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The Municipal Cost of Foreclosures: A Chicago Case Study

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EXECUTIVE SUMMARY

The recent rise in nonprime mortgage foreclosures has opened a new and costly chapter in many of the nation's most distressed urban neighborhoods. Particularly problematic is the fact that today's foreclosures impose significant costs not only on borrowers and lenders, but also on municipal governments, neighboring homeowners and others with a financial interest in nearby properties. While there is an extensive literature on the impact that delinquency, default, and foreclosure have on lenders, borrowers, and other entities that are direct parties to the mortgage transaction in question, the costs that these mortgage failures impose on municipalities and other third parties are far less well understood. This is due to two factors. First, municipal and other third party costs are difficult to identify, and therefore often go undetected. Second, even where identified, the activities that generate costs often blend in with other governmental functions, or are otherwise difficult to quantify, reinforcing the tendency for them to remain invisible.

This study attempts to fill that void. Using the City of Chicago as a case in point, this study presents a conceptual framework that makes explicit the various costs of foreclosure, especially as they relate to local governments and courts. By carefully reviewing the foreclosure process as it plays out in Chicago, the paper isolates 26 separate costs incurred for the provision of 'foreclosure related services.' These costs reflect actions undertaken by 15 separate governmental units that are part of the overall municipal infrastructure underlying the foreclosure process. While in some cases these municipal activities are limited to simple and relatively inexpensive ministerial duties of agencies like the Recorder of Deeds, in more complex foreclosure scenarios these municipal costs can reach tens of thousands of dollars. In extreme cases, the concentrated foreclosures can put downward pressure on area property values and indirectly rob area homeowners of hundreds of thousands of dollars of home equity.

SUMMARY OF FINDINGS

Foreclosures, especially in the nonprime mortgage market, have been on the rise for over a decade. While mortgages of all types may end up in foreclosure, the rate of serious delinquencies and foreclosures for nonprime loans can easily be ten times higher than the rate for prime loans due to a number of factors, most obviously the generally lower credit quality of the borrowers. Moreover, the focus on credit impaired and higher risk borrowers leads to a natural tendency for nonprime foreclosures to cluster in lower-income and largely minority distressed urban areas.

This tendency for nonprime foreclosures to cluster generates significant negative spillover effects. Since many foreclosed properties become vacant and abandoned, they act as magnets for crime, violence, and other social ills. The foreclosure situation facing property owners on a single block in the Auburn/Gresham neighborhood of Chicago is illustrative. Over the past decade, the block's 37 properties experienced 14 separate foreclosures, with several homes going through the foreclosure process multiple times. Accounting for both the foreclosure costs paid for by City and County agencies, and the impact of foreclosures on area property values, a foreclosure on this block could impose direct costs on local government agencies totaling more than $34,000 and indirect effects on nearby property owners (in the form of reduced property values and home equity) of as much as an additional $220,000.

Foreclosure related costs of this magnitude raise a number of policy concerns. At the core of these concerns are questions about how best to reduce the financial burden foreclosures impose on neighbors and municipalities, and how best to pay for the unavoidable costs that do arise. The fact that municipalities and residents living near the foreclosed property currently bear a significant portion of foreclosure related costs is certainly an unintended consequence of efforts to attract mortgage capital to previously underserved inner-city areas. The result, however, is that local taxpayers and area residents are forced to shoulder burdens that are rightfully the responsibility of borrowers, mortgage lenders and others that are direct parties to the mortgage transaction. The failure of borrowers and lenders to pay the full social costs of nonprime lending also leads to perverse market effects, as less than scrupulous lending organizations overextend credit to highly foreclosure prone borrowers.

The extension of mortgage lending to higher risk borrowers has benefited millions. At the same time, risk-based pricing only efficiently allocates mortgage credit if all the expected risks and costs are reflected in the pricing of the deal. In the many instances in today's market where nonprime loans are likely to lead to concentrated foreclosures that produce significant negative external effects, this is simply not the case. Absent greater efforts to identify those costs that properly should be paid by some combination of the borrower, originator, noteholder, and/or other parties to the transaction, competitive pressures favor a race to the bottom as some lenders lower their standards to extend their reach into ever more risky and vulnerable urban neighborhoods. In such a race, market share flows to entities willing to under price their product at origination only to later leave behind a host of costs that are ultimately paid by municipalities, neighboring homeowners and businesses, and other mortgage entities invested in the neighborhoods where these loans go bad.

To address the rising costs of foreclosures, municipalities, along with their industry and non-profit partners have much work to do. First and foremost, it is imperative that municipalities join with responsible mortgage industry and community leaders to reduce the incidence of poorly underwritten and/or fraudulent loans made in distressed neighborhoods. Beyond these efforts lie a number of workable and effective solutions through which industry, government, and non-profit organizations can reduce the damage foreclosures cause in vulnerable urban neighborhoods. The following three areas summarize the most promising strategies.

Reform Key Elements of the Foreclosure Process

The current level of public awareness and concern about concentrated foreclosures provides an excellent opportunity to reassess state and local laws governing the foreclosure process, some of which increase the costs that foreclosures impose on others while providing little or no compensating benefit to borrowers or lenders. Here the case of so-called ‘walkaways,’ in which both borrower and lender abandon their interest in the property, is illustrative. Procedures designed to speed the transfer of potential walkways to the City’s land bank or to a designated non-profit before squatters and illicit activities arrive on the scene would substantially reduce the total social cost of foreclosures. Other solutions could involve better coordination of the activities of the various municipal agencies involved in the foreclosure process, including better coordination with the loan servicer and the note holder to minimize the overall extent and costs of foreclosures.

Support Collaborative Foreclosure Avoidance Efforts

Innovative programs now in operation demonstrate that it is possible for government, industry, and non-profits to address the challenges posed by the growth in nonprime foreclosures, and in doing so devise solutions that are not available to any of the parties individually. For example, working in partnership with Neighborhood Housing Services of Chicago and a group of responsible nonprime lenders, the City of Chicago is helping distressed borrowers gain access to legitimate and effective credit counseling services and other foreclosure avoidance information through its 311 non-emergency call system.

The 311 operators directly link callers to the Credit Counseling Resource Center (CCRC) a national counseling network created to "help distressed borrowers restore financial balance to their lives."

To help build public trust in the 311 approach, Chicago Mayor Richard Daley led a highly visible campaign to introduce the system and encourage distressed borrowers to seek help before it becomes too late. Callers have the opportunity to receive counseling from the Credit Counseling Resource Center (CCRC), a national alliance of HUD Certified Housing Counseling agencies operated by the Homeownership Preservation Foundation, and then be put in contact with the loan servicer to explore a potential workout or be referred to other available local resources or assistance if appropriate. The goal is to help distressed borrowers find the best way to address a temporary financial crisis, to mitigate the downside effects of a permanent income reduction, or to devise strategies to better manage their credit and/or to avoid foreclosure. Half of the credit counseling is paid for by lenders that have signed on to the program, while the City picks up the tab for the customers of others that have not joined the effort.

Encourage all Industry Participants to Pay Their Fair Share of Foreclosure Related Costs

Although well targeted municipal expenditures for foreclosure avoidance efforts can reap tremendous rewards in terms of avoided costs, it is also important that parties to the mortgage transaction pay their share of the cost generated by the foreclosures that do occur. To accomplish this, municipalities should carefully review the costs of providing foreclosure related services, move to increase the cost effectiveness of the delivery of these services, and, as appropriate, recover all or some of these costs through higher user fees. In addition, municipalities should work with industry leaders to ensure that by better coordination of the foreclosure process, municipalities are able to recover a fair share of the municipal costs from the proceeds of foreclosure sales.

While in theory correctly pricing municipal services will promote efficient resource allocation, in some cases the cost of collection is prohibitively high. One way to help municipalities address the rising costs linked to nonprime foreclosures would be to require nonprime lenders to pay a reasonable fee - tied to the likelihood that the mortgage will fail - into a central remediation fund when they originate a mortgage. Alternatively money could be collected on a voluntary basis, with the proceeds targeted to promote foreclosure avoidance activities. Of course municipalities will inevitably bear some of the costs of foreclosure and therefore must be prepared to deploy their own resources to support foreclosure avoidance strategies that help families in distress, limit damage to surrounding stakeholders, and reduce their own overall exposure to future foreclosure related expenditures.

REPORT METHODOLOGY AND OUTLINE

This report is based on a detailed examination of relevant sections of City of Chicago and Cook County budgets for 2003 and 2004, as well a series of interviews with key informants in various departments in Chicago. Interviews were conducted primarily in person and in some cases by phone between August and November of 2004. Throughout the report, interviewees are identified by Department only, rather than by name, in keeping with our agreements prior to those interviews. For the most part, interviewees hold positions of significant responsibility in Chicago's governance structure, such as Deputy Director or Assistant Commissioner.

The research is funded by the Homeownership Preservation Foundation, a charitable organization established in 2004. The report serves as a companion effort to the Home Ownership Preservation Initiative (HOPI), a collaborative effort between the mortgage industry, Neighborhood Housing Services of Chicago, and the City of Chicago to improve foreclosure avoidance efforts and reduce the impact of mortgage foreclosures on Chicago's lower-income neighborhoods.

The structure of the report is as follows: Section 1 presents a detailed typology of foreclosure costs that are borne by individuals and entities that are not direct parties to the loan transaction. Section 2 then documents in some detail the foreclosure process as experienced in the City of Chicago and other cities. Next, Section 3 uses Chicago budget and other information to estimate costs of providing 26 distinct foreclosure-related services provided by 15 separate agencies. These individual cost estimates are then combined in a series of scenarios designed to estimate the direct municipal costs associated with simple foreclosure cases in which the home is quickly vacated and resold, to those in which the property lingers vacant for years, motivating significant municipal expenditures. These include costs associated with court procedures, record keeping, demolition of abandoned buildings, and efforts by the Departments of Building, Police, Fire and other municipal agencies to address the adverse neighborhood consequences of a prolonged foreclosure process. The final section of the report places the report's findings in the context of broader nonprime mortgage market trends and related public policy discussions.

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SECTION 1: A SIMPLE CONCEPTUAL FRAMEWORK OF THE SOCIAL COST OF MORTGAGE FORECLOSURES

This section presents a simple conceptual framework for thinking about the social costs of foreclosure. It includes costs incurred by borrowers, mortgage lenders and other parties to the mortgage transaction, as well as others living and/or having business interests located near the foreclosed property. The framework not only makes explicit social costs of foreclosure that are typically ignored, it serves to situate costs incurred by municipalities and courts within this larger framework. The remainder of this section enumerates the cost categories for each entity in additional detail.

CONCEPTUAL FRAMEWORK

As illustrated in Figure A, four distinct groups – borrowers, lenders, neighbors, and municipalities - are affected by foreclosures. As noted, the impact extends well beyond the individual borrower and lender or other mortgage industry parties with a direct financial interest in a particular loan in default (hereafter simply referred to as the mortgage lender or lender).[1] Additional costs are incurred by 'neighbors,' including the owners of homes and commercial establishments, and others with a financial interest in properties located near to the foreclosure site. Note that this last group also includes other mortgage lenders with outstanding loans on properties in the neighborhood. Local municipalities and court systems also incur costs linked to providing services as part of the foreclosure process. To the extent that foreclosures reduce the value of homes and businesses – a particular concern when foreclosures are concentrated – local governments will suffer a loss in property tax revenue as well.

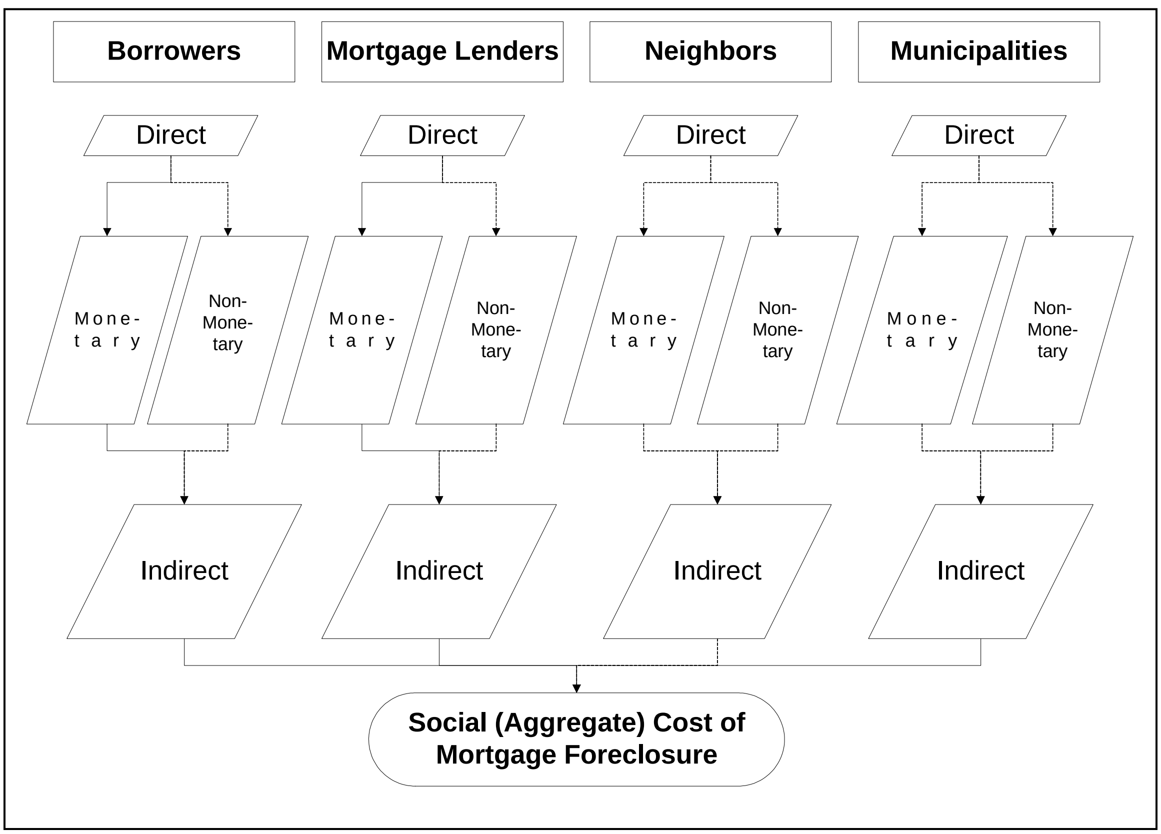
Potentially, entities falling into each of the four groups are subject to both direct and indirect impacts from mortgage foreclosures. Direct impacts can be either monetary, non-monetary, or both. In Figure A, solid lines depict costs that are incurred by the borrower and the lender and are clearly reflected in the pricing of mortgage loans. Dotted lines are used to indicate costs that mortgage foreclosures impose on society but are not reflected in the price of credit in the mortgage contract. Further discussion of these various costs follows.

