# Thousands of Homeowners Still Drowning in Underwater Mortgages

# How Toxic Loans Keep Fueling Foreclosures and the Need for Eminent Domain

An Analysis of Privately Labeled Securitized Mortgages in New York City by New York Communities for Change, New York Communities Organizing Fund, and the Mutual Housing Association of New York





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#### **Executive Summary**

Even as home sales prices increase in some parts of New York City and a loud and increasing buzz around a supposedly revitalized housing market ensues, there continue to be over 60,000 homeowners in crisis. These families, concentrated in predominantly African-American and Latino low- and moderate-income neighborhoods, continue to live in a precarious world where the values of their homes are less than the outstanding balances on their mortgages. These families are living underwater. Many of them continue to pay and remain current on their mortgages despite extenuating economic circumstances. But increasingly, more and more families cannot continue to pay their inflated mortgage premiums and are at risk of defaulting and entering the foreclosure process.

There are more than 60,000 underwater mortgages in New York City, which is almost 12% of all NYC homeowners.<sup>3</sup> New York City has the seventh-highest number of underwater homes in the country, <sup>4</sup> and the collective value of these underwater mortgages exceeds \$13 billion.<sup>5</sup> Because the banks and government

http://www.zillow.com/research/data/

<sup>&</sup>lt;sup>1</sup> Zillow Real Estate Research, Q1 2014 data,

<sup>&</sup>lt;sup>2</sup> American Community Survey 5 year Estimates, 2008-2012, Social Explorer, <a href="http://www.zillow.com/research/data/">http://www.zillow.com/research/data/</a>; Zillow supra.

<sup>&</sup>lt;sup>3</sup> Zillow *supra*.

<sup>&</sup>lt;sup>4</sup> Negative Equity Report, Zillow, May 2012.

<sup>&</sup>lt;sup>5</sup> Zillow supra.

have not effectively helped underwater homeowners, the city lost \$1.9 billion in property taxes and other expenses associated with vacant properties from 2008-13.

Over 24,000 of the underwater mortgages in New York are private-label securitized (PLS) mortgages.<sup>7</sup> These are primarily high-interest, subprime mortgages that investment banks bundled and sold on the secondary market to investors, leading to the economic collapse of 2008. PLS mortgages are also the hardest to modify in a sustainable way, with a variety of complex and hastily drafted service and trust agreements that typically prevent servicers from reducing principal for homeowners.

In particular, the concentration of underwater PLS loans are at epidemic levels in African-American and Latino neighborhoods. Seventeen of the 20 zip codes with the highest number of PLS mortgages have populations that are more than 50% African American and/or Latino; seven of the 10 zip codes with the highest number of PLS mortgages have populations that are more than 90% African American and or Latino.<sup>8</sup>

#### **Recommendations**

1. Loan holders — banks, government-sponsored enterprises (Fannie, Freddie and FHFA), and PLS trusts that pool loans and send proceeds to investors — must reduce the principal on underwater mortgages to reflect current market values; if loan holders are unwilling or unable to reduce principal on underwater mortgages to current market values, they should allow loans to be purchased by a designated entities (preferably not-for-profit or government entities) that are willing and able to restructure them with fair and affordable terms.

<sup>&</sup>lt;sup>6</sup> How the Foreclosure Crisis is Costing New York City Millions, New York Communities for Change, Mutual Association of Housing New York, April 2013, salsa.wiredforchange.com/.../nycc%20how%20the%20foreclosure%20cri <sup>7</sup> PLS source.

<sup>&</sup>lt;sup>8</sup> PLS data supra; American Community Survey supra.

- 2. The City should use all options at its disposal to induce principal reduction so that mortgage debts match current home values, including utilizing the tool of "eminent domain" to acquire mortgages in PLS trusts at their current fair market value and restructuring them with fair and affordable terms.
- 3. Banks; government-sponsored enterprises like Fannie, Freddie and its conservator FHFA; and PLS trusts should sell foreclosed property to not-for-profit entities that can convert them to affordable housing for community residents rather than to absentee investors for speculative purposes. This is what "land banks" in many states are doing with success.

#### <u>Introduction – the underwater mortgage crisis</u>

"Underwater" homes are those homes where the value of the mortgage exceeds the current market value of the home. Depressed home prices coupled with economic downturn and the loss of jobs has left thousands of homeowners unable to pay their mortgages at current rates and has left even more in the position where what they owe far exceeds the current value of their homes.

Despite claims of a national housing recovery, disaggregating the NYC data shows that there are thousands of homeowners, particularly in African-American, Latino and low- and moderate- income communities, whose home values have not increased. These homeowners are still far underwater, struggling to make payments and either already in foreclosure or at risk of soon going into foreclosure. Data also shows an increased probability that underwater mortgages, even those where homeowners are current on their mortgage payments, will go into default and risk foreclosure in coming months and years.

THE PROBLEM is exacerbated for a specific loan type. There are three basic mortgage types: a first group of loans underwritten and held in a bank's portfolio; a second group of loans underwritten and held by government and quasi-government

entities like Fannie, Freddie and FHA; and a third set of loans, "private-label securitized," which investment banks bundled and sold to investors. The majority of the PLS mortgages are subprime, Alt-A and other unconventional loans – precisely the kinds of predatory loans originated during the housing bubble that are now the most likely to be underwater or in foreclosure. Many of the sources drawn upon to analyze the PLS problem refer to sub-prime loans and while all sub-prime loans are not PLS loans there is so much overlap that the two terms could be used almost interchangeably.

Subprime mortgages are much more likely than conventional prime loans to go into foreclosure. These subprime mortgage products were targeted to African-American and Latino communities, which helps explain why the foreclosure crisis has impacted these neighborhoods more heavily than other areas of the city, and why most people with PLS loans live in those neighborhoods. Not only are PLS loans clustered in areas with high numbers of foreclosures, they are also twice as likely as non-PLS to be underwater.

