Shuttered Subdivisions: REOs and the Challenges of Neighborhood Stabilization in Suburban Cities

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Driving along California's Interstate 580, the freeway that connects San Francisco to Stockton, the landscape of newly built subdivisions is hard to miss. Neat rows of clay-colored roofs, all of which are the same size, the same shape, and extend just to the edge of the property line, flank both sides of the road. A huge sign hanging from the concrete wall that encircles one development reads, "If you lived here, you'd be home already," beckoning new buyers with the promise of a three-bedroom home with a two-car garage. At the exit ramp, there's a Target, a Home Depot, a few gas stations, and a fast food restaurant or two. And a drive-through Starbucks, providing much-needed caffeine to early morning commuters headed toward the distant labor markets of San Francisco and San Jose.

Get off the freeway, however, and the repetitive roofline of these communities disappears from view. The neighborhoods are much more vibrant and varied. Yards are decorated with personal tchotchkes, ranging from statues of the Virgin Mary to flags in support of the A's or the Giants; strollers, Big Wheels, and basketball hoops hint at the ages of the kids inside. The residents themselves represent a wide range of ages, races, family types, and nationalities, and a sunny afternoon reveals women walking around in colorful saris as well as elderly African-Americans tending their yards. Unlike the Levittown homes and exclusionary credit markets that fueled the suburban sprawl of the 1950s and 60s, these new suburban spaces have provided homeownership opportunities for a much more diverse population.

Since 1990, subdivisions such as these have sprung up all over urban America, but nowhere more rapidly than in California, Nevada, and Arizona. In *Boomburbs: The Rise of America's Accidental Cities,* authors Lang and LeFurgy point out that areas that were once small subdivisions with obscure names such as Henderson, Chandler, and Santa Ana have grown larger than many better-known cities, including Miami, Providence, St. Louis, and Pittsburgh, and house an ever-increasing share of the nation's urban population. By 2000, nearly 15 million people lived in boomburbs and "baby boomburbs."[1] That number has likely grown, as new construction fueled by the recent housing boom has led, in just a few years, to a doubling of population in communities such as Avondale, Arizona, and Elk Grove, California.

Whether or not these boomburbs continue to grow is dependent at least in part on whether these neighborhoods can stabilize their housing markets in the wake of the foreclosure crisis. Indeed, it is not only Detroit and Cleveland that have been hit by waves of foreclosures: Some of the highest rates of foreclosure and subsequent concentrations of real-estate-owned (REO) properties have been in both small and larger subdivisions near larger metropolitan areas.

The large number and concentration of REOs in suburban communities has troubling policy implications, since these areas often have less-well-established community development infrastructure.[2] Local governments and nonprofits may therefore have limited capacity to respond to the destabilizing effects of large

numbers of vacant homes. In addition, most strategies for addressing blight and vacant buildings have been developed based on the experiences of inner-city neighborhoods with older housing stock. Lessons and best practices for how to respond to vacant and abandoned property in suburban communities are scarce.

This article seeks to fill that gap by exploring what is happening with concentrations of REOs in suburban cities, focusing on the states of California, Arizona, and Nevada. How long are REOs staying on the market in these suburban areas? What are the implications of vacancies and house price declines for the long-term viability of these subdivisions and the services that support them? Will these boomburbs become ghost towns, particularly as rising energy costs limit the attractiveness of neighborhoods that require long commutes? Or will the continued demand for homeownership translate into new buyers once house prices and the economy stabilize?