[1] Depending on the details of the transaction, these parties may include the lender, the servicer, the mortgage insurer, the securities issuer, the investor, and various other participants in the primary and secondary mortgage markets.

Borrowers

Mortgage borrowers experience many obvious direct, monetary costs in the foreclosure process. As shown at the left of Figure A, these include: net loss on downpayment and principal paid; penalties and fees charged by servicers during the period of delinquency and default; and legal fees associated with the foreclosure process. Borrowers' indirect costs result mainly from increased future borrowing costs as a result of diminished credit quality and from the expenses associated with moving to a new unit. Non-pecuniary costs include but are not limited to: the emotional and physical stress of managing the foreclosure process; and the psychological effects of a dramatic and public 'failure' at one of life's key milestones and simultaneous reduction in socioeconomic status; and negative effects on children in households forced to move as a result of foreclosure.[2]

Figure A: The Social Cost of Foreclosure



[2] For summary of the negative impact of unexpected relocation on the educational achievement of children see Eric A. Hanushek, John F. Kain, and Steven G. Rivkin, (2004). Disruption versus Tiebout Improvement: The Costs and Benefits of Switching Schools. *Journal of Public Economics*, 88(9): 1721-1746.

Mortgage Lenders

For mortgage lenders and other industry parties to the mortgage transaction, direct costs of mortgage failures are legion. They include: reduction in the value of assets held by mortgage investors, increased servicing expenses, and the opportunity cost of funds tied up in the foreclosure process. Similarly, there are many indirect costs, including weaker pricing on subsequent bond issues and increased monitoring costs in originations. Further, to the extent that one foreclosure makes subsequent foreclosures on nearby loans more likely ('foreclosure contagion'), the indirect impacts of foreclosure cycle back to produce additional indirect effects on the lender or the investor in the foreclosed property, as contagion may weaken the performance of other loans in their portfolio. Finally non-pecuniary costs include exposure to 'headline' or reputational risk associated with being publicly perceived as responsible for removing families from their homes.

Neighbors

Neighbors (including nearby property owners, businesses, and others with financial interests in the area) also suffer from foreclosures and the vacancies they generate. Given that foreclosures tend to concentrate in low-income and/or minority neighborhoods, many of these 'external' costs are incurred by some of the nation's most vulnerable households.[3] Direct monetary costs for neighbors include but are not limited to loss of rent collected by neighborhood landlords and reduced sales by local businesses. Non-pecuniary costs are often linked to quality-of-life issues of great concern to most families, such as crime. Police officials interviewed for this report noted a range of social ills occurring in vacant properties, including gang activity, drug dealing, prostitution, arson, rape, and even murder. The presence of vacant homes and those in foreclosure also has an indirect effect that operates through their negative impact on local property values and price trends. As a result, these indirect effects are a major concern for existing homeowners and prospective buyers in the area, as well as other mortgage lenders and servicers operating in the area. Indeed, because the cost of mortgage capital at some level reflects the likelihood and severity of default, foreclosures indirectly raise mortgage interest rates for all new borrowers, and reduce the market value of all existing loans.

Municipalities

Though there is some variation from one city to the next due to local ordinances and state-level legislation governing the foreclosure process, direct costs to municipalities and local courts typically include some or all of the following: increased policing; increased burden on fire departments (due to vandalism and/or arson); demolition costs; building inspections; legal expenses; costs associated with managing the foreclosure

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3 See Duda, M. and W. Apgar. 2004. Mortgage Foreclosure Trends in Los Angeles: Patterns and Policy Issues. Report prepared for Los Angeles Neighborhood Housing Services. July.

process or resulting from it (*e.g.*, record keeping/updating); and increased demand for city social service programs. In the case of completed foreclosures, costs are also incurred for human services programs aimed at reducing the negative effects of foreclosure on families, such as homelessness prevention activities. These costs accrue during the foreclosure process and in some cases afterwards as well. Especially in cases where the property has little no economic value, the city inherits the responsibility for securing and/or demolishing the unit, removing trash from the lot, mowing the lawn, and a range of other activities intended to keep the unit from becoming a dangerous eyesore.

Foreclosure also leads to a direct loss of tax revenues. A borrower in financial distress often simply stops paying their property tax. Though the municipality can issue a lien against the property, this process can take months or years to complete and even then the municipality may have to settle for less than full repayment. Equally costly can be situations when the foreclosure leads to the demolition of the structure judged to be unsecured and a public nuisance. In such instances the tax base is diminished by the assessed value of the structure demolished.[4]

Indirect costs to municipalities occur mostly through the impact that foreclosures, especially concentrated foreclosures, can have on house price appreciation.[5] Because homes often deteriorate and/or become vacant during the foreclosure process, they often become associated with crime and general unsightliness, and act as a deterrent for prospective homebuyers. In addition, the presence of foreclosed properties may encourage existing stable owners to leave the area. Reduced attractiveness of the neighborhood and its associated reduction in the rate of increase of home values translates into slower growth (or potentially a decline) in the municipal property tax base. This same phenomenon may also adversely impact business location decisions as well as reduce the profitability of existing business in the city. This in turn can impact sales and income tax receipts in municipalities where they exist.

Of course, high foreclosure areas are also subject to speculation by investors seeking to either convert the building to rental uses, and or to flip an often deteriorated property to unsuspecting first time buyers. Both outcomes can give the appearance of increasing the values of homes in otherwise distressed areas. Yet even to the extent that short term sales prices appear to be on the rise, their positive impact on longer term property values is short lived as the appraisal fraud and other related activities underlying these schemes are ultimately revealed. By this time, the perpetrators of these schemes are long gone, while the lender and/or the city are left to work through a messy new foreclosure. Alternatively the flipper can sell the home at an inflated price to

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4 These two direct tax effects are explained more fully in Appendix A.

5 Further discussion of the indirect impact of foreclosures on property values and tax revenues is presented in Appendix B.

unsuspecting buyer. The new buyer must pay higher mortgage and property taxes - costs that they often cannot afford on a home that may be worth less than the amount owed on the mortgage. This again can trigger another round of foreclosure and loss.

Finally, in addition to having direct and indirect impact on municipal expenditures and receipts, foreclosures also have a non-pecuniary cost component as well. Just like companies and individuals, municipalities care about their reputation. To the extent that the growth of foreclosures and resulting vacancies undermine the attractiveness of particular neighborhoods, the municipality may gain a reputation as not being a good place to live and work – a negative image that may extend well into the future.

In general, this section has illustrated the fact that the damage caused by increased rates of mortgage foreclosure is substantial and wide-ranging. In contrast to general perceptions about the mortgage market which suggest that the cost of mortgage failures are shared by borrowers and industry participants, the conceptual scheme here argues that mortgage failures impose substantial third party costs. The remainder of the report focuses on the direct municipal component of these costs, bringing to light and detailing these formerly hidden costs of mortgage foreclosure.

SECTION 2: MORTGAGE FAILURES AND THE FORECLOSURE PROCESS IN CHICAGO

Following a brief discussion of the extent of foreclosure activity in the City of Chicago, this section describes the complex foreclosure process as it plays out in Chicago in order to illustrate the numerous mechanisms through which mortgage failures impose costs on municipal governments. Since loans that are simply delinquent or in default may generate municipal costs even if foreclosure is never fully consummated, the section describes the many ways that Cook County and the City of Chicago incur direct and indirect costs as a result of what are here referred to as 'mortgage failures,' a term that includes delinquent mortgages that may cure before the foreclosure process in complete, as well as situations where delinquent mortgages do not end in a foreclosure sale because the potential foreclosing agent is financially better off walking away from his or her interest than taking possession of the property. This latter situation is responsible for some of the most costly 'mortgage failures' that Chicago and other cities experience.

Because the subset of units that become vacant and are unsecured during the foreclosure process pose the most pressing public safety issues and command the majority of effort and resources, the discussion is dominated by procedures and expenditures related to vacancy and rectifying code violations.[6] Although some cost information is presented here in order to flesh out the descriptions, information on specific municipal costs is largely reserved for Section 3 and the methodological appendix in which the focus is on estimating these costs, rather than understanding the foreclosure process.

THE GROWTH OF FORECLOSURES IN CHICAGO

Foreclosures, particularly nonprime foreclosures, have been on the rise in Chicago and other major metropolitan areas for over a decade. Compared with prime loans, one recent study found that nonprime loans have serious delinquency rates and foreclosure rates that can be as much as 10 times higher than the rate for prime loans.[7] Moreover and as noted above, there is growing evidence that nonprime foreclosures tend to cluster in lower-income and largely minority distressed urban areas.

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6 Although foreclosures are not the only source of vacancies (others include owners dying without heirs, fires, and landlords being unable to attract tenants to marginal properties), they are the largest. Consensus among our interviewees put the share of foreclosure-generated vacancies at 60 percent of the total.

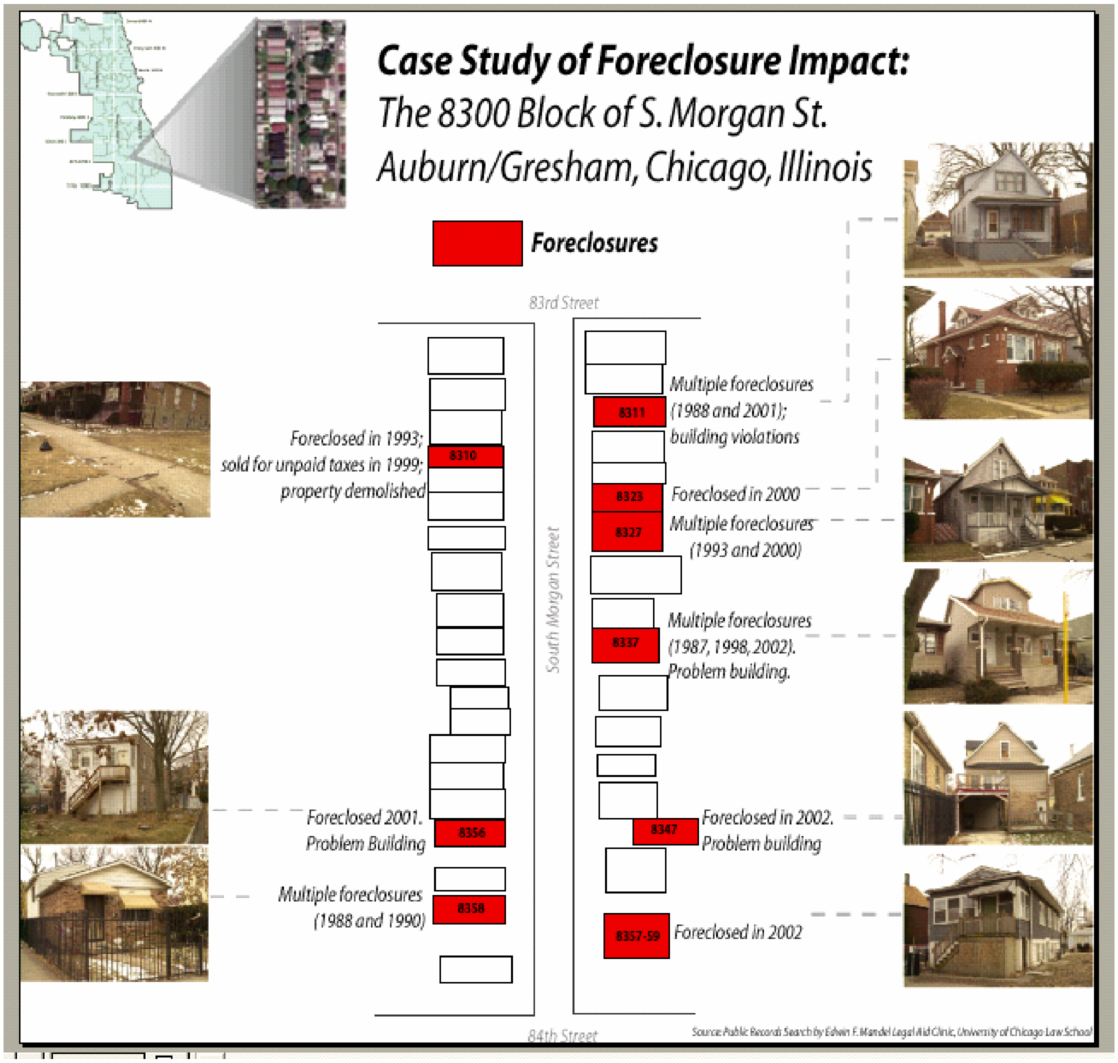
7 See Amy Crews Cutts and Robert Van Order. 2003. On the Economics of Subprime Lending. Freddie Mac working paper. March.

Best available estimates suggest that the foreclosure and serious delinquency rate in Chicago stood at 4.7 percent in 2001 – over ten times the national average for prime conventional loans.[8] In the nine low-income neighborhoods served by Neighborhood Housing Services of Chicago (NHSC), the foreclosure rate reached 7.7 percent in 2001. Overall, some 40 percent of all completed foreclosures in Chicago were in these nine targeted neighborhoods. Yet, these communities represented only 5 percent of all mortgage originations in 2001 and account for just 18 percent of the city's population.

The foreclosure situation in the 8300 Block of South Morgan Street in the Auburn/Gresham neighborhood provides a clear example of foreclosure concentration. As shown in Figure B, since 1990 the 37 homes on this block have experienced 14 foreclosures, affecting 9 separate properties. NHSC Executive Director Bruce Gottschall argues that the phenomenon of foreclosure contagion is very real in these neighborhoods. He describes the dynamic as one in which "one foreclosure often prompts another and another and in no time a decade of neighborhood revitalization work can be undone."

