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When the Meaning of Home is Financially Exhausting:

How Families in Foreclosure are Motivated to Exhaust Their Wealth

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Introduction

Since 2008 upward of four million families have lost their homes to foreclosure. However, many families who defaulted on their mortgages avoided foreclosure and still remain in their homes. Policy makers do not have a clear picture of the financial impacts of default and foreclosure for households. Yet, households who have experienced default and foreclosure, whether or not completed, are likely to have experienced financial impacts that may increase their need to draw on public programs. Unique and timely data reported in this brief, shows that the financial impacts of foreclosure are significant. Motivated by the social and economic meanings attached to their homes, families spend down their savings and retirement funds leaving themselves vulnerable to future economic shocks and financially insecure. This is a process of asset depletion when families *use up savings and other liquid and non-liquid investment vehicles to cover day-to-day expenses when income is not enough to do so.*

Asset depletion often leads to asset exhaustion when all liquid and non-liquid financial resources are depleted completely. Drawing on thirty-seven interviews with predominantly families of color in foreclosure around the city of Boston between 2007 and 2008, the following brief will outline the ways that families spend their assets to keep their home, and then explore the contextual meanings that are important motivators for making the decision to keep paying the mortgage rather than selling the house or walking away from it.

Financial Assets are Important to Family Well-being and Mobility

Research has established evidence that assets, or wealth, are important to family well-being and mobility (Elliot 2012; Lerman and McKernan 2008; McKernan, Ratcliffe, and Vinopal 2009; Shapiro 2004; Zhan 2003). Scholars have found a positive association between holding assets and increasing income (Bynner and Despotidou 2001; Moore et al 2001; Raphael and Rice 2002), reducing teen pregnancy (Green and White 1997), increasing mental and physical health (Bynner and Despotidou 2001; Moore et al 2001), increasing civic engagement (DiPasquale and Glaeser, 1999 (Moore et al 2001), and child well-being (Scanlon and Page-Adams 2000). Assets reduce material deprivation in the face of an economic shock buffering the impact of events like unemployment.[1] Assets also provide the means for investments in family members that might lead to social and economic mobility, e.g., investing in a college education for a child. Investments that occur earlier in life, mean the beneficiary families have a head-start over families that do not have inheritances or in-vivo gifts to use for such opportunity investments such as buying a house (Shapiro 2004).

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"Asset Exhaustion" Occurs When Incomes Decrease Relative to Expenses

Assets, or wealth, provide an important cushion for families to draw on in financially strained periods – in times when incomes decrease, or in the face of an unanticipated expense. Yet usually household wealth is

[1]An economic shock is an event that causes financial hardship for a family. For example a period of poor health that prevents an individual in the family from working. McKernan (2009) Boguslaw et al (2013)

only able to support a short period of reduced income before all assets are depleted to the point of asset exhaustion. Asset exhaustion is when a household uses financial assets (wealth) to cover day to day expenses until there are no financial assets remaining. Asset exhaustion compromises immediate well-being and financial security as well as future economic opportunities.

Foreclosures Can Lead to Asset Exhaustion

Foreclosure is the process that results in the forced taking of a home by the lender because of default on the mortgage payment. When families are unable to make the mortgage payment due to a reduced income and/or an unaffordable mortgage, they have the option to keep paying the mortgage by drawing on and depleting their assets, or to leave the house either by selling it at a loss or walking away from it. The data reported in this brief point to family's strong motivations to deplete their wealth in an attempt to cure the default and retain the home. As a result foreclosure often leads to asset depletion and exhaustion.

Why Did Families Have an Out of Balance Household Budget?

If asset depletion occurs when a household has expenses that are greater than income, the first question important to understand is why families have an out of balance household budget. The Boston interviews suggest that families' household budgets were misaligned because of (1) income reduction, and (2) increased household expenses.

(1) *Income reduction*. At least twenty families experienced reduced incomes from a combination of unemployment; decreased self-employed work; sickness or disability; and reduced rental income (inability to find a tenant, or renovations that prevented an apartment from being rented). For example, an immigrant pastor was unable to rent out his house after a fire tore through the building requiring substantial repairs. An African American homeowner needed to do repairs to the house for Section 8 rentals and had to stop renting the property while the repairs were completed. A young African American man experienced reduced work hours (and resultant income loss) for the first time in his work history. When the household income dropped families had to make decisions about which bills to pay, often having not enough cash to make the mortgage payment, despite its high priority.

