

# **The American Nightmare:**

## **Foreclosures and Their Impact in Metropolitan Tucson**

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### **Summary Version**

Prepared for:

**City of Tucson  
Community Services Department**

&

**Pima County  
Community Development and  
Neighborhood Conservation Department**

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## **Preface**

This version of “The American Nightmare” is a relatively detailed summary of the full study intended to be a helpful aid to time-strapped planners, decision makers and those with an interest in local housing issues. This version covers all the major issues discussed in the full version but in less detail and with less documentation. A number of references in this version direct readers to the location in the full study where they can find the more complete discussion and additional data.

## **Introduction**

The foreclosure nightmare is hitting the Metropolitan Tucson Area hard. Foreclosures increased from 2,767 in 2006 to 4,640 in 2007, and as of the end of August 2008, the 5,644 Notices of Foreclosure filed with the Pima County Recorder’s Office in 2008 have already surpassed 2007 and are on a trajectory to exceed 8,000 for the year. From 2006 to 2007, foreclosures rose by 67.7% and will rise at least 72% from 2007 to 2008 and 289% from 2006 to 2008.<sup>1</sup>

The increase in foreclosures is creating a community crisis that is damaging people and families in the following ways:

- Foreclosures damage virtually all residents of foreclosed dwellings whether owner-occupants (representing over 75% of foreclosures) or renters.
- The value of homes that went into foreclosure in Pima County in 2007 is estimated at over \$600 million. How much of this is actual equity lost to individuals and families is hard to determine with specificity, but it likely exceeds \$100 million.<sup>2</sup>
- Foreclosures impact home values in communities through the “spillover effect.”
- The loss of home values will have a huge impact on home equity, which is currently the principal source of savings and wealth for many people. They depend on it to:
  - Maintain their homes
  - Meet financial and personal crises when they occur
  - Pay medical bills
  - Educate their children
  - Start small businesses
  - Support them in retirement

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<sup>1</sup> The data contained in this paragraph was obtained by SWFHC directly from the Pima County Recorder’s Office.

<sup>2</sup> Zillow.com estimates that foreclosures in Metro Tucson are currently selling for an average of 22% under market value.

When the decline of home values that have already occurred is combined with those that are forecast, it will eliminate this home equity reserve for many families and significantly reduce it for the rest. Some of the consequences include:

- Home improvement projects and home maintenance will be deferred
- Consumer spending will decrease
- Student loans to send children to schools and colleges will become harder to get
- Unexpected expenses like medical bills will become more difficult to pay
- The need for public funded social services, particularly for the elderly will increase

Because of the current foreclosure crisis, many families will experience a decline in their standard of living, a reduction in their quality of life and increased insecurity and tension.

Foreclosures also damage neighborhoods and communities in the following ways:

- In Pima County, the financial spillover effect of foreclosures will lead to a reduction in the property tax base and revenues. Since tax assessments lag home market value by about two years, the impact of the decrease in home values on tax revenues has not yet been felt. When it does hit in 2009, Pima County tax districts are going to face some very difficult decisions in order to maintain public services and programs and governmental functions that depend on local taxes. Responses are essentially limited to raising the tax rate, expanding and increasing fees and penalties and/or cutting back on services and programs. None of these will be politically popular.
- Foreclosures can cause a reduction in consumer spending which depresses the local economy and reduce revenue from sales taxes that pay for the maintenance of public infrastructure, public services and community programs. The total tax loss from the 15,000 to 20,000 foreclosures projected for 2008 and 2009 will likely amount to several million dollars.
- Foreclosures have direct costs through increases in law enforcement, lost revenue from utilities, and increased demand for social services. Studies show that the cost of one foreclosure can directly cost a community thousands of dollars depending on the location.
- Neighborhoods can be destabilized when investors and speculators buy foreclosed properties that were owner-occupied and turn them into rentals.
- Neighborhoods with high foreclosure rates negatively impact nearby businesses, further contributing to the downward economic spiral caused by foreclosures.
- Neighborhoods with foreclosures become more vulnerable to “red lining” by lenders and insurance providers who either increase rates and fees or restrict the availability of loans and coverage.

#### **Local Efforts to Reduce Foreclosures**

Local efforts to reduce foreclosures and ameliorate their impact in neighborhoods and the community began in 2004 after the release of the foreclosure study “The American Dream Lost.”

These efforts included organizing an anti-predatory lending community-based committee; the establishment of the Freddie Mac “Don’t Borrow Trouble Campaign;” monitoring foreclosure filings with the Recorders Office and informing home owners facing foreclosure of foreclosure prevention assistance; developing a network of foreclosure counselors; and conducting foreclosure workshops that bring together borrowers and their loan servicers to work out loan modifications.

### **Purpose of this Study**

The purpose of this study is to update the 2002 Pima County foreclosure data with current data; provide an analysis of the present situation based on data and insights from studies, reports, articles and websites; and offer recommendations to advance planning and programming to meet the challenges presented by the continuing foreclosure crisis.

### **Methodology**

This study utilized both secondary and primary research sources. The Southwest Fair Housing Council (SWFHC) researchers collected existing data from studies, reports, media articles, and web and blog sites, which are cited in footnotes. SWFHC also gathered primary data from foreclosure records filed at the Pima County Recorder’s Office, interviews conducted with knowledgeable people in the housing industry and surveys.

### **Format**

This report is divided into three parts. Part 1 updates the “American Dream Lost” foreclosure study and is based largely on primary research. Part 2 is based on a review of existing secondary data and addresses questions and issues that are intended to help better understand the foreclosure situation in Metro Tucson. Part 3 presents the results of the survey as well as recommendations to deal with the current situation.

# Part 1: Update of the American Dream Lost

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## Comparison of 2002 and 2007 Foreclosure Data

As noted, one purpose of the study is to collect and compare current foreclosure data to that collected for 2002. It is anticipated that this will help planners to better understand the foreclosure dynamic in order to develop effective strategies and programs to ameliorate the damage to neighborhoods and Pima County communities.

An important methodological change to note is that while SWFHC reviewed all 3,426 foreclosures filed in 2002 in Pima County this study used a sample of 451 foreclosures that were randomly selected from a total of 4,640 foreclosures filed in 2007. Standard statistical procedures consistent with a 95% confidence level were adhered to.

Another methodological revision was that the number of loans used for loan to foreclosure ratio compared loans originating in 2006 to foreclosures filed in 2007. In the 2002 study, foreclosures filed in 2002 were compared to loans originated in 2002. The lending market in 2002 was representative of a relatively stable market since 1995. This was not the case in 2007. In late 2006, the credit crisis hit and lending was severely restricted. By 2007, the types of loans causing most foreclosures that year, subprime ARMs, were no longer offered by many lenders.

## Summary of Differences between the 2002 and 2007 Foreclosure Studies

- 1. Foreclosures increased from a reported 3,426 in 2002 to 4,640 in 2007, an increase of about 40%.**
  - From 2003 through 2006, foreclosures actually decreased from 2002. The prevalence of subprime lending and loose underwriting standards allowed many people in difficult circumstances to avoid foreclosure by refinancing.
  - Foreclosures in the first seven months of 2008 in Metro Tucson surpassed the total recorded for all of 2007 and are on a trajectory to exceed 8,000 for the year.
  - In 2002, subprime loans accounted for less than 10% of all loans in Metro Tucson. By 2005, they were 25% of all loans.
  - Subprime loans became more toxic. In 2002, the projected lifetime foreclosure rate for subprime loans originating in Metro Tucson was 9.3%. By 2006, that had jumped to 21.6%, an increase of 132.4%.<sup>3</sup>

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<sup>3</sup> Keith Ernst, Ellen Schloemer, Wei Li, and Kathleen Keest, "Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners," The Center for Responsible Lending, December 2006.

**Table 1: Foreclosures, Cancellations and Trustee Deeds**

Year	Foreclosure Notices	Cancellations(%)	Trustee Deed (%)
2002	3315	1690 (50.98%)	1541 (46.48%)
2003	3208	1822 (56.80%)	1554 (52.64%)
2004	2952	1944 (65.51%)	1268 (42.95%)
2005	2586	2181 (84.34%)	767 (29.66%)
2006	2767	1973 (71.30%)	603 (21.79%)
2007	4640	2047 (44.12%)	1499 (32.31%)
2008 ( as of Aug.)	5644	N/A	N/A

Source: Pima County Recorder's Office<sup>4</sup>

**2. In 2002, relatively few lenders were responsible for a large percentage of foreclosures. This was also the case in 2007.**

- A total of 22 lenders, out of 497, were responsible for 37% of the foreclosures in 2002. Of these, 16 were identified as primarily subprime lenders. These 16 lenders were responsible for about 21% of all the loans that ended in foreclosure in Pima County in 2002.<sup>5</sup>
- In 2006, the study focused on subprime loans and the impact of the expansion of subprime lending on foreclosures was telling. Only 13 out of a total of 316 lenders originating 16,346 subprime loans accounted for virtually the same percentage of foreclosures (36.3%) that 22 did in 2002. The top five lenders with over 300 subprime loans in 2006 made 25% of all subprime loans. The top 12 lenders accounted for over 38% of all subprime loans.

**3. There were disparities in the ratio of loans to foreclosure among lenders providing mortgages in Pima County both in 2002 and in 2007.**

- In 2002, 8 of 12 lenders with the most foreclosures had loan to foreclosure ratios that exceeded the then national average of about 4%. These 8 lenders had a low of 6.14% of loans to foreclosures and a high of 31.31%. These 8 lenders accounted for 11.4% of foreclosures in Pima County in 2002.
- The current study focused on subprime loans and indicated that these were much more lethal than loans in 2002. Ten of the top 13 lenders in foreclosures had ratios of

<sup>4</sup> The information reported here is as it was received from the Recorder's Office. Disparities between the total of cancellations and sales to the total of notices are typical of the system and have not been explained.