Although modifications have been slow in coming in all loan categories, the most difficult to modify are PLS mortgages. This is due in part to the way these PLS loans were packaged after origination, leaving them subject to pooling and servicing agreements that, according to the trustees, typically prohibit or effectively prevent principal reduction modification.<sup>11</sup>

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<sup>&</sup>lt;sup>9</sup> Gerardi, K., Shapiro, A., and Willen, P., *Subprime outcomes: Risky Mortgages, Homeownership Experiences, and Foreclosures,* Federal Reserve Bank of Boston Working Paper 07-15, 2007; Gerardi, Chirstopher, Paul S. Willen, *Subprime Mortgages, Foreclosures, and Urban Neighborhoods*, Public Policy Discussion Papers, Federal Reserve Bank of Boston, 12/2008

<sup>10</sup> *Id.* 

<sup>&</sup>lt;sup>11</sup> Hockett, Robert. Breaking the Mortgage Debt Impasse: Municipal Condemnation Proceedings and Public / Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery.

In fact, many people, including servicers and trustees, argue that modifying PLS mortgages is nearly impossible. While the single best, well- documented solution for homeowners who are trying to stay in their homes is a principal reduction modification (reducing the current mortgage amount to current market value and restructuring the mortgage payments to keep the home occupied by its original owner), it is often impossible to implement due to the structural obstacles of the PLS mortgage pools even when agreed upon by the investors themselves.<sup>12</sup>

Of all the potential solutions outlined in our recommendations, eminent domain is the cleanest most direct way to release these PLS loans from their structural confinement and allow for loan modifications, which would result in homeowner home retainment and neighborhood stabilization.

Outside of Manhattan and a few areas in Brooklyn, values are only expected to rise by a little more than 1% in 2014, 13 and the average underwater PLS mortgage is roughly 30% underwater in New York City. Coupled with the heightened probability that underwater mortgages will go into foreclosure in the future and the downward effect of foreclosures on nearby home prices, it will be nearly impossible for home values in areas with large numbers of underwater PLS mortgages to increase in value by 30% in the foreseeable future. 14

stagnant in 2013; increases in Queens were modest; and Brooklyn's increases are to

skewed by large increases in neighborhoods closest to Manhattan.

<sup>&</sup>lt;sup>12</sup> *Id.* 

<sup>&</sup>lt;sup>13</sup> Zillow Real Estate Research, New York Metro area predicted increase in 2014 is 1.4%, <a href="http://www.zillow.com/new-york-metro-ny">http://www.zillow.com/new-york-metro-ny</a> r394913/home-values/; New York City expected increase in 2013 is 3.1% http://www.zillow.com/new-yorkny/home-values/; New York State expected increase in 2014 is 1.2%. <sup>14</sup> Home value increases in NYC are skewed by Manhattan's 17.4% property increase in 2013. In the Bronx, values declined; Staten Island property values were

#### **Key Findings**

An examination of PLS mortgages in New York City reveals that PLS mortgages are more likely to be underwater, more likely to go into foreclosure, and more heavily concentrated in African-American, Hispanic, and moderate-income communities. There is no way to address the foreclosure crisis in neighborhoods of color without fixing PLS mortgages.

**Table 1: Delinquent, Underwater, and PLS Mortgages Compared to Total Mortgages** 

Total Mortgages	483,000	100% of mortgages
PLS Mortgages	72,365	15% of mortgages
<b>Total Delinquent Mortgages</b>	48,300	10% of mortgages
<b>Delinquent PLS Mortgages</b>	24,460	51% of delinquent mortgages
Total Underwater	60,303	15.7% of mortgages
<b>Underwater PLS Mortgages</b>	24,214	40% of underwater mortgages
PLS Mortgages Underwater and Delinquent	12,203	50% of underwater PLS mortgages

PLS mortgages are more likely than conventional mortgages to default.

- 6% of total mortgages are in foreclosure compared to 20% of PLS mortgages
- 10% of total mortgages are delinquent compared to 34% of PLS mortgages.
- Less than 15% of total mortgages are underwater compared to 33% of PLS mortgages.

Even though PLS mortgages constitute a relatively small percentage of total mortgages, a large percentage of both foreclosed and/or underwater mortgages are PLS.

- 15% of mortgages are PLS.
- 50% of mortgages in foreclosure are PLS.
- 50% of mortgages that are delinquent are PLS.
- 40% of underwater mortgages are PLS.

The impact of the foreclosure crisis has been felt most acutely in African-American and Latino Communities, and PLS mortgages are heavily concentrated in African-American and Latino neighborhoods.

- 18 of the 20 zip codes with the highest number of foreclosures in New York City have populations that are more than 50% African American and/or Latino.
- 19 of the 20 zip codes with the highest number of REO<sup>15</sup> properties have populations that are more than 50% African American and or Latino.

Indications of continuing crisis are strongest in African-American and Latino communities

- 13 of the 20 zip codes with the highest number of underwater PLS mortgages have populations that are more than 50% African American and or Latino.
- 19 of the 20 zip codes with the highest number of PLS mortgages have populations that are more than 50% African American and or Latino.
- 19 of the 20 zip codes with the highest number of underwater mortgages have populations that are more than 50% African American and or Latino

#### Methods

This report uses zip code-level data on PLS loans for the five boroughs – data purchased from Lewtan, a large experienced data and analytics provider to the securitization marketplace – to show where the PLS mortgages are concentrated, what their loan-to-value ratios are, and how they are currently performing. The total number of mortgages and number delinquent is as reported by the Federal Reserve Bank of New York, and the total underwater mortgage numbers come from Zillow. Foreclosure and REO figures come from RealtyTrac. Various scholarly articles are drawn from to show trends related to PLS and subprime mortgages and to support recommendations made by this report. Demographic data came from the American Community Survey.

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<sup>&</sup>lt;sup>15</sup> REO (Real Estate Owned) is a term used to describe properties that went through the foreclosure process and are now vacant and owned by the mortgagor.