(2) *Unaffordable household expenses*. Household budgets among the sample of people interviewed were not sustainable. In many cases housing costs were too high and incomes had been reduced. Mortgages for those interviewed were large (median $304,925), reflecting high house prices in the Boston metropolitan region. As a result, the median annual mortgage payment to income ratio was 54 percent.[2] HUD considers that for a housing payment to be affordable it should not be more than 30 percent of the monthly income. Even when not counting taxes and insurance and looking at mortgage payments alone, only two people met this recommended 30 percent monthly income to mortgage payment ratio. And even using 40 percent of monthly income as a proxy for affordability, only seven families of the total 37 interviewed would have had an affordable mortgage.

While families did not explicitly state that their housing expenses had increased, it was often implied. Families talked about how prior to owning the house or refinancing the mortgage, the family budget was in balance, ensuring that the family could build assets. Catherine said: "*I used to be good at saving. Then I bought a house.*" In not one interview did respondents describe other household expenses increasing, yet they

Data for this brief

Data in this brief draw on detailed interviews with a sample of families (n=37) that were in different stages of foreclosure in Boston in 2007 and 2008. Interviews explored the financial path to foreclosure as well as the after-effects on the family's financial balance-sheet. The families in this study were predominantly families of color, reflecting the disproportionate role such families have had in the pattern of foreclosure petitions and foreclosure sales in Boston. Information gathered from these interviews gives some indication of the consequences of the financial crisis for those families specifically going through foreclosure in Boston at the start of the crisis.

[2] This percentage calculation is based on the current income, and on the current monthly mortgage payment. It does not account for payment increases anticipated from adjustable rate mortgages.

would describe finding that their household finances were in trouble after buying the house.[3] In fact, interviewees pointed to attempting to reduce their household expenses because of the larger housing costs that had resulted from buying a house or from refinancing their home. Eveline described how she had to take her son out of daycare and her daughter away from the private school she was attending to cut back on expenses to afford the mortgage payment after she refinanced. Several families talked about having a family member move in to help cover the cost of the mortgage after they had refinanced into a less affordable mortgage.

Foreclosures are disproportionately located in communities of color

Certain types of loans are more likely to go into foreclosure: subprime, high loan-to-value ratios, adjustable-rate mortgages and interest-only mortgages with prepayment penalties and balloon payments. Subprime loans, and the associated foreclosures, were disproportionately located in communities of color. There is good evidence that segregation provided an important underlying structural contribution to the foreclosure crisis.[4] This is possibly due to the targeting of certain communities by mortgage brokers, a pathway into a mortgage that has been demonstrated to increase the risk of foreclosure.

Families found ways to put off paying some other bill so that the mortgage could be paid. Many described this process as "robbing Peter to pay Paul." The mortgage had put such families over the edge and they then had trouble paying their regular bills. Despite cutting back on household expenses, drawing on gifts and loans from extended family members, and taking on extra work, these families eventually could not find the income to pay their mortgages and found themselves depleting their assets to pay the mortgage and other household bills.

Families Spent Their Assets to Manage Their Unsustainable Budget

With an unsustainable household budget, homeowners interviewed for this study used their fungible assets to cover the gap between income and expenses. Families spent a range of different assets and also took on debt in order to stave off foreclosure. Families initially used savings and then liquidated or borrowed against retirement accounts and savings bonds to cover bills and mortgage payments so that they could keep the house. Often, once they had used up their available savings and retirement accounts, they were no longer able to keep making the mortgage payment and went into foreclosure. Eighteen families (48 percent) had depleted their 401Ks and equivalent retirement accounts to pay the mortgage and bills, or to complete housing repairs. For example, Dawn took $36,000 from her retirement account to pay the mortgage. She couldn't remember the penalty she had to pay. Amelia took out $8,000 from her 401K retirement account to catch up on delinquent mortgage payments. William, an immigrant, found that he was spending everything that he earned and all his savings on paying for the mortgage. He spent $35,000 from his savings. He said that *"all the money that I had, all the savings all the income was just feeding the house, feeding the house."*

Every person interviewed had a savings account and seventeen of the 37 or 45 percent had depleted their savings accounts to pay for their mortgages and other bills. These approaches to paying the household bills were an attempt to stave off the loss of the home. But with a long-term unsustainable household budget resulting from an unaffordable mortgage payment or a reduced income, or both, and an insufficiently large asset pool, families often ended up using up all their fungible assets to pay their household expenses.