<sup>5</sup> In 2002, types of loans were not able to be differentiated in the Home Mortgage Disclosure Act (HMDA) reports submitted by lenders to the Federal Reserve Bank. In 2005, changes in reporting requirements identified the spread between the interest rate of the loan and the yield on Treasury securities over the same duration. Loans above a spread of 3% are identified as "high cost," normally have other characteristics common to subprime loans, and the two terms are frequently used interchangeably. SWFHC focused on high cost loans made in 2006 since these loans were typical of the loans that were associated with foreclosures in 2007.

subprime loans made in 2006 to foreclosures in 2007 that ranged from 2.24 to 5.87 loans for each foreclosure.<sup>6</sup> These 10 lenders accounted for 26.9% of all foreclosures in Pima County in 2007.

**4. The time between loan origination and Notice of Sale (the start of foreclosure proceedings) decreased in 2007 compared to 2002.**

- The study of 2002 foreclosures reported that approximately 15% of foreclosures occurred within one year of origination, 36% within two years and 56% within three years.
- In 2007, the time between loan origination and foreclosure decreased compared to 2002. Fully 22.39% of foreclosure notices were filed within one year of origination with an average of 260 days from the time the loan was made; 57.92% were within two years of origination with an average of 432 days; and 78.27% were within three years with an average of 545 days.

The relatively short time between loan origination and the filing of a Notice of Sale in 2007 brings into question the extent of due diligence conducted by lenders in qualifying loan applicants. The wide use of ARMs and terms and conditions that rewarded lenders and investors for greater risk only increased the likelihood of default and foreclosure early in the loan schedule. Many of the loans in 2004, 2005 and 2006 were simply bad loans that set borrowers up for an early failure.<sup>7</sup>

**5. In 2002, a majority of foreclosures were concentrated in a relatively small number of zip codes. This was also the case in 2007, but to a slightly lesser degree.**

- In 2002, the three zip codes with the most foreclosures accounted for 27% of all foreclosures. The eleven zip codes with the most foreclosures had over 53% of all foreclosures.
- In 2007, the three zip codes with the most foreclosures accounted for 22.2% of all foreclosures, about 18% less of the total number than in 2002. However, the eleven zip codes with the most foreclosures had 65% of all foreclosures, or about 18.5% more of the total than in 2002.
- In 2007, the overall ratio of households per foreclosure in Metro Tucson was 77.58 households per foreclosure. In the eleven zip codes with the most foreclosures, the ratio was 49.73 households per foreclosure. In the remaining twenty-one zip codes, the ratio was about 130 households per foreclosure. In the three zip codes with the highest ratios of households to foreclosure, the average was 19.7 households per foreclosure.

**6. The 2002 foreclosure study reported that foreclosures were higher in lower income zip codes. In 2007 it was determined that although lower income zip codes had more**

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<sup>6</sup> Three of these lenders did not file HMDA reports for 2006 and therefore no information on loans was available.

<sup>7</sup> Parapundit.com on March 6, 2008 reported that “people are losing their homes even before their mortgages reset ... about 40% of all foreclosures are homeowners with prime or subprime loans who couldn’t make their payments before the reset.”

**foreclosures these zip codes tended to have more households and that the ratio of households to foreclosures in zip codes remained relatively constant across income levels.**

- In 2007, zip codes above the median household income of \$40,213 had 1,618 foreclosures, or an average of 101 per zip code. Zip codes below the median income had 2,864 foreclosures, or an average of 179 per zip code.
- Zip codes below the median income have more households than zip codes above the median. The number of households per foreclosure for zip codes above the median was 70.26 and below the median 72.92.

The data appear to show that the increases in recent foreclosures have hit across virtually all income levels. However, experts warn that foreclosures have a greater negative impact in areas where housing and population are concentrated. Thus, while the aggregate data indicates that foreclosures are occurring in all income areas at similar rates, foreclosures in lower income neighborhoods have a greater impact in decreasing housing values and the tax base, increasing the rate of crime, escalating the cost of public services and fostering redlining by loan and insurance providers.

**7. The 2002 foreclosure study reported that Hispanics had a disparate rate of foreclosures compared to other racial and ethnic groups. Disparities in foreclosures based on Hispanic National Origin continued in 2007.**

- In 2002, Hispanics accounted for 34.7% of foreclosures while they received 18.7% of home loans and had a population share of approximately 30%.
- In 2007, Hispanics accounted for 36.1% of foreclosures while receiving 23.8% of all loans in Pima County in 2006 with a population share of 32.6%.
- Out of a total of 8,825 loans to Hispanics in 2006, 3,723 or 42.2% were subprime. For White Non-Hispanics out of a total of 20,076 total loans received, 3,377 or 16.8% were subprime.<sup>8</sup>

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<sup>8</sup> These figures are based on an analysis of 2006 HMDA data for Metro Tucson conducted for SWFHC by the National Community Reinvestment Coalition (NCRC) in June 2008. NCRC released a national study containing similar data that included over 200 metro areas, including Tucson, in July 2008. The study is titled "Income is no Shield against Racial Differences in Lending II: A Comparison of High Cost Lending in America's Metropolitan and Rural Areas" and is available at [www.ncrc.org](http://www.ncrc.org).

**Table 2: Home Mortgages in Metro Tucson in 2006**

Market Share Analysis	Count of Loans			As a Percent of Loans to that Race (Market Share)		Ratio of that Race to White (Market Share Ratio)	
	Prime	Sub prime	All	Prime	Sub prime	Prime	Subprime
<b>Borrower Race</b>							
White Non-Hispanic	16,699	3,377	20,076	83.2%	16.8%	1.00	1.00
Black or African American	465	298	763	60.9%	39.1%	0.73	2.32
Hispanic or Latino	5102	3,723	8,825	57.8%	42.2%	0.70	2.51
Asian	570	115	685	83.2%	16.8%	1.00	1.00
<b>Total<sup>1</sup></b>	<b>27,715</b>	<b>9,318</b>	<b>37,033</b>	<b>74.8%</b>	<b>25.2%</b>	<b>0.90</b>	<b>1.50</b>

**Source:** National Community Reinvestment Coalition

While the causes for the disparity can be argued, the fact that a much greater proportion of loans to Hispanics were subprime suggests that the foreclosure crisis will continue to hit Hispanics particularly hard. In 2007, the three zip codes with the highest number of foreclosures were 85746, 85706, and 85713. They combined for over 31% of all foreclosures in Pima County. All of these zip codes are over 50% Hispanic and are located adjacent to each other on Tucson's South Side.

## **Part 2: Housing Market Analysis**

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The United States housing market is undergoing a correction resulting in historically steep price declines. California, Nevada, Florida and Arizona are leading this trend. Pima County has not been spared. The overall market trend in 2008 through the end of July shows that home sales are down, demand is down, supply is up, prices are falling and foreclosures are spiking. Experts and analysts are making predictions about how much more value the housing market will lose and when to expect a recovery. Some regions will decline more than others depending on numerous variable market factors. While national and regional trends are useful, they do not necessarily reflect real estate markets at the county or city level. Even in submarkets within a city, house prices can fluctuate up and down at different rates depending on local factors. For example, newer subdivisions in the exurbs with a concentration of foreclosures can have much more significant price declines than more stable neighborhoods with fewer foreclosures.<sup>9</sup>

### **National Housing Market Trends**<sup>10</sup>

- Nationally, existing home sales were down 16% in June 2008 compared to a year ago.<sup>11</sup>
- Goldman Sachs believes that the nationwide market correction currently underway is only half-complete. They predict a further decline in home values of 11-13% from their point in May 2008 for an overall correction from peak to trough of 18-20%. Their models indicate, however, that Arizona and five other states may see prices decline a total of 25% or more before the market fully corrects itself.<sup>12</sup>
- Merrill Lynch believes that home prices are well above historic norms in comparison to measures like GDP or rent. It predicts that house prices will need to fall another 20 to 30% to correct the imbalance.<sup>13</sup>
- A report published in late July 2008 by an International Monetary Fund economist estimates that U.S. home prices in the first quarter of 2008 were overvalued by 14% with a range of 8 to 20%.<sup>14</sup>

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<sup>9</sup> Christie Smythe, "Foreclosures push down your home's selling price," *Arizona Daily Star*, June 1, 2008.

<sup>10</sup> Karl E. Case (co-creator of the Case-Schiller home price index) stated that, "Anybody who says they know when it's going to end with confidence is delusional...But yes you can get a sense of where things are going." He was referring to forecasts regarding the current housing crisis in an article by Catherine Rampell in the August 13, 2008 New York Times article "In Various Ways, Economists Try to Find the Right Price for a Home."

<sup>11</sup> Bob Willis, "U.S. Economy: Home Resales Decline to 10-year Low," *Bloomberg.com*, July 24, 2008.

<sup>12</sup> "Map of Misery," *The Economist*, May 8, 2008.

<sup>13</sup> David Goldman, "Housing prices to free fall in 2008 – Merrill," *CNNMoney.com*, January 23, 2008.