#### **Signs of a Continuing Crisis**

New York City has been heavily impacted by the foreclosure crisis. Since the foreclosure crisis began in 2008, there have been nearly 100,000 foreclosures in New York City<sup>16</sup> and the percentage of mortgages that are in foreclosure has been increasing since 2004.<sup>17</sup> Nationally, about 2%<sup>18</sup> of mortgages are in foreclosure, but in New York City 6% are in foreclosure.<sup>19</sup> New York City's foreclosure rate, in other words, is three times the national average. Corelogic reports that New York State has the third-highest percentage of its homes currently in foreclosure, exceeded by only New Jersey and Florida.<sup>20</sup> In New York City, foreclosures are up 15% in 2014.<sup>21</sup> Hopes that the housing market is healing on its own, especially in New York, are overly optimistic.

The large number of mortgages that are currently delinquent and/or underwater indicates that the foreclosure crisis is far from over in New York City. One in 10, or 48,300, of the city's 483,000 mortgage are past due.<sup>22</sup> Over 60,000 mortgages are currently underwater.<sup>23</sup>

Across all types of mortgages and borrower FICO scores, the strongest indicator of whether or not a homeowner will default on his or her mortgage is the equity position; as equity decreases, the probability of default increases.<sup>24</sup> Homeowners that are

<sup>&</sup>lt;sup>16</sup> RealtyTrac.

<sup>&</sup>lt;sup>17</sup> Regional Mortgage Briefs supra; see also Klein, Jeffery D., Foreclosure's Persistent Threat to New York City and its Minority Communities, The New York State Senate, June 9<sup>th</sup> 2014.

<sup>&</sup>lt;sup>18</sup> *National Foreclosure Report*, Corelogic, May 2014.

<sup>&</sup>lt;sup>19</sup> Foreclosure's Persistent Threat to New York City and Its Minority Communities *supra*; Regional Mortgage Briefs *supra*.

<sup>&</sup>lt;sup>20</sup> Corelogic, National Foreclosure Report supra..

<sup>&</sup>lt;sup>21</sup> Foreclosure's Persistent Threat supra.

<sup>&</sup>lt;sup>22</sup> Id.

<sup>&</sup>lt;sup>23</sup> Zillow, Negative Equity Report, 05/2014

<sup>&</sup>lt;sup>24</sup> Goodman, Lori S., Roger Ashworth, Brain Landy, Lidan Yang. *The Case For Principal Reductions*. The Journal of Structured Finance 2011.17.3:29-41. Downloaded from

underwater (in a negative-equity position) are at risk of foreclosure because the home, which has historically been the bedrock of many people's savings, has become a liability rather than an asset. There is a 90% probability that homeowners who are both delinquent and underwater will transition into foreclosure. <sup>25</sup> A homeowner struggling to stay current on mortgage payments who has equity could historically sell or refinance in order to avoid a default, but these are options households with negative equity don't have.<sup>26</sup> These delinquent and underwater mortgages could almost double the weight of the foreclosure burden already borne by the city.

www.iijournals.com; see also Foote, Chistopher, Kristopher Gerardi, Lorenz Goette, Paul Willen, Reducing Foreclosures; No Easy Answers, National Bureau of Economic Research, University of Chicago Press, April 2010.

<sup>&</sup>lt;sup>26</sup> Gerardi, Kristopher S, Paul S. Willen, *Subprime Mortgages, Foreclosures, and Urban* Neighborhoods, Federal Reserve Bank of Boston, No. 08-6, 12-22-2008, page 17.

#### Economic Impact on Homeowners, Adjacent Homeowners, and Neighborhoods

The foreclosure crisis has already cost the city approximately \$1.9 billion in expenses and lost real estate tax revenue.<sup>27</sup> Foreclosures cost the city money in two ways. First, foreclosures cause property-tax revenues to decline as property values erode and second, many properties that enter the foreclosure process end up as vacant, bankowned properties that result in significantly increased maintenance costs to the city.

**Table 2: The Cost of Foreclosures** 

Source of cost	Loss in value	Cost per	Number of	Total Cost
	per property	property	properties	
Property Tax	-20%	\$844	95,961	\$81 million
loss from				
foreclosed				
properties				
Property Tax	-1%	\$42	40.1 million <sup>28</sup>	\$1.7 billion
loss from				
surrounding				
homes				
REO properties		\$19,277	7,341	\$141.5 million

When a property goes into foreclosure its value is reduced by roughly 20%, <sup>29</sup> and values of properties within an eighth of a mile of a foreclosed property go down by 1%. <sup>30</sup>

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 $<sup>^{27}</sup>$  How the Foreclosure Crisis Cost New York City Million, New York Communities for Change & Mutual Housing Association of New York, 2013,

salsa.wiredforchange.com/.../nycc%20how%20the%20foreclosure%20cri...

<sup>&</sup>lt;sup>28</sup> Each foreclosure reduces the value of every home within an eighth of a mile by 1%. Many homes have been affected multiple times so rather than saying 40.1 million homes have been effected, there have been 40.1 million instances of foreclosures reducing the value of nearby properties.

<sup>&</sup>lt;sup>29</sup> Pennington-Cross, Anthony. *The Value of Foreclosed Property*. Journal of Real-estate Research, Volume 28, No. 2. (April-June 2006); *see also* W. Scott Fame. *Estimating the Effects of Foreclosures on Nearby Property Values; A Critical Review of the Literature*. Federal Reserve Bank of Atlanta Economic Review, Volume 95, November 2010.

Assuming a median home value of \$422,000<sup>31</sup> the resulting loss of real-estate value totals \$177.3 billion. Using New York City's average property-tax rate for residential property of approximately 1%<sup>32</sup> this leads to a loss of nearly \$1.8 billion in property tax revenue since the inception of the crisis.

