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When does delinquency result in neglect? Mortgage distress and property maintenance

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ABSTRACT

Numerous studies have found that foreclosed properties sell at a discount and push down the sale prices of nearby properties, which may be partly driven by poorer maintenance of the foreclosed homes. However, direct evidence of foreclosure-related property neglect has been scarce. This paper uses data on constituent complaints and requests for public services made to the City of Boston to examine the incidence and timing of this type of foreclosure externality. Interior and exterior property conditions appear to suffer most while homes are bank owned, although complaints about reduced maintenance are also common earlier in the foreclosure process.

1. Introduction

The recent mortgage foreclosure crisis spurred numerous policy initiatives at the local, state, and federal levels to tackle vacant, abandoned, and undermaintained properties. Congress, for example, authorized nearly 7 billion dollars of spending between 2008 and 2010 for the Neighborhood Stabilization Program, funding a variety of activities to reduce foreclosure-related blight (Spader et al., 2015). In the academic community, researchers have debated the extent to which foreclosures are responsible for poor property conditions, with a particular emphasis on whether physical externalities exist that harm neighboring owners. This paper investigates the relationship between the foreclosure process and property conditions in Boston, Massachusetts.

A growing body of research has found that foreclosed properties negatively impact the prices of houses sold nearby (Immergluck and Smith, 2006; Schuetz et al., 2008; Campbell et al., 2011; Hartley, 2014; Ellen et al., 2012; Anenberg and Kung, 2014; Fisher et al., 2015; Gerardi et al., 2015).[2] One line of reasoning is that when foreclosures result in vacancies and decreased maintenance, this "disamenity" harms neighboring properties, and as a result they sell for less. A competing explanation is that foreclosures increase the supply of low-cost properties on the market, creating competition for neighboring sellers.[3] Researchers have come to different conclusions about which of these channels explain price spillovers. For example, Hartley (2014) finds a supply effect but no measurable disamenity effect in his study of Chicago, and Anenberg and Kung (2014) find evidence of disamenity effects only in high-density, low-price neighborhoods in the four metro areas they study. In contrast, studying fifteen U.S. metro areas, Gerardi et al. (2015) argue that foreclosure spillovers can be explained entirely by property condition, which they speculate is associated with deferred maintenance by lenders and financially distressed

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[2] For a summary of the evolution of the existing literature on foreclosures' price spillovers, see Frame (2010) or Gerardi et al. (2015). In related studies, Harding et al. (2012), Clauretie and Daneshvary (2009), and others quantify the discounts at which REO properties themselves are sold. As Clauretie and Daneshvary explain, these discounts can be explained by deteriorating property conditions, stigma effects, or urgency on the part of the lender.

[3] Foreclosures may also reduce area house prices by providing low priced "comparables" for assessors to use in the valuation process (Lee, 2008). In the event that they are used, appraisers are instructed to adjust their calculations accordingly (Ellen et al., 2012), though in practice, it is hard to know how often—or accurately—such adjustments are made, particularly since there is debate over the extent to which experiencing foreclosure affects a property's sale price.

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homeowners. In fact, they find that well-maintained properties that experience foreclosure do not harm their neighbors' sale prices. Examining condominium foreclosures in Boston, Fisher et al., 2015 find that externalities are strongest for owners located in the same condo building (not simply the same condo association) as a foreclosed property. They interpret this as evidence that foreclosure-related undermaintenance and vacancy within one's building, coupled with condo association financial solvency in smaller associations, drive foreclosures' impacts on house prices, rather than increased supply being the mechanism.

Lenders and the servicers acting on their behalves may lack the ability to properly oversee real estate owned (REO)—that is, bank-owned—properties or may not have sufficient incentives to keep them well maintained. Disinvestment can also occur before a lender takes control of a property. Borrowers who are in the foreclosure process may undermaintain properties, either because of the financial distress that led them to default or because they expect to lose their homes in the near future. This latter effect may even extend to borrowers who have not defaulted but simply owe more in mortgage debt than the value of their homes. As Haughwout et al. (2010) argue, "with little to gain, negative equity homeowners will be much less likely to pursue improvements in their homes or communities. Their situation is essentially analogous to that of renters, who have little incentive to make improvements to the homes they occupy since it is the landlord who reaps the economic benefits," (p. 3). Indeed, using the Bureau of Labor Statistics' Consumer Expenditure Survey, Melzer (2012) finds that borrowers with negative equity spend 30 percent less than positive equity homeowners on home maintenance and improvements.