Families Took on Debt

Concurrent with depleting savings, families accessed store and bank credit cards to cover basic needs such as children's clothing, maintenance costs, and food, in some cases building up substantial debt balances. Nine people (24 percent) had some form of credit card debt they used to help maintain the house. The median outstanding

[3]There is an active debate about whether families should have bought houses with mortgages that were unaffordable to them at the time or re-financed into unaffordable mortgages. The evidence from these interviews points to families that were often duped into purchasing houses or refinancing their existing home at a greater cost than they knew was affordable for them. The point of this paper is not to visit the debate of whether these families should have bought or refinanced those houses, nor to blame them if they did purchase a house or refinance a mortgage beyond their means.

[4]Rugh, Jacob and Douglas Massey. 2010. "Racial Segregation and the American Foreclosure Crisis." American Sociological Review 75:629-651.

balance was $5,000. Other families delayed utility payments which meant late charges, while making just enough payments to prevent the utilities being shut off. Families also used refinances - often prompted by the mortgage broker and increased mortgage interest rates and loan balances - to take out some home equity and get current on the utilities, delaying the inevitable reality of unaffordable mortgage payments. Taking on more debt could exacerbate the process of asset depletion, especially when it was expensive credit card debt. This often brought families' balance sheets into the negative.

Households Drew on Extended Family Wealth

Seven families drew on their extended family and friend resources, getting direct loan and gift assistance in keeping their homes. Yrianna, an African American mother of two, who wanted to keep her family house, borrowed $30,000 from her parents who were approaching retirement. She was feeling pressure to pay back the loan because she knew her parents needed the money. Calvin, who had been taking care of his elderly mother along with his own children, asked for a loan from his sister and her friends when his wife's hours were reduced. Brian, a white unemployed single condo owner used up his inheritance to keep the condo.

The symbolic use and investment meanings of their homes motivated families to spend down all of their assets that might offer future financial security.

The Meaning of Home Motivates Families Towards Asset Exhaustion

The symbolic use and investment meanings of their homes motivated families to spend down all of their assets that might offer future financial security. Ralph, an older African American man, who worked in the home-building business, tried to keep his house for his disabled wife. He hoped to live with her in their retirement in a secure place that had manageable costs.

…in this point in our life we needed to have something that we owned so we could… try to have a steady cost we could fix within my fixed income

When business slowed he found himself emptying his savings in stages,

Well, it didn't completely empty it out, but…it got it down pretty low and … then when the escalations came on, that completely emptied it out, which was this year, well not this year, last year, 2007, that's when it got completely emptied out. And now I'm on deficit spending.

He reminisced about the good times when he could save for retirement. *"It's gone now, it's just a memory (laughing). A memory from when the housing boom was going high and I had more work than I could handle and I was able to put something away."* Ralph found that the lower income from his business in the slow economy and the cost of putting his children through college, coupled with an increase in his mortgage payments had eaten away at all of his savings, leaving him in a precarious financial situation for retirement. Ralph, indeed, ended up losing his home in foreclosure – a case of total asset exhaustion.

The Motivation of Owning One's Home House

Owning one's own home is a deeply held value in the U.S. It provides, therefore, a particularly strong motivation for families to keep their homes even when doing so threatens a family's current financial viability and financial future. For families participating in this study, the meanings and daily realities associated with owning a "home" were important motivators in saving the home at whatever financial cost. Solomon spoke about why he wanted to own a home: *"Ah, why I wanted to buy a house? Because it's always the American Dream, one wants to buy one's own house to live well and to be paying for oneself."*

Families talked about the importance of safety and control. Katarina, an immigrant, summed up the importance of safety for her children, when she described the low quality of rental options.

I found this person was going to my porch, opening the doors, doing whatever he wants in my apartment. So I feel like it's dangerous. Because at nights those apartment don't have a key on every room… When my other two kids come to this country I better have something safe for them because it was, to me it wasn't safe. Nothing happened to me, but it was like, you know, door open, cigarettes, things in my apartment, and sometimes there was marijuana next door. So it's better me living here. So that's why I was looking to buy an apartment.

