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What Housing Recovery?

By PETER DREIERMAY 8, 2014

LOS ANGELES — RECENTLY there's been a lot of happy talk about the nation's housing recovery. Frequent reports about rising prices suggest that the tens of millions of people whose homes lost value just have to wait until the recovery reaches their neighborhood to lift them out of crisis. But this supposed housing recovery is bypassing many of our cities and towns.

The total value of America's owner-occupied housing remains $3.2 trillion below 2006 levels. According to Zillow, a real estate database, 9.8 million households still owe more on their mortgages than the market value of their homes. That's one-fifth of all mortgaged homes. Without government intervention, many of them are at risk of joining the almost five million households that have already suffered through foreclosure since the housing bubble burst in 2007.

With my colleagues Alex Schwartz of the New School and Gregory Squires of George Washington University, I have identified the 15 metropolitan areas, 100 cities and 395 ZIP codes with the highest proportion of underwater mortgages.

How bad is it? More than 10 million Americans, spread across 23 states, live in ZIP codes where between 43 percent and 76 percent of homeowners are under water. The biggest concentrations are in Georgia, Florida, Illinois, Michigan and Ohio. The cities in the worst shape are Las Vegas, Atlanta, Jacksonville, Orlando and Chicago. Places with so many underwater homes are toxic; they depress the value of surrounding homes and undermine local governments' fiscal health.

The blame for this tragedy lies mostly with banks' risky, reckless and sometimes illegal lending practices. The story is a familiar one. In the late 1990s and early 2000s, millions of Americans bought or refinanced homes in an overheated market. Mortgage brokers lied or misled borrowers about the terms of these mortgages, often pushing borrowers into high-interest subprime loans, even when they were eligible for conventional mortgages.

They particularly targeted minority areas. In 2006, when subprime lending was at its peak, 54 percent of blacks, 47 percent of Latinos and 18 percent of whites received high-priced loans, according to the Federal Reserve Board.

Not surprisingly, the nation’s worst underwater areas are disproportionately in black and Latino neighborhoods. In almost two-thirds of the hardest-hit ZIP codes, African-Americans and Latinos account for at least half of the residents.

The banks’ risky loans eventually came crashing down, devastating communities and causing financial havoc. The federal government rescued the banks, but nobody came to the rescue of the communities the banks left behind.

The best solution to this quagmire is for banks and other financial institutions to modify underwater mortgages to their current market value, an approach called “principal reduction.” If lenders rewrote the loans to reflect fair-market values, owners would have lower monthly payments, which would free them to put millions of dollars into local economies. Cities would have more stable property tax revenues, and lenders would ultimately benefit by having fewer delinquent loans.

Of course, many banks no longer own the loans they made. They pooled large numbers of subprime loans into private securities and sold them. The companies that service these securities generally refuse to countenance the idea of “principal reduction.” Yes, some homeowners have been able to persuade lenders to reset their loans, but most get the cold shoulder or a bureaucratic runaround.

In some cities, though, nonprofit lenders, like New Jersey Community Capital and Hogar Hispano, have stepped into the void, raising capital and purchasing troubled loans in order to modify them on affordable terms. But too few loan holders have been willing to sell to these homeowner-friendly groups.

In 2012, some of the biggest banks signed a settlement agreement with 49 state attorneys general to modify mortgages, but many of them continue to heap abuse on their customers, and sufficient relief has not reached trapped homeowners.

The Obama administration created several initiatives to help troubled borrowers, but these programs do not require banks to reset loans as a condition of getting federal funds. The government’s Home Affordable Modification Program has helped only one-quarter of the four million homeowners it was supposed to reach.

Worse, the federal government has actually been an obstacle to reform. The Federal Housing Finance Agency, which oversees Fannie Mae and Freddie Mac, has refused to allow these two mortgage giants to reduce the principal on underwater mortgages that they own or guarantee. All it would take is for President Obama’s new appointee as F.H.F.A. director, former Representative Melvin Watt, to change the policy, an action that does not require congressional approval. He should do so immediately.

Meanwhile, faced with this predicament, some municipalities have been trying to take matters into their own hands. Late last year, Richmond, Calif., was the first city to

develop a plan to use its power of eminent domain to buy underwater mortgages at their current market value and to refinance them, but many other localities are likely to follow. A number of responsible for-profit and nonprofit lenders stand ready to do business with them so that local governments don't have to use tax dollars to purchase these loans.

Dealing with this problem on a city-by-city basis may not be the most efficient way to confront a national crisis, but in the face of Wall Street intransigence and federal indifference, cities have had to find their own way to restore the lost wealth of their constituents.

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