CITIES DESTROYED (AGAIN) FOR CASH: FORUM ON THE U.S. FORECLOSURE CRISIS

Jeff Crump
Housing Studies Program
University of Minnesota

Kathe Newman
Bloustein School of Planning and Public Policy
Rutgers University

Eric S. Belsky
Joint Center for Housing Studies
Harvard University

Phil Ashton
College of Urban Planning & Public Affairs
University of Illinois–Chicago

David H. Kaplan
Department of Geography
Kent State University

Daniel J. Hammel
Department of Geography and Planning
University of Toledo

Elvin Wyly
Department of Geography
University of British Columbia
Vancouver, BC, Canada

Abstract: In 2008, there will be at least 2.5 million new foreclosures in the United States. Record levels of mortgage delinquency, default, and foreclosure are causing widespread hardship in cities and suburbs across America, and causing repeated destabilization of global credit and investment markets. In this Forum, six housing specialists unravel the complex connections between urban geography, subprime lending, and foreclosure. Although a wide variety of viewpoints are represented, three common threads are evident. First, foreclosures are tightly linked to the lax underwriting standards and aggressive business practices of the subprime mortgage market. Second, the subprime-foreclosure linkage is a reflection of the steady deregulation of U.S. financial markets and the promotion of homeownership as the cornerstone of national housing policy. Third, deregulated mortgage market segmentation has created uneven new geographies of debt, risk, and default—superimposed atop existing landscapes of old-fashioned exclusionary discrimination. Low-income and racially marginalized neighborhoods, once redlined and excluded from mainstream credit markets, were at the center of the profitable wave of subprime abuse and equity extraction during the long housing boom, and are now at the center of the long, slowly unfolding catastrophe of the U.S. foreclosure crisis. [Key words: foreclosure, subprime lending, urban policy, housing.]
INTRODUCTION (ELVIN WYLY\textsuperscript{1} AND JEFF CRUMP)

“Many policy makers and bankers said this credit mess was contained. Boy, were they wrong.”

—Vikas Bajaj (2008), in The New York Times

[T]he disaster … was not caused by ignorance or unsophistication. Instead, it was a deliberate program of urban ruin for profit, under the cover of government housing law and with an endless flow of federal money. The destruction of the cities can be understood if put in old-fashioned cops-and-robbers terms—there were a bunch of bad guys who stuck up the cities and rode away with the gold.

—Boyer (1973, p. 4)

From the moment it was first glimpsed by stock-market analysts in the unprecedented profit warnings issued by the global banking giant HSBC in February 2007, the current worldwide crisis associated with U.S. subprime mortgages has been a curious blend of speed and scale. On the one hand, financial market information has spread rapidly around the globe, as brokers and traders who had once made so much money in the rising market for mortgage-backed securities tried to reposition themselves to make money short-selling into a collapsing market. On the other hand, the pace of underlying, truly meaningful information has slowed down dramatically, as financial institutions scramble to hide the losses buried in their balance sheets, to renege on promises made to other institutions, and to assign accounting values to assets whose meaning is defined by the long, slow, and uncertain struggles of millions of cash-strapped borrowers trying to make each month’s payment. Quicksilver billions on global stock markets slide back and forth as investors react to the amortized capitalization of countless local experiences—homeowners facing default on loans for houses with plummeting values, municipal officials dealing with a flood of foreclosures, abandoned homes, and collapsing property tax rolls (e.g., Fig. 1), and speculative suburban builders left with instant ghost-town subdivisions.

With the cascade of disclosures about the full scope and severity of fraudulent and abusive practices used to make so many high-cost subprime loans during the boom, the credit crisis spread to financial institutions and public budgets in France, Germany, Norway, Australia, and elsewhere. Moreover, the crisis soon gave Chinese trade negotiators an opportunity to lecture the U.S. Treasury Secretary on the dangers of unregulated capital markets, amidst a round of talks punctuated by what the Minister of the People’s Bank of China described as “something we have never experienced before”—an American admission of “the inadequacy of regulations” on subprime mortgages and other complex financial instruments (Weisman, 2008b, p. C4). A parade of institutions began writing off mortgage-related assets—now $400 billion and counting—and desperately courting

---

\textsuperscript{1}Correspondence concerning this section should be addressed to Elvin Wyly, Department of Geography, University of British Columbia, 1984 West Mall, Vancouver, BC V6T 1Z2, Canada; telephone: 778-899-7906; fax: 604-822-6150; e-mail: ewyly@geog.ubc.ca
investors for fresh infusions of capital. Much of this new capital has come from sovereign wealth funds—US$12.5 billion from Singapore and $7.5 billion from Abu Dhabi into Citigroup, $6.6 billion from Kuwait into Merrill Lynch, $5.5 billion from China into Morgan Stanley, and many other deals—driving a significant transnational nationalization of parts of the U.S. banking sector.

And yet still the news got worse. By December 2007, the U.S. Federal Reserve Bank (henceforth “the Fed”) began offering $20 billion in short-term loans to banks and depository institutions, accepting as collateral the mortgage-backed securities that had uncertain value, few buyers, and thus no real market price; the Fed upped the ante to $60 billion per month in January and to $100 billion in March, and then added another $100 billion infusion through its ongoing open-market operations. On March 12, the Fed announced another effort, a $200 billion offer of Treasury securities available to investment banks,
which, like the depositories before them, were allowed to pledge dubious mortgage-backed securities as collateral. The Dow Jones average dutifully jumped 3.6%. Yet within days, the Fed had to shift from playing Wall Street’s pawn shop to its matchmaker, trying to contain a classic bank run fueled by fear, panic, and gossip; Fed and Treasury officials were patched in by conference call as bank executives “held the equivalent of a speed-dating auction over the weekend” to find a suitor before the Asian markets opened on Monday and reacted to the total collapse of an 85-year old Wall Street institution (Sorkin, 2008, p. A16). But this was Bear Stearns, the most cut-throat nonbank investment bank, which had lost more than 80% of its available cash in a single day according to rumors that soon became true.

The Sunday-night deal—a shotgun marriage of Bear Stearns to J.P. Morgan Chase for a cut-rate share price—came with $30 billion of Federal Reserve backstop guarantees on Bear’s questionable subprime assets, the first opening of the Fed’s discount window facilities for nonbank institutions since the Great Depression, and a revision to the $200 billion program that made it a limitless, full-faith-and-credit commitment to the investment houses. The gambit seemed to work, reassuring anxious investors once again. But if the concerns of investors kept Fed and Treasury officials working late on weekend evenings, progress was much slower for homeowners facing foreclosure: for months, the White House, the House of Representatives, and the Senate slowly hashed out the terms of legislation to provide limited help to (some) homeowners—within the constraints of the economic-policy mantra that any public intervention in market adjustment would constitute a “bailout” of “irresponsible” borrowers that will exacerbate moral hazards as well as motivate future reckless behavior.

Bailouts and moral hazard, it turned out, were to be reserved for investors. By July, the worsening housing-market indicators had infected even the safest prime-mortgage-backed securities, rapidly eroding investor confidence in Fannie Mae and Freddie Mac, the quasi-public private companies (known in regulatory parlance as “Government Sponsored Enterprises” [GSEs]) who together own or insure some $5 trillion in residential mortgages. As investors became skeptical about the prospects for a small Monday-morning debt offering, both Fannie and Freddie lost half their stock value on Friday, July 11, prompting another long weekend of negotiations and late-night policy formulation among top officials at the Fed and Treasury. The rescue package, announced on Sunday before Asian markets opened, gave the GSEs full access to the Fed’s discount window, and came with twin proposals asking Congress to (1) give the Treasury authority to inject hundreds of billions of dollars directly into the GSEs through investments and loans, and (2) raise the national debt limit. Treasury Secretary Paulson told skeptical legislators that the most important part of the plan was its unlimited expenditure authority, which would reassure investors and thus obviate the need for expenditures:

If you’ve got a squirt gun in your pocket you may have to take it out.... If you’ve got a bazooka, and people know you have it, then you may not have to take it out. By making it unspecified, it will greatly expand the likelihood it will not have to be used. (Labaton and Herszenhorn, 2008, p. A1)

Thus, literally overnight, one of Washington’s central housing-policy axioms had been reversed. For a generation, investors assumed that Fannie and Freddie had an implicit,
“too big to fail” guarantee from the government. This implicit backing allowed the companies to raise debt at a significant discount from innumerable individual and institutional investors around the world. For a generation, top officials in Washington repeatedly denied that there was any kind of guarantee: investors would win or lose based on the wisdom of the risks they accepted, according to free-market fundamentals. But faced with a collapse in confidence that threatened to undermine the value of GSE securities held by thousands of banks, pension funds, and public investment funds throughout the entire global financial system, Washington offered a new message to investors around the world—not only is there a guarantee, it is stronger than you ever imagined. Trust us. Please. President Bush urged Americans to “take a deep breath,” because the nation’s financial system “is basically sound” (Weisman, 2008a).

This was a crisis foretold. Quite a few years ago, analysts, activists, and attorneys began to see and respond to a pronounced shift in the contours of credit in American cities: alongside an older regime of exclusionary redlining that had barred racially marginalized people and places from access to credit, there was a new wave of stratified, unequal greenlining that made credit widely available—but on vastly different terms, with wildly divergent risks for individual borrowers (e.g., Squires, 1992b, 2003; Engel and McCoy, 2002; Immergluck, 2004). It became clear that the distorted incentives for fraud and abuse that had undermined the mortgage insurance programs of the Federal Housing Administration (FHA) in the late 1960s and early 1970s were being privatized and securitized into the broad, unregulated territory of collateralized debt obligations, hedge funds, and credit default swaps (compare Boyer, 1973, and Wachter, 1980, with Engel and McCoy, 2002). The bad guys who stuck up the cities were not using federal mortgage insurance to “FHA” entire neighborhoods with vacant foreclosed homes like they did a generation ago; this time, they used what seemed like an endless flow of money from Wall Street investment banks, who liked the risk-adjusted yields of financial instruments that just happened to be backed by high-cost, abusive, and often fraudulent transactions designed to trap homeowners and homebuyers into usurious obligations. So long as the national housing boom kept home prices rising, quick-flip refinancing and eventual distress default sales helped lenders and brokers escape the costs of even the most abusive predatory loans, so that everyone from brokers to lenders to investment banks to MBS investors kept making money from the increasingly risky instruments—low-doc, no-doc, interest-only, option-ARM, hybrid ARM (quickly dubbed HARM), 2/28 and 3/27 “teaser” rates, and so on—held up as models of financial innovation.