Clauretie and Daneshvary (2009) and Harding et al. (2012); and others document the poor conditions of many foreclosed properties in communities around the country, which may be a product of disinvestment during the foreclosure process, or perhaps homes that end up in foreclosure and bank ownership are simply of poorer quality and upkeep to begin with. Without panel data, it is difficult to identify if or when property conditions change. Using an administrative dataset from Boston, I capture information on the timing of when residents in a neighborhood report problems about particular properties to local government. Complaints include issues like rodent activity, squatters, broken windows, and failure to clear snow from sidewalks or properly store trash. I link this property-level dataset of constituent complaints and requests to five other datasets—a property-level dataset of sales transactions and mortgage originations, tax assessor's data, code violations, a loan-level dataset of mortgage performance for securitized subprime and Alt-A mortgage borrowers,[4] and real estate sale listings data from the area multiple listing service. Using this six-part, master dataset, I estimate multilevel longitudinal models to compare the incidence and timing of complaints, identifying when in the delinquency and foreclosure process a property becomes the subject of complaints.

I find that the frequency of complaints about property maintenance varies during different stages of the foreclosure process. Specifically, borrowers appear to begin neglecting maintenance when they are seriously (90 days or more) delinquent, and complaints about property conditions become even more common once the foreclosure process begins. But properties are most likely to be the subject of constituent complaints when they are bank owned. Properties that are owner occupied, in particular, experience escalating complaints once bank owned—they are four or more times as likely to be the subject of a constituent complaint when REO as before the borrowers became delinquent. These findings apply to a broader sample of securitized and portfolio, prime and nonprime mortgage borrowers and to most types of maintenance studied, including internal and external conditions.

Although banks have an incentive to maintain properties to maximize return when they resell them, in reality it is hard for them to regularly monitor properties and to respond to problems as they emerge. Interestingly, complaints about property conditions become somewhat more frequent in the initial months after a foreclosure auction—immediately after the bank takes control, but once properties are listed for sale by the banks, complaints decline. Once a property is assigned to a real estate agent, it is better monitored and its condition is improved to prepare it for sale on the market.

These findings are broadly consistent with previous work. Gerardi et al. (2015) find that in most metro areas foreclosure price spillovers peak when neighboring properties are bank owned, though in several areas spillovers peak earlier, while still owned by seriously delinquent borrowers. Harding et al. (2009) come to a similar conclusion. Ihlanfeldt and Mayock (forthcoming) also find a negative effect of bank ownership, an effect which quickly abates once properties are purchased by owner-occupants.

2. Data sources

I investigate the relationship between foreclosure events and property condition complaints in Boston using a six-part, property-level panel dataset. I begin with a dataset of mortgage and sale transactions, which I merge with a monthly loan-level panel on mortgage performance. I combine these data with three administrative datasets from the City of Boston: tax assessor's data, constituent complaints about a variety of interior and exterior property conditions, and code violations relating to three types of exterior maintenance conditions.[5] Finally, I match these data to property-level information from the local multiple listing service on sale listings posted by real estate agents. The datasets are described more thoroughly in the following sections, and the information I use from each is summarized in Table 1. A description of the matching procedures can be found in the online appendix.

2.1. Property transactions, mortgages, and foreclosure starts from public records

The foundation of my combined dataset is public records data on property transactions (deeds of sale), mortgages, and foreclosure starts for single-family, two-family, and three-family properties in Boston.[6] The data, based on information from the county registry of deeds and the Massachusetts Land Court, are compiled, cleaned, and processed by the Warren Group, a New England-based company. All deeds, mortgages, and foreclosure starts have complete address information and assessor's parcel numbers. Foreclosure starts (also called "foreclosure petitions" or "foreclosure complaints") signal that a borrower has defaulted and the lender has accelerated the remaining mortgage payments, meaning that the borrower must either pay off the entire balance of his mortgage or lose the property to foreclosure.

2.2. Tax assessor's data

I then combine the Warren Group public records data with the tax assessor's data for each property in Boston. From this dataset I

[4] As Haughwout et al. (2008) explain, "Subprime mortgages are small loans (compared to Alt-A loans) and are often made to borrowers with some blemish on their credit history, or who are willing to commit large shares of their incomes to debt service. Alt-A mortgages are typically larger value loans made to more creditworthy borrowers who, for a variety of reasons, may choose not to provide the income or asset verification required to obtain a prime mortgage," (249). The CoreLogic dataset includes essentially all private-label securitized subprime and Alt-A mortgages originated in 2003 and later.

[5] Information identifying individual consumers, properties, or banks was stripped from the datasets prior to matching loan-level data.

[6] Condominiums are excluded from the analysis because unit numbers are often not reported in the constituent complaints dataset.