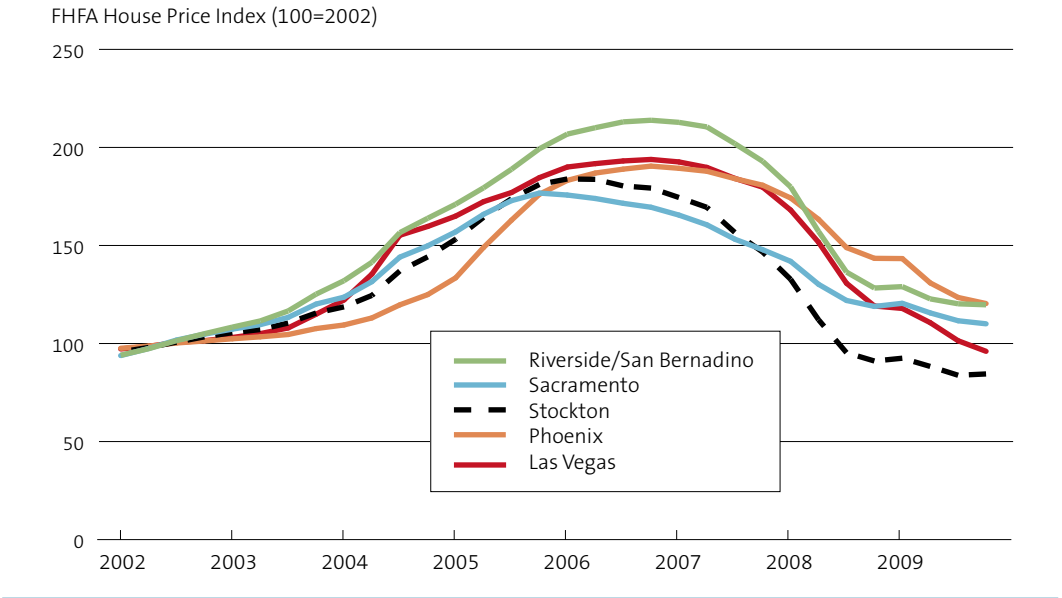
The Wild West of Mortgage Lending: Subprime Lending in the Suburbs

It's a real tragedy. So many families thought that they were moving out from [San Francisco] to Antioch to buy a home, have a real house for the kids with a yard and a neighborhood school, and now they're coming back and having to live with their parents or grandparents…it wasn't affordable after all.

—San Francisco foreclosure counselor
November 2009

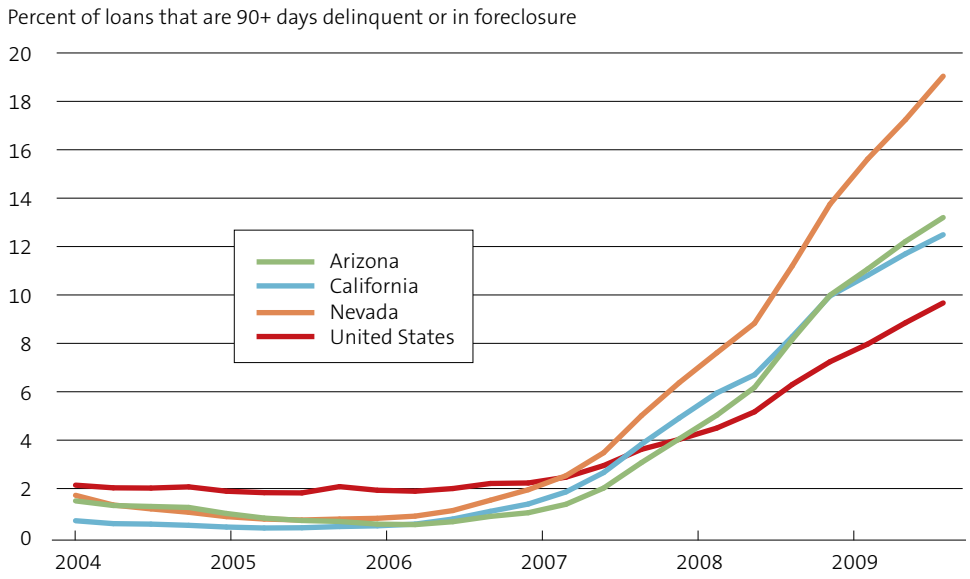
In an early paper on the subprime crisis, Karen Pence and Chris Mayer found that subprime originations were heavily concentrated in fast-growing parts of the country with considerable new construction, such as Florida, California, Nevada, and Arizona.[3] Earlier research had primarily focused on neighborhood racial disparities in the geographic distribution of subprime lending, showing, for example, that subprime loans are more frequent in low-income neighborhoods than in upper-income neighborhoods, and more frequent in predominately black neighborhoods than white neighborhoods.[4]

