



The Neighborhood Stabilization Program: *Strategically Targeting Public Investments*

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Introduction

Launched in 2008, the Neighborhood Stabilization Program (NSP) provides localities with federal funding to help mitigate the negative spillover effects of foreclosed and distressed properties. Using NSP funds, local governments and nonprofits are able to acquire and redevelop foreclosed and vacant homes, and in many cases, convert them into affordable rental and homeownership opportunities. To date, three rounds of the program have been authorized, for a total of \$7 billion, a relatively small amount in the context of the total number of REOs and vacant buildings that exist. To make these dollars count, the program relies on a strategy of geographic targeting, concentrating investments where the market needs public investment to stabilize. This strategy was based on research that has demonstrated that

targeting funding for neighborhood stabilization can lead to greater returns on investment than distributing funds evenly across a wide area.¹

To achieve this type of strategic and targeted investment, HUD specifically requires each grantee to provide it with a strategic plan that describes not only where they intend to target their NSP dollars, but also how they intend to use the funds given the nature of the foreclosure crisis within their communities. In other words, HUD's NSP program emphasizes that local context should shape strategy. A strategy for stabilizing a neighborhood in Detroit would likely look quite different from a strategy for stabilizing a neighborhood in Denver or Miami. In fact, even within cities, different neighborhoods might require different kinds of strategies based on the composition of the housing stock and/or the latent demand for housing. As

a result, NSP strategies have been strongly influenced by the geography of the foreclosure crisis as well as by local housing market dynamics.

This article explores how geographical differences in housing markets have influenced the implementation of the NSP program. It begins with a descriptive examination of the geographic distribution of foreclosures across the United States, and paints a picture of which types of neighborhoods have been most affected by concentrated foreclosures. Second, it examines some of the challenges that exist in identifying target neighborhoods and developing effective NSP strategies. Finally, through case studies of Cleveland and Los Angeles, the article shows how jurisdictions are using data on the geography of foreclosures and housing dynamics to target their NSP resources to effectively meet their local neighborhood stabilization needs.

Hardest Hit: The Distribution of Foreclosures across the United States

In the first half of this decade, foreclosures were a rare occurrence, and were predominantly a problem in the Rustbelt states of Ohio, Michigan and Indiana. For these Rustbelt states, and for some of the larger metro areas in the Northeastern United States, issues of vacant and abandoned properties in low-income neighborhoods have been a longstanding problem. The decline of manufacturing industries, coupled with an older housing stock and decades of population loss, had led to high housing vacancy rates and neighborhoods with large numbers of abandoned homes. Beginning in the late 1990s, however, these cities noticed a new trend: rising foreclosures, particularly in low-income and minority neighborhoods, which served to exacerbate the problems associated with vacant buildings. In Chicago, for example, foreclosure starts tripled in just six years, from 3,814 foreclosure starts in 1993 to 12,923 in 1999. Researchers studying this jump found that there was a close relationship between these foreclosures and subprime lending in lower-income neighborhoods, particularly in the refinance market.² The City of Chicago responded by launching the Home Ownership Preservation Initiative (HOPI), designed to help borrowers prevent foreclosure, and implemented local anti-predatory lending laws to help stem the rise in subprime lending.

Despite these local pockets of rising foreclosures, however, very little attention was being paid nationally to issues related to subprime lending and loan delinquencies. In the second quarter of 2006, only .43 percent of mortgage loans in the US were in foreclosure. By the 2nd quarter of 2008, however, the national foreclosure rate for all loans had jumped to 1.19 percent; among subprime loans, it stood at 4.7 percent. While the Northeastern states continued to show signs of trouble, Arizona, Cali-

fornia, Florida and Nevada all saw a rapid increase in the number of serious delinquencies, and these Sunbelt states quickly came to dominate the foreclosure landscape.

