

Confronting the “Second Wave of the Tsunami”: Stabilizing Communities in the Wake of Foreclosures

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In July 2008, the Federal Reserve Bank of San Francisco convened a symposium in Los Angeles on the topic of stabilizing communities in the wake of foreclosures. The goal of the conference was to identify strategies that could help to mitigate the negative spillover effects of foreclosures on families and neighborhoods.¹ Frank Ford, a veteran community developer from Cleveland, caught everyone’s attention when he referred to the rise in real estate owned properties (REOs) as the “second wave of the tsunami.” With maps of Cleveland literally covered with dots of REOs, Ford graphically showed that communities no longer have to contend solely with the loss of assets and home ownership associated with foreclosure, but that they must now also confront the crime, neighborhood disinvestment, and loss of revenue associated with concentrations of vacant and abandoned properties. There was a collective recognition in the room that the current foreclosure crisis threatens to undo years, if not decades, of community investment.

Confronting this challenge will be far from easy. The current scale of the foreclosure crisis, coupled with an economic recession and the freezing up of credit markets, dwarfs previous efforts at property disposition (See article by Seidman and Jakabovics in this issue). There isn’t much of a road map for how to successfully redevelop the current wave of REOs, and the symposium highlighted that in the area of neighborhood stabilization there are still more questions than there are answers, and more innovative ideas than best practices. Most of the programs were still “in development” or a “small-scale pilot,” while others were “waiting to see what kinds of federal funds may be directed toward property acquisition.” Servicers at the symposium were still struggling with understanding their legal obligations under loan pooling and servicing agreements, and were resistant to talk about bulk sales or significant discounts on REO properties. Would federal funding for property acquisition come through? How do you value REO properties in a declining housing market? At the end of the symposium, participants were energized about the possibility of figuring out solutions to these challenges, but there was also a real sense that the community development field was being tasked to stop a tsunami with a sandbag.

Emerging Lessons

The field has come a long way in nine months. Importantly, Congress authorized \$3.92 billion in neighborhood stabilization grants as part of the 2008 Housing and Economic

¹ The Symposium was part of a Federal Reserve System initiative, *Recovery, Renewal, Rebuilding*, a series of forums held across the country in 2008 to share information about how communities are responding to the challenges associated with concentrated foreclosures. For more information, visit <http://www.stlouisfed.org/rrseries/>.

Recovery Act. Administered through the Community Development Block Grant (CDBG) program, the Neighborhood Stabilization Program (NSP) grants can be used to acquire land and property; to demolish or rehabilitate abandoned properties; and/or to offer down-payment and closing-cost assistance to low- to moderate-income home buyers. The American Recovery and Reinvestment Act of 2009 has further boosted funds for community development, including an additional \$2 billion for NSP, \$100 million in capital for qualified community development financial institutions, as well as new allocations for HOME, CDBG, and public housing. Hopes are high that these programs can be leveraged to help bolster community reinvestment, and that the administration's newly announced housing plan—which emphasizes homeownership affordability and encourages streamlined loan modifications—will work to prevent additional foreclosures.

In addition to federal funding to support neighborhood stabilization, since July 2008 the community development field has also increased its capacity to respond to concentrated foreclosures. Key among these developments has been the creation of the Neighborhood Stabilization Trust, a collaborative effort between NeighborWorks, Enterprise, LISC, and the Housing Partnership Network. (See article by Mary Tingerthal in this issue.) And in the field, as local governments and nonprofits develop and implement their NSP plans, some of the “innovative ideas” raised in panels last July are being tested on the ground.

While it is still too early to put a definitive stamp on what works and what doesn't, the experiences of municipalities across the country are starting to pave the way for a better understanding of how to approach neighborhood stabilization.² In reviewing these strategies, there appear to be three key lessons emerging across sites.

Using Data to Target Interventions

The first lesson is to use data to help identify where investments should be targeted. Granted, the challenge of accessing accurate and timely data on foreclosures is a formidable one. Data on foreclosures are notoriously difficult to work with: most of the data sources are proprietary, do not include important information about the borrower, loan terms, or servicer, and have imperfect coverage, particularly at the local level.

A few cities—most notably Cleveland and Minneapolis—have developed robust data management systems that collect detailed information on neighborhood-level foreclosures. These systems have been incredibly helpful in guiding foreclosure prevention efforts, and now form the foundation for understanding which areas to target for REO acquisition. In Cleveland, for example, the NEO CANDO system has allowed nonprofits to identify which properties are at risk for foreclosure and abandonment so that they can target that home for foreclosure prevention activities, including visits from nonprofit staff and the dissemination of financial literacy information. The data have also guided the development of Neighbor-

2 For an excellent review of the issues associated with foreclosed properties and neighborhood stabilization, see Josiah Madar, Vicki Been, and Amy Armstrong. “Transforming Foreclosed Properties into Community Assets,” NYU Furman Center for Real Estate and Urban Policy White Paper, December 2008.