- The Case-Shiller home price index released in late June of 2008 recorded a 15.3% drop in home prices from the previous year. After adjusting for inflation, this is the biggest drop since 1940-42.<sup>15</sup>
- Lehman Brothers expects the Case-Shiller index to fall another 15% to 20% before hitting bottom at the end of 2009, for a peak-to-trough drop of 30% to 35%.<sup>16</sup>

### **Maricopa County Housing Market Trends**

In Arizona, Maricopa County has experienced the largest number of foreclosures to date and some of the greatest declines in property values in the state and the nation. Kuehl and Franke stated that after the housing boom in 2004, builders were late to respond and continued to build at a prodigious rate well into 2006, creating a severe imbalance in the market. Kuehl and Franke state that even with the drastic reductions in new construction now occurring "it will take many months, if not years, to absorb the inventory. During that time of absorption, prices are likely to be stagnant at best." In fact, in hindsight Kuehl and Franke drastically underestimated the extent of the problem of declining home prices. In June 2008, the Case-Shiller Index found that home prices in Phoenix had declined by 25% from a year ago.<sup>17</sup>

### **Pima County Housing Market Trends**

#### **Housing Permits in Pima County**

Housing permit issues were down significantly in Pima County through the second quarter of 2008, continuing their decline that began in 2005 when over 12,000 permits were issued. This number fell to 8,315 permits in 2006 and to 5,574 in 2007. In 2008, 4,436 permits are forecast to be issued, continuing the downward trend.<sup>18</sup>

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<sup>14</sup> Marvin Clark, "Weekly Review and Outlook: Deleveraging's Not Just for I-Banks," seekingalpha.com, July 28, 2008.

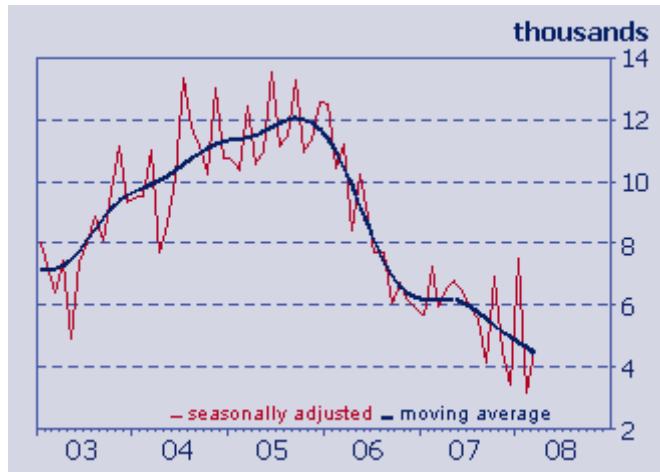
<sup>15</sup> Peter Coy and Mara Der Hovanesian, "Falling Home Prices Spiral into Deeping Abyss," BusinessWeek, June 26, 2008.

<sup>16</sup> Rex Nutting, "Four years of gains in home prices wiped out," MarketWatch.com, June 24, 2008.

<sup>17</sup> Coy and Hovanesian, "Falling Home Prices."

<sup>18</sup> Christie Smythe, "Housing starts dip to lowest since '90s," *Arizona Daily Star*, July 18, 2008.

**Figure 1: Housing Permits Issued in Pima County: 2003 - 2008**



**Source:** Eller College of Management Economic and Business Research Center

Table 3 below shows that, except for January 2008, the number of housing permits issued each month in Pima County continued its downward trend compared to 2007.

**Table 3: New Housing Units Authorized 2008**

<b>Tucson</b>	<b>Jan-08</b>	<b>Feb-08</b>	<b>Mar-08</b>	<b>Apr-08</b>	<b>May-08</b>
<b>Total # of Units Authorized</b>	491	248	451	382	357
<b>% Change vs. Year Ago</b>	37.9	-54.1	-17.7	-34.8	-42.0

**Source:** U.S. Census Bureau

**Table 4: Residential Permits Forecast: 2008 - 2013**

<b>Tucson</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
<b>Forecast Residential Permits</b>	4,027	4,745	6,748	8,403	9,357	8,888
<b>% Change from Previous Year</b>	-23.1	17.8	42.2	24.5	11.3	-5.0

**Source:** Eller College of Management Economic and Business Research Center

### **The Absorption Rate in Pima County**

The absorption rate is a theoretical tool that indicates the balance of supply and demand in a housing market. Based on MLS listings and rate of sales it projects how long it would take to sell all homes if no new listings were added. A six-month (26 weeks) supply is considered a stable market. Less than this causes upward pressure on housing prices, and more than this causes downward pressure.<sup>19</sup>

<sup>19</sup> [Barbaralasky.com/tucson-real-estate-blog/tucson-real-estate-market](http://Barbaralasky.com/tucson-real-estate-blog/tucson-real-estate-market).

- The absorption rate for December 2007 in Pima County was 11.62 months, down slightly from 11.99 months in November 2007. In the first quarter of 2008, the absorption rate trended upwards. In March 2008, it was over 14 months (64 weeks).<sup>20</sup> This compares with 12.5 months (54 weeks) in March 2007.<sup>21</sup> The absorption rate in May 2008 was nearly 10.3 months (44.59 weeks) and in June 2008 was just under nine months (38.4 weeks).
- The number of homes on the market was down to 7,876 in July 2008 from a high of 10,387 in April of 2007. In March 2008, there were 9,022 houses on the market. The absorption rate dropped significantly, from over fourteen months in March 2008 to just under nine months in June 2008. In 2008, April, May, June and July home sales were down between 20 and 27 percent from the previous year.<sup>22</sup>
- While some were encouraged by the drop in the absorption rate, the contradictory sales figures indicate caution for two reasons. First, when home prices drop precipitously in a market and sellers are competing with foreclosures at fire sale prices<sup>23</sup> many will hold their homes off the market to try to wait out the storm of foreclosures and declining prices.<sup>24</sup> Second, lowering absorption rates despite declining sales can be a sign of a “shadow market” that skews the rate lower than it should be. Many properties like REOs, auction properties, defaults and foreclosures may not show up in the MLS listings as they move through the foreclosure process. Nevertheless, they must be sold before the market can stabilize. In one study, bubble markets in nine cities had inventories between 33% and 100% higher than what was on the MLS.<sup>25</sup>
- Other indicators from TAR for June still show a weak market, as well. Compared to June 2007, the following indicators from June 2008 have declined: home sales volume (-34.17%), average sales price (-12.27%), pending contracts (-53.68%), new listings (-25.71%), home sales units (-24.96%) and median sales price (-11.11%).<sup>26</sup>

### **Declining Home Prices in Pima County**

Based on statistics from the Tucson Association of Realtors (TAR), the median sale price of houses in Tucson rose steadily from the late 1990s through 2003, and then dramatically in 2004 and 2005. By the third quarter of 2006, the credit crisis had hit and foreclosures began to escalate. The increase in the median sale price of homes at first slowed and then reversed. From its peak of \$226,465 in 2006, the median sale price of houses in Tucson decreased by

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<sup>20</sup> Monthly Statistical Digest, Tucson Association of Realtors Multiple Listing Service, Inc., March 2008.

<sup>21</sup> Krystal Kraft, Denver Real Estate, November 14, 2006, <http://activerain.com/blogsview/20685/How-Absorption-Rate-is>.

<sup>22</sup> Monthly Statistical Digest, Tucson Association of Realtors Multiple Listing Service, Inc., July 2008.

<sup>23</sup> Alan Zibel, “Tumbling prices push existing-home sales up,” *Arizona Daily Star*, August 26, 2008.

<sup>24</sup> Christie Smythe, “Encouraging signs in Tucson housing,” *Arizona Daily Star*, August 13, 2008.

<sup>25</sup> “Foreclosures likely skewing housing indicator,” MSNBC.com, August 19, 2008.

<sup>26</sup> Monthly Statistical Digest, Tucson Association of Realtors Multiple Listing Service, Inc., June 2008.

13.9% to \$195,000 in April of 2008.<sup>27</sup> According to TAR statistics released in July 2008, the median sales price has remained steady at \$201,000 in May and \$200,000 in June. However, just as the median sales price seemed to be holding steady and just days before the release of this report, the price in August plunged 7.5% from July to \$185,000. This is the lowest median sales price since January 2005 and is a 16% drop from August 2007. Realtors believe that foreclosures and short sales are dragging the price down.<sup>28</sup>

Some forecasters contend that the prices in Pima County will continue to decline into 2010, as most experts now predict them to do in Arizona and several places nationwide.

**Table 5: Estimates of Declines in Home Prices and Projections for Pima County**

Source	Past Decline	Projection
Case-Shiller	-7.6% (as of 1 <sup>st</sup> qtr. 2008)	Addition decline of 16.9% stabilizing by 2010
OFHEO* <sup>29</sup>	-5.9% (as of Aug. 2008)	No Projection
Zillow.com	-10.4% (as of Aug. 2008)	Continued decline in Arizona
Bright Future	-15% (new homes as of Aug. 2008)	Market will bottom out between end of 2008 and 2009.
Global Insight	-15.4% (as of Aug. 2008)	The market will bottom out in 2010

\*Office of Federal Housing Enterprise Oversight

- Land investors play an important role in real estate markets, and currently in Pima County they are waiting to buy large tracts of land because they believe that the real estate market has not bottomed out. One local commercial realtor is advising clients to wait for two or three years before selling land.<sup>30</sup>
- CNNMoney.com places Metro Tucson as one of the ten metro areas<sup>31</sup> projected to have the largest decreases in home prices in the country.
- There are so many foreclosures in some neighborhoods that appraisals are based on nearby foreclosures, because they make up the majority of the market. This is prevalent in some new-home developments on the edge of town and on the South Side. Before the foreclosure crisis, appraisers disregarded foreclosures in appraisals because there were not enough to affect prices.<sup>32</sup>

<sup>27</sup> Christine Smythe, "Tucson median home price slid to lowest since 2005," *Arizona Daily Star*, May 12, 2008.