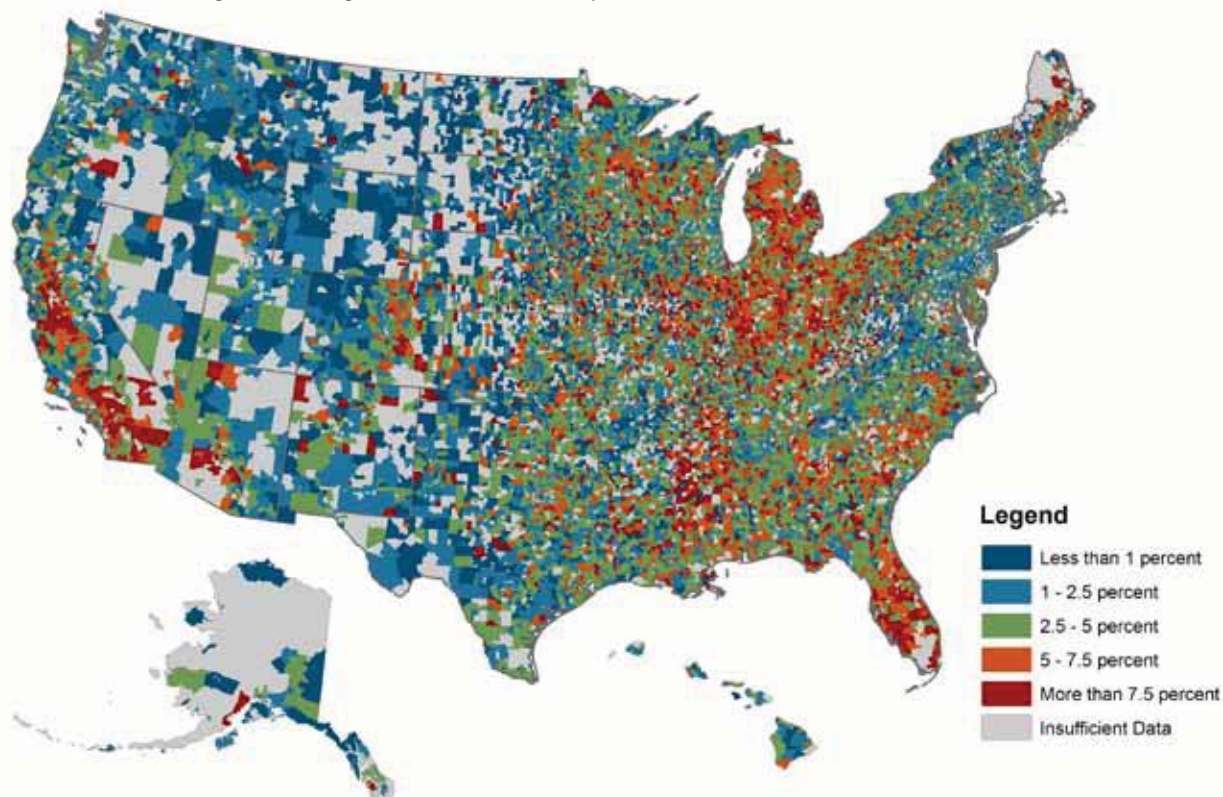
Yet even within states with high foreclosure rates, distinct local and regional patterns emerged in the distribution of foreclosures. Figure 1 shows the distribution of neighborhoods affected by concentrated foreclosures in June 2008. The map shows the regional nature of foreclosures: for example, the foreclosure rates in California's Central Valley were among the highest in the country, while wealthier neighborhoods along the California coast remained largely untouched. Researchers who have studied the crisis have identified two key trends in the spatial variation of foreclosures.³ First, foreclosures have been heavily concentrated in areas that saw considerable new construction and fast house price appreciation during the subprime lending boom, including areas in Florida, California, Nevada, and Arizona.⁴ These neighborhoods, generally located in suburban areas far from a city's core, are characterized by newer, single-family homes and tract developments. Second, older, inner-city neighborhoods – particularly those with high percentages of low-income and minority residents – have also seen a disproportionate number of foreclosures.⁵ These neighborhoods exist in both weak and strong real estate markets, as is evidenced by the high concentrations of foreclosures in minority neighborhoods in Los Angeles, Oakland, Phoenix, and Miami.

To address these two aspects of the foreclosure crisis, NSP was designed to give communities local control of stabilization funds, and allow grantees to target the funds differently depending on differences in local housing market dynamics.

NSP Funding: Targeting it to the Highest Need Areas

For many grantees, however, figuring out how to target their NSP funds proved to be a major stumbling block. A few cities, including Cleveland and Minneapolis, had developed robust data management systems that included detailed information on neighborhood-level foreclosures and property values and conditions. But for the most part, NSP grantees did not have access to any standardized data on foreclosures in their areas. While most county recorders have the responsibility to document liens and defaults on a property, very few of these recordings are stored electronically, making it difficult to aggregate the multiple individual records into a meaningful picture of foreclosures at the neighborhood level. Other foreclosure data sources are proprietary, expensive, and have imperfect coverage across geographies. Even large national datasets such as LoanPerformance and Lender Processing Services Analytics, Inc. may not accurately capture need at the local level, since they only represent a sample of outstanding mortgages.

Figure 1. Neighborhoods Affected by Concentrated Foreclosures, June 2008



Source: Lender Processing Services Applied Analytics, June 2008. Map shows percent of loans by zip code that were 90+ days delinquent, in foreclosure, or in REO.

