

REO and Vacant Properties: Strategies for Neighborhood Stabilization, September 2, 2010
Reserve Bank President Perspective: Eric Rosengren

[Applause.]

Eric Rosengren:

Well I'd like to join Sandy in thanking everyone for being here for a two-day conference at a time that I think is very important. Many of us know that the communities we are looking at are still suffering, and many communities are still going in the wrong direction. Housing has played a central role in this crisis – the financial crisis we have been living, the economic crisis we have been living through for the past few years. I want to pick up on a couple of themes Sandy highlighted. One of the advantages of getting people together from around the country to talk about these issues is that we can learn from both the successes in places, but also the failures because part of it is learning what not to do as well as what we should do in order to address this problem. The fact that the problem has gotten worse I think there is some uniqueness to the various markets. Sandy has highlighted the Cleveland situation where they're facing the declining population. Well, declining population with the demographics of Cleveland may recommend a certain type of solution that may be different than what we would use in New England where we don't have a declining population, but have a series of other problems. And a New England solution might not be the right solution for San Diego that may be experiencing a growing population over time. So I think one of the important things that we're going to get out of this conference is that we do have to look at this in our unique markets and that up one size may not fit all. We don't want to make the same mistakes. We want to learn from other regions, but we want to think about what is the appropriate tools we want to bring to the markets we're actually involved in.

If you're at the edges, you may want to get so you can see the Power Point because I'm going to follow through a Power Point. So when I was first asked by Richard to participate in this conference, I sat back. The focus was REO. But I wanted to ask the question, is this a housing problem? Is this a foreclosure or REO problem, or is this a community problem? And, when I sat back and looked at the program and agenda and various nonprofit organizations that are involved today, I started by asking what are the key words in the names of the organizations participating in this conference. Hopefully, when you're a nonprofit organization, you're not randomly picking your name. You're picking your name because you actually want to talk about what your central mission is. Your central mission highlights to possible donors what it is you're going to focus on. It also highlights to the community you're serving what you're going to focus on. And it highlights to the people who are working for your organization what your central mission is. So I think we do learn something by the types of organization -- you also haven't been randomly selected to be on this program. You're on this program because we think you have interesting ideas for solutions. So what were the key words that came out when I looked at the organizations that were nonprofit on this program? Community or neighborhood for five organizations, housing for two, and foreclosure or REO, 1. I actually think that ranking seems about right in terms of how we should be thinking about our policy responses. But I would highlight that I'm not sure our policy dollars are going in that same order. And so that's something that I want to address as we talk through the rest of this presentation and hopefully as we think about some of the solutions that are being proposed over the course of this morning.

Now the reason I started with that is I think the way you frame the problem is really important. One of the things we learned from behavioral economics is if you don't ask the right question you're not going to get the right answer. So let's start with my initial question. If it's a foreclosure problem, what kind of solutions am I going to be looking for for a foreclosure or an REO problem? The types of problems I'm going to be looking at are more legalistic in their framework. I'm going to be asking how does the bankruptcy code work? How does the foreclosure process work? What can I do to mitigate the foreclosure problem? So that question centralizes a certain set of answers. If I think it's a housing problem, I may address it in a different way. I may ask what is a sustainable financing model? Am I worried about predatory lending? Am I worried about underwriting standards? Am I worried about getting education to people who are going to be first time home buyers? I'm going to be asking myself what is sustainable homeownership? What does that mean, and how do I make that happen? If instead I say it's a community problem, then I may be wanting to take a more holistic approach. One size may not fit all. But I need to think about it in the context of the problems that are facing that community. For that, I may want to have more flexible financing. I may want to have revenue sharing at the state or at the federal level. And I may want to focus on those communities that have been most affected, that have clusters of REO problems, but more than likely -- at least in New England -- have clusters of other problems as well. Now clearly all three of those are part of the problem. This is a foreclosure problem and an REO problem. This is a housing problem. And this is a community problem.

So how do we think about the right way to allocate our resources given that you might come up with different solutions depending on how you frame the question? And so I'm going to talk a little bit more about whether we're putting the appropriate funding into thinking about community. Many of your names highlight that you're looking for community solution. You may be dealing with a housing problem and a foreclosure problem, but you're also thinking about a community problem. So how should we be thinking about funding that, and how should we be funding that?

So as I ask the question, P, Prival and Richard know when they ask me to speak, I start asking for data. And it tends to moderate how many times I get asked to speak as a result, which has positive attributes to it. But I think it is useful to look at the data. And I'm going to look at some of the data from New England. So this first chart looks at two things. It looks at the change in housing prices from 2005 to 2008. And it looks at the real estate owned per square mile. Now, if what I do is I -- if you block off with my body here, before and below, you can see the circles that are empty in the middle are not particularly correlated. If instead I block it out and do the ones that are for more REO that are the circles that are fully filled in, you can see that it actually fits the data reasonably well. This is a correlation, not a causation. And what it does highlight is those communities that have much more REO per square mile also have been communities that have had very substantial declines in housing prices. Now, we don't know if that's because the communities already had a lot of difficulties and REO is symptomatic of that, or whether REO actually contributes to the problem and makes that situation worse and actually makes the prices decline. I think unfortunately we're getting enough panel data now. That's one of the things I'm encouraging both community affairs and research department to think about the correlation a little more and get a better understanding of what the interaction is and which way the arrows go