8 Michael Collins (2003). Chicago's Homeownership Preservation Challenge: Foreclosures. Presentation to the Federal Reserve Bank of Chicago. February.

Figure B: Case Study of Foreclosure Impact: Auburn/Gresham



Moreover, the explosion of nonprime lending and the resulting rapid rise in foreclosures in selected neighborhoods has forced city and county agencies to ramp up activities of those agencies involved in serious delinquency and foreclosure related activities and vacancies.

DIRECT EFFECTS OF VACANT AND OPEN UNITS ON CITY SERVICE CONSUMPTION

Foreclosures and vacancies consume so many resources in part because they involve so many different agencies. As discussed here and described more fully in Appendix A, no fewer than 15 City and County departments play a role in conducting and documenting the process and rectifying its material effects on communities. Collectively, the activities of these departments constitute the complex infrastructure of mortgage foreclosures and vacancy remediation. To illustrate how this infrastructure functions, this section presents a number of representative foreclosure pathways. It is useful to bear in mind, however, these pathways inevitably obscure much of the complexity involved in coordinating activities across various agencies and the timing of the multiple layers of service provision.

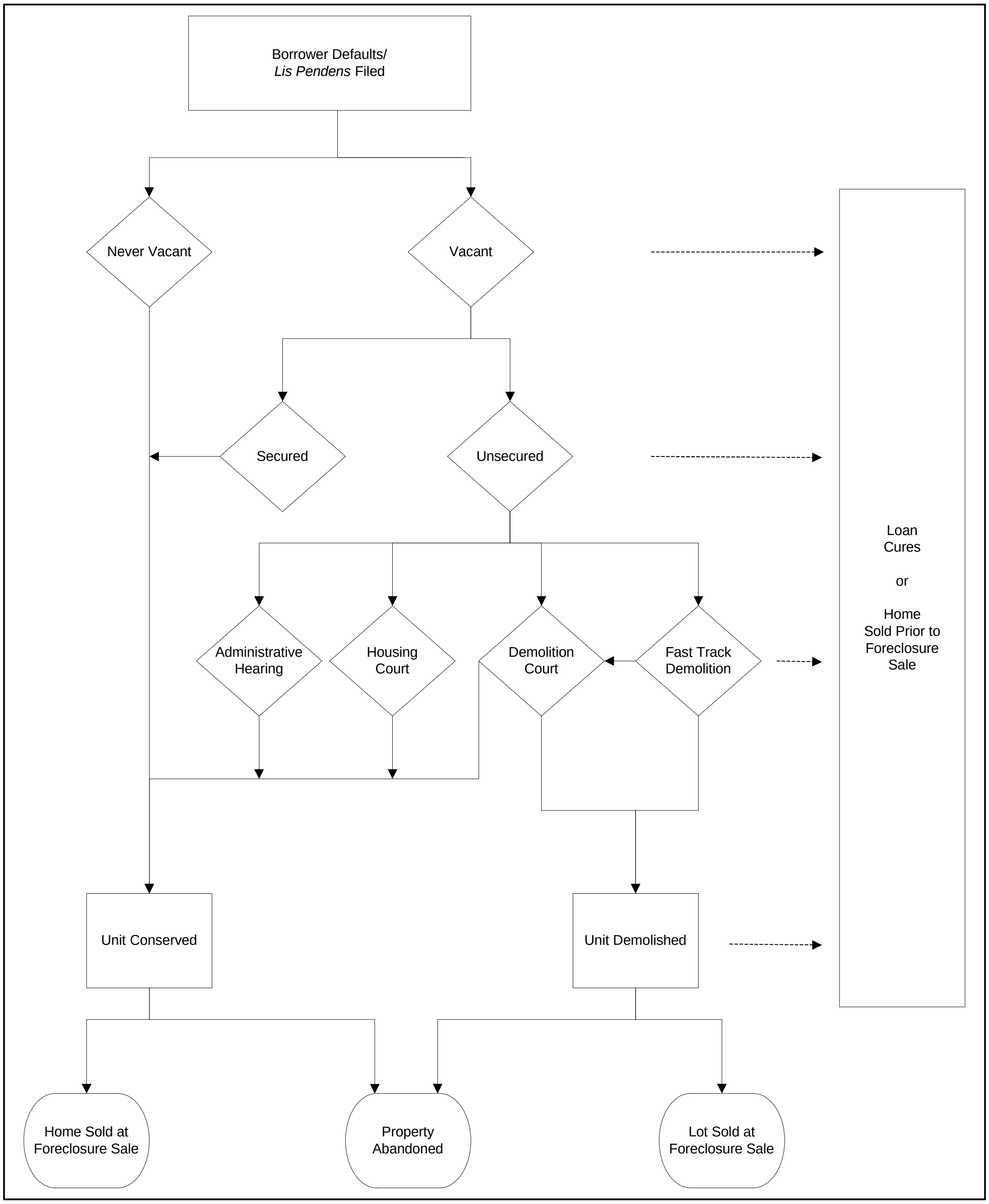
Beginning at the point when default becomes sufficiently serious that the servicer initiates foreclosure proceedings (*i.e.*, files the *lis* pendens), Figure C highlights the key junctures in the foreclosure/vacancy process from a municipal cost perspective. These are: whether or not a unit becomes vacant, whether a vacant unit is secured or unsecured, whether the case enters the court system or not, and whether an unsecured unit is demolished or conserved. As indicated by the box at the right and dotted arrows, the foreclosure process can end abruptly at any point if the borrower sells the home and pays off the loan or manages to cure the delinquency. Barring these solutions, three outcomes are possible as shown at the bottom of Figure C: the home is sold at a foreclosure sale, the property is abandoned by both borrower and noteholder (with or without the structure being torn down), or the unit is razed and the lot sold at foreclosure sale. The rest of this subsection fleshes out the flow chart in Figure C, providing additional detail and linking municipal agencies to the performance of various roles in the process.

Simple Foreclosure

When the servicer files a *lis pendens* and the loan does not cure, the foreclosure process is at its most straightforward (and least costly) in cases where the unit never becomes vacant. In such cases involvement by the County occurs in its role as a provider of foreclosure reporting and record keeping, and as operator of Chancery Court, through which all foreclosures must pass owing to Illinois's status as a judicial foreclosure state. In Figure C, this situation is represented by the path: *Never Vacant → Unit Conserved → Home Sold at Foreclosure Sale*. As many as six separate Cook County departments are involved and additional complications sometimes ensue when the County Sheriff's Department is required to evict a failed borrower.[9]

[9] These six are the Recorder of Deeds, Office of the Chief Judge, the Clerk of the Circuit Court, Office of the Judiciary, Court Services, and the Sheriff's Office.

Figure C: The Foreclosure and Vacancy Process in Chicago



More Complex Cases

Foreclosures become rapidly more complex and costly for municipalities in situations in which the unit becomes vacant. This sequence begins when vacancies are reported to the Department of Buildings (DOB) either directly or via Aldermen, the Mayor's office, the 311 Information System (the City's non-emergency call system), concerned neighbors, community groups, Police and Fire officials, or Building Inspectors in the field doing other jobs. Following receipt of a complaint, DOB sends Inspectors to the unit to confirm its vacant status, and to log and document code violations for which the City issues fines. At this point DOB places the unit on either a demolition or conservation track, depending on structural characteristics and the likelihood that it can be successfully reintegrated into the City's housing stock. Municipal procedures and costs differ for each track.

Demolition Track

The preferred method for dealing with properties that are "vacant, open, and constitute a hazard to the community" is the City's Fast Track Demolition (FTD) process.[10] Fast Track avoids the more lengthy court procedures through which the City can obtain the right to demolish structures that constitute a threat to public safety. Under Fast Track, the City serves notice to parties with a legal interest in the building alerting them that they must secure, repair, or demolish the structure.[11] If after thirty days the property remains vacant and open, the parties are formally notified of the City's intention to wreck the structure. Following a ten day waiting period in which the City solicits bids from demolition contractors, the structure is torn down at City expense and a lien (superseding all others except tax liens) is issued against the property to cover the demolition cost. In the flow chart, this series of events is captured by the path: *Vacant → Unsecured → Fast Track Demolition → Unit Demolished* (at which point the lot can either be sold at foreclosure sale or abandoned). Abandoned lots can subsequently be acquired by the City if it chooses to foreclose on the demolition lien or other outstanding municipal liens, a process that takes over a year in the quickest cases and many years in slower ones.

If the owner objects to FTD or the public safety threat posed by the vacant structure is less imminent, the case is tried in what is widely known as 'Demo Court,' in reality part of the Housing Court section of the Circuit Court of Cook County's First Municipal Bureau.[12] The process begins when the Building Inspector's report is sent to the Department of Law (DOL), which drafts and files a formal complaint, and issues summons to all legally interested parties.[13] The first court date is typically two to three months after the initial inspection. As the process unfolds the City has the legal right to compel the owner to secure the property, clean it up, and remove dangerous porches. If

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10 A more detailed version of the fast track process is available by going to http://egov.cityofchicago.org/city/webportal/home.do and searching for 'Fast Track Demolition.'

11 Notification occurs by four methods: posting at the site; certified mail; recording a 'Notice of Violation' with the Cook County Recorder of Deeds; and publication in the classified section of the newspaper.

12 Much of the information on Demo Court is drawn from a manuscript entitled *Introduction to Demolition Court* by David Smith, a Senior Counsel at the City's Department of Law.

13 If the defendant(s) cannot be located, the intent to demolish is published in the classified section of the newspaper.

the owner refuses, the City can also perform these activities itself and issue liens to cover their cost.

In order for the court to order a building demolished, the City must prove that the structure is a threat to public safety and beyond reasonable repair. If the case is unopposed, the Court usually orders demolition. These demolitions are done by contractor at City expense, again with the City issuing liens to cover the cost. The City then has the option of foreclosing on this lien and eventually selling the property to cover its costs (done for 200-300 loans annually), a process typically requiring several years. In most cases these liens are not actively pursued, though some in the 'passive pool' (roughly 5,000 loans at any one time) eventually repay. If the owner contests demolition, the court will order the defendant to bring the building up to code by a certain date. The City can either agree with the defendant's plan ('consent decree') or object to it (where objecting indicates a belief that the defendant will not actually bring the building up to code). In the latter case the City sets a legally binding time table for finishing the repairs called a 'mandatory order of full compliance' which, if not met, can result in substantial fines. In such cases the Court may then allow the City to pursue its demolition of the building.

In Figure C above, a case in Demolition Court can be represented by a number of paths, because there are a number of possible in-flow channels and outcomes. All begin with *Vacant* → *Unsecured* and reach *Demolition Court* either directly or after beginning in the Fast Track process. As an outcome of the Court proceedings the unit can either be *Conserved* or *Demolished*, with the former outcome being slightly more common.

Conservation Track

The alternative to demolition is conservation. If the Building Inspector's report suggests that the structure is sound and worthy of maintaining as a component of the housing stock, effort is made to contact the owner and ensure compliance with regulations regarding vacant and open buildings. The City also issues fines for the code violations, which encourage compliance by the owner. If the owner responds to the City's initial contact by properly securing the unit, registering it as vacant, and posting a required notice to this effect, the property can remain in this state until sold, or until further deterioration or other changes renders it a threat to public safety.[14]

If the owner fails to comply, the City has two options, the Department of Administrative Hearings (DOAH) or Housing Court. Begun in 1997, DOAH is "the first unified municipal administrative adjudicatory system in the nation," a City agency designed "for the

[14] To register a vacant building, the City requires the owner of record to register it with the Department of Buildings within 30 days of becoming vacant and pay $100 registration fee. The owner must also carry $300,000 of liability insurance on the property.

expedient, independent and impartial adjudication of municipal ordinance violations."[15] The 400,000 cases brought to DOAH annually involve nuisance issues affecting public health, safety, welfare and quality-of-life. Among other things, the City uses Administrative Hearings to collect fines for code violations and compel owners to secure vacant structures and rectify related problems in cases where the total amount owed is less than $50,000. For a conservation case in DOAH, the path in Figure C is: *Vacant → Unsecured → Administrative Hearing → Unit Conserved*, at which point the unit can be sold or ultimately abandoned.

If fines exceed $50,000 or in cases where the issues involved are more complex, the City's Department of Law (DOL) brings suit in the Housing Court branch of Cook County Superior Court. Because the legal process is slower and more complex, these cases result in some of the longest unsecured or marginally secured vacancy periods. For as long as the unit is vacant it is often accessible to vandals, squatters, and criminals, despite efforts to board and otherwise secure it. (In Chicago boarding is notoriously ineffective.) Defendants in Housing Court cases must obey the Court's ruling or risk further sanction. The path and potential outcomes for the property are the same as for the previous example, except that *Administrative Hearing* is replaced by *Housing Court* at the legal channel juncture of the figure.

Crime, Fires, and Trash

Given the fact that in Illinois the foreclosure process typically lasts 13 months, a building may remain vacant and/or unsecured for months. Local governments may be forced to spend resources in several different ways. Of these, fighting crime is probably the greatest area of concern. One respondent from the police force characterized vacant properties as "a haven for bad people doing bad things." This perspective was echoed by an Alderman who spoke of the extreme level of concern that vacant buildings cause among neighbors, community advocates, and police.

Police involvement is often triggered by calls from neighbors who observe activity in and around abandoned buildings. In response, officers come to check the property and may follow this up with regular drive-by checks. Only if they determine that there is sufficient evidence to suspect criminal activity, however, can officers legally enter the property. In some cases this involves evicting squatters or chasing vandals. In others it can mean the more dangerous proposition of arresting drug dealers. In fact, drug dealing is perhaps the most problematic as well as the most common of the more serious crimes taking place in vacant buildings (though our respondents from the Police Department also mentioned prostitution, rape, and murder). Regardless of the magnitude of the crime they are investigating, the officers' safety is always an issue because vacant buildings are often structurally compromised.

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[15] Quotes from DOAH website. http://www.ci.chi.il.us/AdminHearings/Information.html.