There are rarely third-party buyers at foreclosure auctions so most properties that complete the foreclosure process end up bank owned (known as REO).<sup>33</sup> These properties nearly always become vacant.<sup>34</sup> Absent a fire, the cost of REOs to the local government of a large city is likely to be around \$19,277,<sup>35</sup> which totals to \$141.1 million for the 7,341 properties that have become REO since 2008.

Failure to act to stave off the impending wave of foreclosures anticipated by the large number of delinquent and underwater mortgages will drastically increase costs to the city due to foreclosures and related negative impact.

<sup>&</sup>lt;sup>30</sup> Immergluck, Dan and Geoff Smith. *The External Cost of Foreclosure: The Impact of Single-Familiy Mortgage Foreclosures on Property Values.* Housing Policy Debate, Volume 17, Issue 1. 2006; see also Schuetz, Jenny, Vicki Been, and Inrgid Gould Ellen. Neighborhood Effects of Concentrated Mortgage Foreclosures. Journal of Housing Economics, Volume 17, 306-319. 2008.

<sup>&</sup>lt;sup>31</sup> Zillow Real Estate Research. (Median homevalues are higher now, but 422K represents midcrisis values)

<sup>&</sup>lt;sup>32</sup> http://www.nyc.gov/html/dof/html/property/property\_bill\_calculate.shtml <sup>33</sup> Immergluck 2010, page 8. Citing; Cutts, A. C., and W. Merrill. 2008. *Interventions in mortgage default: Policies and practices to prevent home loss and lower costs.* In *Borrowing to live: Consumer and mortgage credit revisited*, edited by N. Retsinas and E. Belsky, 203–54. Washington, DC: Brookings Institution.

<sup>&</sup>lt;sup>34</sup> Immergluck 2010, page 8. Also, Whitaker, Stephen. *Foreclosure Related Vacancy Rates.* Federal Reserve Bank of Cleveland; Economic Commentary. July, 2012. Page 1; *See also* Rao, J., and G. Walsh. 2009. *Foreclosing a dream: State laws deprive homeowners of basic protections.* Boston: National Consumer Law Center. http://www.nclc.org/ issues/foreclosure/content/FORE-Report0209.pdf (accessed November 24, 2009).

<sup>&</sup>lt;sup>35</sup> Apgar, William C., Mark Duda, and Rochelle Nawrocki Gorey. *The Municipal Cost of Foreclosure: A Chicago Case Study*. Homeownership Preservation Foundation. February 2005. Pages 24-27.

#### A Small Percentage of Total Mortgages are Causing a Big Part of the Problem

An examination of PLS mortgage data in New York City reveals four important trends with regard to the ongoing foreclosure crisis.

- 1. In New York City, PLS mortgages are three-times more likely to be delinquent or in foreclosure than other mortgages and twice as likely to be underwater. There are approximately 483,000 mortgages in New York City, <sup>36</sup> of which approximately 72,000 (15%) are PLS. 6% of all mortgages are in foreclosure, and 10% of all mortgages are delinquent. In comparison, 20% of PLS mortgages are in foreclosure and 34% are delinquent. Furthermore, approximately 12% of all mortgages are underwater as compared with 33% of PLS mortgages. These findings are consistent with other studies that have compared the performance of subprime mortgages to conventional prime mortgages and found that subprime mortgages were 5-7 times more likely to default than conventional loans were.<sup>37</sup>
- 2. PLS mortgages comprise less than 15% of all New York City mortgages; however, they represent essentially half of the mortgages that are delinquent or in foreclosure and nearly one third of all underwater mortgages. There are approximately 29,000 mortgages in foreclosure in New York City, of which 50% (14,779) are PLS. There are approximately 48,000 mortgages delinquent

<sup>36</sup> Federal Reserve Bank of New York, *Regional Mortgage Briefs*, http://www.newyorkfed.org/regionalmortgagebriefs/index.html

<sup>&</sup>lt;sup>37</sup> Gerardi, K., Shapiro, A., and Willen, P., *Subprime outcomes: Risky Mortgages, Homeownership Experiences, and Foreclosures,* Federal Reserve Bank of Boston Working Paper 07-15, 2007; Gerardi, Chirstopher, Paul S. Willen, *Subprime Mortgages, Foreclosures, and Urban Neighborhoods*, Public Policy Discussion Papers, Federal Reserve Bank of Boston, 12/2008

- citywide and half of them (24,460) are PLS. Over 60,000 mortgages in NYC are underwater and 40% (24,214) of them are PLS.
- 3. PLS mortgages are heavily concentrated in African-American and Latino neighborhoods, resulting in the disparate impact of foreclosures, delinquent loans and vacant properties affecting African-American and Latino homeowners.
  Several studies show that subprime mortgages have a tendency to be clustered in low-income and minority communities.<sup>38</sup> The 239 New York City zip codes examined for this report support these findings. Seventeen of the 20 zip codes with the highest number of PLS mortgages had populations that were more than 50% African American and/or Latino, and seven of the 10 zip codes with the highest number of PLS mortgages had populations that were more than 90% African-American and/or Latino. The disproportionate number of PLS mortgages that were originated for homes in minority communities directly correlates with the facts that African-American households are more than three times more likely and Latino households are more than twice as likely as white households to experience foreclosure.<sup>39</sup>
- 4. PLS mortgages are disproportionately concentrated in low- and moderate-income neighborhoods. Twelve of the 20 zip codes with the greatest number of PLS mortgages have median incomes below the \$59,000 median income<sup>40</sup> for the zip

<sup>&</sup>lt;sup>38</sup> Subprime Mortgages, Foreclosures, and Urban Neighborhoods supra at 3; see also Immergluck, Dan, Geoff Smith, *The Impact of Single-family Mortgage Foreclosures on Neighborhood Crime*, Housing Studies, Vol. 21, No. 6, 851-66, 853, November 2006; Mayer, Christopher J., Karen Pence, *Subprime Mortgages: What, Where, and to Whom?*, page 2, National Bureau of Economic Research, 2008.

