REO & Vacant Properties: Strategies for Neighborhood Stabilization, September 1, 2010
Opening Remarks: Elizabeth Duke

Elizabeth Duke:
Good morning, and let me add my welcome to the Federal Reserve Board for this two-day summit to examine the problems associated with vacant and abandoned property and to explore innovative approaches to neighborhood stabilization.

We are certain to have an informative and thoughtful discussion of these issues as our agenda is full of experts, including Shaun Donovan, Secretary for the Department of Housing and Urban Development, who will deliver a keynote address.

Like you, I am anxious to get started. But before I begin, I would like to recognize and thank the speakers and panelists that we'll hear from during the conference. I would also like to acknowledge those who contributed to the new volume of papers the Federal Reserve published in conjunction with this event. Many of our panelists contributed to the volume, and their articles give us a look at the issue from every angle, provide great insight, and offer promising solutions. I would also note that a number of participants and contributors are current or former members of the Federal Reserve Consumer Advisory Council. The CAC has been instrumental in furthering our understanding of emerging consumer and community issues, including the topic that brings us together today. Finally, I would like to thank the Federal Reserve staff that have worked tirelessly on this project.

When it became apparent in 2007 that foreclosures were reaching epidemic levels in cities nationwide, the first priority of many community organizations and their public and private partners was to identify ways to mitigate the impact of foreclosure on individual homeowners and their families. To assist in these efforts, the Federal Reserve deployed a number of resources. We developed tools for community organizations to use in identifying areas with high default rates so that they could then target their counseling resources effectively. We helped to organize many foreclosure assistance fairs that brought lenders, counselors, and other resources to individual borrowers. We created foreclosure toolkits for communities. We launched a public information campaign to warn consumers about foreclosure rescue scams.
Despite these and other efforts to help mitigate foreclosures, however, we also recognized that many homeowners would not be able to remain in their homes and that, in time, the community development field would need to turn its attention to the impact of vacant and abandoned properties on communities. While foreclosure mitigation focuses on the risk to individual homeowners, neighborhood stabilization focuses on the impact of foreclosures on others--the neighbors, communities, and municipalities that share the consequences of foreclosure.

We were pleased to be able to support early efforts by NeighborWorks America to educate community development practitioners and public officials on issues related to neighborhood stabilization. Under this partnership, NeighborWorks launched a website, stablecommunities.org, to provide community leaders with the latest information and resources on neighborhood stabilization. In addition, NeighborWorks developed three new learning courses on stabilization strategies that are offered nationwide through NeighborWorks' Training Institute as well as in place-based training settings.

The Federal Reserve also hosted a series of forums in 2008 entitled, “Recovery, Renewal, Rebuilding: A Federal Reserve System Foreclosure Conference Series.” The series highlighted strategies and best practices for addressing foreclosures in both strong and weak market cities. These forums were part of a larger initiative to integrate the Federal Reserve's research and outreach resources in addressing the foreclosure crisis. This integration improved our ability to identify problems and highlight potential solutions--an effort that continues today with this summit and its accompanying publication.

Most recently, we worked with the other federal financial regulatory agencies to propose amendments to the regulations implementing the Community Reinvestment Act. The proposed amendments provide incentives for banks to participate in community stabilization activities in areas designated as eligible for funds under the Neighborhood Stabilization Program authorized by Congress.

I would like to take a few minutes to introduce the types of issues that are faced by communities with high rates of foreclosure and REO, and to discuss the gravity of the problem. I will also highlight some of the lessons we have learned in the last few years about effective neighborhood stabilization strategies, lessons that will be discussed in much greater detail through the course of this meeting.

Yvonne Means, a 74-year old resident of the southeast side of Cleveland, was recently interviewed for a National Public Radio story on that city's efforts to combat the effects of foreclosure on its neighborhoods. Her story was a familiar one: foreclosed homes on her street are vacant and in disrepair, lawns are uncut, and weeds are taking over. Her home, appraised at $70,000 in 2004, was recently valued at $50,000, a nearly 30 percent drop in value. The loss of equity due to neighboring foreclosures represents a very real concern for homeowners, particularly older homeowners who might have expected that home equity would serve as a cushion in retirement. But interestingly, Yvonne Means wasn't focused on her financial loss nearly as much as she was her social loss. Ms. Means told the interviewer that she no longer invites friends over to her home because of her embarrassment about the condition of her street.

I have visited the southeast side of Cleveland and have seen first-hand the challenges faced by homeowners. There is a large inventory of homes that have gone through the foreclosure process and are now owned by financial institutions. That’s why these properties are often referred to as REO, or "real estate owned," which is how they are recorded on bank balance sheets.

