the Dallas County. Recently, an estimate by Campbell et al. (2011) indicates an average price discount of 1% due to a marginal foreclosure occurring within 0.05 mile of the subject property in the state of Massachusetts. In contrast, Lin et al. (2009) report a significant negative impact of up to 8.7% on neighborhood property values up to 0.9 km from the foreclosure, and up to 5 years after the foreclosure in Chicago PMSA.

More crucially, this study finds evidence that foreclosures of multi-family houses in close proximity influence the sales price of surrounding single-family properties after controlling for impact from foreclosure of nearby single-family houses.<sup>2</sup> Multi-family foreclosures have an impact up to one-quarter mile away from the subject property. The most preferred estimate suggests that each multi-family foreclosure that occurs between 660–1320 feet away from a subject single-family dwelling lowers the predicted sales price by approximately 3%. Such nearby multi-family spillover effects are also persistent over time. In addition to the local spillover effects, a distant foreclosure within the entire submarket for a single-family house has a substantial negative impact of about 0.1% on the property sales prices.

The organization of the paper is as follows. The following section discusses the research hypotheses. Data and research methodology make up section three. Results are discussed in section four. Section five concludes the paper.

<sup>1</sup> Fig. 1 shows the basic facts about the spatial pattern of different types of housing in the City of Worcester.

<sup>2</sup> Foreclosure sales deed indicates the end of the foreclosure process.

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