<sup>&</sup>lt;sup>39</sup> Subprime Mortgages, Foreclosures, and Urban Neighborhoods supra at 17.

<sup>&</sup>lt;sup>40</sup> American Community Survey, 2008-2013 5 year estimates.

codes examined. Fourteen of the 20 zip codes with the greatest percentages of underwater PLS mortgages have median incomes is below the study median.

#### **Specific New York City Hot Spots**

Foreclosures, underwater mortgages, and PLS mortgages are clustered in certain parts of the city. In each borough, the highest concentration of underwater PLS loans are in African-American and Latino neighborhoods. Many of these mortgages are deeply – more than 25% – underwater, making it very likely that these homeowners will default and enter foreclosure before regaining equity in the property. In particular, the neighborhoods of East Brooklyn, Southeast Queens, the Northeast Bronx and the North Shore of Staten Island have high numbers of PLS mortgages, a high percentage of which are underwater.

Because we know that African-American and Latino homeowners were targeted with subprime loans, <sup>41</sup> it is logical that these neighborhoods would have the greatest number of PLS mortgages that are underwater. The only way to help these homeowners and save these neighborhoods is for local government to take bold action and step in where the federal government and banking institutions have failed on their own.

<sup>&</sup>lt;sup>41</sup> Schwartztol, Larry. *Predatory Lending: Wall Street Profited, Minority Families Paid the Price.* The American Civil Liberties Union. September 16, 2011

**Table 3: Most Underwater PLS Mortgages by Queens Neighborhood** 

Neighborhood	Zip Code	% African-	# of PLS	# of underwater	LTV of More than
		American/Latino	Mortgages	PLS Mortgages	125%
Springfield Gardens/	11434	95%	1,490	796	466
St Albans					
Brookville/	11413	96%	1,431	642	265
Laurelton					
St. Albans	11412	94%	1,277	624	277
South Ozone Park	11420	51%	1,116	579	280
Jamaica	11433	87%	882	524	311

 Table 4: Most Underwater PLS Mortgages by Brooklyn Neighborhood

Neighborhood	Zip Code	% African-	# of PLS	# of underwater	LTV of More than
		American/Latino	Mortgages	PLS Mortgages	125%
Canarsie	11236	92%	2,478	1,134	444
East New York	11208	90%	1,719	962	549
East New York	11207	95%	1,567	719	339
East Flatbush	11203	94%	1,503	679	333
Bergen Beach/ Old	11234	52%	1,848	659	224
Mill Basin					

Table 5: Most Underwater PLS Mortgages by Neighborhoods in the Bronx

Neighborhood	Zip Code	% African-	# of PLS	# of underwater	LTV of More than
		American/Latino	Mortgages	PLS Mortgages	125%
Pelham Gardens	10469	79%	1,352	689	293
North Baychester	10466	94%	1,289	566	246
Norwood	10467	67%	611	265	135

East Chester Bay	10465	43%	688	256	82
Soundview	10472	89%	540	256	104

**Table 6: Most Underwater PLS Mortgages by Staten Island Neighborhoods** 

Neighborhood	Zip Code	% African-	# of PLS	# of underwater	LTV of More than
		American/Latino	Mortgages	PLS Mortgages	125%
Mariners Harbor	10303	72%	677	426	225
Bulls Head/	10314	17%	1,156	355	107
Westerleigh					
Huguennot/ Arden	10312	10%	921	253	61
Heights					
New Dorp/	10306	16%	729	244	92
Midland Beach					
Stapleton/Clifton	10304	52%	711	239	107

#### **Impact in Neighborhoods Affected by Hurricane Sandy**

There are also thousands of families with underwater PLS mortgages who live in neighborhoods affected by Superstorm Sandy. Not only did many of these families lose income as they missed work and lost tenants in the aftermath of the storm, they also incurred tens of thousands of dollars of damage to their homes. Thousands of homeowners were already struggling and underwater before the storm hit, making the increased costs of repairs and insurance a tipping point.

After Sandy, banks suspended mortgage payments for homeowners – but these were not indefinite. And these suspensions in some cases turned out to be more problematic than helpful for some families, as lump sum payments were required after the moratorium ended. We know from past disaster experiences – like Hurricane Katrina in New Orleans – that when the moratoriums end and insurance premiums rise, there is an influx of foreclosure and mass displacement.<sup>42</sup>

In neighborhoods like Far Rockaway, Canarsie, Midland Beach and Bergen Beach specifically, homeowners are in danger of losing their homes, and as a result there is a real threat that the economic and racial demographics of many Sandy affected neighborhoods will change completely. A total of 4,228 families have a PLS mortgage that is underwater in zip codes hit by Superstorm Sandy.

42 Travers, Suzanne *Canarsie Braces for Foreclosure Wave after Sandy*, City Limits, 19

**Table 7: Underwater PLS Loans in Sandy-Affected Queens Neighborhoods** 

Neighborhood	Zip Code	<b>Underwater PLS Mortgages</b>
Springfield Gardens	11413	642
Howard Beach	11414	161
Far Rockaway	11691	411
Arverne	11692	166
Broad Channel	11693	53
Rockaway Beach	11694	64
Total		1,497

Table 8: Underwater PLS Loans in Sandy-Affected Brooklyn Neighborhoods

Neighborhood	Zip Code	<b>Underwater PLS Mortgages</b>
Coney Island	11224	48
Gerritsen /Sheepshead	11229	114
Red Hook	11231	5
Sunset Park	11232	17
Bergen Beach/Mill Basin	11234	659
Brighton Beach/Sheepshead	11235	210
Canarsie	11236	1,134
Total		2,187

Table 9: Underwater PLS Loans in Sandy-Affected Staten Island Neighborhoods

Neighborhood	Zip Code	Underwater PLS Mortgage
South Beach	10305	188
New Dorp/Midland	10306	244
Great Kills	10308	112
Total		544

#### **Principal Reduction Modification to Prevent Foreclosures**

According to economic experts, lenders would lose less money if they were to grant principal reduction mortgage modifications to underwater PLS mortgages, but structural factors prevent them from doing so, which makes government action necessary. When a homeowner defaults on a mortgage, the choice for investors is to foreclose or modify. Legal fees, maintenance of the property, and selling costs that go along with foreclosing on a property can cost investors anywhere from 49-75% of the unpaid mortgage balance. In many cases, the investor would lose less if a borrower were given a principal-reduction modification than the same investor would lose by foreclosing. However, there are many entrenched barriers preventing a wide-ranging program of principal write-downs.