Having a place to raise children without complaints from neighbors or landlords was also an important factor. Yolanda, an African American mother saw homeownership as a way to ensure she had "a place where children could run and play, [where she could] raise children without a headache." The more general prospect of losing a home and the impact that this might have on children provided a key motivation for Jana:

You know what is sad? If you don't have any kids--I mean, you don't care, you just go pay rent somewhere else or do something--but when you have kids, you look at them, at your situation. You don't think about you, you think about them. What is going to happen to them if they call home and there is no home anymore. And when they're too young to understand these kind of things, so you have to try to … and tell them, well it's not our house anymore, we have to move, we can start again. But kids get used to things like anybody does.

For others, the home had family memories and history, and losing the home would have meant losing these memories. Donna described the family significance of her home:

I inherited it from my grandmother. ... About 20 years, maybe more. I took care of my grandmother, lived there. It's a family house.

Several families articulated the importance of their homes providing some safety and security for their families in the longer term, through inheritance. Solomon, an immigrant, spoke about this as being important for him in owning a house:

I have sons, I have a wife, and if I die tomorrow, that God doesn't want it, but at least I will leave them with a secure place, I leave them with their own place to stay in, for my sons I want an inheritance.

For several families the idea of returning to the rental market was hard to conceive of since they thought rents were as expensive as their mortgage payments. Ralph, introduced earlier, explained it like this:

…because everywhere I'm looking at the rents, it's higher than the mortgage, it's still higher than the mortgage…you know, and maybe they're gonna come down, but…I just don't look at renting long-term as being an answer. I just need to stay at that thirteen to fifteen hundred dollar level …

All these motivations – a home of one's own, safety, a place to raise children, keeping the historic family home, providing an inheritance, escaping high rents - meant that families would work hard to prevent losing their homes. They would in many cases use up their assets and take on debt to cover household expenses that were exceeding income. This was so, even when it was clearly financially unsustainable to keep the house and trying to do so was causing a great deal of stress.[5]

Consequences of Asset Exhaustion Resulting from Foreclosure

Asset exhaustion resulting from foreclosure has real consequences that policy makers should be aware of if they hope to help families maintain well-being and provide opportunities for the next generation.

(1) Future Deprivation

Asset exhaustion leading to foreclosure may lead to an increased risk of short and long-term deprivation and financial instability. While the evidence from the interviews points to families experiencing immediate deprivation, we could also expect that in the future, these families might continue to experience greater deprivation as a result of being asset insecure. For example, if a family manages to re-stabilize its household budget, it will then be in a position of having no assets to draw on in the future when faced with another shortfall in income. Additionally the spending down of retirement funds reported in the interviews points to real potential for deprivation in later years when a retirement account would have offered some measure of increased financial security.

(2) Future Asset Insecurity

As families use up their assets to make mortgage payments, they increase their vulnerability to future financial events. A variety of reports point to increasing asset insecurity in the middle class (Wheary, Shapiro, Draut, and Meschede 2008), with the number of financially insecure middle class families rising to 23 million by 2006, or 28 percent of all families in the U.S. Seniors are particularly vulnerable. In Massachusetts one report found 68 percent of seniors were financially vulnerable prior to the economic recession and foreclosure crisis (Meschede, Sullivan, and Shapiro 2009). This report suggested that at the same time two in five senior couples were insecure with regards to home equity prior to the foreclosure crisis. The impact of asset exhaustion through foreclosure, coupled with equity loss through the overall housing market decline, has the potential to have dramatically increased this number.

Policy Recommendations and Implications

Foreclosure for many families begins a process of literal asset depletion, where savings and retirement funds are liquidated to try to cover the mortgage payments. Once assets are used up, i.e. at the point of asset exhaustion, the family is in a position of losing its home to

[5] In just a few cases, the process of losing the home was sufficiently stressful that the owners decided to walk away. One couple interviewed had moved out of their home and in with their extended family; they were leaving the house for the bank. However, this seemed to be the exception rather than the rule among those interviewed.

foreclosure, or draining future assets through debts incurred to cover legal and late fees to get current on its mortgage. Policymakers primarily focus on preventing foreclosures without paying attention to the state of families at the end of that process, whether it ends in foreclosure or not. Since 2008, federal programs have been expanding to help families in foreclosure, from the Home Affordable Modification Program (HAMP) program out of the U.S. Department of Treasury, to the most recent Emergency Home Loan Program from the U.S. Department of Housing and Urban Development. Cities and states have established foreclosure counseling programs, loan programs, and even buy-back programs such as that run by Boston Community Capital's Sun Mortgage company. These programs try to prevent homeowners in foreclosure from losing his/her home but we need to understand whether such programs are taking into account a homeowner's full financial post-program vulnerability – particularly as related to assets. Following are some policy recommendations.

