

Research Review: Spillover Effects of Foreclosures on Communities

By Kai-yan Lee

A house is not just a physical shelter, but also a stitch in the fabric of society, integrating its residents into the life of the larger community. That is why foreclosures may hurt neighborhoods as much as they hurt those who lose their homes. Foreclosures may negatively impact a community when they depress the values of nearby properties, reduce the property tax base, increase blight and crime, and disrupt local social ties. Below we summarize some of the research that examines foreclosures' effects on the prices of nearby properties.¹

Early Research on Spillover Effects

Foreclosures are thought to negatively impact the values of nearby properties via three channels. The first is blight. Before foreclosures occur, owners with delinquent mortgages usually have limited means to maintain or upgrade their houses, which may contribute to neighborhood blight. After foreclosures, the properties may be vacant for some time, attracting vandalism and crime and further exacerbating blight. The second channel is valuation. Property appraisal is partially based on sales prices of nearby comparable properties. Foreclosed properties are usually sold at a significant discount, which can lower the valuation benchmarks used in appraisals of nearby properties. The third channel is supply. A high concentration of foreclosures can create a glut in the supply of available properties, thereby lowering the values of nearby homes, especially in areas with stable housing demand.

Early Minneapolis surveys by Moreno (1995) suggest that a foreclosed home could detract from the value of another house in its neighborhood by as much as \$10,000, mostly because of declined property values. A Cleveland study by Maric et al. (1998) suggests that, on average, a one-percentage-point increase in property tax delinquency (a proxy for foreclosure) could decrease a nearby property's sales price by \$788, holding all other conditions constant.

Recent Research

A series of studies on foreclosures' spillover effects that made use of sophisticated mathematical models emerged in 2006. Shlay and Whitman (2006) found that the presence of abandoned properties in Philadelphia, of which many were in foreclosure, depressed the prices of properties located within 150 feet by \$7,627, an effect that diminished with distance. In a widely cited study, Immergluck and Smith (2006) estimated that, on average, a foreclosure within 1/8 mile of a single-family home in Chicago could lower its sales price by 0.9 percent, holding all other conditions constant.²

Been's research (2008) on New York City indicated that each additional pre-foreclosure (i.e., a pending foreclosure petition) within a neighborhood had diminishing marginal (negative) spillover effects. This suggests the importance of preventing pre-foreclosures from happening in the first place since the first few have the larger spillover impacts.

Lin et al. (2009) analyzed foreclosure spillover effects in Chicago with special attention to their longitudinal and spatial aspects. The price-depressing effect was most severe on adjacent properties (-8.7 percent), and it diminished to as low as -1.7 percent at about 0.6 miles of distance. Similarly, the price-depressing effect diminished with time: it lowered nearby home sales prices by as much as -8.7 percent within two years of foreclosure, but diminished to -5.5 percent after three to five years and -4.4 percent after six years. The study showed that the intensity of the spillover effects was closely impacted by housing cycles. The effects were half as intense during housing market boom years.

Mikelbank (forthcoming) separates the spillover effects of pre-foreclosure in Columbus, Ohio, from that of vacant/abandoned properties. The study concludes that pre-foreclosures' negative impact on nearby homes' sales prices is less than that of vacant/abandoned properties, but the former effect is more spatially robust. On average, a pre-foreclosure within 250 feet of a property could impact its sales price by -2.1 percent, holding all other conditions constant; but such impact intensifies to -3.6 percent if the property is within 250 feet of a vacant/abandoned property. Nonetheless, a pre-foreclosure's negative impact diminishes to -1.6 percent (i.e., a half-percentage-point reduction in intensity) as the distance increases to 250 to 500 feet, while a vacant/abandoned property's negative impact drastically decreases to merely -0.6 percent at the same distance (i.e., a three-percentage-point reduction in intensity).

What the Research Suggests for New England Communities

These studies confirm that foreclosures can depress nearby properties' sales prices. Their specific findings are not necessarily generalizable for New England, as local housing market conditions and spatial features could critically alter the spillover effects. There are some recent studies that attempt to provide back-of-the-envelope estimates of such effects on the region (see reports by the Majority Staff of the Joint Economic Committee report, 2007, and Center for Responsible Lending, 2008). The actual extent of foreclosures' spillover effects on New England communities is subject to further research. However, it is certain that these impacts exist, suggesting there is a need for a coordinated response to foreclosures that includes efforts to protect the vitality of local communities.

Sources

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Endnotes

¹ A longer version of this research review appears in Kai-yan Lee's "Foreclosure's Price-Depressing Spillover Effects on Local Properties: A Literature Review." *Public & Community Affairs Discussion Paper*, Federal Reserve Bank of Boston, September 2008.

² Despite the pioneering roles these two studies have played in quantifying spillover effects, they are subject to methodological limitations. Possible multicollinearity (i.e., independent variables are highly correlated with each other) and reverse causation are either unaddressed or weakly controlled. Also, discussions of foreclosures' longitudinal and spatial aspects and of the nonlinearity of foreclosures' marginal effects are limited or absent. The more recent studies cited below improve on these limitations.

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