A related concern is arson and other fire activity. Some vacant building fires are the result of arson by owners seeking to make insurance claims and others are set by vandals. According to the arson detective interviewed for this study, many fires are also started by squatters for cooking or keeping warm in buildings without utilities. Although intended as small campfires, these can and often do spread to the structure itself. Such blazes are often serious because no one calls the fire department when the fire is still small enough to be suppressed and, by the time the fire is visible to neighbors, it is often too late to do more than prevent it from spreading to neighboring homes. Fires in vacant units increase the overall municipal service consumption and detract from the Department's ability to fight other fires. Our interviewee also noted that squatters who start accidental fires often simply move on to the closest vacant unit, at which point the process often repeats itself at the new location.

Finally, whether the structure has been demolished or not, abandoned properties must have some degree of supervision and maintenance to prevent from becoming blighted eyesores or trash strewn lots. To prevent these potential negative outcomes, the City must periodically mow overgrown lawns and lots, and remove trash. The cost of doing so is significant, as evidenced a study in Buffalo putting the municipal cost of trash removal alone at $5,000.[16]

Direct Loss of Property Tax Receipts

Broadly speaking, municipalities suffer direct loss of property tax receipts in two ways. First, taxes owed by the property owner sometimes go unpaid due to foreclosure. Though much of the unpaid taxes are eventually recouped, in some cases the County fails to collect all taxes owed. Second, in cases where a housing unit is demolished because the home is judged to be unsafe and/or otherwise a public nuisance, the loss of revenue comes through the removal of the value of the 'improvement' to the raw land from the tax roles

The most obvious loss of tax revenue occurs when property taxes are simply not paid. Like many municipalities, Chicago has a law mandating that delinquent property tax claims are sold in a timely manner in order to take advantage of the private sector's willingness to return these units and parcels to the housing stock and, hence, to the active property tax paying roles. To implement this mandate, the periodic tax auctions are held, the goal of which is to transfer the claim on delinquent taxes to private investors at a discount to the actual amount owed in return for earlier collection on the debt. Claims purchased at the tax sale supersede any other liens or claims on the property and allow the tax investor to eventually take possession of the unit following a series of legal hurdles designed to ensure that the delinquent owner has been given opportunity to repay. Taxes are usually fully recouped at the 'one year sale.'

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[16] See Bendix Anderson. 2004. New Jersey Fights Blight. *Affordable Housing Finance*. June: 78-79.

Occasionally properties not sold at the one year sale are bought at the County Clerk's Office but this is rare. Most wind up in 'scavenger sale' and generate less than the full amount owed with variation accounted for by factors such as the quality of the structure, its investment potential, and the apparent likelihood that the property's owner will eventually pay. In some cases tax bills cannot be sold at auction because there is simply no interested buyer.

Utilities

Since the City collects tax revenue on electric and gas bills, and is the water and sewer service provider, when these bills are unpaid City revenues are reduced commensurately. Unpaid water bills often run into the thousands of dollars. While the city has a process for attaching water liens to properties, the process is distinct from the activities of DOL and conducted by legal staff at the Water Department. As with Taxes, the City has the option of selling lien for collection by a third party, but this assumes that a willing third party exists. Moreover, the City could foreclose on the property, but that itself is a costly process, and often the city may be reluctant to take control of a property with little or no economic value.

SECTION 3: THE COST OF FORECLOSURE IN CHICAGO: SEVEN REPRESENTATIVE SCENARIOS

As shown in the preceding section, 'the foreclosure process' contains several key junctures at which expenditures are either attenuated or escalate dramatically. As a result, there is not a single 'cost of foreclosure' but rather a range of costs associated with a variety of increasingly severe foreclosure scenarios. This section therefore illustrates the impact of failed loans on municipal service demand and expenditures by presenting seven empirically plausible scenarios.

The scenarios, their estimated costs, and their impact on the municipal level foreclosure infrastructure are outlined in Figure D. In both the Figure and the text, scenarios are organized from least to most complex/costly. Depending on the details, each scenario draws on services provided by some share of the 15 separate City and County entities involved in the foreclosure process, and incurs between 4 and 18 distinct direct municipal costs. Detailed explanations of the methodology through which each cost element is calculated are presented in Appendix A of this report.

Note that while the costs presented here reflect a comprehensive estimate of the direct municipal costs of foreclosure for alternative scenarios, they do not reflect the total social costs as defined earlier. In particular, measuring the indirect costs associated with the decline in home prices, and resulting decline in tax base goes beyond what is technically possible to estimate with any degree of precision. As noted earlier, however, in the extreme case of concentrated foreclosures, these losses range upward to hundreds of thousands of dollars.

Figure D: Summary of Municipal Costs for Alternative Foreclosure Scenarios

Scenario Number	Characteristics	Direct Municipal Cost	Number of Agencies Involved
1	Foreclosure, Sold at Auction, Never Vacant	$ 27	5
2	Foreclosure, Sold at Auction, Vacant/Secured	$ 430	7
3a	Foreclosure, Sold at Auction, Vacant/Unsecured, DOAH	$ 5,358	9
3b	Foreclosure, Sold at Auction, Vacant/Unsecured, Housing Court	$ 7,020	8
4a	Foreclosure, Sold at Auction, Vacant/Unsecured, DOAH, Modest Criminal Activity	$ 5,673	10
4b	Foreclosure, Sold at Auction, Vacant/Unsecured, DOAH, Significant Criminal Activity	$ 6,753	10
5a	Foreclosure, Sold at Auction, Vacant/Unsecured, Fast Track, Modest Criminal Activity	$ 13,452	9
5b	Foreclosure, Sold at Auction, Vacant/Unsecured, Demo Court, Modest Criminal Activity	$ 13,324	9
6	No Foreclosure, Vacant/Unsecured, Modest Criminal Activity, Structure Demolished	$ 19,227	11
7	Severe case with Fire	$ 34,199	12

THE DIRECT COSTS OF ALTERNATIVE FORECLOSURE SCENARIOS

Scenario 1: Foreclosure, Sold at Auction, Never Vacant ($27)

The minimalist scenario from a municipal expenditure perspective is one in which foreclose does not result in vacancy and the servicer covers any property taxes not paid by the failed borrower. Cook County is responsible for recordkeeping associated with default, registering the foreclosure sale and the name of the owners following the sale, and operating Chancery Court. Also included is the City's Department of Housing's nearly $1 million annual investment in foreclosure avoidance that is allocated across all foreclosures experienced in the City. Figure D shows that net direct expenditures for the City and County combined amount to $27 in this straightforward case. As with all costs estimates presented here, this one is conservative because it omits the indirect effects that even simple cases can have on neighbors and/or other third parties. Similarly, because eviction of an intransient former owner is not 'typical,' this cost is also excluded in this scenario. Including it would not only increase costs but bring in the Cook County Sheriff's Office as an additional participant agency in the foreclosure process.

Scenario 2: Foreclosure, Sold at Auction, Vacant/Secured ($430)

This situation is somewhat more costly due to the impact of a period of vacancy, albeit a relatively unproblematic one in terms of municipal service consumption. The previous costs apply, to which are added expenses the City incurs maintaining infrastructure and manpower for vacancy reporting and building inspections. In Scenario 2 the vacant unit is properly secured and no code violations exist, indicating that the owner has registered it on the vacant property registry. The largest additional cost stems from the effort of the Department of Buildings (DOB) to conduct inspections and file reports of conditions in vacant properties. As costs grow, so do the number of municipal agencies involved. Even in this relatively simple situation, some seven agencies are involved – raising not only costs, but the need considerable in interagency coordination. Costs here remain modest in part because securing the home prevents undesirable uses, such as drug dealing, that costs upward of $1,000 each time police make arrests at the site. City losses are further limited here because the city saves thousands in boarding, court, and demolition expenses that are required in more complex situations.

Scenario 3a/3b: Foreclosure, Sold at Auction, Vacant/Unsecured ($5,358/$7,020)

When the unit is not only vacant but also 'open,' costs related to compelling the owner and/or noteholder secure the property - or to do so at City expense - accrue. These additional costs begin following the DOB's inspection mentioned in Scenario 2. At this point the Department of Law (DOL) attempts to contact the owner regarding the code violation and need to secure the property. If the City is unable to find the owner and/or the owner is served notice but fails to secure the unit, the city will pay a contractor to board the home and issue a lien to cover its costs. Securing a building is notoriously difficult because boarding is often removed by squatters, vandals, or criminals, as soon as it is put in place. Multiple re-boardings are not uncommon. The City must also pursue collection from the owner and others with an interest in the property either through the Department of Administrative Hearings or Housing Court. This process generates considerable costs associated with the preparation and adjudication of the case, which can range from $2,690 for Administrative Hearings (Scenario 3a) to $4,203 for the Housing Court (Scenario 3b). Operating these judicial venues also involves administrative expenses. The cost presented in Figure D assumes that there was only one judicial notification and three boarding liens. Raising the number of required notifications raises the total cost a minimum of $165 for each additional one (the $180 fee for police time net of the $15 fee).

Scenario 4a/4b: Foreclosure, Sold at Auction, Vacant/Unsecured, Criminal Activity ($5,673/$6,753)

These scenarios, both extensions of 3a, introduce additional costs related to criminal activity.[17] Scenario 4a assumes that such activity is relatively benign, such as squatting by homeless persons, vandalism, and perhaps drug use (as opposed to drug dealing). Such activity requires only that police visit the site periodically but not make arrests or be put at risk. As a result policing costs are for only a half hour visit, without back up. Our interviewee reported that three to four visits is typical so we use the midpoint of this range to produce and estimate of $315 for the 3.5 visits in this simple case. Scenario 4b assumes more severe criminal activity that requires police to call backup and make arrests of individuals involved in serious criminal activity. Costs in this latter case ($1,080 for a single serious crime stop) are higher due to additional manpower requirements and longer time spent on scene and afterward.

Scenario 5a/5b: Foreclosure, Sold at Auction, Vacant/Unsecured, Criminal Activity, Structure Demolished ($13,452/$13,324)

Scenarios 5a and 5b are based on Scenarios 3a and 4a (*i.e.*, effort to collect fines and fees goes through DOAH and the level of criminal activity is ‘typical’ as opposed to severe).[18] These new scenarios differ from the earlier ones by introducing expenses associated by demolishing problem structures. Scenario 5a assumes demolition occurs through the Fast Track Demolition process where the City hires a contractor to wreck the building and issues a lien to cover the cost. In this case City expenses stem from notification requirements prior to demolition, as well as to the imperfect ability to collect the full amount on demo liens. In Scenario 5b the case is pursued in Demolition Court, requiring DOL to prepare and try a relatively complex case. The County incurs the cost of operating the court in which demolition cases are tried. One of the key cost

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[17] If the cases went to Housing Court the total for 5a and 5b would each be $1,563 higher (*i.e.*, higher by the difference between the Administrative Hearings and Housing Court scenarios).

[18] To find alternative combinations of these earlier strategies simply add $1,563 for the higher cost judicial venue and/or $1,080 for each serious criminal event.

increments in both Scenarios is the loss of the structure from the property tax roles. We estimate the resulting loss at $861 annually and assume the lot remains vacant for five years for a direct tax loss of $4,307. Ultimately, the cost estimates for each Scenario here are similar but the key components of those costs differs – in one case the expense associated with paying a for demolition and in the other court-related expenses. In addition, the timing differs, with demolition is accomplished far more quickly through Fast Track.

Scenario 6: No Foreclosure, Vacant/Unsecured, Criminal Activity, Structure Demolished ($19,227)

Scenario 6 assumes demolition occurs through Fast Track but adds complexity by making the property a 'walkaway.' As discussed in several places in this report, walkways are the source of immense problems for city residents, businesses, and neighborhoods because they provide spaces that exist without oversight, potentially in perpetuity. Further, no party with resources to remedy problems associated with the structure is legally bound to do so. In Scenario 6 the loan fails but the noteholder's agent does not consummate the foreclosure process. In this situation, a variety of outstanding bills cannot be collected. Foremost among these are property taxes that often are unpaid at the time the 'walkaway' actually occurs. These technically remain the burden of the home's owner who clearly does not have the ability to pay. As a result, uncollected taxes are ultimately put through a tax sale, at which time some share of the taxes are recouped. In addition, in its role as water provider the City incurs losses when the unpaid water balance is also 'walked away' from. The same principal applies to electricity and gas, though these losses are much smaller because the City taxes these services rather than providing them directly. Finally, because these properties are untended, they not only deteriorate but attract illegal dumping and require periodic outdoor maintenance such as mowing the weeds.

Scenario 7: Severe Case with Fire ($34,199)

In the event that it is not demolished, a 'walkaway' can impose an even greater municipal service burden. Serious criminal activity becomes more likely, trash removal costs are higher, the likelihood that utilities will be illegally reconnected increases dramatically, and a host of other problems arise or intensify, raising costs by thousands of dollars. In this case we assume a long period of vacant/open status, including a fire (estimated at a cost of $14,020) followed by eventually demolition of the remaining structure. It is important to realize that while this is the most serious case presented it does not reflect the absolute highest possible cost burden the City might incur on a failed mortgage. Such an actual worst case would be too idiosyncratic to be instructive but would include things like multiple instances of serious criminal activity, extreme levels of dumping and hence demand for trash removal, fire(s) that spread to adjacent homes and business, and greater foregone tax revenues.

Overall this section illustrates the direct cost of providing foreclosure infrastructure at the local level under a series of empirically common scenarios. As summarized in figure D, these activities are both complex – involving coordination across a number of City and County agencies even in the simplest cases – and costly. Even as large as they often are, direct costs reflect only a portion of the burden loan failures impose on municipalities. The next section summarizes these indirect costs.

INDIRECT COSTS MAGNIFY THE DIRECT MUNICIPAL COST

The previous section showed that, depending on the nature and complexity of the foreclosure scenario, municipalities spend as much as $34,199 to provide foreclosure related services. To the extent that foreclosed properties result in vacant and boarded up eyesores and/or become a magnet for crime they generate significant indirect costs by reducing the desirability of living and working in the area surrounding the property. This in turn acts as a deterrent for prospective home buyers and may even encourage existing neighbors to move out. Reduced desirability will eventually decrease (or reduce the rate of increase of) local home values. This slower rate of home price appreciation not only robs home owners in the area of their housing wealth, it also deprives the city of much needed tax revenue.