<sup>28</sup> Christine Smythe, "Tucson's median home price plunges," *Arizona Daily Star*, September 12, 2008.

<sup>29</sup> OFHEO is less inclusive than other estimates and the decline in value appears lower. Perhaps a more telling figure is that Tucson was 237th out of a total of 292 metro areas tracked by OFHEO. In other words, in the last year Metro Tucson homes lost more value than homes in over 80% of the other metro areas tracked by OFHEO.

<sup>30</sup> Christie Smythe, "Lack of land buyers hints that market's still falling," *Arizona Daily Star*, August 26, 2008.

<sup>31</sup> Phoenix was also in the top ten and is projected to perform only slightly worse than Tucson, having already taken a greater loss in average house prices than Tucson (-15%) in the last 12 months.

<sup>32</sup> Smythe, "Foreclosures."

- Between 1984 and 2000 house prices were 2.8 times the size of the median family income. In the early 1970s when home sales were strong, it was only 2.3 times the median family income.<sup>33</sup> Table 6 shows the ratio of home prices to median family income in Pima County.

**Table 6: Housing Price to Income Ratio in Pima County**

Year	Median Household Income	Single Family Residence Price	Price/Income Ratio
2000	\$35,223	\$128,000	3.63
2001	\$35,617	\$133,000	3.73
2002	\$37,638	\$142,500	3.79
2003	\$37,818	\$150,000	3.97
2004	\$38,800	\$175,000	4.51
2005	\$41,521	\$234,000	5.64
2006	\$43,006	\$272,800	6.34

Source: Pima County Department of Community and Economic Development

### Loss of Home Equity

- In August 2008, Zillow.com estimated that nationwide almost 30% of homeowners who purchased their homes in the last five years now have negative equity.<sup>34</sup> They report that the percentage is higher in Arizona and approaches 40%.<sup>35</sup>
- The large majority of loans that are “upside down” are adjustable rate subprime loans. From 2004 through 2006, the rate of subprime loans in Metro Tucson exceeded the national average.<sup>36</sup> If home values decline further into 2009 as forecasted by many analysts, and refinances are factored in, the number of homeowners who are upside down on paper may approach one-third of all homeowners with mortgages. This will have a substantial negative impact on the housing market’s strength and ability to recover.
- An upside to the home equity situation is that those that owned their homes prior to 2004 and did not draw a large portion of their equity out during the lending debacle with home equity loans or refinancing stand to benefit with increased home values averaging more than 35% even after home prices bottom out.

### Impact of Investors Moving Back into the Market

- Discussions with real estate agents indicate that in Pima County, investors and speculators are increasingly targeting foreclosures and distress sales. In the short term, these types of investors may slightly reduce the absorption rate, but a recovery in

<sup>33</sup> Irwin Kellner, “How low must housing prices go?” MarketWatch.com, December 3, 2007.

<sup>34</sup> Bob Ivry, “Zillow: 29% of homeowners have negative equity,” *Arizona Daily Star*, August 13, 2008.

<sup>35</sup> David Streitfeld, “Ruins of an American Dream,” *New York Times*, August 24, 2008.

<sup>36</sup> Zillow.com, August 2008.

neighborhoods from the impact of foreclosures will not be built on speculation. When the market cools, investors and speculators are the first to walk away leaving their investments in foreclosure. Owner-occupants and tenants are left to face the consequences. However, by far the most destructive long-term effect that foreclosure speculators have is to further decrease home values. This leads to increasing foreclosures, further fueling the downward spiral of the market.

- Even though some investors are starting to buy distressed properties, more are waiting in anticipation of further price declines. One California-based developer is assembling a \$250 million “vulture investing fund” to buy homes, some of which are in Arizona. The developer is waiting for banks that own large numbers of foreclosures to begin to liquidate them at the end of the year to get them off their books. He believes that will cause prices in many places to fall even farther.<sup>37</sup>

### **Other Factors Impacting the Housing Market in Pima County**

Several factors, in addition to those noted, indicate that the housing market in Pima County will remain depressed into 2009 including the following:

- Interest rates have risen recently<sup>38</sup> and may continue to rise in the near term.<sup>39</sup>
- Mortgage terms and conditions have tightened causing lenders to originate fewer home loans.<sup>40</sup>
- The economy is weak and may not recover until mid-2009.<sup>41</sup>
- The rate of foreclosures is high and will likely increase into 2009.
- More foreclosures add cheap supply to the already glutted market, exerting further downward pressure on prices.
- Inflation will very likely continue to rise, particularly in vital areas such as fuel, food, and health care.<sup>42</sup>
- Unemployment is projected to increase.<sup>43</sup>

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<sup>37</sup> Les Christie, “Vulture real estate investors swoop in,” CNNMoney.com, July 2, 2008.

<sup>38</sup> Will Buss, “Local housing market stabilizes but sales still lower than 2007,” *Belleville News-Democrat*, August 26, 2008.

<sup>39</sup> The takeover of Freddie Mac and Fannie Mae on September 8, 2008 by the Federal Government had an immediate effect of slightly reducing mortgage interest rates and further reductions are likely.

<sup>40</sup> Rex Nutting, “Credit squeeze getting worse, banks say,” MarketWatch.com August 11, 2008.

<sup>41</sup> Christine Smythe, “UA panelists paint a dismal portrait for Tucson economy,” *Arizona Daily Star*, June 5, 2008. Also see, Rex Nutting “Leading Indicators show no quick recovery” Market Watch. August 21, 2008.

<sup>42</sup> Becky Pallack, “How inflation eats into your paycheck,” *Arizona Daily Star*, May 18, 2008.

<sup>43</sup> Rich Miller and Matthew Benjamin, “Future economy doesn’t look great,” *Arizona Daily Star*, May 26, 2008. Miller and Benjamin forecast dramatic structural changes in the US economy even after the credit crisis ends. They see weaker productivity, slower economic gains, higher unemployment and a diminished financial services industry as characterizing the economy for years to come.

However, factors that could help to slow the decline in the housing market or begin to strengthen it include the following:

- In July 2008, President Bush signed into law the Housing and Economic Recovery Act of 2008.<sup>44</sup>
- Lenders increase their efforts to negotiate with borrowers in default and modify loans that will provide long-term solutions to prevent foreclosure.
- Local programs are developed/continued/increased that include outreach and education, effective home buying and foreclosure counseling, better data collection and retrieval systems and increased coordination of foreclosure prevention efforts and ways to foster the acquisition of foreclosures for the benefit of owner occupants and neighborhoods (see "Recommendations")
- Some analysts have pointed to signs that, nationally, home prices may be stabilizing, although they warn that those states hardest hit will continue to experience above average declines (including Arizona).<sup>45</sup> Some local sources have also reported that prices in Pima County may be stabilizing.
- The takeover of Freddie Mac and Fannie Mae on September 8, 2008 had the immediate effect of lowering interest rates and putting foreign investors at ease but its full impact on the current problems in the market is unclear.<sup>46</sup>

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<sup>44</sup> Paul Jackson, "As Housing Act Passes Congress, Questions Emerge," <http://www.housingwire.com/2008/07/26/as-housing-act-passes-questions-emerge/>, July 26, 2008.

<sup>45</sup> Reuters, "Home price declines stabilizing: report," August 18, 2008.

<sup>46</sup> David Ellis, "U.S. seizes Fannie and Freddie," CNNMoney.com, September 7, 2008.

## **The Foreclosure Crisis**

"...Until home prices stabilize, we're going to be dealing with elevated foreclosure rates. Government assistance programs and loan modifications can help keep some folks in their homes. But when you're upside down on your loan, and something bad happens (job loss, divorce, you name it), your options are limited. And let's be frank: Too many people bought too much house with too many easy money mortgages in recent years. For many of these people, foreclosure will prove unavoidable."<sup>47</sup>

### **Nationwide Foreclosures**

- RealtyTrac reported that in the first quarter of 2008 there were about 650,000 foreclosures nationwide, a 112% increase over the first quarter of 2007. The Washington Post states that 2.47% of all home mortgages were in foreclosure in the first quarter of 2008, up from 1.28% for the same quarter last year.<sup>48</sup>
- In June 2008, 252,363 homes nationwide received at least one foreclosure related notice, up 53% from June 2007, but down 3% from the all time high in May 2008. Foreclosure filings in Maryland dropped by 18% and by 3% in Massachusetts from last year after both states passed similar laws increasing the time to finalize a foreclosure.<sup>49</sup>
- In addition to the current rate of foreclosures, another 6.35% of home mortgages were delinquent but not yet in foreclosure, up from 4.84% last year. This means that nationally almost 9% of all mortgages were in trouble.<sup>50</sup>
- The Joint Economic Committee of Congress estimated that 2 million families will lose their homes in the next two years. Credit Suisse forecasts that by 2012 there will be about 6.5 million homes foreclosed.<sup>51</sup> They have revised their estimate of 730,000 subprime foreclosures to 1.39 million over the next two years. Credit Suisse goes on to estimate that foreclosures could force 12.7% of residential borrowers out of their homes.<sup>52</sup> Many analysts are saying that with the sputtering economy with unemployment rising towards 6%, the current crisis is only the tip of the iceberg.<sup>53</sup> Predictions continued to worsen and by July 2008, economists projected that across the nation this year 2.5 million homes will begin the foreclosure process. The number in 2007 was about 1.5 million.<sup>54</sup>

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<sup>47</sup> Mike Larson, "MBA: Delinquency and foreclosure rates surge to new highs in Q1 2008," June 05, 2008. <http://interestrateroundup.blogspot.com>.