Figure 1
Boom and Bust of West Coast Housing Prices



Source: FHFA House Price Index

Figure 2
Serious Delinquencies in Western States



Source: Mortgage Bankers Association, National Delinquency Survey

Pence and Mayer's paper also pointed to a new development in the geographic distribution of subprime lending. Although initially defined as risk-based pricing for borrowers with lower credit scores, "subprime" increasingly became an umbrella moniker for a much wider range of nontraditional and alternative mortgage products, including interest-only loans, option ARMs, and loans that coupled extended amortization with balloon-payment requirements. Driving the demand for these products in Arizona, California, and Nevada was a need for greater housing affordability; in many urban markets in these states, house values nearly doubled between 2002 and 2006 (see figure 1). The use of non-traditional mortgage products exploded in tandem. In 2005, approximately two-thirds of all subprime mortgages in Arizona, California, and Nevada included exotic features such as option payments and had limited or no documentation associated with the loan origination.[5]

In 2007, this boom came to an abrupt end. The rise in delinquencies and foreclosures in Arizona, California, and Nevada was sudden and steep (see figure 2). At the start of 2006, these states had among the lowest serious delinquency rates in the country; by the last quarter of 2009, they far eclipsed the national serious delinquency rate, a trend that does not seem to be abating. The combination of falling house values and the origination of loans that did not consider a borrower's ability to repay over the long term have led to unprecedented levels of foreclosure, with significant repercussions not only for neighborhoods but also for city governments that are grappling with the challenges associated with concentrated vacancies and REOs. In two recent papers on the distribution of REOs, Dan Immergluck found that REOs were concentrated in metropolitan real estate markets that saw large concentrations of subprime lending and high rates of house appreciation in the first half of this decade, and that suburban communities contained a large number of ZIP codes with high and severe concentrations of REOs.[6]

Corresponding to the scale of the foreclosure crisis, these states also received a large share of funding under the first wave of the Neighborhood Stabilization Program (NSP1). Authorized in 2008 in response to growing

Table 1
Sample Means for City Clusters

	Established Core Cities	Steady-Growth Cities	Boomburb Cities
Number of loan observations in cluster	2,639,211	1,531,775	441,652
Percent change in population (2000–2008)	2.61	17.69	62.25
Percentage point change in Black share of overall population (2000–2008)	–0.54	0.19	0.70
Percentage point change in White share of overall population (2000–2008)	–3.46	–7.32	–6.16
Percentage point change in Hispanic share of overall population (2000–2008)	3.01	6.36	2.81
Percentage point change in Asian share of overall population (2000–2008)	1.86	1.15	2.73
Percent change in housing units (2000–2008)	4.24	18.18	62.71
Percent of units built after 2000	5.20	16.03	35.07
Median income 2008	$66,542	$58,889	$69,789
Appraisal amount	$572,998	$365,394	$358,243
Percent high-cost loans 2004	10.95	17.06	12.53
Percent high-cost loans 2005	24.93	31.89	25.13
Percent high-cost loans 2006	25.11	35.12	28.10
Median house value 2008	$598,472	$374,095	$377,924

Source: Author's calculations of data from LPS, the American Community Survey, and the U.S. Census

concerns over the concentration of foreclosed homes, NSP1 allocated more than $3.9 billion in funding for the acquisition and rehabilitation of foreclosed properties. Arizona received $121.1 million, California received $529.6 million, and Nevada received $71.9 million. At the time, the largest concern was that these grant amounts were small in comparison to the need.