and what that implies for potential solutions. Now, the reason that you'd worry about the causation is in -- at least in New England -- those places that have four or more REOs per square mile actually have a lot of other problems as well. So this first slide documents some of those other problems. For communities that have four or more REOs per square mile, they have a lot more property crime. They have a lot more low weight births, they have higher unemployment rates and they have declines in small business with 9 or fewer employees relative to those other communities. So there is a difference between these communities. These aren't randomly picked communities. It does highlight that you're not only dealing with REO problems you're dealing with many other problems in many communities. This provides a couple more indicators. If you look at the top, it looks at education. The reason I want to highlight education is I think it's something that's sometimes lost in this debate and, as I was reading through the various papers, children are very rarely mentioned in many of our papers. But children are one of the main aspects of the collateral damage that's occurred through this foreclosure problem, and I think it's something we need to look at. Both in the previous data and this data, it's looking at what's happening prior to the crisis occurring. So this isn't after the crisis or during the crisis. The time periods before the crisis. You can see that the high school dropout rate was far greater for those areas that had 4 or more REOs eventually relative to those who are less, and the students who failed the Massachusetts standardized statewide math tests were much higher. It is not surprising at all to me that children are a central part of the problem. There's a lot of sociological studies that highlighted that children who have to move frequently, frequently also have educational issues keeping up. Well, the one thing that a foreclosure is a movement of a house. It may be a movement to another school. It may be a movement to a homeless shelter. It may be a movement to the back seat of a car. It is very difficult for somebody in that kind of environment to be able to keep up educationally. That means it's a problem not only for that year but it's potentially an effect for those children in those communities. It's important to get a better understanding of some of the collateral damage that's occurring in those crises and how it affects our children and how it affects our communities more broadly. If you look at the bottom chart, what this looks at is a fiscal gap. We're looking at state revenue sharing in the state of Massachusetts. My guess it's not unique to Massachusetts, but we've done a study at the Boston Fed and what we've looked at is the needs of communities their ability to raise funds in those communities. And that's what we're calling the fiscal gap. And what a study Boston Fed showed was those communities who had the most need and least capacity were not getting their fair share of the financing from the state. My guess is it's not unique to Massachusetts. Many of our revenue sharing formulas don't get at where the sources of the problem are, and it may my light that our federal dollars may not be spent in the right way to get to the right communities. Something else I think we have to address over time. You can see the fiscal gap between those with four or more REOs is much, much greater than those communities with less than 4 REOs.

So next, I want to go through a series of charts. I'm going to go through them very quickly since we're short on time. But I think they'll give you a visual image of what's happening in these communities. So this first chart looks at where are the concentration of REO properties. Blue is bad, green is good. If somebody wants to sell you waterfront property in the Boston area, this highlights you might ask a few more questions. Because clearly those waterfront properties are in areas that have four or more REOs. So just as you think of this image, let me go through some of the other problems affecting these communities. So this is prevalence of crime. You see many of the same communities highlighted. You look at high school dropout rate. It's many of

the same communities affected. You look at the percent of students who failed statewide tests. Many same communities affected. You look at the fiscal gap. These communities are not getting their fair share of municipal revenues from the state. It highlights we're not getting it addressed and it is a very, very severe problem.

So observations on policy and research. Clusters of REO do seem to be associated with depressed home prices. Areas that have four or more REO also have a host of other community problems. We have to understand what the causation is. I think that causality is an important research topic and also an important topic for understanding how we spend our policy dollars. But I think it also highlights in many of our communities -- this is only using New England data so it could be different than Cleveland data -- is that we need a more holistic approach. If you deal with this as a housing or foreclosure problem but you don't deal with the crime or schools or all the other problems that these communities are facing, you're not likely to be solving the problem because the foreclosure problem and REO problem may be a symptom of other problems in that community.

So I think we need more funding for holistic solutions. That may imply revenue sharing in a way that gets the money to affected communities that most need it. I think we need more research such as the research that the Cleveland Fed is doing on what are holistic solutions that work. It's much easier to send dollars toward a foreclosure problem or a housing problem. If it's a community problem, that's not as easy to solve. But it does say some communities may want different solutions. Some communities might want to focus on public safety as the main concern. Others might want to focus on schools. Others might want to focus on declining populations and vacant properties. I don't think one size fits all. Many of our public policies are one size fits all. We need to find a way to tailor our spending to the kinds of problems we're facing. As I highlighted in this talk, I think at least in Massachusetts, there's a lot of question of whether we're getting the funding to the communities that most need it and have the least capacity to address it. On going research at Boston Fed is going to look at collateral problems that are occurring from this crisis, including problems from our children that may have a more permanent impact. Those are some of the things I've been thinking about. I'm looking forward to hearing about some of the things around the country and on the course of the panels today. This is a very exciting time, a very important time to be working on these set of problems.