<sup>48</sup> Renae Merle, "Despite Interest Rate Cuts, Foreclosures Hit Record High," June 6, 2008, <http://www.washingtonpost.com/wp-dyn/content/article/2008/06/05/AR2008060501501.html>.

<sup>49</sup> Alan Zibel, "US foreclosure filings surge 53 percent in June," Associated Press, July 10, 2008.

<sup>50</sup> Merle, "Despite Interest Rate Cuts."

<sup>51</sup> Hamedani, "America's crisis."

<sup>52</sup> "Foreclosures to affect 6.5 mln loans by 2012-report," Reuters, April 22, 2008.

<sup>53</sup> Hamedani, "America's crisis."

<sup>54</sup> Zibel, "US foreclosure filings surge."

- Christopher Mayer at the Columbia Business School states that while subprime loans fueled the initial jump in foreclosures, and these continue to rise, prime borrowers are a growing part of the problem. In the first quarter of 2008, the rate of prime loans entering foreclosure increased at a faster rate than subprime loans entering foreclosure.<sup>55</sup>

### **The Economic Impact of Foreclosures Nationally**

Global Impact states that the foreclosure crisis will have profound effects on our economy and in our communities including the following:<sup>56</sup>

- U.S. GDP will be \$166 billion lower. The GDP is now projected to grow by just 1.9% in 2008, a full percentage point lower than would have been the case without the mortgage crisis.
- Demand for goods and services will decrease, and as a result, 524,000 fewer jobs will be created across the country in 2008.
- Homeowners will see property values decline by \$1.2 trillion in 2008. Home price declines across the U.S. will average 7% in 2008.
- Foreclosures in 2008 will increase by at least 1.4 million. These homes represent a market value of \$316 billion.
- Local government property tax revenue will decrease.
- In most states, the growth of sales tax receipts will significantly slow, not only from construction related purchases, but also by the pullback in general consumption by households who feel, and are made, less wealthy by the declines in homeowner equity.
- Consumer spending will slip to 2.0% growth, well below a 3.1% gain in incomes. Rising home prices were once the fuel that allowed consumer spending growth to outpace real income gains. With declining home prices in effect, consumer spending will fall short of income growth.

The Los Angeles Times reported a statement by Federal Reserve Chairman Ben S. Bernanke. The market, Bernanke said, if left to its own devices, could "destabilize communities; reduce the property values of nearby homes and lower municipal tax revenues." He went on to say, "High rates of delinquency and foreclosure can have substantial spillover effects on the housing market, the financial markets and the broader economy. Therefore, doing what we can to avoid preventable foreclosures is not just in the interest of lenders and borrowers. It's in everybody's interest."<sup>57</sup>

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<sup>55</sup> Merle, "Despite Interest Rate Cuts."

<sup>56</sup> "The Mortgage Crisis: Economic and Fiscal Implications for Metro Areas," Global Insight, November 26, 2007.

<sup>57</sup> Peter G. Gosselin, "Bernanke pushes government to curb foreclosures," *Los Angeles Times*, May 6, 2008.

## **Arizona Foreclosures**

- RealtyStore.com reported on June 5, 2008 that foreclosures have skyrocketed in Arizona by 304% in the first quarter of 2008 compared to the first quarter of 2007, and increased by 46% from the previous quarter. From January 2008 through March 2008, there were 23,607 foreclosure notices in Arizona, or one for every eighty households, almost three times the national average.
- Maricopa County was hit the hardest by foreclosures with 17,214 in the first quarter of 2008 or about 73% of all foreclosures in the State. This was a 350% increase from the first quarter of 2007.

## **Pima County Foreclosures**

Information from the Pima County Recorder's Office shows that foreclosure notices increased by 57.3% in 2007 compared to 2006, from 2,767 to 4,640. In 2008, there are 5,644 foreclosures by the end of August, and they are on track to exceed 8000 for the year. What may be more telling in projecting foreclosures into 2009 is that the rate of increase has steadily accelerated beginning in the second half of 2006 to present. Foreclosures averaged 214 per month in the first two quarters of 2006. By July of 2008, they were averaging 721 a month.

### **The Impact of Foreclosures on Housing Values and Wealth in Pima County**

"As this year ends, 2.2 million households in the subprime market either have lost their homes to foreclosure or hold subprime mortgages that will fail over the next several years. These foreclosures will cost homeowners as much as \$164 billion, primarily in lost home equity. We project that one out of five (19 percent) subprime mortgages originated during the past two years will end in foreclosure. This rate is nearly double the projected rate of subprime loans made in 2002, and it exceeds the worst foreclosure experience in the modern mortgage market, which occurred during the "Oil Patch" disaster of the 1980s."<sup>58</sup>

- Kuehl and Franke reported that the Congressional Joint Economic Committee estimated the impact of subprime foreclosures in Arizona to be over \$2.8 Billion in lost housing value and housing wealth.<sup>59</sup>
- TAR estimated that home sales were down \$1.5 Billion between 2005 and 2007.
- CNNMoney.com in May 2008 reported a FiServ estimate that during the previous twelve months home values in Pima County decreased by 7.6% and would decrease another

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<sup>58</sup> Keith Ernst, Ellen Schloemer, Wei Li, and Kathleen Keest, "Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners," The Center for Responsible Lending, December 2006.

<sup>59</sup> Kuehl and Franke, "Under Pressure." The Committee stated that the actual loss from foreclosures in Arizona was much higher than this since their estimate included only subprime loans that were outstanding in the 3<sup>rd</sup> quarter of 2007 and at very conservative assumptions regarding the decline of value that likely underestimated the loss.

16.9% over the following twelve months. Based on this forecast, the loss in home values could be over \$5.3 billion in 2008 and 2009.

- In August 2008, Zillow.com estimated that nationwide almost 30% of homeowners who purchased their homes in the last 5 years now have negative equity. They owe more on their homes than the market value. They report that the percentage is higher in Arizona and approaches 40%. The large majority of loans that are “upside down” are adjustable rate subprime loans. From 2004 through 2006, the rate of subprime loans in Metro Tucson exceeded the national average. Of additional concern is that Zillow.com did not include homeowners who purchased homes prior to 2003 but reduced their equity by refinancing or obtaining home equity loans during this period. When these are added in, and if home values decline further into 2009 as forecasted by many analysts, the number of homeowners who are, on paper, upside down may exceed one third of all homeowners with mortgages.<sup>60</sup>

### **The “Spillover Effect”**

- Contributing to the decline of house values in Pima County has been what is referred to as the “spillover effect.” When a home goes into foreclosure, the negative effects extend beyond the individual families losing their homes to surrounding neighborhoods and the wider community
- The Center for Responsible Lending (CRL) estimates the spillover effect from foreclosures on subprime home loans originated in 2005 and 2006 will impact 44.5 million homes nationwide. The total decline in housing values and tax base from these foreclosures alone will be \$223 billion. This means that homeowners living near foreclosed properties will see their property values decrease \$5,000 on average, nationwide.
- CRL published another study in February of 2008 that predicts that in Arizona 85,726 houses will be lost due to foreclosure in 2008 and 2009. These foreclosures will have significant negative spillover causing 1,201,327 houses to lose an average of \$7,231 in value. The decrease in home values/tax base will total \$8.7 billion.<sup>61</sup>
- For Pima County, CRL reported that 20,760 subprime loans were originated in 2005 and 2006 accounting for 23.9% of all home loans originated during this period. It projects a cumulative foreclosure rate on these loans of 21.6%, or a total of 4,484 homes mortgaged by subprime loans lost to foreclosure.<sup>62</sup> The spillover effect of just these foreclosures will negatively impact 203,974 homes in Pima County with a total decrease in home values/tax base of \$463,249,613, or an average decrease of \$2,271 per home.

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<sup>60</sup> In August 2008 Zillow.com reported that second quarter home prices in the U.S. fell 9.9% in a year.

<sup>61</sup> “The Impact of Court Supervised Modifications of Subprime Foreclosures: Arizona,” The Center for Responsible Lending, February 22, 2008.

<sup>62</sup> Ernst, Schloemer, Li, and Keest, “Subprime Spillover,” The Center for Responsible Lending, November 13, 2007, <http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html>. In 2008, CRL updated the data for Pima Co. that was originally presented in a 2007 report.