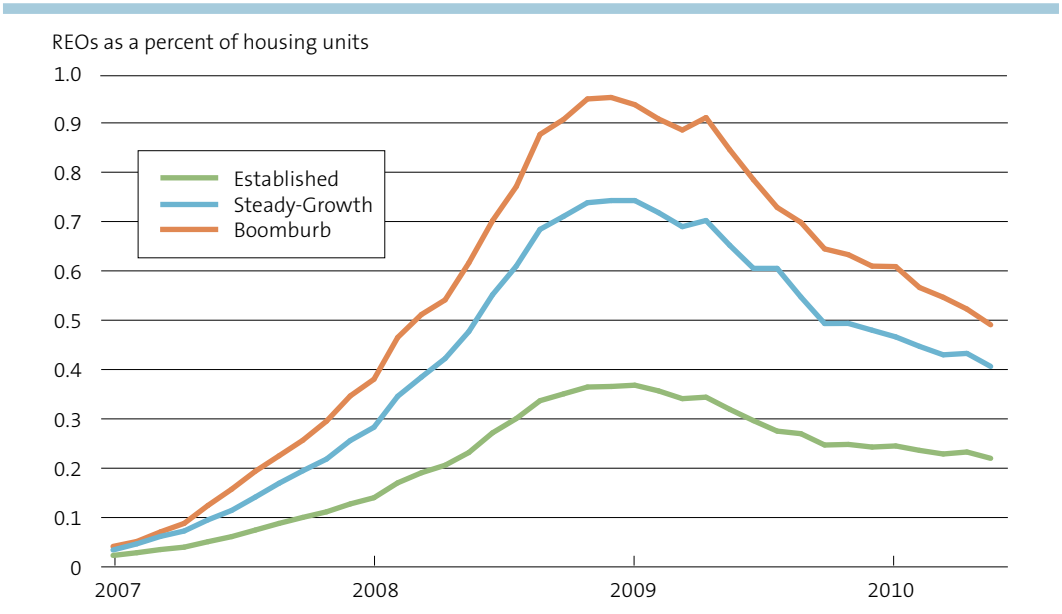
Yet the implementation of NSP in these states has been challenging, and many grantees have struggled with allocating the money within the 18-month timeframe. In part, difficulties arose because of the NSP1 program itself: the program was adopted, designed, and deployed quickly and in a period of crisis, leading to inevitable implementation challenges. But city officials also found that the landscape of REO properties was very different from what they had anticipated. It was hard to find REO properties in NSP1 target areas, for one, and competition from investors with cash offers resulted in numerous lost deals for cities and nonprofits. Why, for example, did North Las Vegas, a city that had more than 4,000 recorded foreclosures by mid-2008, find it so difficult to identify and acquire foreclosed properties under NSP? Clearly, early assumptions about REOs and trends in the housing market in these Western boomburbs deserve to be revisited.

Data and Methods

This article examines vacancies and REOs in more than 275 cities with a population over 25,000 in Arizona, California, and Nevada.[7] These places include older and larger cities, such as Los Angeles, Oakland, and Phoenix, as well as suburban cities that grew quickly in both housing and population during the subprime boom, such as Avondale City, Arizona, and Riverside, California. These cities were then classified into three clusters using Census data and labeled as follows: a) *established core cities*, with older housing stock and slower overall population growth; b) *steady-growth cities*, which saw a moderate amount of growth and investment during the subprime boom, but that have a mixture of older and newer neighborhoods and housing stock, and c) *boomburb cities*, which saw rapid growth in both population and housing stock during the subprime boom.[8] Despite the diversity of cities within each cluster, boomburb cities saw very rapid changes between 2000 and 2008 (see table 1). More than a third of the housing stock in boomburb cities was built after 2000, compared with just 5 percent in established core cities, and the population became increasingly diverse as new households sought the more affordable housing located in these communities.