Principal reduction modifications are the only way to truly heal the real estate market. As securities, mortgage-ownership interests are fragmented in such a way that

<sup>&</sup>lt;sup>43</sup> Li, Wei, and Sonia Garrison. *Fix or Evict; Loan Modifications Return More Value Than Foreclosures*. Center for Responsible Lending. March 2012. www.responsiblelending.org.

<sup>&</sup>lt;sup>44</sup> *Id.*; see also Carr, James H., Katherine Lucas-Smith. *Five Realities About the Current Financial and Economic Crisis.* 44 Suffolk U. L. Rev. 7 2011.

makes it nearly impossible for investors to modify loans within their current structure. 45 Collection authority for these securitized mortgages is entrusted to an agent known as the servicer, and mortgages entrusted to a servicer are subject to pooling and servicing agreements that often prohibit modification. 46 Furthermore compensation to servicers is often structured to be independent of borrower principal payments so that it is more profitable for servicers to proceed with a foreclosure even if that isn't what is better for the investors. 47

And despite evidence that a large-scale principal reduction program targeting PLS mortgages would be in the best interests of investors, there is no indication in the marketplace that this notion is getting traction. No investor wants to be first to initiate such a program because as mortgages are modified and foreclosures are prevented home values will start to increase, the result being that the last to initiate principal reduction modifications has to reduce principal the least. Since the trustees and investors are either unwilling or unable on their own behest to rewrite many mortgages with principal reduction, local government must go around obstacles to action, inducing and coordinating a robust mortgage-modification effort that targets precisely those mortgages that are most at risk of going into foreclosure.

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<sup>&</sup>lt;sup>45</sup> Hockett, Robert. Breaking the Mortgage Debt Impasse: Municipal Condemnation Proceedings and Public / Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery.

<sup>&</sup>lt;sup>46</sup> *Id.* 

<sup>&</sup>lt;sup>47</sup> *Id.* 

<sup>&</sup>lt;sup>48</sup> Hockett supra at 17.

#### **New York City Can Compel Principal Reduction Modifications**

City government can use the power of eminent domain to:

- 1. Purchase existing PLS mortgages at fair market value.
- 2. Rewrite these mortgages so that the new mortgage balances are equal to or less than the homes' current values.

The power of eminent domain allows the city to take ownership of private property (in this case mortgages, not homes) if it serves a public purpose and the private owners are paid fair market value for the taken property. <sup>49</sup> In many cities, a plan has been considered in which those cities, in partnership with private investors, would purchase underwater mortgages (*the loan; not the actual home*) for the fair market value. By using eminent domain the city can write underwater PLS mortgages down to current market values, preventing the loss of billions of taxpayer dollars and creating an enormous economic stimulus for the city.

There are several ways the city can design such a program, including hiring a company to manage the process and lining up private capital for the mortgage purchases. This could be the cheapest option for the city, but there are other ways this can be financed, and the city could develop its own program. After purchasing the mortgages, the city will work with partners, including HUD-approved loan counselors, to modify or refinance mortgages.

Robert Hockett, a Professor at Cornell Law School, has analyzed the legal ramifications of New York City utilizing eminent domain to seize underwater mortgages

<sup>&</sup>lt;sup>49</sup> Hockett, Robert. *Breaking the Mortgage Debt Impasse: Municipal Condemnation Proceedings and Public / Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery.* 

<sup>&</sup>lt;sup>50</sup> Hocket *supra* 

and concluded it is within the power of the city to do so without any state action. He identified language in State Constitution, Article XVIII, Section 9 and the state's Eminent Domain Procedure Law Sections 101, 103, 104, and 708 indicating that the city could use eminent domain, without further state action, to seize underwater mortgages for the public purpose of preventing blight and neighborhood decline so long as the holders of the mortgages are paid the fair market value of those mortgages.<sup>51</sup>

It falls on local government to address the foreclosure crisis. Many of the foreclosure initiatives advanced by both the Bush and Obama Administrations have not had an impact because they failed to reach a significant number of homeowners and didn't address the issues of negative-equity. Significant future action by the federal government is unlikely because 1) Congress is so ideologically divided and 2) local governments feel the negative effects of foreclosures most acutely. Therefore, the willingness of New York City's government to act on foreclosures is essential for underwater homeowners and the neighborhoods where they live.

#### **Principal Reduction Modifications Will Stimulate the Economy**

After inducing the principal and interest-rate mortgage modifications that will lower mortgage loan payments, the city would see an economic stimulus in the neighborhoods with the highest concentration of previously underwater PLS mortgages. Because homeowners would spend the additional money they had each month, there would be an annual stimulus of almost \$300 million if the principal balance and interest rates of all of the city's underwater PLS mortgages were modified to reflect current home

<sup>&</sup>lt;sup>51</sup> Hockett, Robert, *New York Eminent Domain Law and Underwater Mortgages,* Memo to Concerned Fellow New Yorkers, August 6, 2013.

<sup>&</sup>lt;sup>52</sup> Papagianis, Christopher, Arpit Gupta. Making the Housing Market Work Again

<sup>&</sup>lt;sup>52</sup>Policy Review; Feb/Mar 2012; 171; ProQuest

<sup>&</sup>lt;sup>53</sup> Hockett *supra* at 22.

values and interest rates. That would result in the creation of more than 4,400 jobs. If the principal balance of every underwater PLS mortgage in NYC were reduced to 100% of the homes' value and the interest rates were reduced to slightly above the going rate, homeowners would save \$1,578 a month, a total of \$450 million annually.