Analysts documented these processes, and their links with transnational investment circuits, with an impressive, interdisciplinary literature at the crossroads of legal scholarship, housing studies, and the social sciences. Most studies centered on an analysis of a particular new process by which old-fashioned discriminatory exclusion was being interwoven with new innovations of predatory subprime inclusion, and concluded by analyzing the catastrophic implications for individuals, institutions, neighborhoods, and cities. Yet so long as low-income and racially marginalized individuals and communities bore the main brunt of the abuse, even the highest-quality studies of the most egregious practices could be ignored or dismissed as the exceptional problems of basket-case cities, the result of a few bad-apple lenders, or the result of selective, anecdotal evidence that did not properly represent the entire market. Millions were victimized by the subprime boom long before the costs of the crisis eventually reached Wall Street, worldwide press coverage

Many analysts issued prescient, critical warnings of the dangers of the subprime boom, and offered a wide range of recommendations for regulatory reform, legislative changes, public-interest litigation, community organizing, and strategic, targeted research. Among those who have led these efforts in recent years are Kathe Newman, Eric Belsky, Phil Ashton, David Kaplan, Jeff Crump, and Daniel Hammel. Boy, were they right.

THE PERFECT STORM: CONTEXTUALIZING THE FORECLOSURE CRISIS (KATHE NEWMAN)

In the summer of 2007, rating agencies issued downgrades and warnings for billions of dollars of mortgage-backed securities because of rising foreclosures. Moody’s downgraded $5 billion worth of subprime securities in July on one day alone (Fender and Hordahl, 2007). In the wake of the foreclosure crisis that has brought down lenders, a financial investment bank, borrowers, and at least one small town in Norway, there are many efforts to untangle the confluence of factors that produced the crisis. Accounts vary but generally include some combination of an increase in subprime originations, borrower and lender exuberance, poor underwriting, securitization, aggressive marketing, unscrupulous mortgage brokers, fraud, naïve borrowers, a declining housing market, tightened credit, servicer accounting errors, and a lack of regulation (Cagan, 2006; Gerardi et al., 2008; Morgenson, 2008). These are all elements of a perfect storm, but they fall short of illuminating the broader context in which these things were possible. Financialization, which Krippner (2005, p. 174) defines as “a pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production,” set the stage for the foreclosure crisis (Krippner, 2005; Epstein, 2005). Financialization has meant a fundamental restructuring of the economy with the state and market producing new institutional arrangements and rules to facilitate capital accumulation (French and Leyshon, 2004; Wyly, Atia, and Hammel, 2004; Wyly, Hammel, and Atia, 2004; Epstein, 2005; Fox Gotham, 2006; Wyly et al., 2006; Newman, 2008b, 2008c). Whereas the nation-state has played a pivotal role in expanding the new economy, it has done little to ensure that it is regulated.

Financialization

There are many aspects to financialization (Krippner, 2005). Here I explore it through the lens of housing finance, which has played a prominent role in economic restructuring.

In the 1970s and 1980s, the state created the framework for financialization by changing rules and creating markets to facilitate the growth of the financial services industry (Epstein, 2005). At the time, the state was viewed as “neoliberal,” as withdrawing itself

---

2Correspondence concerning this section should be addressed to Kathe Newman, Edward J. Bloustein School of Planning and Public Policy, Rutgers University, 33 Livingston Avenue, New Brunswick, New Jersey 08901; telephone: 732-932-3822, ext. 556; fax: 732-932-2253; e-mail: knewman@rci.rutgers.edu
to allow markets to work more efficiently. Looking back nearly 40 years later, the state is still viewed as “neoliberal” but the definition has changed as the role of the state is seen more clearly. Instead of removing itself to allow markets to function more efficiently, the state has engaged with markets to enhance opportunities for growth (Peck and Tickell, 2002). In short, it was an integral partner in facilitating the growth of the postindustrial economy and financialization in particular. In the United States, the activist state is visible in its efforts to create the secondary mortgage market and in a suite of federal legislation that removed barriers to financial institution expansion and ensured liquidity. Collectively, the 1980 Depository Institutions Deregulation and Monetary Control Act, the 1982 Alternative Mortgage Transaction Parity Act, the 1984 Secondary Mortgage Market Enhancement Act, the 1989 Financial Institutions Reform, Recovery, and Enforcement Act, and the Tax Reform Act of 1986 transformed the context for mortgage lending and real estate investment by facilitating the expansion of the secondary mortgage market, securitization, and the use of flexible multiclass securities and derivatives. It preempted state rules on securities and interest rates, changed tax law, and permitted new mortgage products (Mansfield, 2000; Neighborhood Housing Services of Chicago, 2004; Apgar and Herbert, 2006; Chomsisengphet and Pennington-Cross, 2006; Fox Gotham, 2006; Howell, 2006; Apgar et al., 2007; McCoy and Renuart, 2008).

**Securitization**

Securitization—the process of pooling loans and selling securities in the secondary mortgage market—changed the calculus for mortgage lending. Securitization provided liquidity, a necessary ingredient to growth, and legal protections, which distanced the originator and protected the investor. Securitization enabled nondepository institutions to originate loans and facilitated the growth of the nonbank lending industry and mortgage brokers but provided minimal oversight (Follain and Zorn, 1990). Securitization enables security issuers to more finely assess risk by dividing the assets of loan pools to meet the needs of risk-averse pension funds and high-risk investors alike. In the past few years, securitization has evolved into a complex affair with securities and derivatives, made possible in part by elaborate layers of credit enhancement. Although many have blamed borrowers or lenders for the foreclosure crisis, some have blamed securitization and the demand from investors. But we might consider that the finance industry itself played a prominent role in generating demand for these products. Enhanced liquidity, automated underwriting, and risk assessment and credit enhancement fueled loan origination volume but also fueled the growth of the financial industry. Each securitized pool of loans provides narrowly defined jobs including securities issuer, trustee, loan servicer, master loan servicer, debt swap provider, securities administrator, custodian, interest-rate swap counterparty, and credit issuer, among others, providing highly specialized jobs for a wide range of financial firms. The rating agency plays a crucial function since ratings greatly influence the value of the security. Without a triple-A rating, the securities will not be accessible to many institutional investors or to that small town in Norway. The rating agencies receive much of their income from those seeking ratings and suggests one of many conflicts of interest woven into the securitization process (Ashcraft and Schuermann, 2008).
In the early 2000s, low interest rates produced a high loan origination volume. As interest rates climbed, the industry aggressively created new mortgage products to tap new markets such as borrowers with less than prime credit, investors, borrowers seeking second homes, those who saw refinancing as a way to access much needed cash, and those priced out of low- and even higher-income housing markets. Complemented by a political culture and policy regime that greatly favored homeownership over renting and a cadre of homeowners who had built equity through homeownership, many borrowers took the plunge. Subprime lending figured prominently as it has captured massive market share in this decade.

Subprime Lending

Most observers cite the rapid expansion of subprime lending as the primary reason for the foreclosure crisis (Edmiston and Zalneraitis, 2007; Gerardi et al., 2008; McCoy and Renuart, 2008). Subprime loans have higher fees and interest rates to account for the additional risk of lending to borrowers with less than perfect credit and are expected to go into foreclosure at higher rates than prime loans. Securitization, complemented by technological changes, primarily automated underwriting software, allowed subprime lenders to dramatically increase loan originations while decreasing staff (Browning, 2007; Ashcraft and Schuermann, 2008). Simultaneously, subprime lenders expanded their mortgage product, offering to include more ARMs and “exotic” interest-only loans (borrowers pay interest or a percentage of the interest for a set period of time such as 5 or 10 years) and payment option loans (borrowers can choose their monthly payment), which previously were only available in select markets. Ashcraft and Schuermann (2008, p. 17) describe ARMs and exotic loans in a pool of loans originated by New Century as “rather complex financial instruments with payout features often found in interest rate derivatives.” They add that borrowers, who are ill-equipped to do so, take most of the interest-rate risk in this type of lending. Naïve or ambitious/hopeful borrowers, declining house values, and interest-rate resets have been blamed for subprime foreclosures, but this overlooks loan structure, aggressive marketing, complex lending processes, informational asymmetries, fraud, poor underwriting, and high combined loan-to-value ratios (Baker, 2007; Fellowes and Mabanta, 2007; Ashcraft and Schuermann, 2008; McCoy and Renuart, 2008; State Foreclosure Prevention Working Group, 2008; TRF, 2005). For example, adjustable subprime loans have been cited as a primary reason for foreclosure because borrowers qualified for the loan based on the initial payment rather than the payment after the interest-rate reset. These resets are certainly a concern, but to date many subprime loans have entered the foreclosure process prior to the loan reset date, suggesting that foreclosures thus far have not primarily been due to rate resets (State Foreclosure Prevention Working Group, 2008). Since many of the loans originated in recent years have entered foreclosure so swiftly, sometimes before borrowers have even made a single payment, some have called underwriting standards into question. Securitization includes many points at which there should be checks on the underwriting of individual loans as well as the securities. Ashcraft and Schuermann (2008) argue that “informational frictions” limit the effectiveness of these checks because each actor in the securitization process from issuer to asset manager to rating agency has a limitation that keeps her/him from aggressively checking the quality of the underlying loans. During a period of
enhanced optimism and capital accumulation marked by the phrase “everything works in an up-market,” apparently few were interested in assessing the underlying assets of these deals, with devastating consequences.

The State

Whereas the state featured prominently in the financialization of the economy through legislative and regulatory changes, the state did little to regulate this crucial component of the new economy. Regulation was left to a highly fragmented system that was ill-equipped to assess the implications of the rapidly changing mortgage finance sector (Immergluck, 2004; Apgar et al., 2007). McCoy and Renuart (2008) argue that the lack of regulation was responsible for the subprime crisis. They cite federal preemption of state interest-rate caps and legislative authority for lenders to make riskier loan products with adjustable interest rates, balloons, and negative amortization, which made subprime lending possible (Mansfield, 2000). Many state governments sought to eliminate what they saw as increasingly risky lending behavior with antipredatory–lending legislation, but the Federal Office of Thrift Supervision and the Office of the Comptroller of the Currency preempted state regulations for many financial institutions (McCoy and Renuart, 2008). The effect was to create two different regulatory structures. Apgar et al. (2007) call this “channel specialization” where prime credit flows through one set of regulatory structures, while subprime credit flows through a different set of less well regulated structures. The racial implications are critical as “44.2 percent of all Blacks (vs. 30.1% of Whites) obtain a loan from less heavily regulated independent mortgage companies” (Apgar et al., 2007, p. iv).