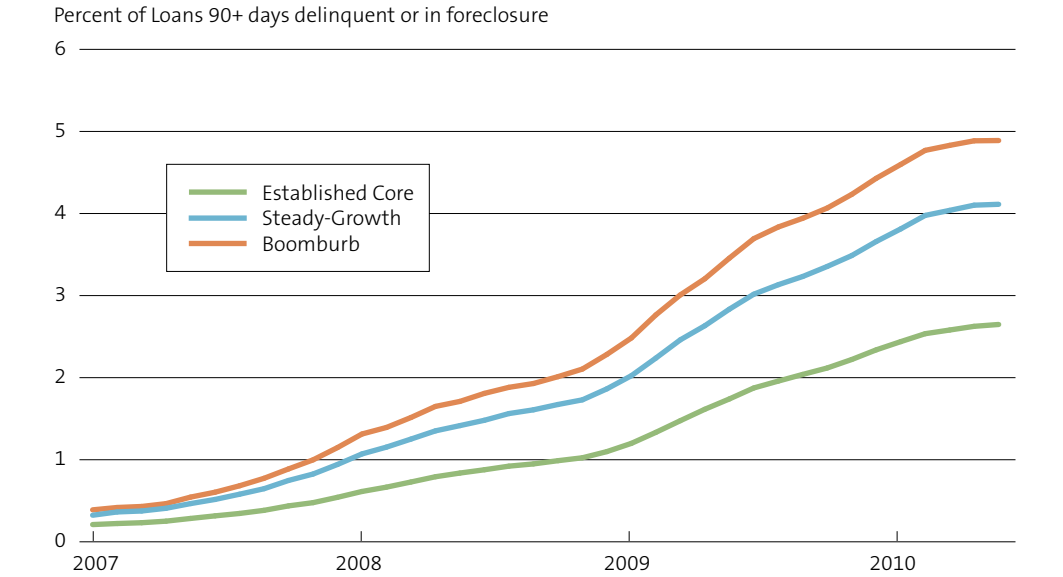
Data on REOs are derived from a proprietary loan performance database known as Lender Processing Services (LPS) Applied Analytics, Inc. As of December 2008, the LPS dataset covered nearly 60 percent of active residential mortgages in the United States, representing about 29 million loans with a total outstanding balance of nearly $6.5 trillion. The broad coverage of LPS allows for comparison across places, yet it also has drawbacks, particularly when one wants to describe what is happening in a specific locality.[9] As a result, the numbers presented here should be viewed as indicative of broad trends across the three clusters of cities rather than as exact percents or estimates of local REO stock. The status of the loans in the database—for example, if they are seriously delinquent, in foreclosure, or in REO—is observed monthly from January 2007 through February 2010. In addition, I draw on insights

Figure 3
Concentration of REO Properties in U.S. Cities
By Cluster Type



Source: Author's calculations of data from Lender Processing Services Applied Analytics, Inc., the American Community Survey, and the U.S. Census

Figure 4
Delinquencies and Foreclosures in U.S. Cities
By Cluster Type



Source: Author's calculations of data from Lender Processing Services Applied Analytics, Inc., the American Community Survey, and the U.S. Census

from interviews with local leaders in many of these communities to supplement the quantitative results.

What's Happening in the Boomburbs?

We've been competing with investors on the acquisition side for months, losing out on a number of houses. Now we don't even have a chance because the houses don't even reach the REO stage.

—NSP coordinator
Central Valley, CA

Figure 3 illustrates the concentration of REOs in each category, measured as the percent of REOs in relation to the number of housing units. The figure illustrates two clear findings: first, REO stock in boomburb cities is much greater than that in established core cities; and second, the concentration of REOs increased dramatically from early 2007 to the end of 2008. In October 2008, approximately 1 in 100 properties in boomburb cities were REOs. Yet the graph also shows that since then, the concentration of REOs has fallen more quickly in boomburb cities than in the other clusters. Although this could be attributed to a drop in the number of foreclosures, in fact, the data show that the share of loans that are 90-plus days delinquent or in the foreclosure process continues to rise steadily, and is greatest in boomburb cities. By February 2010, nearly 5 percent of all housing units in boomburb cities were in this "shadow inventory" of homes on the cusp of foreclosure sale and transition to REO (see figure 4).

So what is driving the drop in REO concentrations in these markets? One contributing factor could be the pace of REO sales. Figure 5 presents data on the number of REOs sold each month as a share of all the REOs on the market. Although REO sales were stronger in established core cities at the start of the foreclosure crisis, REO sales rates in the three categories have converged since the start of 2009. Overall, about one in five existing REO properties is sold each month. Because the inventory of REOs in boomburb cities is significantly higher, greater overall numbers of REOs are sold each month,

thus clearing these properties more quickly from banks' books, which may have some effect on the ratio of REOs to the total number of housing units in a city.