As discussed more fully in Appendix B, it is difficult to quantify the indirect costs linked to the negative impacts that foreclosures and foreclosure related vacancies have on neighboring property values. Clearly, the extent to which serious problem properties flowing from mortgage foreclosures engender indirect costs depends on the degree to which they are concentrated in particular neighborhoods. A single foreclosure in an otherwise healthy neighborhood is certainly not a positive factor but likely has only modest effects on appreciation rates on surrounding properties. As the number of foreclosures in a single area mounts, however, the negative consequences increase rapidly.

Consider the situation facing the 8300 Block of South Morgan Street in the Auburn/Gresham neighborhood depicted earlier (Figure B). As explained more fully in the Appendix B, the best available evidence suggests that the vacancy and resulting demolition of a foreclosed home on that block will generate significant downward pressure on home price appreciation. Moreover, existing studies on the topic suggest that the adverse impacts persist up to 450 feet from problem units. Yet even counting impacts on homes that are within a radius of 150 feet, in the Auburn/Gresham situation, as many as 13 homeowners would see the collective value of their homes decline by nearly $220,000.

Nor are area homeowners the only losers. The blight associated with a neighborhood littered with vacant and boarded homes will limit the willingness of customers to shop at nearby stores, and make it more difficult for local area employers to attract workers. Moreover, the negative impact also extends to other entities with a financial interest in loans on other properties on this block. For example, the downward pressure on home prices reduces the value of the collateral that secures other mortgages in the area, just as it reduces the incentive for other mortgage borrowers to meet their mortgage payment obligations. As a result, foreclosures undermine the economic interests of other mortgage investors, help stimulate more foreclosures, and further increase the social costs of concentrated foreclosures.

SPENDING DOLLARS TO AVOID FORECLOSURE RELATED COSTS

Once the foreclosure process starts, some municipal expenditures for foreclosure related services are unavoidable. As noted earlier, however, there are numerous opportunities for municipalities to devote resources in order to avoid even larger costs in the future. For example, the City's Department of Housing spends nearly $1 million of its Community Development Block Grant funds working with community-based non-profit organizations to avoid costly foreclosures.[19] Though this amount shows up as expenditure in the municipal budget, it generates substantial indirect benefits by avoiding future costs for the city, and their spillover effects on the distressed homebuyer and surrounding neighborhood.

This example of 'spending money to save money' is a reminder that even though the municipal costs of a single foreclosure can run into the tens of thousands of dollars, there are numerous opportunities to reduce, if not entirely eliminating many of them. The last section of this report therefore discusses ways that municipalities - working in partnership with responsible lenders and committed community organizations - can develop initiatives that avoid foreclosures in the first instance and, when foreclosure is unavoidable, minimize the effects of foreclosure for the borrower, the lender, neighbors and the municipality.

[19] See discussion of "Cost 4" in Appendix A.

SECTION 4: CREATING PUBLIC PRIVATE PARTNERSHIPS IN THE FORECLOSURE ARENA

Key developments in the US mortgage market have always been closely linked to the growth and evolution of public sector infrastructure designed to support mortgage origination and secondary market activities. At the federal level, this public infrastructure includes institutions such as the Federal Housing Administration, Ginnie Mae, Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System that blur the line between public and private sector activities. In their role as guardians of the rights and responsibilities of the owners of land and property, local governments also conduct a range of activities such as land and mortgage document registries that are fundamental to mortgage lending. Similarly, local courts play a key role in the mortgage foreclosure process. Finally when a foreclosure results in abandonment, other municipal agencies – including Police and Fire – are called into action.

To address the rising costs and disruptions of growing foreclosures, municipalities, along with their industry and non-profit partners have much work to do. First and foremost, it is imperative that municipalities join with responsible mortgage industry and community leaders to work to reduce the incidence of poorly underwritten and/or fraudulent loans made in distressed neighborhoods. In addition, business, government and non-profit organizations can work cooperatively to: 1) Reform Key Elements of the Foreclosure Process; 2) Support Foreclosure Avoidance Efforts; and 3) Encourage Industry Participants to Pay Their Fair Share of Foreclosure Related Costs. Specific proposals are detailed below.

REFORM KEY ELEMENTS OF THE FORECLOSURE PROCESS

The increase in nonprime foreclosures has tested the ability of local governments to effectively and efficiently provide foreclosure related services. As a result, this is an opportune time to streamline and better coordinate the work of the various municipal agencies involved in the foreclosure process. Effective examples of this type of coordination include Chicago's Troubled Building Initiatives (discussed below) and the work done by Neighborhood Housing Services of Chicago to address the problem of 'walkaways,' and to identify and remedy 'foreclosure hotspots.'

Streamline and Better Coordinate the Foreclosure Legal Process

Public concern about the growing concentration of foreclosures in some urban neighborhoods provides an excellent opportunity for re-assessing state and local laws and regulation governing the foreclosure process. While it remains critical that borrowers be given every reasonable opportunity to cure a default, foreclosure statutes should recognize that the collective good – including the interests of neighbors and local businesses - is best served when the benefits of a speedy and predictable foreclosure process are seen to outweigh advantages individual borrowers reap through a sluggish process. Standardizing and updating foreclosure law with an eye to eliminating provisions that simply delay inevitable foreclosures while worsening their adverse impact on neighborhoods is an important element of regulatory reform.[20]

Better coordination of the various steps in the foreclosure process is also essential. A good example of what can be achieved is the City of Chicago's Troubled Building Initiatives. Building on its first incarnation (TBI1) focusing on multifamily buildings, the City has launched a second phase (TBI2) for single family buildings. Both programs are intended to coordinate city resources and activities across all agencies involved in order to bring about the best solution to the negative effects of problem buildings. The process begins with identification of available resources (*e.g.*, laws, fines/fees, coercive mechanisms, and other signals). In some cases this can mean foreclosing on an existing municipal lien (*e.g.*, for unpaid taxes, water, boarding or demolition) to accelerate the City's ability to take control of the property. In others it means bringing administrative or judicial action against the lender and/or property owner to get their attention and force resolution of the situation. Rather than let foreclosure-related vacancies in single family homes linger, TBI2 helps to accelerate the process and in doing so minimize the adverse impact of mortgage failures on the neighborhoods, the City, and other stakeholders.

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[20] Michigan recently enacted comprehensive tax foreclosure reforms. For a discussion of how these reforms are enabling the City of Flint, Michigan better address issues relating its growing inventory of vacant and abandoned homes see: Daniel T. Kildee. 2004. Reusing Forgotten Urban Land: The Genesee County Urban Land Redevelopment Initiative. *Housing Facts and Findings* 6(2).

Focus on Walkways – A Costly Breakdown of the Foreclosure Process

While many buildings stuck in various stages of the foreclosure process deserve special attention, perhaps none are more deserving of special treatment than so called 'walkaways,' or situations in which both the borrower and lender abandon their interest in the property (though legal interest typically remains with the borrower as s/he is often unaware that the lender has not completed the foreclosure).[21] Problematically for local stakeholders, walkways leave behind a vacant building with title status that can take years to resolve.

Through its HOPI initiative, Neighborhood Housing Services of Chicago is working with the City of Chicago and responsible lender partners to address the walkaway situation. One approach is to craft accelerated procedures to speed the transfer of potential walkways to the city (or a designated non-profit). Rapid transfer of distressed properties would not only reduce the City's costs stemming from properties languishing in limbo, it would also enable the city to move more quickly to either demolish the structure and land bank the parcel, or rehab or otherwise redevelop the property as part of a neighborhood stabilization or revitalization effort. Whatever the details, there can be little doubt early intervention – before squatters and illicit activities arrive on the scene – would substantially reduce the social cost of foreclosure.

Create a Special Foreclosure Hotspot Initiative

Better overall coordination of activities and a special focus on the most troubled buildings and neighborhoods could be the first step in the creation of a 'foreclosure hotspot protocol.' This initiative identifies a series of steps designed to minimize the significant social and financial costs – including costs to city agencies – that result from extreme foreclosure levels. For example, municipal tax collection agencies could forbear on efforts to foreclose on tax liens against individual owner occupants residing in foreclosure hotspots if such efforts would allow the family to remain in their home.

Alternatively, to the extent that the owner of a hotspot home has already vacated the property and decided not to contest the foreclosure, a municipality could work with lenders to accelerate the foreclosure process and speed transfer of the property to a new owner. Again, while it is important to protect the interests of low-income homeowners, in situations of uncontested foreclosures, quickly moving properties in troubled neighborhoods off the vacancy rolls can reduce foreclosure related costs that are now are borne by lenders, municipal governments, and area residents alike.[22]

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[21] Whether such actions themselves should be permitted at all is worth considering. In particular, having been party to a failed loan, the question is whether the lender should be permitted to abandon its interest the property, or instead be minimally be required to complete the foreclosure process, pay any outstanding liens against the property and/or turn the property over to the city.

[22] For further discussion of 'Hotspot Initiatives' see William Apgar, and Mark Duda. 2004. Preserving Homeownership: Community-Development Implications of the New Mortgage Market. A report prepared for the Neighborhood Housing Services of Chicago.

SUPPORT FORECLOSURE AVOIDANCE INITIATIVES

Innovative programs now in operation demonstrate that municipalities can productively partner with responsible mortgage industry representatives and community based organizations to form new partnerships that address the challenges posed by the growth in nonprime foreclosures. This section identifies some approaches that can minimize the adverse impacts of these foreclosures.

Help Servicers Make Contact with Borrowers in Distress

Recognizing that foreclosure imposes costs on borrowers, lenders, neighbors and municipalities alike, most lenders and their servicers go to great lengths to reach out to delinquent borrowers. Yet, the high cost of maintaining contact with distressed borrowers limits the effectiveness of many standard approaches. In the nonprime market, it is very common for delinquent loans to move to foreclosure without the borrower being made aware of possible loan modifications and workout options, not to mention publicly available foreclosure avoidance programs.

The pilot partnership between Homecomings Financial Network[23] and Neighborhood Housing Services of Chicago (NHSC) is a promising way forward. Homecomings is betting that some borrowers that are unwilling to talk to the company directly will instead be willing to talk with the NHSC. Upon contacting NHSC, these borrowers are offered the option of independent credit counseling thru the Credit Counseling Resource Center (CCRC) or speaking with a Homecomings representative. The partnership allows the organizations to work together to arrive at appropriate workouts, and provides borrowers with a trusted advisor to guide them in what can be an intimidating process.

Initial results of this approach point to success. Although it was not possible to avoid foreclosure in every instance, early experience suggests that as many as half of all program participants achieved ‘successful outcomes’ (defined as any resolution of the situation that did not result in the property becoming vacant and abandoned). These successes resulted from NHSC staff interventions with lenders, accessing private and public loan/grant resources (e.g. the Neighborhood Lending Program or Homeless Prevention Fund), or refinancing through NHSC or a partner lender in order to achieve a more sustainable mortgage for the owner.

Connecting Borrowers to Trusted Sources of Credit Counseling

Effective credit counseling can literally be the difference between saving and losing a home. When done poorly, however, counseling is a waste of time and money. When done unscrupulously, it makes a bad situation worse. To help consumers gain access to legitimate and effective credit counseling services, the City of Chicago has begun

[23] The servicing arm of GMAC-RFC.

providing foreclosure avoidance information through its 311 System, a non-emergency city call center equipped to receive inquiries about city services and to direct callers to appropriate city agencies or delegate agencies. The Chicago 311 program builds on previous counseling efforts developed by the Credit Counseling Resource Center (CCRC), an alliance of three credit counseling agencies with a national network formed to “help distressed borrowers restore financial balance to their lives.”

To help build public trust in the 311 approach, Chicago Mayor Richard Daley led a highly visible campaign to introduce the system and encourage distressed borrowers to seek help before it becomes too late. Callers have the opportunity to receive counseling from the Credit Counseling Resource Center (CCRC), a national alliance of HUD Certified Housing Counseling agencies operated by the Homeownership Preservation Foundation, and then be put in contact with the loan servicer to explore a potential workout or be referred to other available local resources or assistance if appropriate. The goal is to help distressed borrowers find the best way to address a temporary financial crisis, to mitigate the downside effects of a permanent income reduction, or to devise strategies to better manage their credit and/or to avoid foreclosure. Half of the credit counseling is paid for by lenders that have signed on to the program, while the City picks up the tab for the customers of others that have not joined the effort.

ENCOURAGE ALL INDUSTRY PARTICIPANTS TO PAY THEIR FAIR SHARE OF PERFORMANCE RELATED COSTS

Failure to account for the full social cost of nonprime lending not only imposes an unfair burden on the taxpayers who fund municipal services but is also economically inefficient. This failure also enables less than scrupulous lenders to overextend credit to the most risky and foreclosure prone borrowers. While the basic theory of risk-based pricing is economically sound, it works to efficiently allocate mortgage capital only if the expected risks are actually priced into the deal. In many instances, this is not the case.

It is critically important to understand that the failure to price loans based on realistic estimates of their total costs helps some industry players to successfully use a 'cut and run' approach. By not bearing the full cost of their activities, less capable and/or less responsible lenders are able to thrive in situations where their business practices are not economically viable. This business model suggests that they will only secure a property or aggressively seek to resolve the delinquency in situations where there is clear private economic gain for doing so. For example, such a business strategy may lead some lenders to 'walkaway' from buildings in foreclosure, leaving behind vacant buildings in a legal limbo that often takes years to sort out.[24]

It is in the best interest of all responsible parties to insure that nonprime mortgage lending occurs only when loan pricing reflects the true social costs and benefits of these inherently riskier loans. Absent such action, competitive pressures will result in a race to the bottom as some lenders lower their standards to extend their reach into ever more risky and vulnerable urban neighborhoods. In such a race, market share will flow to those willing to under price their product at origination only later leave behind a whole host of costs that must be paid by neighbors and municipalities left to pick up the tab. This not only places undo stress on municipalities and neighborhoods but, as negative spillovers diminish house price appreciation, concentrated foreclosures undermine the value of outstanding loans originated, serviced, and owned by all lenders, even the most responsible nonprime market participants.

Raise the Fees on Specific Court and Municipal Foreclosure Related Services

As the provider of basic governmental services, many municipalities are rethinking how best to set fees. While this obviously is driven in part by the need to raise additional local revenue, it reflects the notion that local taxpayers should not be expected to pay for the provision of services that largely benefit specific and identifiable private parties.