To assist localities in determining need, HUD provided grantees with a foreclosure risk index. Because of the lack of a systematic public data source on foreclosures and properties that were now bank owned (REO), HUD created the risk index using proxy measures that were designed to capture neighborhood characteristics associated with a risk of foreclosure and abandonment. The measures included those census tracts with a high percentage of higher-priced loans (analogous to high rates of subprime lending), areas where the mortgage-to-income ratio was high (in an effort to capture areas where homeowners were highly leveraged), areas with falling house prices, and both the average unemployment rate for the county in 2008 and the change in average unemployment rate between 2007 and 2008.⁶

The release of the HUD Index proved to be incredibly valuable to local jurisdictions in developing their targeting strategy. As one stakeholder in Idaho noted, “We were sort of lost. We didn’t have access to any local data on foreclosures, and very little knowledge about which neighborhoods were struggling. Although we didn’t receive a large NSP allocation, the index really helped us develop our strategy.” In fact, most jurisdictions surveyed relied on the HUD index in preparing their NSP proposals and in determining which neighborhoods to target for NSP funding.

Given that NSP was implemented in a time of crisis, and given that there were no publicly available data on either foreclosures, real estate owned inventory, or vacant and abandoned properties, HUD’s index was a creative response to the need for data and the desire to target federal dollars in a strategic way. HUD also worked to refine the index for the second and third rounds of NSP funding to provide a more accurate measure of areas at risk of neighborhood destabilization. Even so, the lack of publicly available data on mortgage and housing markets severely limits the ability of jurisdictions to compete with the private sector in the acquisition of foreclosed properties, and may limit the overall effectiveness of NSP interventions.

For example, the data included in the HUD index do not provide real time information on either foreclosures or the concentration of REO properties, the condition of the housing, or housing demand. In cities with relatively strong housing markets, for example, foreclosures may not ultimately end up as vacant properties, especially if properties are sold as “short sales” or at auction. In other neighborhoods, foreclosure rates may be lower, but the risk of abandonment and negative spillover effects may actually be higher due to local housing market dynamics. In 2008, The Federal Reserve Bank of Boston created the REO Stabilization Opportunity Score (SOS) Index,



NSP is designed to allow local governments to tailor interventions to suburban or inner city neighborhoods.

designed to help local jurisdictions target their NSP dollars.⁷ Rather than focusing on foreclosure data, the SOS Index bases a large part of its score on the number and duration of REOs in a zip code, which may better reflect neighborhood need. REOs and long term vacancies are more likely to drive negative spillover effects than the foreclosures themselves. Comparing the two indices, the Federal Reserve Bank of Boston showed that depending on the index used, different neighborhoods were shown as being “high need” areas, thus suggesting that despite their efforts to target public dollars, NSP funding may not be going to the areas most in need of public subsidy.

Shaping Strategy: Tailoring NSP Strategies to Local Housing Market Conditions

Identifying areas with the highest need was only the first goal of the NSP targeting. Grantees were also encouraged to think about how their local housing market conditions would shape their interventions. In *Bringing Buildings Back*, Allan Mallach shows how the most effective neighborhood stabilization strategies are “solidly grounded in the realities of property ownership and economic conditions in the community” and “are linked to larger strategies to improve the neighborhoods in which abandonment is taking place.”⁸ Case studies of Cleveland and Los Angeles illustrate how NSP grantees incorporated this principle in their NSP plans.

Cleveland: Using Neighborhood Typologies to Shape NSP Investments

For Cleveland, the foreclosure crisis exacerbated a longstanding challenge of dealing with abandoned and

foreclosed properties. Well before NSP, government and nonprofit stakeholders had been working to establish a market typology of Cleveland’s neighborhoods to help determine where to target new investments, distinguishing between neighborhoods that could support new market activity from those where the residential housing market was so weak that investments would merely be “thrown down the drain.” Using indicators of housing market strength, the typology classified the neighborhoods within Cuyahoga County along a continuum of neighborhood types, including “Regional Choice,” “Stable,” “Transitional,” “Fragile,” and “Distressed.” Cleveland’s non-profit community then utilized this typology to help select model blocks within the city. These model blocks, located in transition, fragile, and/or distressed neighborhoods, were chosen because they demonstrated signs of potential market recovery and/or the presence of neighborhood assets, such as proximity to an anchor institution or unmet housing demand. The goal was to ensure that community development funding—such as HOME, CDBG, and LIHTC—would flow into areas that were high need, but that also demonstrated that they were able to support both public and private investment.

With NSP, the city used this same typology to determine its neighborhood stabilization strategy. By overlaying the HUD foreclosure and abandonment risk index with the Cleveland Neighborhood Market Typology, the city identified areas where foreclosure risks were high, and where the need and market potential overlapped. Using this matrix, Cleveland developed an NSP plan with multiple interventions targeted at each of the neighborhood types. For example, in areas where the HUD foreclosure and abandonment risk was high, but where the neighborhood market typology suggested that the market was too weak to support investment, the city decided to concentrate on demolition, land banking and interim uses of land. In contrast, in areas where HUD’s need index overlapped the city’s “model blocks,” Cleveland proposed to use NSP funds in combination with HOME, CDBG and LIHTC resources to acquire and redevelop homes and return them to productive use. In Stable and Regional Choice markets, the city decided to target the funding to the rehabilitation of properties, rather than invest in large-scale property acquisition, since in these neighborhoods there would most likely be homebuyer demand.