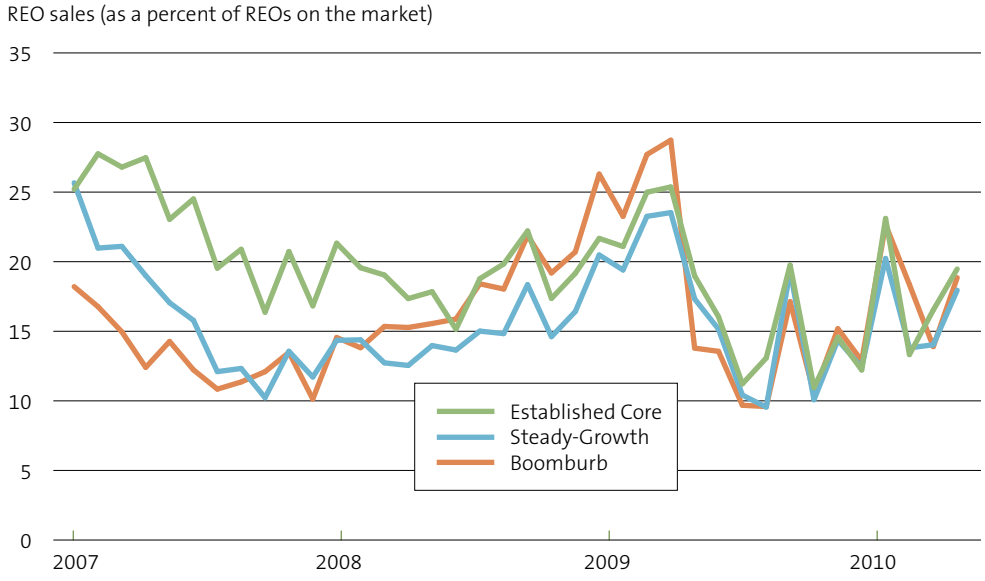
Another contributing factor to the drop in REO concentrations is the rise in forced or distressed sales. Interviews with local leaders point to a growing percentage of sales occurring *before* the property becomes an REO, either selling at auction or through the short-sale process. Nevada Title Company, a local provider of market-level data in the Las Vegas Valley, has seen a significant rise in the number of short sales in the region, accounting for nearly a quarter of all closings in February of 2010.[10] The LPS data show a similar increase, with a greater percent of distressed properties in boomburb markets selling before they enter the REO process, compared to distressed properties in established core cities (see table 2).[11] Within the LPS sample, 8 percent of distressed properties (90-plus days delinquent or in foreclosure) in boomburb areas sold before becoming REO, compared to 3.9 percent in established core cities. REOs also cleared through the pipeline a bit more quickly in boomburb markets, at an average pace of 231 days to REO sale compared with 254 days in established core markets.

Challenges for Neighborhood Stabilization

City officials tasked with implementing the NSP program say that the increasing number of properties selling before they become REO has made it even more difficult to acquire foreclosed properties. Until recently, the program limited acquisition to properties that had gone completely through the foreclosure process, thereby disallowing grantees from purchasing properties through a short sale. In April 2010, the U.S. Department of Housing and Urban Development issued changes to NSP requirements, broadening the definitions of "foreclosed" and "abandoned" and allowing jurisdictions to acquire properties earlier in the foreclosure process.

While the rapid turnover of REO properties may indicate the stabilization of the housing market in these suburban communities, it is hard at this point to assess whether the clearing

Figure 5
REO Sales Rates in U.S. Cities
By Cluster Type



Source: Author's calculations of data from Lender Processing Services Applied Analytics, Inc., the American Community Survey, and the U.S. Census

Table 2
Movement of Properties through Foreclosure Process

	Established Core	Steady-Growth	Boomburb
Mean Number of Days in Foreclosure	189	177	176
Mean Number of Days REO Remains on Market	254	245	231
Percent Short Sales	3.89	7.37	8.01
Percent Change in House Values Since Origination	8.63	23.43	26.48

Source: Author's calculations of data from Lender Processing Services Applied Analytics, Inc., the American Community Survey, and the U.S. Census

of the REO inventory is truly the right way to view "stabilization." One troubling finding in this analysis is that in boomburb markets, prices have fallen much more dramatically than in established core cities. Borrowers in boomburb cities saw price declines of more than 25 percent in their ZIP code since origination, compared with price declines of around 9 percent in established core cities.[12] The increasing number of houses selling at far below their previous assessed values has many housing counselors worried, particularly as they see more and more homeowners questioning whether or not they should remain in their homes.

"The psychology does seem to be changing," said one counselor. "We used to have homeowners coming in begging us to help them keep their homes, but now maybe one in four or one in five clients is asking us the best way of getting out."