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[24] In a recent paper, Duncan Kennedy discusses two approaches to lending: the 'high road' and the 'low road,' and how regulatory policy can help to reinforce the competitive advantage of "high road" market participants over "low road" players. See Duncan Kennedy, (2004). "Cost Benefit Analysis of Debtor Protection Rules in Sub-Prime Market Default Situations," a paper produced for Building Assets, Building Credit: A Symposium on Improving Financial Services in Low-Income Communities, Joint Center for Housing Studies, Harvard University, Cambridge, Massachusetts.

For example, as part of the Fast Track Demolition Process, the City is obligated to make owners aware of its intent to demolish a building. These notices are designed to protect the interests of delinquent borrower and foreclosing agent, yet net of a modest service fee, they cost the city $165 to issue.

Just as local government is rethinking the fee structures in many areas, it makes sense that local governments should identify and correctly price the activities comprising the municipal foreclosure infrastructure.[25] This won't be easy. Note that prior to this study, there was no systematic enumeration of the many municipal costs associated with foreclosures. Moreover, some may worry that raising fees paid by lenders – especially nonprime lenders – will only further raise the costs of nonprime credit and harm future credit impaired borrowers. While this concern merits attention, the alternative argument is simple. The current implicit subsidies now provided by municipalities that are forced to assume a substantial portion of the cost of foreclosures are no substitute for an explicit policy to subsidize lending, or otherwise assist low-income borrowers. For example, to the extent that a locality could capture additional revenue by more appropriately pricing foreclosure services, that revenue could be used to pay the city costs for implementing promising new foreclosure avoidance activities targeted at lower-income borrowers in distress. [26]

Create an Industry Fund to Help Offset Municipal Costs of Foreclosure

While in theory correctly pricing municipal services will promote efficient resource allocation, in many instances collecting these fees may be more costly than the revenue generated. For example, the City of Chicago pays a contractor on average some $900 each time it boards and otherwise secures a vacant home, and issues a lien to cover the costs. While effectively securing properties reduces the costs of police and fire services associated with vacant properties, and the exposure to dangerous and otherwise unpleasant conditions by neighbors, as many as half of the liens go uncollected. In some instances, there is no responsible party capable of paying the lien. In other cases, the cost of collecting the lien may exceed the value of the dollars returned.

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[25] To draw a parallel with another public policy issue in which government expenditures have been used to justify regulation, if cigarette smoking imposed no costs on government, then tobacco sales would be regulated differently than they are in world where government incurs substantial smoking-related expenses though its Medicare and Medicaid programs. That is, anti-smoking regulations are justified based on the fact that smoking imposes costs on government itself, and not just on the need to limit the negative external impacts of smoking on non-smokers.

[26] To draw a parallel with another public policy issue in which government expenditures have been used to justify regulation, if cigarette smoking imposed no costs on government, then tobacco sales would be regulated differently than they are in world where government incurs substantial smoking-related expenses though its Medicare and Medicaid programs. That is, anti-smoking regulations are justified based on the fact that smoking imposes costs on government itself, and not just on the need to limit the negative external impacts of smoking on non-smokers.

One strategy for helping municipalities address the rising costs linked to nonprime foreclosures builds on and extends previous industry proposals to help assume some of the cost burden linked with predatory lending. For example, in the Fall of 2003, the Coalition for Fair and Affordable Lending – a leading national organization representing the interests of some nonprime lenders – proposed that Congress require nonprime lenders to pay a reasonable fee into a central fund when they originate a mortgage.[27] This fee could be used as a significant supplementary funding mechanism for state and community based education programs. A simple extension of this fee concept would be to use the funding generated to defray the municipal costs associated with foreclosure, to support state and local efforts to streamline the foreclosure process, to expand the capacity for localities to launch foreclosure avoidance initiatives, and in other ways to reduce the overall financial and social costs of foreclosure.

[27] Coalition for Fair and Affordable Lending (2003), " National Standards for Mortgage Lending Gain Momentum: Industry Outlines 'Reasonable Compromise Proposals,'" press release dated November 17, 2003

CONCLUSION

Recognizing that they will inevitably bear some of the costs of foreclosure, municipalities must also be prepared to use their own community development resources to support foreclosure avoidance strategies that will both help families in distress and reduce their own overall exposure to foreclosure related costs. While well targeted municipal expenditures for foreclosure avoidance efforts can reap tremendous rewards in terms of avoided costs, it is also important that mortgage industry participants pay their fair share of foreclosure related costs as well. To accomplish this, municipalities should carefully review the costs associated with providing foreclosure related services and, when appropriate, pass these costs along in the form of higher user fees. In addition, municipalities can work cooperatively with industry leaders to ensure that a greater share of municipal costs is recovered from user fees or out of the proceeds of the foreclosure sale.

Finally, there are numerous opportunities for municipalities to increase the efficiency of their provision of foreclosure related services, and evaluate existing laws and regulations that may inadvertently add to the overall social cost of foreclosure. Together these actions will serve to reduce the municipal costs of foreclosure and help preserve the homeownership gains that have resulted from the expansion in access to credit to higher risk borrowers.

APPENDIX A: METHODOLOGY EMPLOYED TO GENERATE MUNICIPAL DIRECT COST ESTIMATES

Figure E: Summary Table for Costs and Scenarios

		Scenario Components	Scenario 1	Scenario 2	Scenario 3a	Scenario 3b	Scenario 4a	Scenario 4b
Scenarios →		Foreclosure	x	x	x	x	x	x
		Unit Sold at Auction	x	x	x	x	x	x
		Vacant		x	x	x	x	x
		Unsecured			x	x	x	x
Costs ↓		Legal Venue			Admin. Hearing	Housing Court	Admin. Hearing	Admin. Hearing
		Criminal Activity					modest	significant
		Other						
Expense Number	**Direct Costs**	**City/County**						
1	*Lis Pendens* Filed	county	$ (13)	$ (13)	$ (13)	$ (13)	$ (13)	$ (13)
2	Operate Chancery Court	county	$ (43)	$ (43)	$ (43)	$ (43)	$ (43)	$ (43)
3	Register Sale & New Owner	county	$ (13)	$ (13)	$ (13)	$ (13)	$ (13)	$ (13)
4	DOH Delegate Agency Funding for Foreclosure Prevention	city	$ 96	$ 96	$ 96	$ 96	$ 96	$ 96
5	Compliant Monitoring/ Intake (*e.g.,* 311, Buildings & Police Dept.)	city		$ 3	$ 3	$ 3	$ 3	$ 3
6	Filing	city		$ 364	$ 364	$ 364	$ 364	$ 364
7	Vacant Buildings Registry	city		$ 36	$ 36	$ 36	$ 36	$ 36
8	Serving Notice to Secure Vacant Unit	city			$ 715	$ 715	$ 715	$ 715
9	Issue Lien	city			$ 1,445	$ 1,445	$ 1,445	$ 1,445
10	Dept. of Law Prepares Case for Administrative Hearings	city			$ 2,690		$ 2,690	$ 2,690
11	Administering Department of Administrative Hearings	city			$ 78		$ 78	$ 78
12	Dept. of Law Prepares Case for Housing Court	city				$ 4,203		
13	Administering Housing Court	county				$ 228		
14	Police Visit	city					$ 315	$ 315
15	Police Enter Property & Make Arrests	city						$ 1,080
16	Dept. of Buildings Contacts Owner re: Demolition	city						
17	Dept. of Buildings Sends Notice of Immanent Demolition	city						
18	Demolition: Vendor Wrecks Unit at City Expense; City Issues Lien	city						
19	Direct Property Tax Losses	county						
20	Dept. of Law Prepares & Tries Case in Demolition Court	city						
21	Administering Demolition Court	county						
22	Unpaid Property Taxes Not Recovered	county						
23	Utility Taxes Foregone	city						
24	Water Bill Unpaid	city						
25	Streets and Sanitation Mows Lawn/Removes Trash	city						
26	Fire Department	city						
Direct Cost Total			**$ 27**	**$ 430**	**$ 5,358**	**$ 7,020**	**$ 5,673**	**$ 6,753**

Figure E continues on next page.

Figure E (continued)

		Scenario Components	Scenario 5a	Scenario 5b	Scenario 6	Scena
Scenarios →		Foreclosure	x	x		
		Unit Sold at Auction	x	x		
		Vacant	x	x	x	x
		Unsecured	x	x	x	x
Costs ↓		Legal Venue	Fast track	Demolition Court	Fast track	Demol Cou
		Criminal Activity	modest	modest	modest	seve
		Other				x
Expense Number	**Direct Costs**	**City/County**				
1	*Lis Pendens* Filed	county	$ (13)	$ (13)	$ (13)	$
2	Operate Chancery Court	county	$ (43)	$ (43)		
3	Register Sale & New Owner	county	$ (13)	$ (13)		
4	DOH Delegate Agency Funding for Foreclosure Prevention	city	$ 96	$ 96	$ 96	$
5	Compliant Monitoring/ Intake (*e.g.,* 311, Buildings & Police Dept.)	city	$ 3	$ 3	$ 3	$
6	Filing	city	$ 364	$ 364	$ 364	$
7	Vacant Buildings Registry	city	$ 36	$ 36	$ 36	$
8	Serving Notice to Secure Vacant Unit	city	$ 715	$ 715	$ 715	$
9	Issue Lien	city	$ 1,445	$ 1,445	$ 1,445	$
10	Dept. of Law Prepares Case for Administrative Hearings	city				
11	Administering Department of Administrative Hearings	city				
12	Dept. of Law Prepares Case for Housing Court	city				
13	Administering Housing Court	county				
14	Police Visit	city	$ 315	$ 315	$ 315	$
15	Police Enter Property & Make Arrests	city				$
16	Dept. of Buildings Contacts Owner re: Demolition	city	$ 165		$ 165	
17	Dept. of Buildings Sends Notice of Immanent Demolition	city	$ 75		$ 75	
18	Demolition: Vendor Wrecks Unit at City Expense; City Issues Lien	city	$ 6,000		$ 6,000	
19	Direct Property Tax Losses	county	$ 4,307	$ 4,307	$ 4,307	$
20	Dept. of Law Prepares & Tries Case in Demolition Court	city		$ 5,884		$
21	Administering Demolition Court	county		$ 228		$
22	Unpaid Property Taxes Not Recovered	county			$ 506	$
23	Utility Taxes Foregone	city			$ 51	$
24	Water Bill Unpaid	city			$ 162	$
25	Streets and Sanitation Mows Lawn/Removes Trash	city			$ 5,000	$

Cost 1: Maintaining *Lis Pendens* Filing Infrastructure

When delinquencies become sufficiently problematic that lenders, servicers, or their representatives become concerned about the ability of the borrower to cure, they complement their efforts to cure the loan with parallel steps to prepare for the loan's failure by initiating foreclosure proceedings. In Illinois, initiating this latter process means filing a formal notice of default (*lis pendens*) with the county records office. Responsibility for this function lies with the office of the Cook County Recorder of Deeds. In order to compute the cost of operating the County's *lis pendens* filing operations we took the total 2004 appropriations for the Recorder of Deeds ($18.7m) and divided it by the share of documents registered annually constituted by foreclosure initiations (0.9 percent). The resulting $215,835 can then be divided by the number of *lis pendens* filed annually (15,811 in 2003) to determine the per-event cost ($14).

This cost is then reduced by the $26.50 fee charged to filers to arrive at our final estimate which shows the County 'earning' $13 per filing. Because $13 is small in relation to many of the other costs in this report we do not make additional effort to determine whether this apparent 'profit' is a profit in actual fact. Our assumption is that potential small errors with our method are random and thus cancel each other out, providing estimates that are, on aggregate order of magnitude correct and serve to accurately illustrate conditions in the City.

expense	cost/amount	multiplier	total
Cook County Recorder of Deeds 2004 Appropriation	$ 18,701,796		
Total filings, Cook County, 2003	15,811		
Lis pendens share of annual records filed		0.012	$ 215,835
Expenditure per filing			$ 14
Filing Charge			$ (26.5)
Net per-filing cost to Cook County			**$ (13)**

Cost 2: Operating Chancery Court

Because Illinois is a judicial foreclosure state, all cases must go through Chancery Court. Though foreclosures are not the only type of cases heard by the court, they are the majority. The challenges in computing this cost are first to include all elements of the cost of administering Chancery Court and second to attribute the correct share of the overall Chancery Court costs to residential mortgage foreclosures.