Conclusion

This perfect storm could be seen as the confluence of subprime loan originations, fraud, inexperienced borrowers, and exuberant lending institutions. But looking beyond these factors to the economic and political context that made them possible suggests a different way of interpreting the problem. The state facilitated the expansion of the new economy and financialization plays a prominent role. Even though this growth has benefitted many, it has also left devastation in its wake, and the people and communities facing the hardest challenges are also those least equipped to address them. Subprime borrowers, urban communities, inner-ring suburbs, and even states are in no position to assist borrowers, navigate the intricacies of securitization to help borrowers negotiate loan workouts, challenge foreclosure, or purchase houses in foreclosure or once foreclosure is complete. As tax revenues decline, students shift schools and districts, displaced borrowers and renters share housing with friends and families or use the few emergency services available, localities struggle to understand the problem and intervene (Newman, 2008a). But this should not be a local problem and a local response is not sufficient to mediate it. The subprime crisis was not caused by naïve borrowers. It was produced as a byproduct of the fundamental transformation of the economy. Local governments and nonprofit organizations are devoting scarce resources to address the crisis. The federal government has ensured that major financial institutions are stable, but that alone is not a sufficient federal response. Again, to cite Krippner (2005, p. 198), “The result of shifting
our ‘lens’ in this way is that financialization—rather than the rise of the service economy or postindustrialism—emerges as the most important ‘fact’ about the economy.” The state has played a critical role in expanding the economy and it is up to the national state to craft a response.

THE CAUSES AND CONSEQUENCES OF THE SUBPRIME MORTGAGE MELTDOWN (ERIC S. BELSKY³)

With remarkable speed, the subprime mortgage market collapsed in the second half of 2007. Few predicted that the loans originated in 2004–2007 would turn in a performance far worse than public ratings agencies had anticipated. Even fewer expected that problems emanating in mortgage markets would threaten to shutter commercial banks, investment banks, and entire segments of credit markets. Yet this is precisely what happened. Now that the system has unraveled, it is time to take stock of what went so badly wrong, how it will affect communities, and what challenges policymakers face in trying to pick up the pieces.

The Roots of the Crisis

In the coming years, there will doubtless be volumes written about what precipitated the subprime mortgage market collapse. At the risk of oversimplification, the preconditions of the crisis likely stem from the remarkable glut of global capital that accumulated during the 1990s. Interest rates in the United States were driven to very low levels by a run-up of domestic wealth and massive inflows of foreign investment from several major nations climbing the steep part of the economic growth curve toward fuller industrialization (Adrian and Shin, 2008). The Federal Reserve aided and abetted the drop in interest rates, easing monetary policy in 2001 and holding the federal funds rate at a mere 1% by 2003.

Unusually low interest rates enabled U.S. homebuyers to chase home prices higher around 2002 and 2003, at a time when housing markets were historically tight in their months’ supply of new homes for sale. This led to record rates of house-price appreciation between 2002 and 2005. At the same time, investors in search of returns beyond what they could get from stocks and bonds developed a larger appetite for riskier instruments. But even the yields on these riskier instruments were below their hurdle rates of return. To boost returns on their equity, many investors resorted to borrowing short-term money to buy mortgage-based securities. These factors combined to create overheated housing markets and overleveraged investments.

In the midst of these conditions, credit providers and investors in mortgage-backed securities had to decide how much risk they were willing to assume. As it turns out, they were only too willing to put the considerable capital they had on their balance sheets—or could get access to by selling loans in the secondary market—to use. Lulled by what

³Correspondence concerning this section should be addressed to Eric Belsky, Joint Center for Housing Studies, John F. Kennedy School of Government, Harvard University, 79 John F. Kennedy Street, Cambridge, Massachusetts 02138; telephone: 617-496-4991; fax: 617-496-9957; e-mail: eric_belsky@harvard.edu
appeared to be powerful predictive risk pricing tools used by ratings agencies, remote investors gobbled up mortgage-backed securities. Eager to meet the strong investor demand for these securities, lenders started to relax underwriting standards in ways that had never been seen before. This created whole new groups of homebuyers who had previously been denied access to credit, including subprime borrowers, self-employed borrowers with uncertain and irregular incomes, and investor/speculators looking to borrow with very little money down. Risk was layered on top of risk in the middle of a booming housing market with unprecedented house-price appreciation in many (but by no means all) areas.

In hindsight, it seems improbable that the risks of these new mortgage products could reliably be assessed and priced. After all, there was no historical precedent to see how these loans would perform in a down market. In 2006, when the Center for Responsible Lending (Schloemer et al., 2006) released predictions of how ugly things could get nationally—drawn from inferences based on the loan performance in states like Ohio that were under far greater economic stress than the rest of the nation—they were roundly criticized by many as alarmist. Now, however, it looks as though their estimates were conservative.

When the housing market finally crested under the weight of rising interest rates and affordability concerns, prices stagnated and eventually declined. As prices fell, homeowners with unmanageable mortgages lost the capacity to get out of trouble by refinancing or selling their homes to fully repay their mortgages. Loan performance eroded swiftly, especially on subprime adjustable-rate mortgages that had been originated at deep initial discounts with minimal or no documentation of income and assets.

The reckless lending practices of the preceding three years that had helped the market to overheat were now contributing to its crash. As the housing market tumbled, other ills that had been lurking in the Pandora’s Box of lax lending practices were unleashed. To begin with, the dependence of mortgage companies on short-term debt to buy and sell loans collided with their own lax lending practices. When an unprecedented share of loans defaulted within just a few months of issue, mortgage companies had to buy back these failing loans. But with little net worth of their own and with banks unwilling to rollover their debt, many of these mortgage companies could not raise enough money to buy back the failed mortgage loans. Several went bankrupt.

Meanwhile, many investors borrowed short-term money to buy long-term mortgage securities. When these investors were suddenly unable to sell the securities at anywhere near par value, their lenders would not renew their loans, causing several investment funds to fail. In addition, it was unclear how much exposure financial institutions had to subprime mortgages because mortgage cash flows had been sliced and diced so many different ways and because there was so little detailed public reporting by individual institutions on their mortgage-backed security holdings. Thus, even some of the biggest institutions could not raise short-term funds. Eventually, Bear Stearns faced a liquidity crisis and was rescued from collapse by a Federal Reserve–engineered bank buyout. Around the same time, large banks with hefty exposure to subprime mortgages had to take huge write-offs when they marked their mortgage portfolios to market values. As a result, major bank after major bank turned to foreign sovereign funds and other overseas investors for equity infusions. With banks and investors hoarding cash, corporate and mortgage debt was harder to obtain and spreads to risk-free Treasuries ballooned.
Spatial and Individual Consequences

Lending without the safety nets of prudent underwriting and the ability to accurately price risk—especially when done at the top of a market fueled in large measure by these practices in the first place—is a truly risky business. The consequences were swift and devastating. According to the Mortgage Bankers Association, fully 3.6% of all loans were seriously delinquent (more than 90 days) or in foreclosure in the fourth quarter of 2007, and 0.9% were entering foreclosure. Two years earlier, the comparable figures were 2.1% and 0.4%. The only published estimate of the share of loans in foreclosure emanating from loans to housing investors (made by the Mortgage Bankers Association for the third quarter of 2007) placed the figure at 1 in 5. The rest were a mix of homeowners in economic trouble and homebuyers who ventured into expensive markets with risky products at the wrong time.

These consequences had very clear spatial dimensions. It is now well known that subprime lending shares of all loans are sharply higher in low-income and minority areas, with the highest concentration in places that stand at the intersection of the two. The high-cost loan origination share in 2006, as reported by the Home Mortgage Disclosure Act (not a perfect but a reasonable proxy for the amorphously defined subprime market), ranged from a low of 15% to a high of 45%. Not surprisingly, default rates are also sharply higher in minority low-income communities. But defaults are up nationwide, and some middle-class and White neighborhoods in the suburbs of metropolitan areas previously barely touched by mortgage woes were feeling the pinch by 2008. The worst performance was turned in by loans in the economically distressed Midwest, followed closely by areas with high investor loan shares and now fast-deflating prices like California, Arizona, Nevada, and Florida.

People losing their homes face uncertain prospects. Now that lenders have tightened their underwriting standards, failed homeowners cannot get loans and may even have a hard time finding rentals because of their now ruined credit scores. Even homeowners who have been making their payments are feeling the effects, as fire sales of foreclosed properties in their neighborhoods reduce the value of their homes. Some neighborhoods face a glut of vacant foreclosed properties that place these communities at risk of a prolonged price decline. These include older low-income and minority communities where subprime loans were concentrated, as well as some new subdivisions where speculators tried to take advantage of the long lag times between putting down a deposit and actually having to take delivery. And in a real sense, everyone is paying in the form of less access to credit and an economy near or in recession.

What Next?

Many are now asking how the mortgage finance system, broader credit markets, and capital markets could have run amok in this way (Gramlich, 2007; Baily et al., 2008). After all, the federal government has long demonstrated a compelling interest in preventing systemic risk from overwhelming the financial system. Deposit insurance and heavy regulation of deposit-taking institutions have been hallmarks of the system since the Great Depression. But over time, funding of mortgages shifted increasingly to institutional investors, such as pension funds and life insurance companies, as well as privately
held investment funds (hedge funds), that are less closely regulated. In fact, regulation is less stringent in the entire asset-backed securities market, from the brokers and state-chartered mortgage companies that originate most of these loans to the larger companies that pool them to the investment banks that engineer securities and trade them to the rating agencies that rate them. On top of this, federal regulation and Supreme Court decisions have created a system in which lenders have far freer reign in the interest rates they can charge and the mortgage products they can offer than if state laws had not been preempted by federal law in the 1980s (McCoy and Renuart, 2008).

There is no lack of recrimination these days. Regulators and lawmakers have been faulted, and legitimate questions have been raised about how stronger regulations might have prevented or at least blunted the crisis. Mortgage investors have been faulted for relying too heavily on ratings by private agencies and for leveraging their investments to try to boost returns. The financial intermediaries standing between the investor and the borrower have been faulted for paying too little attention to the risk that the other financial intermediaries they relied on might act in ways contrary to their interests. This includes insufficient audits and checks on the behavior, conduct, and performance of brokers, insufficient verification of underwriting standards and information, and undue reliance on credit ratings. Homebuyers have been faulted for paying too little attention to understanding the risks associated with their mortgages and taking too many chances.

The more important question is: What next? None of the possible remedies is without its own set of concerns and potential for unintended consequences. Not surprisingly, the least disagreement surrounds calls for greater financial literacy (Lusardi, 2008). This is like apple-pie and motherhood, though it begs the question of how much it would cost, who would set and enforce standards, and who would pay. It also does not address the question of whether financial literacy is likely to succeed in the face of known decision-making biases, and the complexity and uncertainties of making tenure and mortgage choices that are future-regarding (Laibson and Zeckhauser, 1998; Glaeser, 2004; Essene and Apgar, 2007; Belsky and Essene, 2008).

Strengthened consumer disclosures—aimed at the same notion of inoculating consumers by arming them with information—are arguably the second least controversial measure under consideration (McCoy, 2007). But even here, many are doubtful that consumers with better information will make better choices. Furthermore, which new disclosure rules ought to be imposed is hotly contested and many are seen as adding cost without clarity (Durkin and Elliehausen, 2008).