Cash-strapped homeowners would likely spend most of the payment savings creating a direct consumer-spending driven stimulus to the city's economy. The Payments would function similarly to the tax cuts for personal consumption used by the federal government in 2008 to stimulate the economy. The New York Times reported that consumer spending was elevated in the months following the 2008 stimulus. Consumers spent 50-90% of their 2008 economic stimulus payments on durable or nondurable goods. Many underwater homeowners are currently struggling to make their payments; a modification that lowers their payments would have the same economic impact as receiving a check in the mail.

In addition to curbing defaults by easing payment pressures and removing the strategic incentive to walk away, such a modification program would increase consumer spending, thus stimulating the economy and leading to job creation. Payments savings spent by homeowners could create over 4,400 jobs. It has been estimated that it takes

<sup>&</sup>lt;sup>54</sup> Win / Win Solution; How Fixing the Housing Crisis will Create One Million Jobs. The New Bottom Line, 2011.

http://www.calorganize.org/sites/default/files/One%20Million%20Jobs\_0.pdf <sup>55</sup> [1] Grynbaum, Michael M. *Stimulus Payments Elevate Consumer Spending*. New York Times [New York, N.Y] 28 June 2008: C.4.

<sup>&</sup>lt;sup>56</sup> Parker, Joshua A., Nicholas S. Souleles, David S. Johnson, and Robert McClelland. *Consumer Spending and the Economic Stimulus Payments of 2008.* National Bureau of Economic Research. January 2011. Page 3.

\$68,493 to create one job through tax cuts for personal consumption.<sup>57</sup> Since mortgage-payment reductions act like a tax cut for personal consumption, about 70% of payment savings, would flow directly into the city's economy. Modifications would lower payments and increase consumer spending, allowing businesses to create jobs.

#### Conclusion

The foreclosure crisis has hit New York City with a ferocity equal to if not greater than that felt by the majority of the United States, and large numbers of delinquent and underwater mortgages indicate that the crisis is not over. Foreclosures have already cost the city hundreds of millions of dollars, and if the city does not act now to prevent existing delinquent and/or underwater mortgages from going into foreclosure, the cost to the city will increase dramatically. As documented above, a small percentage of total mortgages are causing a grossly disproportionate percentage of the problem with the most substantial impact to African-American and or Latino homeowners. Principal reduction modifications are necessary to turn the tide and to prevent an on-going crisis. The result would include less foreclosures, economic stimulus, and job creation. New York City has the power to bring banks and investors to the table to negotiate the purchase of PLS mortgages. If lenders are not willing to engage in this pragmatic, financially astute solution, the city has the power to use eminent domain to purchase the underwater mortgages at fair market value and provide the necessary principle reduction modifications that will help homeowners, lenders and neighborhoods...

<sup>&</sup>lt;sup>57</sup> Pollin, Robert, and Heidi Garrett-Peltier. *The U.S. Employment Effects of Military and Domestic Spending Priorities*. Department of Economics and Political Economy Research Institute. University of Massachusetts, Amherst, page 6. October 2007.

#### Appendix A. Top 20 Tables

#### 20 Zip Codes w/ the Greatest Number of PLS Mortgages

Zip	PLS	% Minority	Median Income	Neighborhood
			60,758	
11236	2478	92%	00,730	Carnarsie
11234	1848	52%	68,177	Flatlands
11208	1719	90%	35,665	Cypress Hill
11207	1567	95%	32,642	East New York
			ŕ	
			49,002	
11203	1506	94%		East Flatbush
				Jamaica
			57,393	(springfield
11434	1490	95%		gardens)
44442	4.424	0.6%	77,739	Lauraltan
11413	1431	96%		Laurelton
10469	1352	79%	55,724	Baychester
10466	1289	94%	44,038	Wakefield
10100	1203	3 170	,	Saint Albans
11412	1277	94%	71,292	(Hollis)
			27.000	
11221	1230	91%	37,608	Bushwick
11368	1205	82%	46,325	Corona
10314	1156	17%	79,820	Willowbrook
11422	1121	91%	85,151	Rosedale
			60,603	South Ozone
11420	1116	51%	33,333	Park
10202	022	F00/	56,883	Elea Davil
10302	922	59%	97.426	Elm Park
10312	921	10%	87,426	Eltingville
11233	919	95%	35,620	Ocean Hill
11233	313	3370		Occum Timi
			43,419	
11433	882	87%	, -	Jamaica
11419	879	34%	53,815	Richmond Hill

# **20 Zip Codes w/ the Greatest Number of Underwater PLS Mortgages**

ivioi iga	Median					
7in	UW PLS	% Minority	Income	Neighborhood		
<b>Zip</b> 11236	1134	92%	60,758	Richmond Hill		
11230	1154	92%	00,736	KICIIIIOIIU IIII		
			35,665			
11208	962	90%		Cypress Hill		
				Jamaica		
			57,393	(Springfield		
11434	796	95%		Gardens)		
11207	719	95%	32,642	East New York		
10469	689	79%	55,724	Baychester		
11203	679	94%	49,002	East Flatbush		
11234	659	52%	68,177	Flatlands		
11413	642	96%	77,739	Lauelton		
11412	624	94%	71,292	Saint Albans (Hollis)		
11420	579	51%	60,603	South Ozone Park		
10466	566	94%	44,038	Wakefield		
11433	524	87%	43,419	Jamaica		
11422	493	91%	85,151	Rosedale		
			37,608			
11221	465	91%		Bushwick		
11421	437	62%	57,091	Woodhaven		
10000	100	<b></b> 00/	50,137			
10303	426	72%	F2 04F	Mariners Harbor		
11419	412	34%	53,815	Richmond Hill		
11692	411	84%	39,817	Arverne		
11368	399	82%	46,325	Corona		
11212	394	97%	27,901	Brownsville		

