

by Lynn Fisher, Lauren Lambie-Hanson,  
and Paul S. Willen

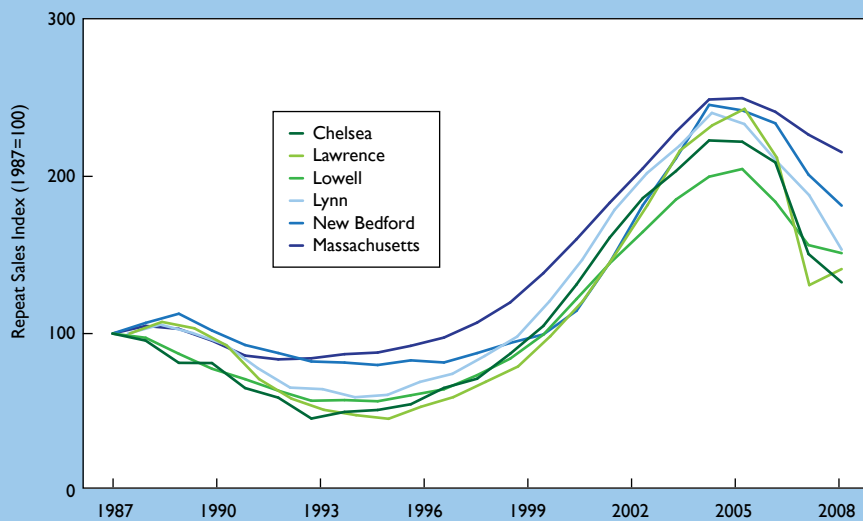
# Chelsea Combats FORECLOSURE



Chelsea Park. Photographs: Elvis Glavas, Courtesy of the City of Chelsea

It is an accepted fact in the current policy debate that the U.S. housing crisis has damaged communities. Falling house prices and high foreclosure rates are typically associated with increased stocks of bank-owned properties and vacancies (also called “real estate owned,” or REO, properties). As neighborhoods become destabilized by vacancies, owners may choose not to invest in their properties or even to sell. They may just leave the community. A recent case study of foreclosures, house prices, and investment in Chelsea, Massachusetts, provides both good and bad news about what can happen.<sup>1</sup>

### Housing Prices in Chelsea, 1987-2009, Second Quarter One- to Three-Family and Condominium Properties



### A Lower-Income Community

Located just north of Boston, Chelsea is home to 34,356 residents. As of the 2000 Census, all of Chelsea's census tracts fell below 80 percent of the Boston metropolitan statistical area (MSA) median family income. More than 56 percent of residents are Latino. Chelsea's land mass is small, about two square miles, making it one of the 50 most densely populated municipalities in the country. According to 2008 census data, there are 12,798 housing units in Chelsea. Its housing stock is old, with almost two-thirds (8,158 units) built before 1940. Only 4,609 of those units are occupied by their owners. Because more than half of Chelsea's housing units are in two- to four-unit buildings, a single foreclosure often affects multiple households.

The bad news is that Chelsea has been hard hit in the housing crisis, experiencing large declines in house prices and many foreclosures. According to repeat-sales indices, by 2009 house prices had fallen by nearly 48 percent from their peak in 2005. The price estimates are not driven by foreclosure sales, as both foreclosure auctions and the sales of bank-owned properties were excluded from the sample studied. Such dramatic price falls, remarkably, are not unprecedented in Chelsea. In fact, through 2009 the descent in this current housing cycle has been significantly short of the price drop that occurred during the last cycle. Between 1987 and 1993, Chelsea's house prices fell by 57 percent.

Collapsing house prices in the current cycle have led to an explosion in foreclosure

activity. Between 1998 and 2005, annual foreclosure numbers in Chelsea were in the single digits every year. In 2005 foreclosures started to rise, and in 2008 there were 125 foreclosures, or more than five times more than the 24 total foreclosures occurring in the eight-year period between 1998 and 2005. If short sales are included, the numbers are much higher. Between 2006 and 2009, 357 homeowners left their homes through either a foreclosure or a short sale. According to the tax records, there are about 4,500 condominiums and one- to three-family properties in Chelsea, meaning that roughly 8 percent of the city's owners have lost their properties since the mortgage crisis began. Virtually every residential block in the city has seen at least one foreclosure.