From there, the intended fixes get more controversial. Some call for imposing assignee liability on holders in due course (investors and others who touch loans after they have been originated), under the premise that, if they are liable for the misdeeds of actors farther down the supply chain (who do not have deep pockets), it will motivate the larger fish to better police the system (Engel and McCoy, 2002). This has the appeal of leaving it up to the market on how to better police itself, although many believe it would add greatly to the cost and restrict the availability of credit. The same complaints are leveled against solutions that call for prohibitions on certain practices, rates, and fees. Solutions that involve establishing a vague suitability standard for lending are viewed as having the advantage of allowing more flexibility, but feared because of the possibility that additional litigation will add to credit costs as consumers challenge how individual lenders choose to meet the standards. Other remedies under consideration include national licensing
standards for brokers, changes in the federal regulatory structure so that there are fewer and more powerful regulators, and expansion of the reach of federal regulators (Belsky and Essene, 2008; U.S. Department of the Treasury, 2008). Additional bold steps that have been proposed include using default rules to steer borrowers to better products and de-bias consumers (Jolls and Sunstein, 2005; Barr et al., 2008), and creating a Financial Product Safety Commission modeled along the lines of the Consumer Product Safety Commission (Warren, 2007).

Then there is the question of what to do with the mess already at hand. Despite the enormous weight that foreclosures are placing on certain communities and the economy as a whole, many feel that bailing out borrowers and/or lenders is unfair and would be a mistake. It would, they say, let irresponsible borrowers and lenders off the hook in whole or in part, adding to the moral hazard that they would be even more reckless in the future.

There are no easy answers. In the end, what is done or not will be decided by the political process. There are many points of view and interests at stake. What is certain is that the ability of homeownership to deliver on its asset-building potential has been shaken to the core. Although this time price declines and defaults may be the worst in more than a generation, it is certainly not the first time these events have occurred. As recently as the late 1980s and early 1990s, homeowners in many areas defaulted or lost money when they sold their homes (Belsky and Duda, 2002). Though the rate of homes entering foreclosure had never before topped 1% per annum since record-keeping began in the late 1970s, defaults over the years have left millions of homeowners with a bitter taste in their mouths.

Memories are short, however, and far more households have benefitted from homeownership than not. Still, one hopes that renting will now be taken more seriously as an option and that the knee-jerk assumption that homeownership is best for everyone at all times and at all costs will be questioned. The MacArthur Foundation, among others, has committed significant resources to underscore the importance of low-cost rental housing and to preserve the dwindling supply of affordable rentals. Let us hope the federal government takes notice and follows suit.

SUBPRIME LENDING, WEAK-MARKET NEIGHBORHOODS, AND THE MULTIPLE DIMENSIONS OF THE MORTGAGE CRISIS

(Philip Ashton\textsuperscript{4})

As the mortgage market crisis has unfolded since early 2007, a critical focus of public discussion and policy formulation has been the sources and broader implications of the growing wave of mortgage defaults and foreclosures. Upon closer examination, it is more appropriate to speak of multiple mortgage crises than of a singular crisis, with this multiplicity having at least two sources.

\textsuperscript{4}Correspondence concerning this section should be addressed to Philip Ashton, Department of Urban Planning and Policy, College of Urban Planning and Public Affairs, University of Illinois–Chicago, 412 S. Peoria, 231 CUPPA Hall (MC 348), Chicago, Illinois 60607; telephone: 312-413-7599; fax: 312-413-2314; e-mail: pashton@uic.edu
First, the evolution of the subprime mortgage market since the late 1990s has involved the development of a new market structure capable of exposing a much wider and diverse set of borrowers to the downside risks of overspeculation. Whereas subprime lending—auto or home loans to borrowers with poor credit histories or other blemishes that impaired their access to mainstream credit—has been a feature of the U.S. financial system for several decades, its scale has always been relatively small. As subprime mortgage lending expanded rapidly during the early 1990s, it brought with it higher rates of default and foreclosures. This was not seen as a crisis but characteristic of the higher likelihood of defaults inuring borrowers with poor credit histories (Avery et al., 1996). Indeed, higher interest rates and fees charged to borrowers as a risk premium were key to drawing in investment capital at a significant scale to expand the market after 1994 (Ashton, 2008b).

The expansion of the subprime market has seen these problems widen. A first subprime mortgage crisis unfolded in 1997–1998 as defaults, delinquencies, and prepayments were higher than expected (Temkin et al., 2002). Here again, the scope of the subprime market was limited enough that these problems did not represent a true crisis either for public policy or for the broader mortgage market. Rather, losses and bankruptcies presented arbitrage opportunities for larger companies to buy out smaller regional lenders and finance companies that had formed the basis for the market’s expansion through the 1990s (Temkin et al., 2002). After 1998, a new market structure for subprime lending emerged, marked by significant consolidation of the sector into some of the largest bank holding companies in the country, along with the centralization of financing through major Wall Street investment banks (Ashton, 2008b). In a market environment where low yields elsewhere in the financial system made the returns to subprime lending very attractive, this new market structure attracted investors and pumped liquidity into the mortgage market at an unprecedented rate, causing the overall position of the mortgage market to jump from 46.22% of GDP in 1998 to 69.35% by 2005—a 50% increase in seven years (Angell and Rowley, 2006).

As the expansion of the market proceeded after 2001, lenders targeted new borrower segments and new geographies (Chomsisengphet and Pennington-Cross, 2006). In order to maintain high yields, originators and secondary market conduits competed to develop new loan products that allowed borrowers to overcome income and down-payment constraints, overleveraging themselves and their properties in the process and giving shape to the speculative housing bubble (Angell and Rowley, 2006). This competitive process shaped the transformation of the subprime market into the broader nonprime market, with different channels or segments targeting variously high-interest (“rate spread”) loans to riskier borrowers (Apgar et al., 2007; Wyly et al., 2008), or nontraditional loans to borrowers seeking to compete for homes (or to tap more of their home equity) in highly speculative or appreciating markets (Chiu, 2006).

This highlights what can be referred to as the “front end” of the mortgage crisis—that is, the evolution of a market structure within mortgage lending that exposed a broad set of homebuyers and homeowners to the risks of default, foreclosure, and property value depreciation as the speculative housing bubble burst. The diversity of foreclosure experiences has a common source in a market structure that evolved after 2001 to allow lenders to stretch for profits by making even riskier loans to a larger segment of the population (Angell and Rowley, 2006). However, multiple channeling or segmentation in the mortgage
market have created more than one foreclosure crisis, as inner-city neighborhoods, smaller Rustbelt cities, and urban or suburban submarkets exhibiting different degrees of speculative activity find themselves affected by different forces driving owners to forfeit their homes.

Second, the multiplicity of mortgage crises is also rooted in the overall scale of foreclosure activity, which has produced spillover effects with varying degrees of intensity as it has evolved in different local circumstances. In many cases, these spillover effects transform the otherwise cyclical nature of the housing downturn into an expanding set of problems for localities, including: declining home values; a growing credit crunch as lenders retreat from risk; further reducing effective demand for housing; increased crime or other social costs associated with a growing stock of vacant, foreclosed properties; pressures on both the supply of and the demand for rental housing; and a diminished tax base that threatens local fiscal stability. Also of note are localized job losses that have reverberated through sectors of the economy tied directly or indirectly to the housing market, notably including finance and construction (Kochhar, 2008). These spillovers form what can be best thought of as the “back end” to the foreclosure crisis—an expanding set of effects that continue to draw in households, neighborhoods, and localities notwithstanding their actual exposure to the subprime mortgage market. As the dimensions of this back end become clear, localities are having to redirect resources and design new policy interventions to manage the cumulative effects of mortgage market instability on their local economies.

However, while popular and media accounts have democratized these multiple crises—emphasizing shared pain across the socioeconomic spectrum—the longer-term implications of the mortgage crisis have a spatial dimension that maps onto earlier patterns of investment and disinvestment, and that exposes select markets to much greater downside risk. Metropolitan Chicago is a good example. Although foreclosure activity has spread across the region, drawing in greenfield suburban and affluent urban submarkets alike, the problems in those submarkets are often the more conventional ones of excess speculation and overbuilding. By contrast, the problems look much different for the cohort of low- and moderate-income, owner-occupied neighborhoods within the central city (officially labeled Community Areas) that have borne the brunt of the foreclosure wave. One dimension of this can be seen in the extent of the crisis: just 16 out of Chicago’s 77 community areas accounted for 42% of all foreclosure filings citywide between 2000 and 2007 (Ashton and Doyle, 2008). Foreclosure rates in these “weak-market” neighborhoods are three to four times as high as in other neighborhoods, with a cumulative foreclosure prevalence between 2000 and 2007 ranging from 175 to 350 foreclosure filings per 1,000 mortgageable housing units—equivalent to as many as one in three properties entering the foreclosure process.

A closer examination of the characteristics of these neighborhoods, concentrated on the southern and western sides of the city, reveals the role played by earlier waves of housing and mortgage market segmentation in generating a landscape of disadvantage relative to the current instability. Even though many weak-market neighborhoods maintained stable owner-occupancy conditions through the 1970s and 1980s, they did so by creating a cohort of owners through government-insured loan programs (FHA and VA) or with the assistance of small community banks (Harvey, 1977; Stuart, 2003). By the 1990s, the basis for their stability was beginning to erode. They began to lose owner-occupants as the
aging cohort of owners (those who had lived in the neighborhood for 20 years or more) began passing on or moving into assisted living. As the housing-market boom took shape in the late 1990s, home-purchase demand passed over weak-market neighborhoods, concentrating instead on speculative markets surrounding the CBD. This translated into flat or declining real home values and a declining stream of replacement buyers from the early 1990s onward (Ashton and Doyle, 2008).

These patterns of market segmentation and weakness established the basis for the particularly fierce foreclosure effects currently being seen in weak-market neighborhoods. First, housing-market instability was among the factors that contributed to the dominance of subprime lenders within those neighborhoods. The stable cohort of long-term owners represented a significant stock of equity to be targeted by refinance and home improvement lenders (Newman and Wyly, 2004). The tenuous connection to the labor market for many owners translated into a heightened risk profile within the emerging regime of credit scoring, contributing to their segmentation into a corner of the mortgage market where they were exposed to higher prices and more onerous loan terms. Stagnant or declining owner-occupancy rates meant low profit growth for mainstream lenders, causing them to forsake those markets as they searched for the kinds of profit and market-share growth increasingly demanded of publicly traded banking organizations. The lack of effective competition from mainstream lenders, in turn, facilitated the kinds of rent-seeking behavior associated with high-cost mortgage lending (Ashton, 2008a; Wyly et al., 2008). These market trends made weak-market neighborhoods the core of the subprime mortgage market within the city of Chicago. Citywide, 27% of all high-cost home-purchase loans and 32% of high-cost refinance loans between 2004 and 2006 were made in these 16 community areas. High-cost loans were much more prevalent here than elsewhere: 61% of home purchases in weak-market neighborhoods closed with a high-cost loan between 2004 and 2006, a rate almost double that of other neighborhoods (Ashton and Doyle, 2008).