hood Progress Inc.'s Strategic Investment Initiative, which focuses on the comprehensive redevelopment of six "model" neighborhood blocks, and targets those blocks with a wide range of interventions including foreclosure prevention, land assembly, demolition, acquisition and rehab, and home and landscaping improvements.³

For the rest of us who do not have access to these Cadillac data systems, however, there is still a lot that can be learned from existing information, even if it isn't perfect. For example, neighborhoods with a high proportion of higher priced loans in 2004 and 2005 are almost certainly neighborhoods that are now dealing with concentrated foreclosures; these HMDA data are publicly available and easily accessed through dataplace.org. Aligning these data with Census data on race and/or income can help to define priorities associated with racial or socio-economic equity. In addition, there are also many local sources of information that can help to identify neighborhoods at risk of the negative effects of foreclosure. Local real estate agents can provide important insights about which neighborhoods are still attracting new buyers, utility companies can provide information on the number of properties shutting off their water or electricity, or a local nonprofit may help to shed light on which immigrant communities have been affected based on who is seeking out foreclosure prevention counseling. In addition, some of the best NSP plans integrate these new federal funds with existing priorities or investments, such as aligning NSP target neighborhoods with city redevelopment areas.

The City of Los Angeles provides a compelling example of how the strategic use of data can help to guide a comprehensive strategy for neighborhood stabilization as well as build political support for the strategic use of resources. Mercedes Márquez, the general manager of the Los Angeles Housing Department, recognized early on that the strategic use of data was critical to developing targeted interventions in Los Angeles, a city larger in size than Boston, Cleveland, St. Louis, Pittsburgh, Minneapolis, Milwaukee, San Francisco, and Manhattan combined. Using data obtained relatively inexpensively from DataQuick, they learned 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 city then aligned these data with existing priorities, such as the preservation of affordable rental housing and transit-oriented development. The result: a strategy that targets NSP investments in a way that supports these other goals.⁴ Márquez notes that the guiding principle for developing their NSP plan was, "How many of our values can we hit with the same dollars?" 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 who and where would get the most NSP dollars.

In all of this, the foreclosure data were only a small part of L.A.'s analysis. Perhaps more

3 For more information, see <http://www.stablecommunities.org/node/1489>.

4 Mercedes Márquez, "Models of Vacant Property Disposition: Los Angeles Housing Department," presented at *Confronting the Neighborhood Impacts of Foreclosure Conference*, Federal Reserve Board, Washington, D.C., October 20, 2008. Available at http://www.stlouisfed.org/rrseries/event_5.html.

important were the answers to questions like “Where do we want to preserve affordable multi-family rentals? Does the existing single-family-housing stock (small, two-bedroom/one-bath homes) meet the needs of current families, or should we use this as an opportunity to “resize” foreclosed homes? Where can we complement our existing investments in transit-oriented development? Where will prospective home buyers be able to “cherry pick” high quality foreclosed properties, so all we need to do is provide some down-payment assistance?” It was the answers to these questions that allowed the city of Los Angeles to develop a strategy for foreclosed properties that was responsive to the market forces affecting its neighborhoods.

Cross-Sectoral Collaboration

If data are critical to developing effective interventions, so is the establishment of a local collaborative or task force that brings together a wide range of stakeholders, from nonprofits, researchers, and state and local governments, to real estate agents, servicers, and lending institutions. The scale of the foreclosure problem, coupled with the complexity of acquiring, rehabbing, and selling REO properties, means that it is impossible for any one entity to take on the task alone.

Take, for example, the role of the servicer in REO disposition strategies: lenders and servicers control the information about the REO inventory, are responsible for REO property maintenance and upkeep, and determine the REO sales price on behalf of the properties’ investors. Many of the large servicers are participating in the National Stabilization Trust’s “First Look” and “Bulk Purchase” programs, yet there is still a need to engage local servicers and CRA officers in the development of neighborhood stabilization strategies. Heidi Coppola, formerly of Citibank, notes that local servicers and bankers are often more knowledgeable about local market conditions than national REO units, and as a result can be an important ally to nonprofits in negotiating discounted sales that make sense for both the community and the investors. CRA officers in particular can also be important partners in providing end-loan financing once the acquired REOs are ready for resale to newly qualified home owners.

In Massachusetts, a statewide task force initiated by the Urban Land Institute and the Massachusetts Association of CDCs was critical in helping to develop a multipronged approach to foreclosures in the state.⁵ By building on the strengths of multiple partners, the task force was able to develop local models for neighborhood stabilization and helped to build political support for a \$20 million revolving loan fund for property acquisition. (See article by Prabal Chakrabarti in this issue.) At the symposium, Rebecca Regan, COO of Boston Community Capital, said that the Massachusetts Task Force has been effective because it has tackled the problem from all directions, including foreclosure prevention,

5 Prabal Chakrabarti, “Foreclosed Properties in Massachusetts: Early Responses,” presented at *Confronting the Neighborhood Impacts of Foreclosure Conference*, Federal Reserve Board, Washington, DC, October 20, 2008. Available online at http://www.stlouisfed.org/rrrseries/event_5.html.

code enforcement and vacant-property ordinances (the “stick” that can help bring servicers to the table), data collection and dissemination to community groups, and models for property acquisition and disposition.