Los Angeles: Linking NSP to Local Housing Needs and Investments

From the outset of the foreclosure crisis, Mercedes Márquez, then the general manager of the Los Angeles Housing Department (LAHD), recognized that without targeting, the city’s \$17 million in NSP funds would not go far to stem the crisis. By September of 2008, more than

18,000 homes had gone into foreclosure in Los Angeles, covering an area larger than Manhattan, Cleveland, Detroit, and Chicago combined. To develop its strategy, the LAHD analyzed and mapped data from many sources, including: DataQuick Information Systems, HUD, Home Mortgage Disclosure Act (HMDA), U.S. Census, gang and crime violence data from the Los Angeles City Attorney's Office and the Police Department (LAPD). Representatives from LAHD also met with over 25 local organizations to help them understand where foreclosures were happening as well as the impact of those foreclosures on the neighborhood.

LA's index incorporated several data points, including the income level of the neighborhood, the incidence and percentage of foreclosed units, and the neighborhoods that had seen the greatest increases in crime. They also overlaid this with the HUD risk index and found significant overlap. The confluence of the above factors created clusters in Central, East and South Los Angeles and in the North and South Valley. In addition, the data showed that foreclosures in Los Angeles were a two-pronged problem: the city had to grapple with significant concentrations of multifamily foreclosures in South Los Angeles, a predominantly low-income, minority part of the city, as well as concentrations of foreclosed single-family homes in the San Fernando Valley. The data were also important in helping to build political support among city council members about the need for targeting interventions and avoided the problem of local infighting over which neighborhoods would get the most dollars.

The city then aligned these data with existing priorities, such as the preservation of affordable rental housing and transit-oriented development. Márquez noted that the guiding principle for developing LA's NSP plan was, "How many of our values can we hit with the same dollars?" The City thus developed a multi-pronged NSP strategy. First, using the infrastructure from its existing first-time homebuyer program, it implemented a direct to homeowner subsidy program, targeted at neighborhoods where there was an inventory of single family homes and continued unmet housing demand. The goal was to facilitate the purchase of homes without significant government intervention, relying instead on latent homebuyer demand. Unfortunately, several factors have limited the effectiveness of this component of the program. First, many of the foreclosed properties in NSP targeted neighborhoods were in much worse condition than initially anticipated, requiring rehabilitation investments beyond the limits of the Walk-In Program. In addition, the tightening of credit markets coupled with the recession both made it more

difficult for would-be borrowers to obtain mortgages, especially for properties needing significant rehabilitation after purchase.

More successful, however, has been the work of a newly created nonprofit, Restore Neighborhoods L.A. (RNLA), to acquire, rehabilitate and sell foreclosed properties. RNLA purchases both single-family and multifamily properties, and either sells them to first-time homebuyers or redevelops them into affordable rentals. By establishing a nonprofit—which is more agile and flexible and encounters fewer bureaucratic requirements than a city agency would when acquiring and transferring properties—Los Angeles has been able to be more effective in competing with investors for foreclosed homes (see article "When Investors Buy Up the Neighborhood"). RNLA also plays a significant role in rehabilitating properties, including bringing the unit up to code, incorporating environmentally responsible "green" building components, and "right-sizing" acquired properties to bring them in line with housing needs in Los Angeles; for example, many homes in South LA are two bedrooms with one bath, and many of the families that currently live there are much larger, reflecting the multi-generational household that is more common among Asian, African, and Latino populations. As of fourth quarter 2010, RNLA has purchased 94 properties totaling 182 units, including 61 single family homes and 121 units in multi-family properties.

Conclusion

Consistent with the underlying intent of NSP to give communities local control of stabilization funds, the case study cities of Cleveland and Los Angeles demonstrate that strategic responses must take local housing market conditions and regional context into account. In addition, both of the case studies above demonstrate how NSP grantees used local data in crafting responsive and appropriate community stabilization strategies. In the same way that geography of housing and mortgage markets played an integral role in the unfolding of the foreclosure crisis, they will also be key factors in NSP's success. At the end of 2010, more than 36,000 properties were either under construction or rehab as a result of NSP. While this is small in comparison to the total number of foreclosures, those 36,000 properties make up approximately 20 percent of the REO in NSP-targeted areas.⁹ Although more research is needed to truly understand neighborhood dynamics after the foreclosure crisis, past research would suggest that these investments will have a multiplier effect, spurring other private investment in these communities and helping to spark neighborhood recovery. **CI**

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