Moreover, the attractive returns to high-cost lending drew in lenders and buyers at unprecedented rates, and after decades of flat or declining home-purchase demand, the number of home-purchase mortgage originations in weak-market neighborhoods exploded after 2000, doubling by 2004 (Ashton and Doyle, 2008). By 2005, Austin—a community on the City’s West Side, long a poster child for persistent poverty and disinvestment—was the largest single mortgage market within the city of Chicago by application volume. The explosion of mortgage liquidity had a significant effect on sales prices as more buyers and relaxed credit terms increased bidding: in even the slowest neighborhoods median sales prices grew by 12% to 15% between 2001 and 2005, while in hotter weak-market neighborhoods prices grew anywhere from 30% to 60% (Ashton and Doyle, 2008). This created incentives to refinance and drew all homeowners into a pattern of speculative market development.

Whereas the common experience of increasing foreclosure activity ties together a variety of neighborhoods and localities, the intensity of the crisis in weak-market neighborhoods suggests new processes of dispossession and urban structuration at work. In all cases, these processes extend and intensify the risks for select households, neighborhoods, and localities. At the front end of the developing mortgage crisis, select neighborhoods were exposed to the hazards associated with high-cost mortgage lending at a much greater scale, translating into a stream of owners stripped of their assets and pushed
deeper into the ranks of risky borrowers. At the back end of the crisis, the depth of housing-market deflation, triggered by so large a scale of foreclosure activity, maps onto a history of housing-market weakness to further the likelihood that these neighborhoods will be seen as ever more risky—a fact confirmed by Fannie Mae’s tightened standards for mortgage purchases in “declining markets” (Razzi, 2008). As it becomes clear that neighborhoods will be abandoned to the forces of market recovery to determine the paths that they follow out of the foreclosure crisis, these effects portend a much longer and deeper urban crisis.

FORECLOSURES, PREDATORY LENDING, AND REVERSE REDLINING

(DAVID H. KAPLAN5)

The issue of foreclosures and their relationship to predatory lending was first brought to my attention in early 1999. An attorney in a Washington, DC, law firm wanted to know if I had heard anything about a practice that he called “reverse redlining.” I had not. The research with which I was familiar examined the causes and consequences of de facto redlining: the absence of mortgage opportunities in particular neighborhoods, primarily minority neighborhoods, and on the much greater tendency of minority applicants to be denied a loan when compared to White applicants (Myers et al., 1993; Buist et al., 1994; Leven and Sykuta, 1994). Much of this research had been conducted from the 1970s through the 1990s, spearheaded by economists, sociologists, and a few geographers (Harvey and Chatterjee, 1974; Dingemans, 1979; Listokin and Casey, 1980; Guy et al., 1982; Kantor and Nystuen, 1982; Squires and Velez, 1987; Shlay, 1988, 1989; Bradbury et al., 1989). In regard to policy applications, the continued practice of mortgage discrimination had spurred such well-known tools as the Home Mortgage Disclosure Act and the Community Reinvestment Act (Canner, 1991; Squires, 1992a; Avery et al., 2005).

Like many other social ills afflicting American cities, the practice of redlining was bound up with problems of racial and class segregation. The persistent separation of neighborhoods and the concentration of poor Black households in the inner city produced a variety of specifically geographical inequities. A pernicious poverty—measured not only in income but also in access to job, educational, and credit opportunities—had emerged, in part, from where people lived (Massey, 1990). This was especially apparent in the absence of mortgage credit. Social science research had an obligation to uncover where, why, and how such redlining occurred.

As the name suggested, reverse redlining was something like a mirror image of traditional redlining. What was happening in Washington was that a large number of properties—private residential homes as well as churches—had gone into foreclosure. These loans were all tied to a mortgage lender with a history of making unsavory loans, and he had made a number of refinancing loans used to consolidate debt. The problem was that such loans were set with terms that we have now come to identify as hallmarks of predatory lending. These loans were misrepresented. Borrowers were charged interest rates 24% or higher—more in line with a bad credit card rate than with prevailing mortgage rates.

5Correspondence concerning this section should be addressed to David H. Kaplan, Department of Geography, Kent State University, Kent, Ohio 44242; telephone: 330-672-3221; fax: 330-672-4304; e-mail: dkaplan@kent.edu
There were additional fees and charges assessed that had nothing to do with the servicing of the loan. The loans contained balloon payments that were set as high as the original principal. When the loans failed—and many of them did—the lender would begin foreclosure proceedings and, once a property foreclosed, he would resell it. The foreclosed properties cut a swath through neighborhoods that were more than 50% Black; three out of five such loans were issued on blocks that were almost exclusively Black. It was clear from this particular case that predatory lending and foreclosures were linked together geographically, in precisely those sorts of places that had historically suffered a deficit of mortgage lending, areas that had been redlined.

Since 1999, the relationship between foreclosures and predatory loans has gained tremendous notoriety (Van Order and Zorn, 2000; Bunce et al., 2001; U.S. Department of Housing and Urban Development, 2001; Pyle, 2003). In Ohio, which has been particularly plagued by the foreclosure crisis, the number of foreclosures quintupled between 1995 and 2007. This has paralleled an astonishing increase in what are termed subprime loans—loans issued to people with less than stellar credit history. Are these two trends related? As discussed elsewhere in this forum, the burgeoning of subprime credit is a consequence of the uncoupling of mortgage loans from traditional banks, whose mortgage officers carefully assessed the creditworthiness of applicants as well as securitized loans that minimized the risks of loans to the lenders.

The relationship between subprime loans and predatory loans is murky. By itself, subprime lending is not necessarily a bad thing. It involves the extension of credit to individuals and households with a compromised credit rating, often determined by one of the three major credit bureaus. In return, borrowers are asked to pay higher interest rates or additional fees. This practice exploded in the 1990s and 2000s, increasing from a $35 billion to a $600 billion industry between 1994 and 2005 (Avery et al., 2006). Because it provided credit to previously ineligible households, subprime lending may have helped nudge the rate of U.S. homeownership to an all time high of 69% by 2004 (U.S. Bureau of the Census, 2005). Predatory loans go well beyond what would be considered a reasonable fee or rate to compensate for the additional risk involved in a subprime loan. Many of them involve prepayment penalties that make it all but impossible for mortgage borrowers to escape their existing loan and move on to a loan with better terms. And they often are loaded with other features designed to extract extraordinary profits from borrowers, many of whom would struggle just to meet the payments of a legitimate loan.

Studies have determined that subprime lending can lead to foreclosures (Immergluck and Smith, 2005; Carr, 2007). One reason might be that the expansion of the subprime lending market has opened up mortgage credit to people who are less financially stable and therefore more likely to go under. The clearly positive aspects of this practice, however, also contained a negative: should some of these new homeowners have remained as renters? Complicating matters is that many of these subprime loans originate from less than reputable mortgage lenders, such as the lender in Washington mentioned above. These lenders do not just make subprime loans. They make predatory loans with terms that mercilessly exploit borrowers. There is also a strong spatial dimension. Subprime loans, predatory loans, and foreclosures tend to be concentrated in particular neighborhoods, mirroring the type of discriminatory racial geography evidenced in redlining. The very fact that particular neighborhoods appear to be targeted by subprime lenders, well beyond what might be predicted in econometric models, indicate that “whether we call it
subprime or predatory, it is clear that the profits extracted by these lenders are based on systematic inequalities in access to information, capital, industry resources and power” (Wyly et al., 2006, p. 123). Research conducted in Summit County, Ohio, showed that subprime lending and foreclosure rates were strongly related at the neighborhood level and that both occurred in tandem in lower-income, minority neighborhoods—with the minority composition of the neighborhood emerging as a significant independent variable.

Three sets of conclusions can be drawn from these recent trends and the research that has been conducted thus far. First, public policy has been guided, beneficially, by the analysis of housing finance and provision. Prior research helped expose many of the problems with de facto redlining, and current research has enabled us to get to the bottom of the relationship between predatory lending and foreclosures. However, the analysis has only been as good as the data that are available. The dissemination of foreclosure information, while improving, is fairly uneven between counties. Credit scores are difficult to obtain, and are only available through some proprietary vendors (like Transunion) and are not geographically precise enough to see how particular neighborhoods are affected.

The attempt to determine which loans may be predatory has always proven difficult because the nature of predatory lending is such that it cannot be singularly identified. The U.S. Department of Housing and Urban Development (2001) releases a list of subprime lenders, but this only means that the majority of loans made by these lenders are subprime. Prime lenders may also make several high-interest loans but do not get classified in the HUD database. My analysis of the Summit County, Ohio, data showed that many of its foreclosed properties exhibited loans at incredibly high interest rates from prime lenders. One sign of progress has been the additional disclosure requirements mandated by the Home Mortgage Disclosure Act. Since 2004, it has been required to report higher-priced loans, generally defined as in excess of 3% between the loan APR and Treasury securities of comparable maturity. According to an analysis by the Federal Reserve, 98% of subprime loans fall into the higher-cost category (Avery et al., 2005). Nonetheless, HMDA does not cover about 20% of the mortgage market (Avery et al., 2006).

Second, while foreclosures are still mainly concentrated in inner-city neighborhoods, they have increasingly been migrating to the outer city as the current housing crisis deepened and expanded. In 2007, Cuyahoga County had the largest number of foreclosure filings in Ohio and the highest rate of foreclosures per 1000 population (Table 1). More than half of all foreclosures within Cuyahoga County are concentrated within the city of Cleveland, particularly in the neighborhoods just east of downtown, but the fastest growth now is within the inner and outer suburban rings (Fig. 2). Some inner-ring suburbs, such as the middle class Black community of Bedford Heights, have suffered acutely and foreclosures here may be related to the same processes afflicting inner-city Cleveland neighborhoods. But foreclosures in such outer-ring suburbs as Solon, Strongsville, and Westlake are probably the result of different factors. I suspect that, for many borrowers, their desire to stretch themselves financially was fueled by dreams of ever-increasing housing values, and realized by questionable loans issued by questionable lenders. When housing values stopped rising, many borrowers found themselves “underwater,” owing more than their property was worth. This underscores that foreclosures are a geographically contingent phenomenon and care must be taken to examine where they occur.