## Impacts on the Community and Economy in Pima County

- Foreclosures have a direct impact on local economies in a number of ways, but two key effects are the loss of tax revenue and an increased need for public services and programs to mitigate the damages. These two effects have come together in Pima County to create the “perfect storm.” While the need for police patrols, enforcement, foreclosure prevention, foreclosure counseling and social services for evicted families goes up, foreclosures are dragging housing values down and reducing tax revenues needed to pay for public services.<sup>63</sup>
- Foreclosures create a need for counselors to work one-on-one with borrowers to try either to prevent a foreclosure through negotiations with lenders, or to develop plans that can put families in better positions to deal with the impacts and mitigate the damage caused. These types of services are normally very labor intensive.
- Foreclosures in Pima County have created a downward spiral in housing prices that feeds on itself. Foreclosures have come onto the market at reduced prices adding to the supply and pushing prices down. At the same time, lenders have become restrictive in their loan products, which has limited borrowing, further depressing home buying. This pushes prices down, making it more difficult for people with little equity who encounter financial crisis to refinance or sell. The reduction in property values hits tax assessments a year or so later and results in either reduced tax revenue, or higher rates, new taxes or increased fees, which further strains families struggling to pay for the dramatically rising prices for such necessities as fuel, food and health care. Keeping a home becomes harder and more foreclosures result, which feeds back to provide more fuel to continue the destructive cycle.
- Metro Tucson stands to lose substantial tax revenue from the current foreclosure crisis and loss of home values. Kuehl and Franke state that the National Center for Real Estate Research estimates that every dollar of property value will affect annual spending by six cents.<sup>64</sup> They used this estimate as part of their formula to forecast the loss in tax revenue from their projection of 60,000 to 75,000 foreclosures in Arizona in 2008 and 2009. They concluded that Arizona communities would lose \$7 million in property tax annually and \$12 million in sales tax annually for a combined loss of \$38 million in taxes in 2008 and 2009.
- Global Insight and National City Corp released a projection for the loss of housing values in Metro Tucson on June 2, 2008.<sup>65</sup> According to the study, homes in the Tucson Area are moderately overvalued at this point and the correction is likely to be about 15.4% in the next two years. If this estimate were used, it would mean a loss in home values between June 2008 and June 2010 of about \$6.4 billion. Since there is about a two-year lag between tax assessments and market values, the full impact of the decline in housing prices is not going to hit tax jurisdictions until 2012. This drastic reduction in the tax base will severely pressure tax jurisdictions to find ways to develop the

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<sup>63</sup> City and County of Denver. “Understanding Mortgage Foreclosures in Denver,” Issued March 2008.

<sup>64</sup> “Under Pressure,” Kuehl and Franke.

<sup>65</sup> News and Notes, *Arizona Daily Star*, June 4, 2008.

alternative revenue sources that will be needed to maintain public services. The substantial loss in sales tax revenue will exacerbate this problem.

### **Forecasting Foreclosures in Pima County in 2008 and 2009<sup>66</sup>**

- Virtually all forecasts that were made in 2007 and early 2008 of the number of foreclosures that will occur in 2008 and 2009 have drastically underestimated the number that is currently occurring in both Pima County and Arizona. For example, Kuehl and Franke in their report “Under Pressure” released in January 2008 for the Arizona Department of Housing estimated Arizona would experience 60,000 to 75,000 foreclosures in 2008 and 2009 combined. In fact, Arizona is on track to exceed 75,000 foreclosures for 2008 alone.
- Pima County recorded 5,644 foreclosures through August 2008, and is on a trajectory to exceed 8,000 for the year. Indicators point toward the rate of foreclosure continuing to increase into 2009 and bottoming out no sooner than the 4<sup>th</sup> quarter of 2009. Based on this, a reasonable projection of foreclosures in Pima County for 2008 and 2009 is in excess of 17,000.

The following are just a few of the reasons that foreclosures are likely to remain high:

#### **1. Pima County has a High Number of Subprime Adjustable Rate Mortgages**

The rate of foreclosure is considerably higher on subprime loans, of which Pima County has a high number. In 2005 and 2006, 23.9% of all loans were subprime compared to 13% of all loans nationally. Over 70% of these loans are adjustable rate mortgages that reset in 2007 or will reset in 2008. Resets have been peaking in most areas of the country, including Pima County, in the third quarter of 2008. Mark Fleming, chief economist for First American CoreLogic states that “it will not be clear for months how many will lose their homes. We may not see the impact in foreclosures until the middle of 2009.” This suggests that foreclosures will continue to increase in Pima County and may not bottom out until the end of 2009.<sup>67</sup>

#### **2. Delinquency Rates are Increasing**

Delinquency rates indicate the likelihood of foreclosure and these are up substantially both nationwide and in Pima County. The National Association of Realtors estimates that about 23% of prime loans and 41% of subprime loans that become delinquent will result in foreclosure.<sup>68</sup> Nationally, the Mortgage Bankers Association reported that as of the end of June 2008, a record 9.16% of all American homeowners with mortgages

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<sup>66</sup> “Let’s be honest. No one actually knows when and where the housing market will bottom. Experts have been proclaiming the bottom is now – this very moment – since Alan Greenspan notoriously predicted the worst was over way back in 2006.” Catherine Rampell “In Various Ways, Economists Try to Find the Right Price for a Home,” *New York Times*, August 13, 2008.

<sup>67</sup> Renea Merle, “Resets Peaking on Subprime Loans” *WashingtonPost.com*, July 1, 2008.

<sup>68</sup> “Under Pressure,” Kuehl and Franke.

(almost 1 in 10) were either behind on their payments or in foreclosure. This is up from 8.1% in the first quarter of 2008 and from 6.5% a year ago.<sup>69</sup>

The delinquency rate in Arizona is even higher at 9.3%. About 5% of Arizona home loans are in serious default (more than 60 days late) and 3.3% are in foreclosure.<sup>70</sup> The most current data available for metro Tucson indicated approximately 2.4% of mortgages were at least 60 days past due in the fourth quarter of last year. This is up from 1.4% in the fourth quarter of 2006, an increase of 71%.<sup>71</sup>

### **3. Continuing Decline in Home Prices**

While there are differences of opinion as to the extent that prices in Metro Tucson will decline and when they will stabilize, nevertheless the majority of analysts anticipate further significant decreases and prices not bottoming out before the last half of 2009 at the earliest. CNNMoney.com had perhaps the most pessimistic forecast by projecting that prices will not bottom out until 2010, and by that time have declined from the fourth quarter of 2007 by 26.7%.<sup>72</sup>

### **4. Weak Economy**

The economy plays a large role in the rate of foreclosures. A weak economy including depressed economic growth, rising unemployment and increasing inflation will drive foreclosure rates up. A snapshot of the economy presented by the Federal Reserve on June 11, 2008 indicated two sore spots for the economy, "Listless economic activity coupled with high energy and food prices. Those rising prices carry a risk of both spreading inflation and putting together another drag on overall economic growth."<sup>73</sup> Guy Caruso of the U.S. Energy Department, on June 11, 2008, forecasted that gasoline prices can be expected to stay around \$4 gallon through next year with crude oil prices settling around an average of \$126 a barrel for 2009.<sup>74</sup> On August 21, 2008, the Conference Board stated that leading U.S. indicators pointed to "slow economic growth for the rest of the year, and possibly an economy grinding to a halt."<sup>75</sup>

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<sup>69</sup> Allen Zibel, "Mortgage meltdown is growing still wider" *Arizona Daily Star*, Sept. 6, 2008.

<sup>70</sup> Christie Smythe, "Mortgage meltdown..." *Local Angle, Arizona Daily Star*, Sept. 6, 2008.

<sup>71</sup> "Delinquency Rates for Mortgages Rises," News and Notes, *Arizona Daily Star*, May 5, 2005. Delinquencies across the country averaged about 3% in the 4<sup>th</sup> quarter of last year and in Phoenix, the delinquency rate was approximately 3.3%.

<sup>72</sup> "10 Markets set for steep losses," CNNMoney.com, May 8, 2008.

<sup>73</sup> Jeanne Aversa, "Fed: High energy, food prices keep economy weak," June 11, 2008, <http://news.yahoo.com>.

<sup>74</sup> H. Josef Hebert, "Energy Dept. says oil, gas prices to stay high," June 11, 2008, <http://news.yahoo.com>.

<sup>75</sup> Rex Nutting, "Leading Indicators show no quick recovery" *MarketWatch.com*, August 21, 2008.

Arizona has been hit hard by the economic downturn. The Blue Chip Economic Forecast published by the W.P Carey School of Business at Arizona State University states bluntly that Arizona is in a recession. Rebecca Seweryn, a senior economist with Moody's is quoted as saying "Industries are shedding jobs, the housing market remains tumultuous, the mortgage delinquency rate is rising faster than the national rate and credit conditions aren't likely to improve in the near term." In May of 2008, the unemployment rate nationwide shot up. The Blue Chip Economic Forecast predicts the unemployment rate to continue to rise to 5.7% through the end of the second quarter of 2009 before turning around. The chairman of Macroeconomic Advisers warns that the labor market could end up a lot worse than even the most pessimistic forecasts.<sup>76</sup> With housing-related employment making up more than 15% of employment in Arizona the situation in the housing industry is a particularly strong drag on the economy. Seweryn claims it has impacted Tucson "worse than Phoenix. If you look at Tucson, you definitely see that employment kind of topped out in the first quarter of 2007 and has been declining since. Its decline is much stronger than you see in other areas."<sup>77</sup>

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<sup>76</sup> Chris Isidore, "Job market: No bottom until '09," CNNMoney.com, July 2, 2008.

<sup>77</sup> Betty Bard, "Arizona is now in a recession," *The Arizona Republic*, May 9, 2008.

## Part 3: Recommendations

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### **Current City and County Foreclosure Related Activities**

The City of Tucson and/or Pima County are funding and participating in on-going foreclosure prevention and mitigation efforts including, but not limited to, this report, the Don't Borrow Trouble Campaign, foreclosure prevention workshops, the Arizona Foreclosure Prevention Task Force, the notification of homeowners receiving a Notice of Sale about foreclosure prevention resources.

### **Issues that Warrant further Study**

A number of issues referenced or covered only superficially in this report warrant further study and attention. The impact of the foreclosure crisis on homeowners is well documented; however, the plight of renters is not. In the City of Tucson this is especially pertinent because according to the American Community Survey, 45.1% of housing units in Tucson are occupied by renters. Renters have very limited rights when the property owner faces foreclosure. Property owners are not obligated to inform tenants of foreclosure. Tenants are not allowed to break the lease agreement if their landlords' property is in foreclosure, and frequently have only a matter of days to vacate a foreclosed property. Often times they never get their deposit or last month's rent returned and have little recourse. Renters in precarious financial situations can find it difficult to gather enough money to get into a new apartment, and some renters are at risk of being homeless after eviction. The Emergency Services Network State Housing Trust Fund administered by the Pima County Community Action Agency used to provide up to \$2,000 for moving costs, but the relief fund has been depleted.<sup>78</sup> More relief funds should be made available to renters and more needs to be done to understand the effect of foreclosures on renters.