Even for homeowners not directly affected by foreclosure, falling prices have a deleterious effect. No matter which price index is used, anyone who bought after 2000 owns a home that today is worth less than they paid. Since the typical homeowner is highly leveraged, falling prices have completely wiped out the down-payment investment for most homeowners who purchased since the beginning of the decade.

Buyers, however, benefit from lower prices. For first-time homebuyers, falling prices represent an opportunity to get into the housing market that was not present in 2005. But repeat buyers of homes are also sellers, so the reduction in purchase prices is potentially offset by the reduction in the value of their current property.

### Making the Best of It

How has Chelsea dealt with falling house prices and foreclosures? Here the news is better. The picture is of a fundamentally viable community coping reasonably well with a bad situation. What would be worrisome is if the foreclosure crisis pushed Chelsea over the proverbial tipping point and transformed it into a dying community in which no one wanted to buy, stay, or invest. Fortunately, there is little evidence that any such dynamic is developing.

For one thing, the stock of bank-owned properties appears to be under control. REO properties, often left vacant, are one of the main avenues by which foreclosures are thought to damage communities. Lenders evict homeowners, then have trouble selling the properties, which in turn may be subject to vandalism and theft of appliances, wiring, and pipes. During 2008, there was some initial evidence of growing REO stocks in Chelsea because lenders' ability to sell distressed properties was not keeping pace with the rise in new foreclosures. But starting in 2009, two changes took place. Lenders rapidly increased their sales of distressed properties. More important, they made increasing use of short sales, meaning that properties were transferred from one *bona fide* homeowner to another and never entered the bank-owned portfolio.

Second, homeowners appear to be investing in their properties despite the collapse in house-price appreciation. Ordinarily, the fear would be that a plunge in house prices and the growing number of homeowners with little or no equity would result in their having little or no long-term interest in maintenance. But Chelsea's building permit data tell a different story. After a dramatic fall in 2008—which may have been exacerbated by wider credit-market problems—the city's permit activity returned to its 2005 level by the beginning of 2009. Among recent buyers there has been little fall-off in property investment. Thus, contrary to some predictions, Chelsea's homeowners have lost equity but not an ongoing interest in their homes.

Third, long-term homeowners appear to remain committed to Chelsea. An exodus of homeowners would be one potential piece of evidence that residents consider Chelsea fatally wounded. In particular, one would expect such a trend concentrated among the homeowners who could most easily leave, the ones who still had positive equity in their homes despite recent price



## Chelsea homeowners seem to be investing in their properties despite the collapse in house prices.

falls. In fact, the opposite effect is evident. Owners with more than five years of tenure typically account for 75 percent of all sales in Chelsea, but in 2008 their share dropped to less than half. The exodus was of those owners who purchased at the market peak in 2005, not the city's long-term residents.

This picture of Chelsea is of a community under enormous economic stress but displaying a fair amount of resilience. Chelsea's location means that, ultimately, its viability depends on that of its big next-door neighbor, Boston. So long as Boston is healthy, there will be demand for real estate in a nearby residential community. Fears that the foreclosure crisis would tip Chelsea into long-term decline do not seem to have been well founded.

Although Chelsea is probably not unique, it may not be possible to generalize these findings for the rest of the country or for other cities in Massachusetts. Location is the key issue when making comparisons with other low- and moderate-income municipalities. For similar cities in the industrial Midwest, the collapse of manufacturing has raised questions about their long-term viability. It is likely that an analysis of a city adjacent to a metropolis other than Boston would not paint such an optimistic scenario.