Third, we need to better understand how individuals may slide into foreclosure and how this may relate to predatory lending. Qualitative research is rare in the study of
foreclosures, but there are two good recent examples (Community Development Studio, 2006; Fields et al., 2007). The questions that can be addressed with this kind of research include the extent to which individuals are targeted by particular types of mortgage lenders, a more complete understanding of the loan terms taken by borrowers, how well the

<table>
<thead>
<tr>
<th>County</th>
<th>Population</th>
<th>Foreclosure filings</th>
<th>Filings per 1,000 population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cuyahoga</td>
<td>1,295,958</td>
<td>14,946</td>
<td>11.53</td>
</tr>
<tr>
<td>Montgomery</td>
<td>538,104</td>
<td>5,119</td>
<td>9.51</td>
</tr>
<tr>
<td>Summit</td>
<td>543,487</td>
<td>4,920</td>
<td>9.05</td>
</tr>
<tr>
<td>Lucas</td>
<td>441,910</td>
<td>3,796</td>
<td>8.59</td>
</tr>
<tr>
<td>Preble</td>
<td>41,739</td>
<td>348</td>
<td>8.34</td>
</tr>
<tr>
<td>Franklin</td>
<td>1,118,107</td>
<td>9,145</td>
<td>8.18</td>
</tr>
<tr>
<td>Lorain</td>
<td>302,260</td>
<td>2,401</td>
<td>7.94</td>
</tr>
<tr>
<td>Highland</td>
<td>42,653</td>
<td>334</td>
<td>7.83</td>
</tr>
<tr>
<td>Mahoning</td>
<td>240,420</td>
<td>1,880</td>
<td>7.82</td>
</tr>
<tr>
<td>Butler</td>
<td>357,888</td>
<td>2,783</td>
<td>7.78</td>
</tr>
</tbody>
</table>

*Source: Ohio Supreme Court; U.S. Census Bureau; Policy Matters review of filings in U.S. District Courts. (Schiller et al., 2008)*

*Fig. 2. Foreclosures in Cuyahoga County, 2007. Only selected municipalities are labeled. Each dot represents one foreclosure. Data source: Cuyahoga County Court of Common Pleas; State of Ohio Department of Commerce, Division of Financial Institutions. Source: Map courtesy of The Housing Research and Advocacy Center, Cleveland, Ohio (2008).*
type of loan matches up to an applicant’s credit history, financial means, and property, and the process by which a borrower goes from missing a few payments to suffering the hardship and indignity of foreclosure.

I have recently had the opportunity to supervise the interviewing of some foreclosure victims in northeastern Ohio. Thus far, the findings are quite suggestive. What emerges is a picture wherein most of the interviewed seek lenders through informal channels, often learning about a specific lender from a friend or acquaintance. Most borrowers interviewed were quite naïve and had little experience navigating the world of mortgages. Given the complexity of lending documents, this could refer to any borrower who to a great extent must take on faith that she/he is being given a fair shake, but for financially inexperienced borrowers this trust can be misplaced and devastating. These characteristics surface in neighborhoods where there is a general lack of access to conventional banks and financial institutions and where little opportunity exists to shop around for the best loan terms.

Once a borrower gets into trouble with payments, what is the next step? Gone are the days when a borrower could count on a single point of contact. With loans being sold and resold, and the entire industry given over to hyperspecialization, borrowers were never able to communicate with the same person. Instead they were shuffled from agent to agent, with no opportunity to continue the story or to have any follow through. Without some sort of centralized contact, or ombudsman, missed payments more readily slipped into foreclosures. Some of these foreclosures could probably have been prevented.

Foreclosures are a deeply personal tragedy. But they are also part and parcel of the geographically segmented society in which we live. High-cost lending, subprime or predatory, has been concentrated in the same neighborhoods in which mortgage credit was long absent. Foreclosures too, although increasing in the White suburbs, have also ravaged these minority neighborhoods in focused and disastrous ways.

THE FORECLOSURE CRISIS IN MINNESOTA: STATE LEGISLATIVE RESPONSES (JEFF CRUMP6)

In Minneapolis, Minnesota, foreclosures have reached record levels. In 2007, there were a total of 2,895 foreclosures in the city, an 80% increase over the 2006 total of 1,607 (HousingLink, 2007). As if to underline the destructiveness of the foreclosure crisis, on the evening of March 26, 2008, a natural gas explosion leveled a vacant house in the predominantly African American neighborhood of North Minneapolis (Collins, 2008). Later investigation revealed that the gas leak was likely the result of an ill-fated attempt to strip copper pipe from the vacant house. The explosion, which left a debris-filled hole in the ground, is emblematic of the destructive wave of devaluation that is sweeping through the Minneapolis–St. Paul metropolitan region.

6Correspondence concerning this section should be addressed to Jeff Crump, Housing Studies Program, University of Minnesota, 350 McNeal Hall, St. Paul, Minnesota 55108; telephone: 612-624-2281; e-mail: jrcrump@umn.edu
In 2003, I initiated a research project focused on analyzing patterns of subprime lending and foreclosure in the Twin Cities. I began by using Home Mortgage Disclosure Act (HMDA) data to map the spatial distribution of subprime loans in the Twin Cities. In addition, I collected and mapped the foreclosures in Hennepin and Ramsey Counties (the core counties of the Twin Cities metropolis) for 2002.

The research findings left little doubt that subprime lending was disproportionately concentrated in minority neighborhoods (Crump, 2005). When the 2002 foreclosures were geocoded and mapped, it was evident that these neighborhoods were also the focus for an alarming number of foreclosures (Fig. 3). These findings were hardly surprising, however, given the similar results reported in other studies on subprime lending and foreclosure (Newman and Wyly, 2004; Immergluck and Smith, 2005).

The visual evidence provided by the maps was supplemented by logistic regression analysis that used the origination of a subprime loan as the dependent variable and vectors of individual as well as neighborhood characteristics as explanatory variables (Crump, 2007). These equations yielded the finding that, irrespective of income or neighborhood characteristics, African Americans were 64% more likely to receive a subprime loan as compared to Whites. Similar findings were observed for Asians and Hispanics as well (Crump, 2007).

Although the brunt of the social and economic costs of foreclosure is borne by the minority neighborhoods of Minneapolis and St. Paul, it is now apparent that foreclosure has spread to the suburbs. For example, Dakota County (located on the southeastern fringes of the Minneapolis–St. Paul metropolitan region) experienced an 93% increase in foreclosures (from 880 to 1,610) between 2006 and 2007.

Foreclosure: Investor Speculation

In low-income minority neighborhoods such as North Minneapolis, many foreclosures are the result of the speculative activities of investors. According to staff at local CDCs, approximately 70% of the foreclosures in North Minneapolis are investor owned. Although tracking the prevalence of investor-owned foreclosures is difficult, an analysis using the Minnesota homestead exemption as an indicator of owner occupancy does provide empirical verification of the prevalence of investor-owned foreclosures. In the heavily impacted North Minneapolis neighborhoods of Jordan and Hawthorne, 62% of the 2007 foreclosures are not homesteaded, indicating that these foreclosures are related to investors.

The large number of investor-owned foreclosures has resulted in significant repercussions for renters. Many unsuspecting tenants have been evicted from rental properties when foreclosure proceedings began and some were left in the dark when utilities were cut off. Furthermore, some tenants who were evicted due to an investor foreclosure, ended up with a damaged rental record that made it difficult to find another rental unit.

These speculative investments in rental property are very profitable. Typically, investors purchase rentals with a subprime loan and subsequently refinance the property several times to extract the equity. Concomitantly, investors continue to collect rent as
Fig. 3. Subprime share of all loan originations (2006, top), and foreclosure sales (2007, bottom), Twin Cities metropolitan area.
well as security deposits from tenants. At the end of the process, investors simply walk away from the property, leaving tenants without a place to live and leaving the neighbors (and city officials) to deal with neglected and abandoned structures.

Fraud

Another aspect to the foreclosure crisis in the Twin Cities, especially (but not limited to) North Minneapolis, is large-scale fraud. For many years, the Northside has been plagued by fraudulent real estate transactions such as property flipping. Fraud reached a new peak, however, in the subprime-fueled real estate boom of 2005–2007. A recent example involved the firm of TJ Waconia (Brandt, 2008). The Waconia scheme involved the purchase of rental properties and their subsequent resale to straw buyers who were given $2,500 and provided with funds to pay the mortgage for two years. Most of these properties were purchased sight unseen and when Waconia ultimately collapsed these “investors” were left holding the mortgage. Subsequently, a total of 162 properties with $32 million in mortgages were foreclosed upon (Brandt, 2008). According to the Minneapolis Star Tribune, “Most of these properties were in North Minneapolis where … the men and their firm laid waste to three neighborhoods, leaving blocks dotted with vacant, deteriorating housing” (Brandt, 2008).

Legislative Responses

Although federal responses to the foreclosure crisis are slow in coming, at the state level, advocates and legislators have been extremely active. At last count, 36 states have some form of regulation over the subprime lending industry (Li and Ernst, 2007). Minnesota is no exception and, in the last two legislative sessions, several significant bills regulating subprime lending and foreclosure have been passed.

During the 2007 legislative session, two bills limiting predatory lending were passed. The Minnesota antipredatory lending laws are among the most stringent in the nation. Stipulations of Minnesota’s Anti-Predatory Lending Law include: (1) lenders must verify borrower’s ability to repay a loan; (2) “loan churning” (i.e., refinancing) is prohibited unless there is a “reasonable and tangible” benefit to borrower; (3) loans that result in negative amortization are prohibited; (4) a duty of agency for mortgage brokers is established; (5) lenders are prohibited from making misleading or false statements; (6) selling a borrower a subprime loan is prohibited if that borrower qualifies for a prime mortgage; (7) prepayment penalties are outlawed; (8) a right to private action is provided; and (9) mortgage fraud is defined and prohibited.

Nearly a year after its implementation, the Minnesota antipredatory lending law is considered a success. In particular, the more stringent requirements placed on mortgage brokers have caused many to give up their licenses, and the number of active mortgage brokers dropped from over 4,000 in 2007 to 1,319 at present (Buchta, 2008). Although the Minnesota laws are strict, it is important to note that the legislation does not apply to federally regulated banks and lenders (e.g., Wells Fargo, Countrywide) that are exempt from these (and other) state regulations.

In fall of 2007, five bipartisan working groups were convened to address the foreclosure crisis. Significant legislative proposals came out of the foreclosure data committee
(which I chaired)—the renter working group and the remedies working group. Subsequently, in the 2008 Minnesota State Legislative session, 11 bills dealing with some aspect of the foreclosure crisis were passed and signed into law.

In terms of foreclosure data, the new Foreclosure Data Practices Act adds the address, property tax identification, and lender’s information to preexisting public foreclosure documents. These data will provide more readily available locational and lender information. The legislation also established a working group charged with developing and planning a statewide electronic foreclosure data system that will facilitate improved access to foreclosure data.

Several important bills addressing foreclosure and rental properties were also passed in the 2008 session. Most noteworthy are new requirements to notify current and prospective tenants of landlord foreclosure, facilitating the ability of tenants to pay utility bills, and another bill that provides for the mandatory removal of foreclosure-related evictions from the tenant’s rental record in cases of landlord foreclosure.