While nonprofits and servicers/lenders are clearly key partners in neighborhood stabilization efforts, other groups can also play an important role in delivering services and helping to fill in gaps in capacity. For example, in Colorado, Funding Partners for Housing Solutions has been working with the housing authority on its strategy to stabilize communities. The housing authority has the experience of managing scattered-site rental housing and also has connections to the social services residents will need to get back on a path to financial stability. Mission-oriented real estate brokers can help to connect prequalified home buyers with foreclosed and REO properties with minimal public investment. In other cities, NSP plans rely on engaging private developers for acquisition and redevelopment, paying a developer incentive fee once the home is sold to a qualified home buyer.

Leverage Multiple Sources of Funding

The third lesson is to leverage public funding and to use it effectively. After all, let’s be honest; while the NSP funds are a welcome addition to local neighborhood stabilization efforts, even now with \$5.92 billion allocated to NSP, this level of funding is a drop in the bucket. Mercedes Márquez puts Los Angeles’ NSP allocation in perspective: the \$33 million that L.A. received is probably just about enough to turn around 150 properties, yet in September 2008 the city had more than 18,000 units in foreclosure.

Several neighborhood stabilization strategies, therefore, are drawing in other sources of funding to make acquisition and redevelopment possible, including HOME funding, Lead Abatement Grants, FHA’s 203(k) program, and local private investment or revolving loan funds. Washington, DC, and Columbus, Ohio, are both making use of New Markets Tax Credits to redevelop areas affected by foreclosures. (See article by Anna Steiger in this issue.) In New York, the city is supplementing its NSP grant with \$6 million from the Battery Park City Authority Housing Trust Fund.⁶

Floyd Gardner of NHS Chicago also provided an important word of caution: nonprofits should not underestimate the carrying costs of holding properties either, particularly in the current climate of declining property values and tightened credit availability. Under these conditions, it may be difficult to find willing and able buyers, and nonprofits may face the need to find additional subsidies or offer deeper discounts to sell the rehabbed homes. In light of this, many groups are exploring other disposition strategies, such as Self Help’s lease-to-purchase model, that do not rely on quickly finding new home-owners.⁷

6 See <http://www.innovations.harvard.edu/news/144041.html>.

7 See *Self-Help: National Initiative to Bring Lease Purchase to Scale, Secondary Market Initiative to Help Absorb Excess Inventory*, available at <http://www.stablecommunities.org/node/450>.

Effectively Valuing REO Properties

Ultimately, one of the most important factors that will influence the success of NSP and other community stabilization efforts is the ability to negotiate sufficiently discounted house prices to make the acquisition and redevelopment of REOs into affordable housing feasible. At the San Francisco Fed conference in July 2008, many participants noted that a key challenge was negotiating house values: declining property values and servicers' obligation to sell the property at the highest value to meet investor contracts constrained the ability to determine a fair price for REOs. Since the symposium, one of the key innovations has been the development of a model that helps to determine the "net realizable value" of REO properties, which attempts to capture the "current" market value minus the costs of disposition (including the holding costs of insurance, real estate taxes, maintenance, transaction costs, rehab costs required for code compliance, and marketing).⁸ While posing its own challenges, this approach may bring seller prices closer to what nonprofits may be able to pay based on program feasibility (e.g., rental income, affordability for low- and moderate-income home buyers).

Conclusions

While these emerging lessons provide a framework for neighborhood stabilization, many questions remain unanswered. For example, what are the right policy responses in the "boomburbs" of cities like Atlanta, Stockton, Phoenix, and Las Vegas? (See article by Dan Immergluck in this issue.) What are the best ways to leverage NSP funds in communities that have less infrastructure or experience related to housing or community development strategies? What will be the impact on communities if the bulk of REOs are swept up by investors rather than home owners? And can the community development field—which even in the best scenarios may be able to redevelop only a fraction of the growing REO inventory—really have much of an impact? Ultimately, the answer to that question may depend on whether or not the NSP program is a one-time federal investment that may make a difference on the margins, or whether it represents the first step in a much more concerted and longer-term effort to bring reinvestment and responsible lending back into low- and moderate-income communities.

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8 Charles Laven, "Pricing and Valuation of Vacant Properties: Developing a Neighborhood Stabilization Approach," presented at *Confronting the Neighborhood Impacts of Foreclosure Conference*, Federal Reserve Board, Washington, DC, October 20, 2008. Available online at http://www.stlouisfed.org/rrrseries/event_5.html.