In addition, the predominance of investor purchases of distressed properties leads many local leaders to question what kind of communities they will be left with at the end of the crisis. While the LPS data don't allow an analysis of who is buying the REOs, local interviews corroborate the fact that houses at the lower end of the market are selling much more quickly than higher-priced homes.

"Investors—both big and small—are buying up the cheap inventory. So far we've seen no evidence that they plan to put any money into these properties," reported a city official in Murrieta, a suburban community located in southwestern Riverside County in Southern California. "If they're just holding these houses for land values to go back up, we're going to have a hard time rebuilding the schools, small businesses, and services that go into a healthy community."

Others offer a less bleak assessment for the future of these communities. In Elk Grove, California, a community that typifies the "boom" and "bust" of newspaper headlines, city administrators are seeing many homes being purchased by families and other first-time homebuyers, driven at least in part by the federal homebuyer tax credit.

"Investors seem less interested in these homes," reported one city official. "They're still selling a bit too high to buy in bulk, and instead they look attractive to new homebuyers who can now buy a three-bedroom house—which was out of reach just a few years ago—for around $150,000."

NSP administrators from boomburb cities report that the REOs they purchase in these markets generally need less rehab investment than those in older neighborhoods, which allows them to commit more funding to acquisition. This is different from the experience of cities such as Los Angeles, where rehabbing properties is generally significantly more costly than administrators there had anticipated.

"Buyers like the newer homes," said a housing developer in Stockton. "The properties that are

languishing are the older homes, in the older neighborhoods. No investor wants those either, and they require a lot of investment to turn around, which makes it hard for a nonprofit. I'd be more worried about the lower-income neighborhoods than the new ones."

Conclusion

At this point, it's too early to know which neighborhoods will experience the most long-lasting negative spillover effects from concentrated foreclosures, especially given the lack of publicly available data sources that compile comparable data on housing units, their mortgage status, and information on the purchaser and seller. However, the LPS data provide a small window into this question, and so far shows that REO inventory in newer cities is selling and clearing faster than REO inventory in older cities. Concerns that these communities will become "shuttered subdivisions" seem to be largely unfounded; Postal Service data indicate that long-term vacancy rates in these cities have not dramatically increased. In addition, anecdotal evidence suggests that new households are moving in. While the length of the recession and strength of the labor market will be critical—and uncertain—factors shaping the housing market in these communities going forward, unmet housing demand in western states will likely prevent wholesale abandonment of these suburban cities.

More troubling from the community development perspective is that this positive trend in boomburb cities is being driven both by the deep discounting of house values in these areas and a high volume of investor purchases. Stabilization thus remains elusive.

Although some boomburb cities have been able to obligate a large share of their NSP1 funds, the number of REOs redeveloped to date as affordable housing (both rental and homeownership) remains small. And while house prices have fallen, median house values still remain out of reach for many low- and moderate-income households, especially in California. Other boomburb cities, especially those with limited local community-development infrastructure, have struggled with implementing NSP1 and stand to lose their non-obligated allocations.[13] In both cases, the promise of these cities to serve as bedroom communities with affordable homeownership opportunities for an emerging middle class is at risk.

While it may seem naïve to have thought that a small federal program like NSP could intervene in the larger world of private housing-market investment, it is worth considering the importance of public funding—local, state, and federal—in helping to build community in these places: Investing in local schools, transit, and small businesses is critical if we hope to ensure that property values stabilize and that investors view the houses as more than junk bonds. As the recent Brookings report *The State of Metropolitan America*[14] points out, the growth of these boomburbs was neither economically nor environmentally sustainable. The report concludes that the long-term viability of these communities requires investing in their workforce and new industries, as well as reconfiguring their housing and transportation plans to provide options for both homeowners and renters within a carbon-constrained economy.

REO inventory in newer cities is selling and clearing faster than REO inventory in older cities.

Carolina K. Reid, *PhD, is manager of the research group in the Community Development Department at the Federal Reserve Bank of San Francisco, which she joined in 2005. Her recent research includes analyses of the impact of state anti-predatory lending laws on mortgage market outcomes, the Community Reinvestment Act and the subprime crisis, loan modification outcomes, and racial disparities in housing and mortgage markets. Dr. Reid earned her PhD in human geography from the University of Washington.*

Endnotes

[1] Robert E. Lang and Jennifer B. LeFurgy, *Boomburbs: The Rise of America's Accidental Cities* (Washington, D.C.: Brookings Institution, 2007). Lang and LeFurgy define a boomburb as a municipality of more than 100,000 people that has been growing at a double-digit pace for three consecutive decades and is not the major city of any metropolitan area. A "baby boomburb" is a place with the same characteristics but with a population between 50,000 and 100,000.