#### 20 Zip Codes w/ the Greatest Number of Underwater Mortgages

Zip	CCD	UW	% Minority	Median Income	Neighborhood
11434	27	1776	95%	57,393	Jamaica (Springfield Gardens)
10314	50	1453	17%	79,820	New Springville
11234	46	1409	52%	68,177	Flatlands
10469	12	1373	79%	55,724	Baychester
11412	27	1271	94%	71,292	St Albans (Hollis)
10466	15	1266	94%	44,038	Wakefield
11203	45	1220	94%	49,002	East Flatbush
11413	31	1215	96%	77,739	Springfield Gardens
10462	15	1207	72%	46,001	Morris Park
11420	33	1063	51%	60,603	South Ozone Park
10303	49	1049	72%	50,137	Mariners Harbor
11433	28	990	87%	43,419	Jamaica
10312	50	955	10%	87,426	Eltingville
10306	51	945	16%	77,720	Richmond Town
10023	6	910	13%	105,311	Lincoln Square
11435	28	904	56%	53,914	Jamaica (Briarwood)
10465	13	887	43%	63,352	Throgs Neck
10024	6	867	16%	110,091	Upper Westside
11422	31	853	91%	85,151	Rosedale
11419	28	838	34%	53,815	Richmond Hill

### **20 Zip Codes w/ the Greatest Percentage of Underwater Mortgages**

		%	Median		
Zip	% UW	Minority	Income	Neighborhood	
11433	28%	87%	43,419	Jamaica	
			50,137	Mariners	
10303	28%	72%		Harbor	
11436	27%	84%	60,820	Jamaica	
10462	27%	72%	46,001	Morris Park	
11434	24%	95%	57,393	Jamaica (Springfield Gardens)	
10470	24% 22%	93% 52%	56,058	Wakefield	
11412	22%	94%	71,292	Saint Albans (Hollis)	
10302	22%	59%	56,883	Elm Park	
11416	21%	47%	55,225	Woodhaven	
10466	20%	94%	44,038	Wakefield	
10459	20%	96%	21,913	Longwood	
11429	20%	89%	70,478	Queens Village	
10473	20%	95%	37,616	Soundview	
11435	20%	56%	53,914	Jamaica	
11411	19%	95%	81,390	Cambria Heights	
10469	18%	79%	55,724	Baychester	
11413	18%	96%	77,739	Laurelton	
11206	18%	68%	28,584	Bedford Stuyvesant	
11693	18%	53%	50,006	Far Rockaway (Broad Channel)	
11212	18%	97%	27,901	Brownsville	

#### 20 Zip Codes w/ the Greatest Number of Foreclosures

		<u>~~~~</u> %		Median		
Zip		Foreclosures	Minority	Income	Neighborhoods	
	11208	2528	90%	35,665	Cypress Hills	
	11207	2527	95%	32,642	East New York	
	11236	2436	92%	60,758	East Flatbush	
	11221	2335	91%	37,608	Bushwick	
	11434	2007	95%	57,393	Jamaica (Springfield Gardens)	
	11233	1999	95%	35,620	Ocean Hill	
	11234	1785	52%	68,177	Flatlands	
	11203	1688	94%	49,002	East Flatbush	
	11412	1578	94%	71,292	Saint Albans (Hollis)	
	10314	1510	17%	79,820	New Springville	
	10466	1508	94%	44,038	Wakefield	
	11433	1503	87%	43,419	Jamaica	
	11420	1422	51%	60,603	South Ozone Park	
				55,724		
	10469	1419	79%	,	Baychester	
	11413	1405	96%	77,739	Laurelton	
	11691	1319	73%	38,631	Far Rockaway	
	10312	1216	10%	87,426	Eltingville	
	10303	1163	72%	50,137	Mariners Harbor	
	11216	1161	82%	41,688	Crown Heights	
	11212	1100	97%	27,901	Brownsville	

# 20 Zip Codes w/ the Greatest Number of REO Properties

<u>Properties</u>							
				Median			
Zip	REO		% Minority	Income	Neighborhood		
11433		314	87%	43,419	Jamaica		
					Jamaica		
				57,393	(sprinfield		
11434		293	95%	·	gardens)		
					gan area o		
				71,292	Saint Albans		
11412		192	94%	71,232	(Hollis)		
11412		192	94/0		(HOIIIS)		
44604		403	720/	38,631	E DI		
11691		192	73%	50.000	Far Rockaway		
11436		191	84%	60,820	Jamaica		
				60,603	South Ozone		
11420		181	51%	00,003	Park		
11413		170	96%	77,739	Lauelton		
11233		158	95%	35,620	Ocean Hill		
				27.600			
11221		153	91%	37,608	Bushwick		
11207		151	95%	32,642	East New York		
					Queens		
11429		141	89%	70,478	Village		
11123			3370		v mage		
11421		132	62%	57,091	Woodhaven		
11421		132	02/0		vvoodilaveli		
11200		122	000/	35,665	Cymross Hills		
11208		123	90%		Cypress Hills		
				F2 04 4			
				53,914	Jamaica		
11435		122	56%		(Briarwood)		
				50,137	Mariners		
10303		119	72%	33,237	Harbor		
				85,151			
11422		116	91%	03,131	Rosedale		
10466		109	94%	44,038	Wakefield		
10301		105	48%	54,792	St. George		
11369		103	81%	55,553	Elmhurst		
10314		98	17%	79,820	Bloomfield		
				•			

	Total PLS	100-110%	110-125%	125-150%	150-200%	
Borough	Mortgages	LTV	LTV	LTV	LTV	> 200% LTV
Queens	27,586	2,563	3,070	2,815	1,409	324
Brooklyn	22,375	1,931	2,142	1,975	960	200
Bronx	8858	1,007	1,206	1,152	413	96
Staten						
Island	7335	773	815	641	297	64
Manhattan	6211					
Total	72365	6274	7233	6583	3079	684