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Stopping foreclosure delay will bring housing improvement, study says

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As housing prices in the United States continue to drop, a Kansas State University professor says the best way to help the market is to stop delaying foreclosures.

While negotiations continue between state attorneys general and banks over a settlement that looks at foreclosure practices, some of the settlement proposals may backfire and do more harm than good, according to two recent studies co-authored by Kansas State finance professor Eric Higgins.

Higgins co-authored the studies with Charles Calomiris, a professor at Columbia Business School, and Joseph Mason, finance professor at Louisiana State University, in response to current negotiations that have delayed many foreclosures from occurring.

Because the terms of the proposed servicer settlement call for banks to do more on forgiving mortgages, the studies say it would only encourage more homeowners to strategically default on their loans. Delaying or prolonging the foreclosure process doesn't help either because it prevents the market from recovering.

"In no way do our studies suggest that foreclosure is a good thing," said Higgins, von Waaden Chair of Investment Management and head of the department of finance. "It is very unfortunate, but to delay the foreclosure process doesn't help anybody. It doesn't help the homeowner who is in debt and can't get out of debt. It's not helping the economy because we can't find the bottom of the housing market. And it's not helping neighborhoods because you have neglected houses."

It's also not fair to call the banks the only "bad guys" who caused the housing market fiasco, Higgins said.

"Of course, there's blame to be had by the banks," Higgins said. "But there's also blame to be had by the people who knew that they were borrowing too much. There's blame to be had for investors who bought these mortgage-backed securities without performing adequate diligence. And there's blame on the regulators who overlooked many problems in the housing market."

Yet current negotiations don't appear to be helping the market -- home prices nationwide are still dropping and the market is still stagnant. Higgins said it is not so much a double dip in the market, but rather the market never hit bottom.

"The reason it appears to be a double dip is because foreclosures stopped due to the uproar over robo-signing practices," Higgins said. "So, what we were seeing for home prices at that time wasn't really a true price. Once a true regulatory settlement was reached with mortgage servicers, the foreclosure process began again, the inventory of houses increased and prices dropped."

Completing foreclosures and clearing bad mortgages is the best way to help the market improve, Higgins said. According to the studies it takes an average of 17 months for a foreclosure to happen -- and during that time, the home can be sitting, becoming run down and declining in value.

"By delaying foreclosures and modifying mortgages, all you are doing is prolonging the borrower's problems," Higgins said. "Statistics show that mortgage modifications don't really work and people are eventually going to be in a situation where they are unable to pay the adjusted mortgages. It gives borrowers who are in trouble a sense of a false hope and encourages other borrowers to engage in strategic default."

Now the market finds itself in a cycle full of bad news. As long as foreclosures remain in limbo, no one will know the bottom of the market. In turn, homebuilding won't pick up until builders know where the market bottom is.

Additionally, Higgins sees a connection between the housing market and the country's high unemployment rate. He suggests the rate may be remaining high not because of job availability but because of labor force mobility.

Labor force mobility, or the ability of workers to move wherever job opportunities exist, has declined during the past decade, even though technology and other forms of mobility have increased. Labor force mobility may be declining because of mortgage-foreclosure overhang.

"People are stuck in these houses that either have been foreclosed or will be foreclosed, or they are so underwater that they can't sell the house," Higgins said. "So there may be jobs out there, but folks can't get to them because they are stuck in bad mortgages, and that keeps the unemployment rate higher."

It may all seem doom and gloom, but Higgins has hope in a market recovery as long as banks can begin to process foreclosures. While home prices may drop even more when these foreclosures are processed, doing so will help give the market a clean slate so it can begin the slow trek to recovery.

"A lot of pain is going to happen, but the market needs to clear," Higgins said. "Once it clears, new construction can start. When construction starts, we create jobs in that area and then things might be able to pick back up."

Provided by Kansas State University

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