Interviews with local foreclosure counselors revealed that financial education and planning are crucial skills that many of their foreclosure clients at-large lack. For a number of years real wages for many workers have been stagnant and declined while prices for food, utilities and energy have risen. During this same period, access to "easy money" from credit cards, payday loans and subprime mortgages has greatly expanded. Due to lack of understanding and/or to make ends meet, many people fall victim to these easily accessible and expensive sources of money that leave them in worse financial condition. Financial education programs have not kept pace as easy and expensive credit has proliferated, and many families find themselves on shaky financial ground. Expanding financial education at the grassroots level could help better

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<sup>78</sup> Cody Calamaio, "Foreclosure crisis hurting renters, too," *Tucson Citizen*, July 2, 2008.

prepare citizens to navigate the increasingly complicated and treacherous world of personal finance and credit by providing important tools to help make informed financial decisions.

While personal financial literacy is important, it is also important to study the role that predatory lending in areas other than home lending and have played in the foreclosure crisis. For example, more needs to be known about the connections between the foreclosure, credit card debt and payday loans.

### **Foreclosure Task Force**

A number of cities and counties across the country have created task forces in order to better control, manage and recover from the damage caused to communities by foreclosures. A task force coordinates foreclosure response efforts across city and county government departments, nonprofit agencies, community groups and the private sector. Creating a centralized entity like a task force charged solely with dealing with foreclosures makes a comprehensive approach and response possible. A task force can also serve as a clearinghouse for important information and foreclosure related activities. A task force can help to define the roles of the various players and more effectively leverage resources and political will in ways that an ad hoc response cannot. Coordinated efforts led by a task force can help to get all stakeholders collaborating to maximize resources and efforts to find practical and effective solutions.

#### **Examples in Massachusetts<sup>79</sup>**

Boston Mayor Thomas Menino and the City's Department of Neighborhood Development created a six-bank refinancing consortium that adheres to model loan origination and foreclosure prevention business practices and has helped homeowners refinance out of \$3 million in bad loans. The mayor also formed the Foreclosure Intervention Team (FIT) to identify property owners to hold them accountable and to move forward with future renovations and sales. Other city departments are engaged in education and outreach efforts to renters to inform them of their rights if their property owners are facing foreclosure.

The cities of Lawrence, Lowell and Brockton created task forces that act as a base for government departments and agencies, housing counselors and advocates, legal services attorneys and local lenders to more effectively communicate and coordinate foreclosure prevention and mitigation efforts. The City of Lowell formed a triage committee to help homeowners that have trouble refinancing through existing programs and sometimes sends eligible homeowners to the Lowell Development Financing Corporation. The corporation offers

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<sup>79</sup> Janna Tetreault and Ann Verrilli, "Addressing the Foreclosure Crisis: State and Federal Initiatives in Massachusetts," Citizens' Housing and Planning Association, March 2008.

up to \$10,000 (which is paid back over ten years) to cover closing costs, prepayment penalties or build equity to refinance into loans with more favorable terms and conditions.

The City of Lawrence's Housing Partnership, held quarterly "mortgage check-up clinics" to bring homeowners together with lenders and counselors to help homeowners understand their mortgage terms, their options and how to maintain healthy mortgages. Lawrence also has a separate task force coordinated by the Mayor's Office and the Planning Department made up of the Fire Department, Police Department and Inspection Services to monitor abandoned properties to assure proper maintenance and security in order to prevent fires and crime.

The Brockton Housing Partnership is formed by thirteen local banks, credit unions, and non-profit agencies. Together they developed a foreclosure hotline with a multilingual staff that refers homeowners to counseling or financial education programs. A local affiliate of the Brockton Housing Authority is revitalizing distressed properties to provide housing to low income families.

#### **S.A.V.E. (Stabilize – Assist – Value – Enforce) Our Neighborhoods Action Plan<sup>80</sup>**

The City of Worcester, Massachusetts, led by the City Manager, developed the "S.A.V.E Our Neighborhoods" comprehensive action plan to stabilize neighborhoods with high foreclosure rates. Worcester is seeking to manage properties in the foreclosure process by designating "receivers" through Housing Court to manage properties between the time when owners walk away to when the mortgage holder takes the deed. The multi-departmental Property Review Team (PRT) was created to enhance monitoring and enforcement of current and potential problem properties. The PRT uses the Property Analysis Database to see real-time data on any property from all participating departments allowing for a holistic view of any property on a single monitor.

#### **Denver, Colorado<sup>81</sup> and Hennepin County, Minnesota<sup>82</sup> Foreclosure Task Forces**

The President of the Denver City Council and the Hennepin County Minnesota Board of Commissioners both formed task forces with stakeholders from public, private, nonprofit and community entities to identify the scope of the foreclosure crisis and impacts on their communities. They also evaluated impacts on public services, neighborhood safety and property values. The goals were stabilization, education, prevention, intervention, legislation, policy and enforcement. The task forces made a number of recommendations to guide policy to combat the foreclosure crisis in their respective cities.

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<sup>80</sup> "S.A.V.E. Our Neighborhoods," Michael V. O'Brien, City Manger, Worcester, Massachusetts, January 29, 2008.

<sup>81</sup> Denver's Foreclosure Task Force Assessment and Recommendations Report, July 2007.

<sup>82</sup> Hennepin County Foreclosure Task Force Report, October 18, 2007.

## **Foreclosure Counseling**

In Pima County, foreclosure counseling has been the major response to the foreclosure crisis. A number of local nonprofit agencies provide free foreclosure counseling services. Staff from four local agencies was interviewed to better understand what foreclosure prevention and mitigation services are available to the community, how those services work and what outcomes are being observed. Agencies offering foreclosure counseling generally provide services including understanding loan documents and terms, budgeting, negotiating with lenders and as a last resort, how to handle foreclosure if the home cannot be saved. The large foreclosure education and prevention workshops were generally seen as very successful. Housing counselors also identified a number of impediments to their counseling efforts, and made recommendations about how to enhance their efforts.

## **Data Accessibility and Information Technology**

For this study, the SWFHC reviewed a random sample of 451 Pima County foreclosure records from the 4,640 Notices of Sale (NOS) filed in 2007 at the Pima County Recorder's Office. A team of four data collectors gathered the data. The current method of recording and accessing county data is cumbersome and should be improved to be a more effective tool for community-based research. The Jefferson County Colorado Public Trustee's website provides an excellent example of a user-friendly and comprehensive publicly accessible database.

### **Neighborhood Early Warning System (NEWS)<sup>83</sup>**

Residents, neighborhood groups, community-based nonprofits and local governments need current and vital neighborhood-level information to target actions and programs and to make effective housing and community planning and policy decisions. Advances in information technology, including Global Information Systems (GIS) and increasingly automated administrative records, allow for a better understanding of the health and functioning of neighborhoods and communities. Internet-based systems, called neighborhood early warning systems (NEWS), have been developed in a number of cities to integrate public administrative data with maps that allow properties and neighborhood conditions to be monitored. NEWS can track indicators of financial disinvestment, physical decline and physical abandonment, as well as areas at risk of gentrification.

The City of Minneapolis partnered with the University of Minnesota to create an early warning system that uses eight layers of administrative data, including property status, code violations,

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<sup>83</sup> Christopher W. Snow, Kathryn L.S. Pettit, Margery Austin Turner, "Neighborhood Early Warning Systems: Four Cities' Experience and Implications for the District of Columbia," Fannie Mae Foundation, March 2004.

and delinquencies to rank properties by four risk categories. Based on the data, the system can identify properties that will likely become vacant or abandoned. As the foreclosure crisis began to become a major issue, the system was expanded to incorporate other data to address foreclosure-related issues.

Chicago maintains the Community Information Technology & Neighborhood Early Warning System (CityNews) that combines a database interface with online mapping capabilities that allows the public to analyze housing-related data. The system is transparent and accessible and allows tracking of real estate trends for better community planning.

The City of Tucson and Pima County collect a wealth of public information, and more should be done to make it available and easily accessible with online tools to analyze the data. Creating a NEWS should be a priority to help deal with the lasting impacts of the foreclosure crisis, as well as other on-going housing and community development issues in Pima County.

### **Community Land Trust**<sup>84</sup>

A community land trust (CLT) is a tool to create and preserve permanent affordable housing by acquiring land and holding the title in perpetuity, while allowing the residential and commercial structures to be bought and sold. The owners of the structures on the land have exclusive use of the land through a long-term ground lease that typically lasts for ninety-nine years. The ground lease agreement places equity limitations by restricting the resale price of the house to ensure that affordability is maintained for future low and moderate-income buyers. When the house is sold, the lease agreement allows for a fair (not unlimited) return on the investment so that affordability is preserved. CLT homeowners have all of the normal responsibilities and benefits of homeownership.

#### **Benefits and Limitations**

CLTs use public subsidies more efficiently than other common affordable programs like down payment assistance, because the initial subsidy is tied to the housing and is recycled from owner to owner. The CLT model also allows homeowners to build wealth through homeownership and make money by selling. Historically, acquiring land and developing properties has limited the expansion of CLTs. The high number of foreclosures and bank-owned properties on the market in Metro Tucson provides an unprecedented opportunity to assemble the land and property necessary to start a CLT.