Moreover, important steps were taken to facilitate early intervention by foreclosure prevention agencies. Here, Minnesota’s foreclosure law was amended to require lenders to provide borrowers who are in default on their mortgages (default usually occurs when borrowers are 30 to 90 days behind on their payments) but not yet in foreclosure, with information pertaining to foreclosure prevention counseling. The new law also requires that lenders provide authorized foreclosure prevention agencies with the mortgagor’s name, address, and telephone number. Subsequently, foreclosure prevention counselors will contact the borrower with information pertaining to actions that can be taken to prevent a foreclosure.

The preforeclosure notification requirement provides the opportunity for foreclosure counselors to intervene earlier in the process, and it is hoped that this will facilitate more effective intervention. The effectiveness of foreclosure counseling, however, hinges on the willingness of lenders to renegotiate loan terms or to provide payment plans that provide the homeowner with a realistic opportunity to repay the loan. The record of lenders in this regard is not encouraging (California Reinvestment Coalition, 2008).

In the 2008 session of the Minnesota legislature, the most noteworthy and controversial bill relating to mortgage foreclosure was the Minnesota Subprime Borrower Relief Act. The bill provides for a one-year foreclosure deferment for borrowers who currently hold a subprime loan or who have a negatively amortized loan. During the deferment period, borrowers would still have to make payments to the lender and would also have to participate in mortgage foreclosure prevention counseling. However, the foreclosure process would be halted for a year. Supporters estimated that over 15,000 subprime borrowers would be eligible for a foreclosure deferment (Cox, 2008).

Although the Minnesota Subprime Relief bill was narrowly passed by the Minnesota House and Senate; it was subsequently vetoed by Governor Tim Pawlenty. In vetoing the bill, Pawlenty argued that it would create additional risk for mortgage lenders and thereby, raise the cost of mortgages in the state (Merrick, 2008). As Pawlenty stated, “While the bill is well-intentioned, it could have a negative impact on the credit market for the 98% of Minnesotans who are not in foreclosure” (Merrick, 2008, p. A3). The governor also argued that such a moratorium constituted a change to the mortgage contract signed by the borrower and that he had significant philosophical and constitutional concerns over the stipulations of the bill. Pawlenty’s veto was supported by the Minnesota Bankers
Association and was praised by Kieran P. Quinn, Chairman of the Mortgage Bankers Association, who stated, “we applaud Governor Pawlenty for his leadership in promoting solutions to aid troubled borrowers and correctly deciding to veto this bill” (Mortgage Bankers Association, 2008).

Supporters of the Minnesota Subprime Relief Act countered these arguments by pointing out that the mortgages covered by the bill were outlawed by the 2007 Anti-Predatory Lending bill and were no longer legal in Minnesota. Since these loans are not even available in Minnesota, supporters claimed the cost of credit would not be affected by its passage and implementation. Advocates also pointed out that preventing additional foreclosures was essential to preventing a further erosion of home values due to the large number of foreclosed homes that are currently flooding the housing market.

The Pawlenty veto also brings out the salience of the foreclosure crisis in the national race for the Presidency. Pawlenty was an early supporter of Republican nominee John McCain and was often mentioned as a likely vice presidential candidate on the McCain ticket. His veto of a bill that would directly help homeowners in foreclosure might, according to the Wall Street Journal, be seen as “insensitive to homeowners” (Merrick, 2008).

In response to Governor Pawlenty’s veto of the Subprime Borrowers Relief Act, the author of the bill, Professor Prentiss Cox, stated:

This notion that lenders will refuse to make financially sensible mortgage loans … based on Minnesota helping subprime borrowers now can accurately be described as a threat of class warfare. It may make good, if divisive politics—inciting fear in the affluent against homeowners in need … but it doesn’t make sense from a market perspective. (Priesmeyer, 2008)

**The Crisis Is Just Beginning**

As foreclosures become common in suburban and exurban locations, it is evident that the foreclosure crisis, caused by the reckless, speculative activities of subprime lenders and investors, continues to grow in intensity and scope. As the foreclosure crisis evolves, I think that one can discern two distinct phases in the evolution of the housing crisis.

First, there was an early phase during which subprime lenders successfully targeted minority neighborhoods. These early-stage subprime loans subsequently resulted in a foreclosure spike in minority neighborhoods that was largely ignored. The exploitation of inner-city minority neighborhoods was classic mortgage industry behavior and can be termed the reverse redlining phase. This was followed by a second, “money chasing borrower” phase. Beginning around 2005, securitization boomed on Wall Street. To meet the financial sector’s insatiable demand for mortgages to package and sell on the securities market, subprime lenders lowered their standards and the Alt-A loan sector (marked by no document or interest-only loans) boomed. The “money chasing borrowers” phase lasted until the mortgage market meltdown of late 2007. In spatial terms, it is characterized by the spread of subprime lending to heretofore untouched suburban markets. By early 2008, it was evident that those loans were going into foreclosure at a rapid rate.

What we are witnessing now is the spreading of foreclosures to both suburban and exurban locations. Ill advised (and poorly underwritten) mortgages, problems in the
broader economy, and an unexpected surge in energy costs have fueled a rapid rise in foreclosures in formerly secure outlying metropolitan locations. The spread of the foreclosure crisis is reflected in recent data that indicate that one out of every eleven mortgages in the United States is either in arrears or foreclosure (Bajaj and Grynbaum, 2008). This is a frightening statistic and points to the need for immediate and significant action to stem the still expanding foreclosure explosion.

Although many states are attempting to grapple with the difficulties presented by the foreclosure crisis, the federal government has offered little if any relief for homeowners. Meanwhile, up to two million households may lose their homes to foreclosure between mid-2008 and mid-2009, with entire neighborhoods being depopulated in both the inner city and suburbs. The foreclosure crisis calls for significant federal intervention to keep families in their homes and prevent further deterioration in the housing market. If steps are not taken toward mitigation, what we are seeing today is simply a prelude to a deeper and more serious economic and social crisis.

THE FORECLOSURE CRISIS: IDEOLOGICAL STRUGGLES AND RESEARCH CHALLENGES (DANIEL J. HAMMEL)

For the past several years I have required my introductory human geography students to read “Prisoners of Geography” by Ricardo Hausmann (2001), who was at that time a professor at Harvard’s John F. Kennedy School of Government. In his attempt to explain persistent poverty in Africa, Hausmann raised some legitimate and thought provoking issues about latitudinal biases in research and development spending in a wide range of fields from agronomy to epidemiology. He then extended his argument about the importance of geography well beyond where most academic geographers would be comfortable, moving toward explanations derived from long discredited theories that formed the core of environmental determinism. He also launched into a spirited defense of Ellsworth Huntington. Perhaps most disturbing though, was Hausmann’s ability to ignore Africa’s colonial history: in a 10-page essay he did not even use the term colonialism. Many of the introductory students noticed the omission even before I called their attention to it.

I mention this essay because of a recent speech by Federal Reserve Board Chair Ben Bernanke in which he sought to explain mortgage foreclosures by resorting to geographic analysis or at least a rudimentary form of it (Bernanke, 2008). Bernanke presented a series of county-level “heat maps” of the United States showing foreclosure activity and a range of economic and housing-market variables that might account for it. His analytical technique might best be described as “eyeballing it,” somewhat disappointing given the apparent richness of his data. Yet, like Hausmann, Bernanke presents us with a similar

7This material is based on work completed while serving at the National Science Foundation. Any opinions, findings, and conclusions or recommendations expressed in this material are those of the author and do not necessarily reflect the views of the National Science Foundation.

8Correspondence concerning this section should be addressed to Daniel Hammel, Department of Geography and Planning, The University of Toledo, Toledo, Ohio 43606; telephone: 419-530-4709; fax: 419-530-7919; e-mail: dhammel@utnet.utoledo.edu

9The maps themselves are quite interesting and can be found online at http://www.federalreserve.gov/newsevents/speech/Bernanke20080505a.htm
dilemma—a respected economist insisting that geography is an essential component in resolving a fundamental and serious problem while ignoring elements that many geographers (and scholars from the social sciences in general) would identify as root causes of the problem. You see, in a nearly 3,000-word speech, Bernanke mentions subprime lending only in passing.

To be generous, I should note that the choice of county-level analysis masked the fine-grained geographic variation in subprime lending that is driven by the urban geographies of capital, class, and, most importantly, race (Squires, 2004; Ashton, 2008a; Wyly et al., 2008). To be less charitable, I would note that the absence of any discussion of subprime lending reflects Bernanke’s unwillingness to acknowledge the substantial regulatory failures over the mortgage market created by a decade and a half of neoliberal governance.

The U.S. foreclosure crisis, despite its potential global repercussions, pales in comparison to the issue of global poverty. It is revealing, though, that in Bernanke we have not a Harvard-based policy wonk like Hausmann, but an individual who exerts as much influence on the nation’s economy as anyone. The analysis is also revealing in what it tells us about the foreclosure crisis. For the sake of brevity (and perhaps simplicity), I will focus on three issues that Bernanke inadvertently highlighted: spin, data, and context.

**Spin**

This colloquialism is an apt term for the recent discussions of the mortgage crisis among policymakers and pundits. Ideological debates are commonplace in urban policy discussions. Even among those who depend on empirical approaches, differences in interpretation based on careful analysis occur with some frequency. Unfortunately, we have not yet reached this point in the discourse on the foreclosure crisis. This is not to say that there is not yet good scholarship on foreclosures. There is some (e.g., Bunce et al., 2001; Quercia et al., 2007), and certainly much of the recent work on subprime lending can inform the discussion. At this point, however, the volume of work is not to the point that it seems to be having much effect on policy discussions. This is changing, but in its absence we are left with spin.

Whereas policymakers and talking heads on all sides of the foreclosure crisis are capable of spinning, in the absence of any scientific polling data it appears that the right—the neoliberal right and its associated cult of individual responsibility—is winning the battle. My claim is based on the admittedly unscientific reading of opinion pieces and letters to the editor in some of the nation’s most influential newspapers. Conservatives make strong claims about the efficacy of the free market and its ability to weather the crisis, and even more progressive writers are quick to note that much of the blame can be placed on low-income borrowers who are seen to be too greedy for their own good. I do not have space for a full-scale analysis of popular press coverage, nor do I possess the requisite analytical skills for such an endeavor, but let me turn to a brief consideration of the very peculiar term, “predatory borrower.”