Our conference publication includes an article by Frank Ford, of Cleveland-based Neighborhood Progress, Inc., that paints a very troubling picture of the impact of a large number of foreclosures in a once vibrant community. Ford estimates that every blighted house in Cleveland can negatively impact five or six other houses near it. Homeowners in close proximity to foreclosures experience even greater losses in value than the general price declines that occur as a market absorbs a large number of distressed sales. With an estimated 11,500 vacant houses in Cleveland, Ford calculates that some 60,000 occupied homes will likely be impacted.1 Even worse, he explains, is that losses don't stop at home equity: tax revenues decline and along with them the financial support necessary to provide for public schools, police, fire, and social services. Neighborhoods that were once vibrant have, in many cases, become blighted, and the necessary resources to address the problem are scarce.

The challenges associated with REO are not exclusive to older cities, such as Cleveland or Detroit, where economic forces have long threatened the sustainability of large infrastructures that support fewer residents. Carolina Reid, of the Federal Reserve Bank of San Francisco, has written an article that describes how formerly thriving subdivisions outside of larger metropolitan areas, once known as "boomburbs," are now suffering some of the highest rates of foreclosure and subsequent REO inventories. These communities are often so new that they do not have the community development infrastructure to address the impact of the large volume of REO properties. While REO properties in these relatively strong markets are more attractive to investors, the nature of these communities may change dramatically without the opportunity for local government to direct--or even prepare for--those changes.

To make matters even more challenging, potential REO inventories may be larger than the current inventory numbers indicate. The Brooking Institution's Alan Mallach provides us with an article that focuses on the growing number of properties that are delinquent or in the foreclosure process, but have not yet entered the market as REO. This "shadow inventory" threatens to continue the downward pressure on housing prices and further destabilizes communities. On a more positive note, however, Mallach contends that the neighborhood impact of REO properties can be mitigated if the subsequent owners have a long-term interest. He points out that the community impact of an REO property purchased by an individual homebuyer is barely noticeable. Moreover, purchases by investors that plan to buy and hold the property for the long term can have positive outcomes for neighborhoods. Finally, Mallach asserts that local governments are not powerless to limit the destructive impact of speculative investors. Rather, he argues, they can influence investor behavior through the use of regulatory tools, such as licensing and inspections, to promote stability.

The challenges faced by communities with large inventories of REO and vacant property will not be resolved overnight. What began as a problem rooted in poorly underwritten loans has been exacerbated by high unemployment and slow economic growth. As delinquencies and foreclosures continue to grow, they will hinder the ability of communities to heal and ultimately to thrive. So it only makes sense that we focus our research, data analysis, outreach, and community development expertise on better understanding the market dynamics of the communities impacted by foreclosures and identify solutions to help speed their recovery.

This summit brings together people who have been on the front lines of addressing vacant and abandoned properties throughout this crisis--local government officials, community development practitioners, lenders, servicers, and researchers--to share their experiences for the common good. Thanks to the work of Community Affairs staff at the Boston and Cleveland Reserve Banks and here at the Board, we have been able to document many of these lessons in the conference publication. And while I don't want to spoil the plot, I do want to use the remainder of my time to preview some of the most important lessons about community stabilization.

First, we have learned that effective interventions emerge when there is a full understanding of mortgage markets, their dynamics, and incentives. Several articles describe the steep learning curve that policymakers have navigated in order to effectively implement the NSP created by Congress and to utilize the $6 billion in funds made available through the first two rounds of the program. These funds were provided to help stabilize neighborhoods through the acquisition, rehabilitation, financing, demolition, and land banking of properties that are blighting communities. While the NSP funds were intended to provide an aggressive response to the forces destabilizing communities, time limits, such as the requirement that grantees obligate funds within 18 months, often underestimated the time needed to navigate the property disposition process, especially when paired with the myriad other requirements and limitations on uses of the funds.

The complexities of the secondary mortgage market have made it difficult for local governments and community organizations to ascertain who owns a particular property, much less arrange for its purchase in a timely way. The pooling of mortgages in securities further complicates the process, making it difficult for municipalities to acquire one or two properties among many. Several articles in our publication discuss the challenges of using NSP funds, particularly in a competitive environment where investors have the resources to purchase properties in bulk without the constraints related to neighborhood stabilization plans.

Craig Nickerson's article, for example, describes the efforts of the National Community Stabilization Trust, which was established to create local capacity so that communities could effectively acquire, manage, rehabilitate, and sell foreclosed properties. Despite a slow start, NCST now has transactional expertise, development infrastructure, asset management skills, land banking approaches, and the comprehensive planning necessary to effectively utilize NSP funds for REO acquisition. I also commend the article by Terry Theologides, which serves as a primer on servicing arrangements, the fiduciary relationship between servicers and investors, and the imbedded incentives that drive servicer decision-making. It is a cogent explanation of a complex set of relationships that are key to better understanding and negotiating the intricacies of REO acquisition.