Community Land Trusts are located throughout the United States in cities, towns and rural areas. A number of examples can be found in the full report. Now is an excellent time to create

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<sup>84</sup> "The Community Land Trust, A Solution to the Crisis of Housing Affordability," Burlington Associates in Community Development, 2005, <http://www.burlingtonassociates.net/resources/archives/CLT%20Overview.pdf>.

CLTs because home prices have dropped considerably in Metro Tucson making land acquisition and assembly more feasible. CLTs can help to mitigate the negative impacts of the foreclosure crisis while creating permanent affordable housing.

### **Anti-Predatory Lending Ordinance**

A local ordinance is recommended for at least three reasons: First, homebuyers and owners in Tucson will need it. Prime lenders have tightened qualifying standards and these will remain tight at least until the current crisis has subsided. This opens the door for subprime and predatory lenders to target those in the market with money and equity but less than sterling credit to accept more risk than they would normally. Second, there is the likelihood of a second wave of foreclosures from the fallout from the first. As home prices decrease, the foreclosure market will expand and heat up and help feed the subprime market. Many of the buyers of foreclosed homes are speculators looking to flip the properties and this could lead to another surge of foreclosures. Third, a local ordinance could trigger action at the state level at a time that legislators may be more amenable to effective regulation of the loan industry in Arizona. Few metro areas in the country have suffered as much as metro Phoenix from the current housing market crisis.

There have been a number of anti-predatory loan ordinances in cities across the County including Chicago, Los Angeles, Oakland, Philadelphia, and Washington D.C. An ordinance was passed in Chicago in 2001 and in Washington D.C. in 2002. Both remain active. An ordinance in Philadelphia was preempted by State Legislation, and the laws in both Oakland and Los Angeles are currently held up by lawsuits.<sup>85</sup>

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<sup>85</sup> National League of Cities, "Anti-Predatory Lending Ordinances," February 2008.

## Survey

SWFHC surveyed fifty-eight people regarding housing issues and their perceptions of the impact of foreclosures in Metro Tucson. Respondents included real estate agents, lenders, brokers, government employees, non-profit staff and private consumers. The results are as follows:

- About 95% of people surveyed in metro Tucson considered foreclosures a problem; 60% called them a major problem.
- Almost 38% thought that home values had decreased significantly over the last 12 months, 24.1% moderately and 8.6% slightly.
- In the next 12 months, 58.6% believe home values will decrease, only 5.2% see them increasing. Of those expecting a decrease in home values, 41.2% thought it would be slight, 52.9% moderate and only 3.4% large.
- Slightly over 29% of respondents thought that home sales would stay about what they are now over the next 12 months, 27.6% believed they would decrease and 22.4% said that sales would increase. Of those who thought sales would decrease all said slightly or moderately, and of those that saw increases, almost 85% stated they would be slight.
- Almost 33% of people responding said irresponsible brokers, lenders, and investors were the primary cause of current foreclosures, 13.8% said it was the mortgage loan product and 15.5% stated it was lack of federal oversight. Only 8.6% stated that irresponsible borrowers were the primary cause of the high rate of foreclosures.
- About 33% of respondents said that programs that work directly with borrowers on foreclosure prevention would help the most to improve the foreclosure situation, 27.6% said educating consumers to help themselves would be best and 15.5% believed that more federal regulation of the home loan industry would work best.
- With 129 responses by 58 respondents, over 34% of the responses indicated that their neighborhood or nearby neighborhoods were impacted by foreclosures and 22% said that everyone in the community was affected. About 21% said that their property value was declining, about 11% stated that a friend or family member had been affected by a foreclosure and about 7% indicated that they had been personally affected.
- Over 24% of respondents said that changes in neighborhoods would be the largest long term impact of foreclosures, 22.4% believed it would be a decline in the local economy and 20.7% said that the market would eventually correct itself and the long term impact would be minimal. Only 10.3% thought the greatest impact past 2010 would be a decrease in home values.

## **Conclusion**

To understand the full impact of the dramatic increase in foreclosures in Pima County, it is necessary to look beyond the housing market itself to see the effect they are having on people, neighborhoods and the community. This is not just a correction in the housing market that will be resolved when a balance is reached between supply and demand. This is a community crisis that is continuing to build and will continue to impact peoples lives for years to come.<sup>86</sup> Metro Tucson will never be the same, in some ways for the worse and some ways for the better. With the damage foreclosures cause comes opportunity for new and creative ways to plan, organize and deal with such long range issues as affordable housing and sustainable neighborhoods. This study provides some of the information that will help to move in that direction.

The following is a summary of the significant points and conclusions presented in this report:

1. Foreclosures are increasing and indicators point to continued increases in 2009. Foreclosures are on a trajectory to exceed 8,000 in 2008 and more than that in 2009 for a total exceeding 16,000 over the two years. Even after foreclosures peak and decline, their impact will continue for years in such areas as home equity, tax revenues, public services, community programs and neighborhood stability.
2. Continuing foreclosures will put more pressure on housing prices and indications are that there will be a continuing overall decline into 2009. Analysts have estimated an overall reduction in home values in Pima County since their peak in 2007 of from 6% to 15% to date. Many analysts see another likely decline of at least 10% by late 2009. A caveat however is that the decline in home prices differs greatly depending on location. The values of homes in some neighborhoods have decreased slightly, less than 5%, if at all. In other neighborhoods where foreclosures are concentrated, decreases in values have exceeded 30%.
3. Zillow.com estimates that nationally 30% of homeowners who purchased homes in the last five years are upside down in their mortgages (owe more than the home is worth). Since more loans in Pima County were subprime with adjustable rates and exotic terms and conditions than the national average, the percentage of homeowners with negative equity is probably higher than that. If projections for further decreases in home values are accurate, it is possible that by the end of 2009 a third of all mortgage holders in Pima County will be, on paper, upside down. The silver lining in this scenario is that

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<sup>86</sup> The level of response that this crisis merits on the local level is indicated by the concerns expressed and actions taken on a national level. Most notable is the takeover of Fannie Mae and Freddie Mac by the United States government. This was an unprecedented move indicating the degree of anxiety felt by this county's top analysts, experts and decision makers about the widespread dangers inherent to the current crisis in the housing market.

those that owned their homes prior to 2004, and did not draw a large portion of their equity out during the lending debacle with home equity loans or refinancing, stand to benefit with increased home values averaging more than 35% over the last 5 years, even after home prices bottom out.

4. The impact of foreclosures on neighborhoods is spotty with some suffering more than others depending on location and prevalence of foreclosures. Some of the recommendations offered in this study would help to ameliorate the damage. Those impacted the most will see:
  - More foreclosures
  - Long term reductions in home values
  - More vacancies and homes in disrepair
  - An increase in crime, vandalism and graffiti
  - More renters and less owner-occupants
  - Local businesses closing or moving out of the area
  - Increased redlining (higher denial rates for mortgages loans, home equity loans, home improvement loans, home insurance coverage and increasing fees and rates)
5. Metro Tucson stands to lose substantial tax revenue from the current foreclosure crisis and loss of home values. Kuehl and Franke state that the National Center for Real Estate Research estimates that every dollar of property value will affect annual spending by six cents.<sup>87</sup> They used this estimate as part of their formula to forecast the loss in tax revenue in Arizona from foreclosures. They concluded that Arizona communities would lose \$7 million in property tax annually and \$12 million in sales tax annually for a combined loss of \$38 million in taxes in 2008 and 2009.

In a study focusing Metro Tucson, Global Insight states that homes are moderately overvalued at this point and the correction is likely to be about -15.4% in the next two years.<sup>88</sup> If this estimate were used, it would mean a loss in home values in Pima County between June 2008 and June 2010 of over \$5 billion. Since there is about a two-year lag between tax assessments and market values, the full impact of the decline in housing prices is not going to hit tax jurisdictions until 2012. This drastic reduction in the tax base will severely pressure tax districts to find ways to develop the alternative revenue sources that will be needed to maintain public services. The substantial loss in sales tax revenue will exacerbate this problem.

6. As foreclosures increase, investors and speculators are moving into the market to pick up bargains. In the short-term, these types of investors may slightly reduce the

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<sup>87</sup> "Under Pressure," Kuehl and Franke.

<sup>88</sup> News and Notes, *Arizona Daily Star*, June 4, 2008.

absorption rate, but a long-term recovery from the impact of foreclosures in neighborhoods will not be built on speculation. When markets slump investors and speculators are the first to walk away leaving their investments in foreclosure. Owner-occupants and tenants are left to face the consequences. However, by far the most destructive long-term effect that foreclosure speculators have is to further decrease home values. This further fuels the downward spiral of hard hit neighborhoods noted in number four above.

7. The following recommendations are offered by this study:
  - Develop a foreclosure task force, or similar body, to coordinate a comprehensive effort to reduce foreclosures and ameliorate their impact.
  - Increase support and coordination of programs offering foreclosure counseling and hands-on assistance for people in foreclosure or at risk of losing their homes.
  - Establish a GIS-based Neighborhood Early Warning System (NEWS). Integrating layers of public data through a NEWS will help to identify neighborhoods in distress from foreclosures and other issues and focus efforts to address these issues.
  - Create a community land trust (CLT) to help mitigate the negative impacts of the foreclosure crisis while creating permanent affordable housing.
  - Pass a local anti-predatory lending ordinance to reduce the risk of a second wave of foreclosures developing from the fallout from the first wave. While preemption by a state statute as a result of local action is a distinct possibility, the timing is better than ever for passage of effective state legislation.