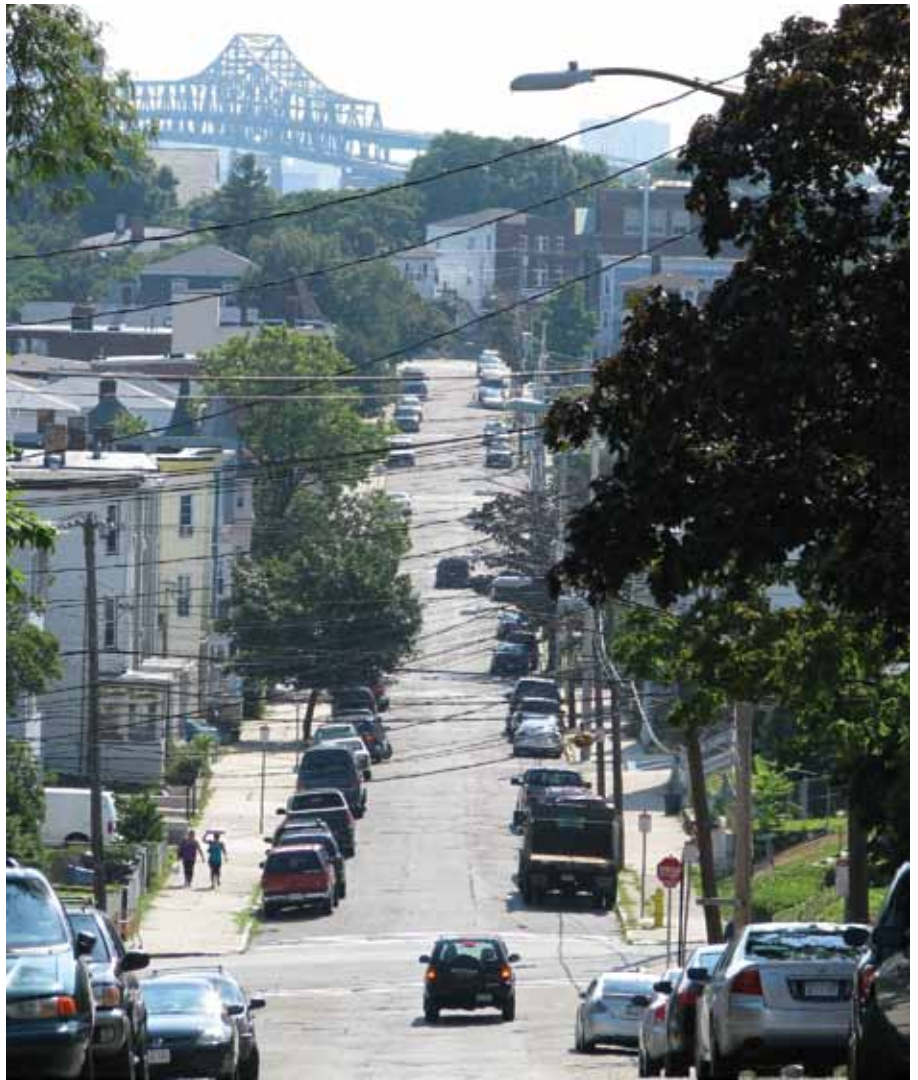
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**Lynn Fisher** is a visiting adjunct associate professor of finance at the Kenan-Flagler Business School at the University of North Carolina at Chapel Hill. **Paul S. Willen** is a senior research economist and policy adviser at the Federal Reserve Bank of Boston, where **Lauren Lambie-Hanson** is a graduate fellow.

### Endnote

<sup>1</sup> See Lynn Fisher, Lauren Lambie-Hanson, and Paul S. Willen, "A Profile of the Mortgage Crisis in a Low- and Moderate-Income Community" (paper no. 10-6, Federal Reserve Bank of Boston Public Policy Discussion Paper Series, 2010), <http://www.bos.frb.org/economic/ppdp/2010/ppdp1006.pdf>.

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Chelsea with a view of the Tobin Bridge.



Chelsea police station.