[2] Daniel Immergluck, "The Accumulation of Foreclosed Properties: Trajectories of Metropolitan REO Inventories during the 2007–2008 Mortgage Crisis,"

Community Affairs Discussion Paper No. 02-08, Federal Reserve Bank of Atlanta (2008).

[3] Chris Mayer and Karen Pence, "Subprime Mortgages: What, Where, and to Whom?" Federal Reserve Board of Governors, Finance and Economics Discussion Series Working Paper No. 2008–29 (2008).

[4] Paul S. Calem, Kevin Gillen, and Susan M. Wachter, "The Neighborhood Distribution of Subprime Mortgage Lending," *Journal of Real Estate Finance and Economics* 29(4): 393–410 (2002); Daniel Immergluck and Marti Wiles, *Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development* (Chicago, Ill.: Woodstock Institute, 1999); and Jonathan Hershaff, Susan Wachter, and Karl Russo, "Subprime Lending: Neighborhood Patterns over Time," paper presented at Promises and Pitfalls, the Federal Reserve System's Fourth Community Affairs research conference, Washington, D.C., April 7–9, 2005.

[5] Anthony Sanders, "The Subprime Crisis and Its Role in the Financial Crisis," *Journal of Housing Economics,* 17(4): 254–61(2008).

[6] Daniel Immergluck, "The Accumulation of Foreclosed Properties: Trajectories of Metropolitan REO Inventories during the 2007–2008 Mortgage Crisis," Federal Reserve Bank of Atlanta, Community Affairs Discussion Paper No. 02-08(2008); and Daniel Immergluck, "Intrametropolitan Patterns of Foreclosed Homes: ZIP-Code-Level Distributions of Real-Estate-Owned (REO) Properties during the U.S. Mortgage Crisis," Federal Reserve Bank of Atlanta, Community Affairs Discussion Paper No. 01-09 (2009).

[7] Population data of Census-designated places in the 2006–2008 American Community Survey.

[8] Clusters were defined using PROC CLUSTER in SAS following Ward's minimum-variance method on the following four variables: percent of housing units built after 2000, change in population between 2000 and 2006–08, change in house values between 2000 and 2006–08, and change in the percent of minority households between 2000 and 2006–08.

[9] The data collected by LPS do not represent a random sample of the mortgage lending industry and significantly underrepresent subprime loans. In addition, the LPS data have added new servicers over the study period, which means that an increase in REO activity might not represent an increase in the number of new REOs, but rather additional new loans entering the survey as servicer participation expands. To account for the differences in subprime-mortgage-market coverage between LPS and the overall mortgage market, I create weights using data from the Mortgage Bankers Association National Delinquency Survey. In addition, I restrict the observations to loans that entered the dataset before January 2007 or those that entered after January 2007 but had less than five months of history (which ensured that they were newly originated loans, not loans that merely transferred from one servicer to another). See Immergluck 2008, 2009 for a similar approach.

[10] Hubbell Smith, "Short sales skyrocketing: Trend may prevent foreclosure wave," *Las Vegas Review-Journal,* April 25, 2010.

[11] LPS does not officially record whether a property is a short sale. To estimate short sales, I assume that properties that are at least 90 days delinquent or in foreclosure and are "paid off" before entering REO are short sales. A loan is paid off when it is sold or refinanced, so this method may overestimate. However, given the difficulty borrowers faced in refinancing homes during the period of this study, the error is probably small.

[12] Using ZIP code–level data on house price changes from Zillow, I attach house price data to each of the loans in the LPS sample for every month the loan is in observation. These estimates of house price declines at the ZIP code level are likely an underestimate, since Zillow's index does not include the sales prices of foreclosed homes.

[13] In May of 2010, HUD announced plans to reallocate non-obligated funds from NSP1 through a new round of funding.

[14] See brookings.edu/metro/stateofmetroamerica.aspx.