The table below details our response to the first challenge, listing each cost element for operating the Court. We calculate the Chancery Court share of the budgets of the four County agencies involved using several different methods of proportioning, depending on what data were availability (as indicated in the table below). To meet the second challenge we used a figure for the share of Chancery Court Cases that are foreclosure related (62.5 percent) provided by one of our interviewees). Since all components of this cost are shares of Cook County Budget lines pertaining to Chancery Court, each the total cost outlay for Chancery Court is multiplied by the same percentage to yield a roughly $3.4 million overall cost, which can be divided by the number of cases (15,009 in 2003) to produce a cost estimate of $228 per case. This is offset, however, by the $271 court fee, meaning that the City nets some $43 per case processed.

expense	cost/amount	multiplier	total
Clerk of the Circuit Court, County Wide Operations 2004 appropriation	$12,951,965		
Chancery Court portion (based on share of salaries)		0.210	$2,721,149
Office of the Chief Judge, 2004 Appropriation	$ 42,577,165		
Chancery Court portion (Chancery case filings as percent of all filings, 2003)		0.037	$ 1,573,469
Court Services, 2004 Appropriation	$ 98,274,188		
Daly Center portion (based on share of all salaries)		0.134	$ 13,160,373
Chancery Court portion of Daley Center Cases		0.037	$ 486,934
Judiciary, 2004 appropriation	$ 18,663,917		
Chancery Court portion (chancery case filings as percent of all filings, 2003)		0.037	$ 689,738
Total expenditures			$5,471,290
Foreclosure portion of Chancery total (share of cases)		0.625	$3,419,556
Foreclosure cases (Chancery cases * foreclosure share)	15,009	0.625	
Per case cost			$228
Chancery Court fee charged			($271)
Net per-case cost of chancery court cases			**$ (43)**

Cost 3: Registering Sales (Cook County)

Like the *lis pendens* filing, registering sales is an activity of the Cook County Recorder of Deeds. Selling a property through the foreclosure process triggers the filing of two documents, the first of which records the sale outcome and the second the new owner. In order to estimate the number of documents filed annually we therefore doubled the number of foreclosures completed in 2003 (9,958) and used it to calculate a share of the department's overall activity level (1.45 percent). Multiplying this by the 2004 budgetary allocation for the Cook County Recorder of Deeds and dividing the resulting number ($271,872) by the number of recordings yields a per-event expenditure of $14, the same as in Cost 1. This cost is offset by the $26.50 filing fee for a net gain of $13 for the City.

expense	cost/amount	multiplier	total
Cook County Recorder of Deeds 2004 Appropriation	$ 18,701,796		
Total completion & sale documents registered	19,916		
Share of annual record filings comprised by sale and new owner registry		0.0145	$ 271,872
Expenditure per filing			$ 14
Filing Charge			$ (26.5)
Net per-filing cost to Cook County			**$ (13)**

Cost 4: DOH Delegate Agency Foreclosure Funding

In order to address the foreclosure problems it faces, the Department of Housing partners with CBOs ('delegate agencies'). These agencies (*e.g.*, Neighborhood Housing

Services of Chicago and the National Training and Information Center) provide homeownership and credit counseling, supply legal assistance, and conduct research on foreclosure issues. In 2004 the total amount supplied to these activities was $953,550. Spreading this over each foreclosure recorded in the city (9,958) yields an expense of $96 per foreclosure.

expense	cost/amount	multiplier	total
Counseling, Legal Assiatnce, Research	$ 359,800		
Hoem ownership Preservation Loans	$ 593,750		
Total delegate agency funding of foreclosure avoidance			$ 953,550
Number of foreclosures	9958		
Expenditure per event			**$ 96**

Cost 5: Intake of Vacant Building Complaints

In addition to the standard channels for vacancy reporting there are dozens of idiosyncratic ways that vacant buildings come to the attention of DOB. The most standardized of these, however, is through the City's 311 reporting system. Our interviewee the Office of Emergency Management and Communications, where 311 is housed, put the per-call cost for abandoned building reports at $1.50 per call (based on internal study of process efficiencies at 311). Because the 311 intake mechanism is the most efficient way that complaints can be referred to DOB, the $1.50 figure is surely below the average intake cost of all vacant building intake, and is therefore doubled to reflect the lower efficiency of other methods, with the resulting $3.00 estimate still likely conservative.

expense	cost/amount	multiplier	total
311 per-call cost			$1.50
Double cost to account for 311's efficiency relative to other methods			$3.00
Expenditure per event			***$3***

Cost 6: Department of Buildings Inspections and Inspection Report Filing

DOB inspections staff spend a significant amount of time locating and then inspecting properties, filing the necessary administrative documents regarding their findings and, in some cases, presenting these findings in court. To calculate hourly wages, we began with the salary for the median Building Inspector in the Hazardous Building Clearance section of the DOB budget. We then increased this $59,640 by the ratio of fringe benefits as a share of salary in DOB (38 percent), yielding a total compensation for the median Building Inspector of $82,530. Dividing this figure by 1,815 (the number of hours an average American works each week according the International Labor Organization) yields an hourly wage of just under $45. One event (*i.e.,* one day of work), therefore costs the City $364.

expense	cost/amount	multiplier	total
Building inspector salary (median)	$59,640		
Ratio of fringe to salary		0.38380353	
Building Inspector Salary and Fringe (median)			$ 82,530
Hourly rate			$ 45
One day at hourly rate	$ 45	8	$ 364
Expenditure per event			**$ 364**

Cost 7: Vacant Building Registry

At DOB there is not a specific staff person assigned to manage the vacant building registry. Rather it is done on an *ad hoc* basis by a variety of the Department's employees. In order to generate a cost estimate we were therefore required to make several assumptions about the level of the staff person involved and the amount of time the process takes. We resolved these issues by assuming that the average staffer would be a Building Inspector and that, all told, it takes three hours to add a unit to the registry, issue the notices for public posting, instruct the owner or owner's agent on requirements for proper posting, and conduct subsequent file updates associated with the property. In estimate this cost we use the same hourly rate for Building Inspectors as in the previous expense (just over $45) and multiply it by 3 hours for a total of $136. This reduced by the vacant building registry fee of $100 for a net cost of $36 per event.

expense	cost/amount	multiplier	total
Building inspector hourly rate			$ 45
Three hours at hourly rate	$ 45	3	$ 136
Registry fee			$ 100
Expenditure per event			**$ 36**

Cost 8: Serving Notices to Owners to Secure Building

The process of service can be simple or complex depending on factors such as whether the party being served is locally based or out of state and whether public notification is required (cases where one or more parties cannot be located). Our interviewee at the DOL, which is responsible for preparing and serving these notices, estimates the Department's out-of pocket cost at $550 per event. This estimate understates the actual cost, however, because DOL does not pay the Police Officers that actually serve the papers on code violations.

We therefore augment the $550 figure by the hourly rate for policing provided by one of our interviewees ($180) and conservatively assume that it takes one hour to achieve service (requiring three attempts before service is successful is "very typical" according to our interviewee). Adding to the $550 from DOL yields a total of $730 per event. This is offset by a $15 summons fee, yielding a final cost per event of $715.

expense	cost/amount	multiplier	total
DOL cost per notification			$550
Police cost (1 hour)			$ 180
Expenditure per event			$ 730
Summons fee			$ 15
Net expenditure per event			**$ 715**

Cost 9: Net Boarding Costs

Boarding not done by the owner is performed by contractors at City expense. For a typical single family home this cost runs around $900. Because the City issues a lien, however, in some cases this cost is recovered. In addition, recovery time can easily require 24 months, during which the City incurs an opportunity cost on the capital it has tied up in the process. This reduces the value of the 50 percent of funds that it recoups directly by an additional 7 percent over the 24 months. Losses on the average boarding are therefore the original $900 charge less the share of recovered liens and adjusted for losses due to opportunity cost. Most units are boarded multiple times, however, so our final figure of $1,445 reflects an estimate of three boardings per foreclosure proceeding.

expense	cost/amount	multiplier	total
Cost of boarding advanced by City			$900
Share of boarding liens recouped		0.50	
Average cost per event			$ 450
Average recovered amount after accounting for 7 percent opportunity cost		0.07	$ 419
Average net cost of boarding			$ 482
Number of boardings per vacancy		3	
Expenditure per event			**$ 1,445**

Cost 10: Preparing and Adjudicating Case in Administrative Hearing

There are three costs (Cost 10, 12, and 20) associated with DOL preparing cases for different legal venues (Administrative Hearings, Housing Court, and Demolition Court). Though for the most part the same attorneys do not work on all types of cases, all are City employees, and our method costs units of effort equally across the three venues. The cost of preparing a case for each venue therefore varies only by the amount of time involved.

In constructing the standard effort measure we use the costs for attorneys in the Demolition Legal Services section of DOL, where the median attorney salary is $78,576. Because support staff play prominent roles in the legal profession we also include work by paralegals, clerks, and legal secretaries in our overall hourly cost of effort measure. Adding in these other salaries at the median level and adjusting for the additional 36.6 percent cost of fringe benefits yields a number that can be divided by the annual number of hours worked (1,815) to arrive at an hourly wage for the team of $168.

For Administrative Hearings, the typical foreclosure-related case involves 4-5 court dates and between 12 and 20 hours of preparation and court time according to our respondents. We use the mid point of this range, 16 hours, as our hours multiplier to get a per event cost of $2,690 to prepare and try a case in Administrative Hearings. This is offset slightly by the $50 fee charged in these cases to produce a final cost of $2,640.

expense	cost/amount	multiplier	total
Median attorney (Assistant Corporation Cousel) salary	$ 78,576		
Median paralegal salary	$ 43,104		
Median legal secretary salary	$ 53,250		
Median clerk salary	$ 48,522		
Subtotal - salaries			$ 223,452
Ratio of salaries to fringe		0.36557792	
Annual cost of fringe benfits for legal team			$ 81,689
Total annual compensation for legal team			$ 305,141
Hourly rate for legal team			$ 168
Hours of effort needed		16	
Total cost per Administrative Hearing			$ 2,690
Fee charged per hearing			$ 50
Expenditure per event			**$ 2,640**

Cost 11: Administering the Department of Administrative Hearings

As noted earlier, DOAH's Building Hearings Division is the City's preferred forum for adjudicating code violation issue when the total owed is less than $50,000. In order to determine the cost of administering this section we use Building Hearings Division's share of total salary costs (16 percent) and apply this to the overall budget ($6.1 million), yielding $975,040. Because not all hearings in the Building Hearings Division are related to vacancy code violations we further reduce this by multiplying by 2 percent, the vacancy code violation share of all Building Hearings. Dividing this by the number of vacancy-related cases (250 annually according to our respondent in DOAH) yields a per-hearing cost of $78.

expense	cost/amount	multiplier	total
Total DOAH 2004 Budget	$6,111,923		
Building Hearings Division share (based on share of salaries)		0.16	
Building Hearings share of overall DOAH 2004 budget			$ 975,040
Share of Building Hearings related to vacany code violations issuess		0.02	
Funds necessary to operate vacancy code violations hearings			$ 19,501
Number of cases	250		
Expenditure per event			**$ 78**

Cost 12: Preparing and Trying Case in Housing Court

As noted above, we use the same hourly figure in Cost 10 for the legal effort measure. Housing Court cases are more difficult to try because they involve more dangerous structures, the City is more often seeking injunctive relief, and because buildings can be ordered vacated and put into receivership, all of which require additional legal machinations relative to an Administrative Hearings case. According to our interviewee at DOL, the "typical case with no complications" requires roughly 20 hours, though as much as 100 hours is not uncommon. Due to the vastly different potential costs of these two scenarios we use a figure of 25 hours for the 'average' case. Multiplying the hourly figure by 25 yields a per-case cost of just over $4,200.

expense	cost/amount	multiplier	total
Hourly rate for legal team			$ 168
Hours of effort needed		25	
Expenditure per event			**$ 4,203**

Cost 13: Administering Housing Court

Conceptually, the costs of administering housing court are similar across the branches of civil court involved in this report (*e.g.,* clerking, court services, and the judiciary). We therefore use the same numbers for operating expenses across the three cost figures (Costs 2, 13, and 20). Where the Housing and Demolition Court differ from Chancery is in the court fees assessed, with the former having fees generally half as much as the latter. Because government agencies are not assessed fees, however, the offset to costs incurred is zero for Housing and Demo Court. Our estimated cost of administering each of them is therefore equal to the pre-offset figure of $228 from Cost 2.

expense	cost/amount	multiplier	total
Chancery Court per event cost			$ 228
Expenditure per event			**$ 228**

Cost 14: Routine Police Visit

Policing is one of the key municipal interventions necessitated by the foreclosure and vacancy processes. It is also one of the most common due to the repetitive nature of many minor crimes such as squatting and vandalism. Our cost estimate uses an estimate of the hourly cost of policing of $180 that was provided by an interviewee in the Department. A single visit where no major problems occur typically takes half an hour so the per visit cost is $90. Total cost is therefore driven by the number of times police must visit the unit to deal with these misdemeanor-type issues, which our interviewee put at 3-4 times per vacant building, though many are much higher. We use the average of these two figures and multiply by the $90 cost figure to get a per-unit cost for the 3.5 visits of $315.

expense	cost/amount	multiplier	total
Cost per half hour call			$90
Total number of calls		3.5	
Total cost per vacant unit			$ 315
Expenditure per event			**$ 315**

Cost 15: Police Make Arrests

Often police officers called to vacant buildings detect more serious levels of criminal activity that require arrests. In such cases more personnel are involved and the process takes longer, pushing costs up accordingly. In a typical version of this scenario, two arresting officers spend two hours on-site and doing related follow up and paperwork, and four backup officers spend half an hour on-site. All of this time is valued at the $180/hour figure discussed in the previous cost description. The arresting officers' total is therefore $720 and the backup officers' total is $360, for an aggregate cost per event of $1,080. We assume that this happens only once for a 'problem case' but some vacant buildings clearly exist as sites of repeated drug and gang activity that require multiple arrests.

expense	cost/amount	multiplier	total
Cost per officer per hour			$180
Number of hours spent by arresting officers		2	
Total costs per arresting officer			$360
Number of arresting oficers		2	
Arresting officer subtotal			$720
Non-arresting officer cost (half hour)			$90
Number of non-arrestign officers		4	
Non-arresting officer subtotal			$360
Total policing cost for arrest event			$ 1,080
Expenditure per event			**$ 1,080**

Cost 16: Serving Initial Notice of Demolition

The City is obligated to make owners aware of its intent to demolish a building at two points in the Fast Track process. These notices are typically served by police officers, so we use the hourly policing cost in the two previous costs ($180/hour) in calculating this City expense. Because multiple visits are often required we use a conservative one hour estimate of the time required to serve the notice. This is offset by a $15 service fee for a net cost of $165.

expense	cost/amount	multiplier	total
Legal notice served by DOL			$180
Summons fee			$15
Net expenditure per event			**$ 165**

Cost 17: Serving Notice of Imminent Demolition

The second notice informs interested parties that demolition in imminent. Cost are the same as the previous expense except for the fact that we assume only one half hour is required for service because contact information has been confirmed via the preceding service. Again the $15 offset fee applies so the cost of $90 per half hour is reduced to $75.

expense	cost/amount	multiplier	total
Legal notice served by police on behalf of DOL	$180	0.5	$90
Service fee			$15
Expenditure per event			**$ 75**

Cost 18: Demolition of Unit at City Expense

In cases where the City demolishes homes the actual work is done by contractors that bid to do the job. Bids are obviously determined by the difficulty of the job (*e.g.*, wood frame homes costing less to tear down than brick). Single family home costs run roughly from $5,000 to $20,000 but we use a figure closer to the lower end of the range ($10,000) based on an examination of actual bids that indicates that $7,000-$12,000 is typical.

In order to recover the cash outlay, the City issues a lien on the property. These liens are sometimes recovered in cash, sometimes by foreclosing on the lien and taking ownership of the property (this can yield less than the amount owed), and sometimes not at all. Staffing constraints limit DOL to actively pursuing about 250 of liens at any one time, meaning that this activity must be prioritized. Properties whose values are most likely to cover City costs or those in locations that have strategic importance given the City's redevelopment goals are pursued first, leaving a revolving 'passive collection' pool of about 5,000 liens that persists over time.