The second important lesson learned in working with communities to effectively put NSP dollars to work is that good data are necessary to target scarce resources. The funds provided under NSP, while substantial, are not nearly sufficient to tackle the entire inventory of vacant and abandoned homes. But the strategic use of these funds can help to stabilize individual neighborhoods. In his article, Ira Goldstein emphasizes the difference between stabilizing neighborhoods and impacting individual properties. He describes a data-based tool developed by the Reinvestment Fund to characterize the underlying dynamics of local real estate markets. Their Market Value Analysis is focused on a set of indicators drawn from local administrative records and third-party data sources. Indicators include such things as median sales price, number of sales as a percent of housing units, foreclosure filings as a percentage of sales, percentage of commercial properties, percentage of tax abated properties or newly constructed properties, percentage of owner-occupied properties, and residential vacancy rates. Data such as these are analyzed on a census tract basis, making them small enough to capture slight variations in community character but large enough to be reliably aggregated for mapping and statistical analysis.

Using such analysis, communities can more effectively decide where NSP funds will have the greatest impact. For example, using Philadelphia data, Goldstein begins by identifying neighborhoods that are eligible for use of NSP funds. He further calculates the percentage of foreclosures in each neighborhood that could be addressed using NSP funds. He argues that, from the standpoint of neighborhood stabilization, the best use of funds is in neighborhoods where there is the intersection of one, a demonstrated need combined with the ability to impact a significant fraction of foreclosures, two, the absence of other significant barriers to revitalization, and three, the presence of additional strengthening factors, such as the strength of surrounding neighborhoods. Combining indicators-of-need with indicators-of-probable-success within data-driven analytical tools can help communities strategically invest scarce dollars to build on community strengths and remove barriers to community success. This approach also helps communities to leverage other funding in the context of a larger community stabilization plan.

Data-based decision-making is not as easy as it sounds. In fact, the third lesson we have learned is that we need to use technology to create better decision-making tools to assist communities. Claudia Colton, Michael Schramm, and April Hirsh describe Case Western University's work to support community organizations by providing critical data and information to help them determine which properties are priorities for acquisition and rehabilitation, keep abreast of current property conditions, and monitor issues as they arise. This means keeping up-to-date records of foreclosures, sheriff's sales, and the REO status of properties, as well as gathering information on vacancies and tax delinquencies that can serve as a proxy for identifying properties that may be falling into delinquency. These researchers are also using technology to develop tools to help communities strategically invest in areas with significant needs, but also great potential. Moreover, they recognize the need for tools to help community organizations monitor the ongoing conditions in their neighborhoods so that they can anticipate and plan for bumps along the road to recovery.

The partnership between Case Western and its Cleveland community partners is a fine example of the fourth lesson we have learned from this crisis: the need to collaborate in new ways in order to develop a comprehensive approach to neighborhood stabilization efforts. Researchers from Case Western are part of a Neighborhood Stabilization Team that meets monthly to exchange information on the status of particular properties and discuss intervention strategies. The conference publication is replete with examples of local collaborations that have successfully addressed neighborhood stabilization issues through partnerships between federal, state, and local governments, community organizations, lenders, servicers, universities, foundations, and others. Moreover, the most promising initiatives that you'll be hearing about over the next two days take a comprehensive view of community development.

It is not sufficient, given current economic conditions and the significant needs of our neighborhoods, to do things the way we have always done them. Homeownership, long promoted by federal policy and facilitated by local housing organizations, cannot and should not be the only alternative for REO properties. Indeed, redevelopment strategies profiled in the conference publication. They include rental housing, lease-purchase, and even converting owners to renters to avoid vacancies. Including rental options among the mix of stabilization strategies makes particular sense at a time of high unemployment. Even in the best of times, homeownership limits mobility in the labor market.

Today's summit and companion publication also highlight several promising models of "non-redevelopment" to stabilize communities, such as simple code enforcement, land banking, and demolition. The scale of the problem is such that communities must consider a variety of strategies to repurpose REO properties within the context of a comprehensive plan that addresses a variety of community needs. Only in this way will our neighborhoods be restored to health and vitality.

This brings me back to Yvonne Means and her street in Cleveland. Her plight illustrates that while it is important to avoid foreclosures whenever possible, it is equally important to pay attention to the properties that despite everyone's best efforts will end up in foreclosure, or worse, will become vacant and abandoned with no one even willing to take responsibility through foreclosure. We owe it to Yvonne Means and others like her to work to repair the financial and social damage, and restore services to the remaining homeowners in communities with high rates of vacancy and foreclosure. The problems caused by foreclosure are not solved until properties are restored to responsible ownership and occupied by families who call them home. Neighborhood stabilization is not just sound economic policy, it's rooted in a vision of our shared future, our sense of community.

In conclusion, I want to thank you for being here and especially for your work to promote neighborhood stabilization. The program today is certainly not the end of this project. I am pleased to say that, as a follow-up to this summit, the Federal Reserve and NeighborWorks will be working together to provide technical workshops for communities as they implement some of the strategies identified here. As of now, we have scheduled workshops in Providence, Rhode Island, and Cleveland, Ohio, this fall and plans are underway to schedule similar workshops on the West Coast. I look forward to your participation and feedback today and to new partnerships going forward as we continue to identify ways to streamline the process of repurposing REO and to address the community development needs of neighborhoods that have been harmed by foreclosures.

Thank you.