1. Protecting Assets in the Foreclosure Process

In protecting their assets as families go through the foreclosure process, policy makers might consider three steps:

(a) ***Preventing retirement fund cash-outs without counseling about all other possible options such as the availability of loans against the retirement account.*** Increasing families' access to loans against their 401Ks and finding ways to counsel homeowners about the decision to take out a loan against a 401K would provide an opportune moment for families to look at their financial vulnerability and make an informed decision about their choices in relation to their future financial vulnerability.

(b) Developing a financial asset vulnerability assessment tool for use in financial and foreclosure counseling as well as for use when a family attempts to cash-out its retirement account. Coupled with such financial counseling, the use of tool to help families assess their financial vulnerability in several different scenarios would be useful – scenarios could include allowing house to go through foreclosure, cashing out 401K or savings, taking out a loan against 401K.

(c) Establishing a mortgage payment grace period that might prevent the exhaustion of all assets for families going through unemployment or other financially negative life events. Servicers could offer a grace period for a life event such as illness, unemployment/reduced work hours or salary, fire damage etc. with the arrears being put on the end of the mortgage. This is currently an option with loan modifications, but should and could be established as standard practice. If necessary servicers could look to working more closely with non-profit financial counselors who have expertise in assessing the impact of a life event on a family's ability to pay a mortgage.

Key Policy Recommendations

1. Protect Assets in the Foreclosure Process

- Prevent retirement fund cash-outs without counseling about all other possible options such as the availability of loans against the retirement account.
- Develop a financial asset vulnerability assessment tool for use in financial and foreclosure counseling as well as for use when a family attempts to cash-out retirement account.
- Establish a mortgage payment grace period that might prevent exhaustion of all assets for families going through unemployment or other financially negative life events.

2. Rebuild Family Asset Profiles

- Establish programs to assist families who experienced foreclosure to rebuild assets.
- Work with lenders and insurance agents to remove impact of foreclosure on credit score.
- Create programs, such as Individual Development Accounts, to help families regain a solid base of savings.

2. Rebuilding Family Asset Profiles

If the families profiled here are anything to go by, the survivors of the first wave of foreclosures between 2006 and 2008 are likely very financially vulnerable as they exit foreclosure whether as homeowners or now renters. These are families that federal programs have largely ignored to date. A federal program that attempted to assist rebuilding assets of the families in foreclosure, especially from the 2006-2008 period, would help reduce future re-foreclosures and would ultimately assist in stabilizing the housing market as well as helping establish future stability and well-being for these families. Policy makers could work with lenders and insurance agents, and even credit scoring agencies to remove the impact of foreclosure on credit scores. They could implement programs such as Individual

Development Accounts[6] targeted for families who have experienced foreclosure to regain a solid base of savings.

Conclusion and Next Steps

Families in foreclosure face short-term wealth-depletion and asset exhaustion resulting from strong motivations to keep their homes. Policies can help discourage inappropriate spending of financial wealth that may impact later family well-being. Programs can also focus on helping families who have experienced foreclosure to re-build wealth. This research raises questions about the long-term financial well-being of families who have been through foreclosure. A next step in this research project is to study families who have experienced foreclosure to study the long-term wealth and well-being impacts through both interviews and survey data.

About the Author

Hannah Thomas is a research fellow at the Center for Financial Security and a senior research associate at the Institute on Assets and Social Policy. She recently completed her PhD, funded by the Department of Housing and Urban Development, examining how foreclosure sales impact neighborhoods. She conducted earlier research on families' experiences of foreclosure with the City of Boston between 2007 and 2008. Hannah is the project manager for the project "Leveraging Mobility," a multi-site interview study examining the interaction of race, assets and social mobility. Her additional work at IASP examines the impact of foreclosures on wealth in communities of color and the intersection of individual and community assets. Prior to working at Brandeis University, she worked as a research associate for a community development organization in Maine, researching and evaluating the impacts of asset-related policies and programs. Hannah has written and published works on community development finance and foreclosures and has presented at several national meetings of asset practitioners and researchers. She holds a MA Cantab in Geography from Cambridge University, and an MA and Ph.D. in Social Policy and Sociology from Brandeis University.

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[6] Individual Development Accounts are matched savings programs usually used for low-income families to build up savings towards starting a business, buying a home or investing in education.

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