The existence of these two pools makes estimating the share of recovered liens difficult. Collection is somewhere near 90 percent on the high priority pool (though even on these the City incurs the opportunity cost on its capital tied up while pursuing foreclosure and then reselling the property, processes that take several years to complete), but others may languish unpaid forever. Due to the combined losses from opportunity cost and complete non-payment we estimate use a value for current dollar lien recovery of 40 percent, making the average amount recovered on a $10,000 demolition $6,000.

expense	cost/amount	multiplier	total
Cost of single family detached home demolition			$10,000
Likelihood of lien recovery (including opportunit costs)		0.4	
Average amount recovered			$4,000
Expenditure per event			**$ 6,000**

Cost 19: Direct Tax Loss from Demolition

The direct property tax loss due to demolition (as different from non-payment of property taxes) is due to the assessed value of the structure being removed from the tax roles. The City loses the ability to collect this revenue until the property is redeveloped, often a long period of non-use. To compute the amount of these losses we take the median home price in the lower-income neighborhood of Auburn/Gresham ($167,440) and assume that the structure accounts for half of the home's market value. The demolition therefore removes $83,720 of market value from the tax roles. The effective property tax rate is 1.029 percent, so the loss of this market value directly reduces annual tax collections by $861 dollars. We conservatively assume that the lot will remain empty for five years, for a total loss of $4,307.

expense	cost/amount	multiplier	total
Median Home Price in Auburn/Gresham Neighborhood of Chicago			$ 167,440
Improvement (Structure) Share of House Value		0.5	$ 83,720
Effective Tax Rate		0.01029	
Annual Loss			$ 861
Five Year Loss		5	$ 4,307
Expenditure per event			**$ 4,307**

Cost 20: Preparing and Trying Case in Demolition Court

As noted earlier, we use the same hourly legal cost rate of $168 in all three court venues (explained in Cost 10 above). According to our respondent at DOL, demolition cases, require preparation of roughly 10 hours and an additional 25 hours to for the court process. The total expenditure on such case therefore approaches $6,000.

expense	cost/amount	multiplier	total
Hourly rate for legal team			$ 168
Hours of effort needed		35	
Total cost per case			$ 5,884
Expenditure per event			**$ 5,884**

Cost 21: Administering Demolition Court

As noted in the description of the cost of administering Housing Court, the costs of administering the civil courts discussed here are similar. We therefore use the same numbers for operating expenses across the three cost figures (Costs 2, 13, and 20). The latter two are higher, however, because there is no court offset, as explained in the Cost 13 description.

expense	cost/amount	multiplier	total
Chancery Court per event cost			$ 228
Expenditure per event			**$ 228**

Cost 22: Unpaid Property Taxes Foregone

Calculating the value of revenue lost on unpaid taxes is virtually impossible due the complexity of the tax sale process, which involves multiple sale types and recovery routes, as well as a way for the County to actually collect nothing in some cases even in which it does ‘sell’ the lien (this occurs through the ‘sale in error’ loophole). Our method makes several assumptions about the compensating effects of various over and underestimates.

On average, during the years for which we have data (1999-2002), 43.9 percent of tax claims were sold at the annual sale (the sale in which the City typically collects the full amount owed). The average tax bill due on properties unsold at the annual sale was slightly more than $1,012. We assume that a higher share of properties are sold but do not account for the losses associated with opportunity cost of funds tied up in the tax process or the fact that many parcels are taken over by the City, only a fraction of which are rapidly returned to the tax roles or generate compensation for the County. Using this method halves the estimate to $506 in losses per event.

expense	cost/amount	multiplier	total
Amount due over four year period in Chicago	$ 54,060,019		
Number of properties	53,402		
Amoutn due per property			$ 1,012
Likelihood of recovery		0.5	
Expenditure per event			**$ 506**

Cost 23: Utility Taxes Foregone

Utilities losses accrue because services are typically not shut off by providers at the first missed payment. Rather, shutoffs are triggered by non-payment thresholds. Further, in the case of gas for heating, providers are barred from shutting off anyone’s supply during the winter months by a City ordinance. Because usage, and hence bills, are highest in winter, large bills often accrue before gas can be legally cut. Our interviewee at People’s Gas provided an estimate of $1,000 as the typical unpaid bill on a vacant property and an average monthly bill of $112. The typical delinquency period is therefore nine months, during which time the City loses tax revenue at a rate of 1.8

percent (the municipal gas tax rate) of the unpaid balance, or roughly $2 per month. For electricity, the tax rate is $0.0061 per kilowatt hour. Applying this to monthly usage of 600 kilowatt hours for a typical home yields monthly taxes of roughly $4. Over nine months, the combined losses on taxes and electric are $51.

expense	cost/amount	multiplier	total
Tax rate on electricity (per kilowatt hour)		0.0061	
Kilowatt hours used in typical single family home (month)	600		
Average monthly tax paid for single family detached home			$ 4
Tax rate on gas		0.018	
Average monthly bill for single family detached home	$ 112.00		$ 2
Monthly tax gas amount			
Average unpaid period		9	
Total foregone tax revenues during unpaid period			$ 51
Expenditure per event			**$ 51**

Cost 24: Unpaid Water/Sewer Bill

As noted in the text of the report, the City is actually the water provider in Chicago. The obvious cost consequence of this in a delinquency situation is that the City sustains losses more rapidly and directly on water than on other utilities. We were not able to get an average shutoff period from the Department of Water and so use the nine month figure from the other utility calculations in the preceding expense. In cases where homes are un-metered, bulk rates are used to compute water charges. We use the rate for a typical single family home of around $30/month (specific rates vary based on things such as the type of fixtures inside the unit). Multiplying this by nine months yields $270. As with demolition and boarding, however, the City can issue liens to recoup some of its losses. We assume that the recovery rate on these liens is the same as for demolition liens (40 percent), reducing the loss on the average unpaid bill to $162.

expense	cost/amount	multiplier	total
Monthly bill for typical home			$ 30
Length of unpaid period		9	
Total losses over nonpaying period			$ 270
Share of water liens recovered		0.4	
Redution in net loss due to lien recoveries			$ 108
Net Expenditure per event			**$ 162**

Cost 25: Removing Trash from Vacant Units or Lot and Mowing the Lawn

Because vacant homes and lots attract trash, in some cases through illegal dumping, and City ordinances mandate that properties are kept from becoming eyesores, debris must be removed from vacant homes and lots, and lawns must be mowed periodically. These tasks fall to the Department of Streets and Sanitation. We were unable to obtain a cost estimate from Chicago for these activities so we instead use the figure of $5,000 for the same tasks in Buffalo noted in a recent article on abandoned properties in

Affordable Housing Finance.[28] Due to the higher price level in Chicago relative to Buffalo this figure likely underestimates this cost element. The $5,000 figure agrees in principle with HUD's reimbursement rate of $35 per cubic yard for trash removal from its properties.

expense	cost/amount	multiplier	total
Buffalo estimate			$ 5,000
Expenditure per event			**$ 5,000**

Cost 26: Fire Suppression

The cost of fire suppression obviously varies with the severity of the fire. Relative to other residential fires those stemming from the foreclosure and vacancy processes are problematic because they are typically unreported until they are burning intensely and, in some cases, until they have become a threat to neighboring properties. (In contrast, fires in occupied units are often reported earlier by their legal occupants.) In the interests of being conservative, we treat all fires equally, dividing the budget of the Operations Division of the Fire Department by the number of fires (for the year 2000) to get a per fire cost of $14,020.

expense	cost/amount	multiplier	total
Budget of Fire departmetn Operations Division			$311,418,526
Number of Fire Responses	22,213		
Expenditure per event			**$ 14,020**

[28] Anderson, B. 2004. New Jersey Fights Blight. *Affordable Housing* Finance. June. pp. 78-79.

APPENDIX B: INDIRECT COST EFFECTS

In addition to direct impacts on municipal expenditures and tax receipts, there are numerous indirect ways that foreclosure imposes costs on municipalities, as well as other homeowners, property owners and individuals with a financial stake in the area where the foreclosure occurs. Unlike direct costs, these indirect costs are especially difficult to measure. Even so, it is important not to lose sight of them because these indirect effects may significantly add to the overall social costs of foreclosure, especially in situations of concentrated foreclosures.

Indirect Impact on Area Property Values and Municipal Tax Receipts

Because homes tend to deteriorate and/or are left vacant during the foreclosure process, foreclosed homes tend to become associated with crime and general unsightliness, and act as a deterrent for prospective borrowers. The result is that prospective homebuyers consider the area desirable and will pay less for properties located near to vacant or otherwise unattractive foreclosed properties. Reduced desirability will eventually decrease (or reduce the rate of increase of) area home values. This same phenomenon may also adversely impact business location decisions as well as reducing the profitability of existing business in the city. This in turn can impact (where applicable) sales and income tax receipts.

Unless carefully monitored, the sale of foreclosed properties (REO sales) can also depress property price appreciation. Homes sold at foreclosure sales have typically deteriorated and require substantially more work than ‘normal’ properties. Selling prices therefore reflects the new owner’s anticipated expenses for deferred maintenance and repairs and are proportionately lower. These lower prices are then part of the set of ‘comps’ used by real estate agents. Therefore, if properties sold at a ‘foreclosure discount’ are used in valuing others in the area, this will tend to reduce the price appreciation on other homes in neighborhoods where foreclosures and vacant buildings are common. Both the direct value reductions and reduced house price appreciation translate into lower assessed values and thereby reduced municipal tax revenues.

Though in theory, these indirect impacts are most plausible, in the only published effort to measure the magnitude of these effects, a study by Temple University, found that in Philadelphia properties within 150 feet of an abandoned unit sold for $7,627 less than those not located near abandoned units, with the effect tapering off to $3,543 at distances of 300-450 feet, and the impact being negligible beyond 450 feet (the length of a typical block). Further, having two abandoned properties on the same block was shown to lower sales prices for homes on the block by more than $10,000.[29] These findings are consistent with a broader literature on the impact of so-called negative externalities on house price appreciation. Though these studies also face significant empirical challenges, they nevertheless indicate that the presence of a deteriorated property (or the removal of a similar blighting influence) can reduce (or increase in the case of blight removal) area property values by as much as 10 percent – with the largest impacts being recorded on properties located closest to the blighted property.[30]

Although no study on this issue has been conducted in Chicago, the adverse impact of blighting influences such as foreclosure related vacancies is likely to be strong enough to reduce block and sub-block level home prices (or lower the rate price appreciation). Steady upward movement of prices in all neighborhoods in the City and active speculation and flipping by professional investors that ‘paint and patch’ in order to turn a quick profit may temporarily obscure this effect, but over time the fact that, all else equal, potential buyers do not want to invest their life savings in a home next to or near an eyesore serving as a potential site for crime, fires, and other problems will work to keep prices down in the immediate vicinity of vacant units.

The extent to which serious delinquency and foreclosure generate these indirect costs will depend of course on the degree to which foreclosures concentrate. A single foreclosure in an otherwise economically healthy neighborhood is certainly a negative factor, but as the number of foreclosures in a single area mount, the negative consequences are likely to increase disproportionately. Consider the situation facing the 8300 Block of South Morgan Street in the Auburn/Gresham neighborhood depicted earlier in Figure B. Of the 37 properties on the block, over the period 1993 to 2002, one was demolished, 4 had multiple foreclosures, 2 more were identified by neighborhood groups as problem buildings, and a final 2 experienced less problematic types of foreclosure. In such a case, the impact of serious delinquency, foreclosure, and related vacancy on property values and property tax collections is surely substantial. Given that the effective tax rate in the city is 1.029 percent per $1,000 of value,[31] even the loss of one modest home valued at $100,000 costs the city $1,209 each year.

Indirect Costs for Other Parties

While this paper focuses on municipal costs, it is important to recognize that other individuals and firms suffer losses as a result of serious delinquencies and foreclosures.

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[29] Anne B. Shlay and Gordon Whitman. 2004. Research for Democracy: Linking Community Organizing and Research to Leverage Blight Policy. University of Toledo COMM-ORG working paper. http://comm-org.utoledo.edu/papers2004/shlay/shlay.htm.

[30] For a summary of the literature on the housing spillover effects see Amy Ellen Schwartz, Ingrid Gould Ellen, Ioan Voicu, and Michael H. Schill, (2003). Estimating the External of Subsidized Housing Investments on Property Values. A paper prepared for the Federal Reserve System Conference on Sustainable Community Development.

[31] The property tax rate is 6.433 percent while assessments are 16 percent of market value.

For example, in addition to expenses incurred by the city, residents of the 3800 Block of South Morgan Street in Auburn/Gresham also suffer losses as a result of the failure of their neighbors' mortgages. Looking only at the one unit actually demolished on the block, if the spillover affects just the three homes on either side (total of six) and the same set across the street (seven more), thirteen homeowners (those within 150 feet of the vacant unit) lost a collective $219,893 as a result of that one severely failed loan.[32] For the units determined to be 'problem buildings' the same price attenuating mechanism surely operates as well, though perhaps not to the same magnitude.

Nor are property owners the only losers. The blight associated with a neighborhood littered with vacant and boarded homes will limit the willingness of customers to shop at nearby stores, and make it more difficult for local area employers to attract workers. Moreover, the negative impact also extends to other entities with a financial interest in loans on other properties on this block. To the extent that serious delinquency, foreclosure and resulting vacancy is concentrated in specific areas, the resulting downward pressure on home prices also reduces the value of the collateral that secures other loans in the area, just as it reduces the incentive for other mortgage borrowers to meet their mortgage payment obligations. As a result, foreclosures can help stimulate more foreclosures, and the circle of individuals suffering costs becomes quite wide indeed.

[32] The $219,893 figure is calculated by adjusting the Philadelphia figure for reductions within 150 feet of the vacant unit by the ratio of City of Chicago to City of Philadelphia median house prices. As of the 2000 Census, Chicago's median of $132,400 was 2.21 times higher than Philadelphia's $59,700. Multiplying the Philadelphia figure of $7,627 by 2.22 yields $16,915, which, multiplied by 13 yields $219,893.