---

10 Unfortunately, much of the earlier work on foreclosures does not apply well to the current situation due to the massive changes in home-purchase finance over the past decade.
The origins of this term are not clear, but its popularity may be due to a column written by the conservative commentator, Michelle Malkin, in the *New York Post* (Malkin, 2008). It has been used to describe a specific act of fraud on the part of the borrower during the loan application process (Cowen, 2008), as well as a more general term to include all of those borrowers who just should have known better (Malkin, 2008). The first of these meanings refers to the now infamous NoDoc loans whereby mortgage issuers, departing from over a half-century of business practice, required no documentation of the prospective borrower’s income or assets before writing a mortgage. The existence of these loans provides some insight into the new housing finance. Discounting a sudden movement toward increased trust in humankind by the financial sector of the economy, the only logical assumption one can draw from NoDoc loans is that lenders understood that a borrower’s ability to repay a loan was inconsequential. Lenders knew that they could profit from a loan even if the borrower defaulted within several months. To the uninitiated or to those whose understanding of mortgage process is more than a decade old, this statement may seem bizarre. Yet, thanks to the increasingly complex securitization process, it is true—or at least was true for a time (Engel and McCoy, 2004, 2007). Today, these same lenders are conducting studies with questionable findings to suggest that they have been victimized by unscrupulous borrowers, and that this victimization led to the mortgage crisis.12

The phrase “predatory borrower” has appeared in *New York Post* and the *New York Times*, and subsequently spread rapidly across the Internet in a viral manner. By mid-2008, it could be found on the websites of most major conservative think tanks. George Will stopped just short of using the term in a May 15, 2008, editorial in the *Washington Post* (Will, 2008); however, six months earlier Will wondered, “But did ‘predatory’ lenders expect the borrowers upon whom they supposedly preyed to default?” (Will, 2007, p. B07, emphasis original). Obviously, he thought the answer was no. This suggests that at least some of those using the phrase may not fully understand how much the mortgage market has changed over the past decade. Others seem to have a clearer picture.

The issue of spin is not insignificant. In early 2008, the mortgage crisis had become a major ideological battleground. While liberals may know this, and some proposals for increased regulation have emerged, conservatives clearly understand what is at stake. They have mobilized, and are already successfully attacking the victims, although not yet in an orchestrated or organized fashion. One hopes that the crisis will not continue to deepen. It has already inflicted significant suffering and financial loss, but the impending maturation of large numbers of Alt-A loans is certainly cause for renewed concern. If we do see a continued increase in foreclosures, however, it may provide one of the clearest

11Many storefront lenders and mortgage brokers have still managed to avoid significant loss of funds on sub-prime loans that go into foreclosure. It is the investors that hold the securities, the securities firms, and the U.S. taxpayers who will bail them out that will lose money. Of course, the subprime borrowers are hurt no matter the condition of the economy.

12The study was conducted by Base Point Analytics who describe themselves as “a leading provider of predictive analytic fraud and risk management solutions for the mortgage and global banking industries” (http://www.basepointanalytics.com). Their findings according the *New York Times* (Cowen, 2008) suggest that as many as 70% of early-payment defaults on loans in 2005 and 2006 had fraudulent claims on the mortgage application. They did not report on what percentage of the lenders made fraudulent claims to the borrowers.
views that the U.S. middle class will have of the repercussions of the neoliberal project. What action this might engender is still to be seen, but it is a challenge that organizers and progressive policymakers need to rise to.

Data

Our understanding of the foreclosure crisis suffers from a lack of accurate, consistent data on foreclosures themselves. Even the feeble analysis offered by the Bernanke is worth attention, not simply because of his position as Chair of the Federal Reserve Board, but also because he presented some very interesting data that help fill some gaps in our current understanding. Yet datasets like Bernanke’s are not enough and the data gap we are currently experiencing is problematic.

The dearth of data revolves around three aspects of foreclosures that make them somewhat different than other common “transactions” in the housing market. First, the foreclosure process is inherently local. Legislation governing foreclosures is made at the state level, which immediately introduces a great deal of variability into the national picture. Second, the legal filing of a foreclosure typically occurs at the county level. Thus acquiring national-level foreclosure data would involve contacting each of the roughly 3,143 county (or county-like) entities. And third, the foreclosure process has several data collection points from the reporting of a property in default, to the foreclosure filing, and to the subsequent sheriff’s sale. Not all properties go through each of these stages, and not all jurisdictions require them.\(^\text{13}\)

Unlike most other segments of the housing market, there is no federal regulation that might require a nationwide data-gathering effort. Much of the now substantial literature on subprime lending and the work on racial and ethnic discrimination in lending that preceded it relied heavily on the data reported by the Federal Financial Institutions Examination Council as a requirement of the Home Mortgage Disclosure Act (HMDA). HMDA has its faults and gaps, but it has provided something of a gold standard for studies of mortgage lending. It is also worth noting that the most useful aspects of the HMDA data were a product of forced compromise created during the bailout of U.S. savings and loan institutions—the last major crisis in the housing and real estate market. At this point, the only significant efforts to create a nationwide dataset have been made by such private firms as RealtyTrac. These data are proprietary and thus expensive; their quality is suspect; and there are no metadata available. Perhaps the lack of data on foreclosures provides us with yet another glimpse of the future of neoliberal governance.

Given the data issues involved, studies of foreclosures have come in two forms. Quantitative work tends to be localized (often countywide) research drawing on privately collected data over a reasonably short time period, and analyses have ranged from basic to econometric (e.g., Immergluck and Smith, 2006). Qualitative work has been oriented toward interviews of a small number of people who lost their homes in foreclosure (Libman et al., 2007; Saegert et al., 2008). All of these studies have produced valuable information on foreclosures, their root causes and effects, the foreclosure process, and the effectiveness

\(^\text{13}\)For example, slightly more than half of the states allow a nonjudicial form of foreclosure termed foreclosure by power of sale that does not require a formal filing unless challenged.
of various policy interventions. Some of them have begun to link foreclosures to broader theories of urban process (Newman, 2008c). They have also highlighted the difficulty of accessing or collecting good data on foreclosures. Indeed, without a significant amount of this kind of research on foreclosures, our true understanding of the crisis and its impacts is limited. But this is not enough.

We need more nationwide econometric analyses of foreclosures at a detailed geographic scale. I do not claim that this type of research is more rigorous or insightful than qualitative research, but it is different. It is based on the methods on which policy analysts rely, and uses the terms that policymakers, when they choose to listen, pay attention to. Foreclosures do pose some thorny but surmountable issues for econometric analysis, in part due to the time lag between the multitude of causes and the eventual filing. Yet this type of analysis will not occur, at least not soon, unless we are able to create a representative and reliable dataset to support it. We need to move beyond Bernanke’s heat maps, and some form of comprehensive data gathering needs to be part of any legislation intended to bail out the financial sector.

Context

Bernanke’s attempt at spatial analysis did at least highlight the importance of geographic context for understanding the foreclosure crisis. His maps show clear patterns of concentrations of foreclosures in particular regions. The old industrial core has been hit hard by the crisis, but so have the areas where the housing bubble burst the most dramatically—the West and parts of the Southeast. As Bernanke pointed out, there is a different mix of causes for the increase in foreclosures in each of these areas. Some causes prevail nationwide. The effect of rising interest rates on adjustable-rate mortgages as they mature and begin to reset have increased monthly mortgage payments beyond an affordable level for many homeowners. The rising cost of health care and unexpected health-related expenses have left many struggling to pay off substantial debts.

Other causes vary greatly among different U.S. regions. As I have already noted, differences in the process of foreclosure can create state-to-state and even county-to-county variation in foreclosure rates. More significantly, unemployment rates are much higher in some regions than others. The strength of the local housing market (even at the submarket level) plays a crucial role in mitigating or exacerbating foreclosure rates. It has been evident for several years that foreclosure rates in particularly hot housing markets have stayed low because homeowners could sell their homes quickly and for a price that allowed them to stave off default or foreclosure. With stagnant house values and moribund housing markets, that option has not existed for nearly a decade in cities like Cleveland and Detroit.

14Kathe Newman’s work in Essex County, New Jersey has resulted in the largest and highest quality dataset that I know of. To collect the data she and a small team labored over the course of several years in an effort she notes may have moved from dedication to obsession.

15Although a claim such as this could undoubtedly set off serious epistemological debates, I take the more simple-minded approach that the foreclosure crisis, like many significant social issues, ought to be subjected to the full range of analytical approaches that urban geography and urban studies can bring to bear. For a much more sophisticated treatment of this issue, see Plummer and Sheppard (2001).
Even though all of these factors contribute to the foreclosure crisis, subprime lending provides the most important contextual issue. It is present all over the country, but in most major cities clear patterns of lending have emerged that indicate low-income and minority neighborhoods have been targeted for subprime loans (Calem et al., 2004; Newman and Wyly, 2004). To many observers, this pattern makes sense because it is the low-income and minority borrowers that pose the greatest credit risks and therefore are only qualified for subprime loans. They are the borrowers who, in retrospect, should not have sought loans. Setting aside for a moment the unevenly applied principles of individual responsibility that drive these arguments, there are two observations that substantially weaken these assertions. First, many borrowers did not seek loans; the borrowers were sought out by lenders. Refinance loans are an important component of the subprime and predatory market, and in 2006 about 28% of all refinance loans were made at interest rates at least three points higher than the prime rate (FFIEC, 2006). Second, some estimates suggest that in 2006 as many as 60% of subprime borrowers may have been qualified for prime loans (Brooks and Simon, 2007). Why did this happen? In part, a borrower’s likelihood of segmentation into the subprime market is more a function of where the borrower lives than his or her creditworthiness. Given the level of racial and ethnic segregation in U.S. cities, it is minority borrowers who suffer the most. This is geographical targeting, and this is the geographical context that must be included in any analysis of foreclosures.

Conclusion

The foreclosure crisis has deeply affected tens of thousands of people, and if it provides a trigger for a sustained economic slump, its effect could be magnified enormously. Short-term policy and legislation is needed to assist the most vulnerable, and a case might be made that the Wall Street actors behind much of the crisis need assistance as well. However, the real battle will be over the long term, and involves a move toward a reasonable, just, welfare state—or a continued move toward an increasingly harsh neoliberal state. We do not know which path will be chosen, but solid research on foreclosures, their causes, their effects, and their relationship to larger policy issues needs to be part of the decision.

REFERENCES


This number is based on a study commissioned for the Wall Street Journal and relies heavily on credit scores. As the Mortgage Bankers Association always notes, there is more to an application than the credit score. Previous estimates by Freddie Mac have been in the 15% range. The use of credit scores does call into question the assertion of the poor creditworthiness of subprime applicants.


Fender, I. and Hordahl, P., 2007, Overview: Credit retrenchment triggers liquidity squeeze. BIS Quarterly Review, 1–16.


HousingLink, 2007, *Foreclosures in Greater Minnesota: A Report Based on County Sheriff’s Sale Data* (Supplement 1, October 31). Minneapolis, MN: HousingLink.


York, NY: Graduate Center of the City University of New York, Center for Human Environments.


Shlay, A., 1988, Not in that neighborhood: The effects of population and housing on the distribution of mortgage finance within the Chicago SMSA. Social Science Research, Vol. 17, 137–163.


