

**In the Wake of the Foreclosure Crisis:  
Targeting Neighborhood Stabilization Funds**

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While many of the papers at this conference focused on rebuilding the housing finance system and the macro housing market, our focus is on rebuilding neighborhoods, or very local markets. Specifically, we explore how the federal, state, and local governments might practically apply principles of efficient and equitable planning, evidence based policymaking, and fair housing in targeting federal funds for neighborhood revitalization and recovery. Researchers commonly advocate such principles but rarely explain how they might be applied in practice. We take up this challenge in the context of the foreclosure crisis, offering a set of recommendations for how federal, state and local governments might target neighborhood stabilization funds, or funds designed to help communities address the problem of vacant and abandoned foreclosed homes. Given the magnitude of the problem, and the limited resources available, government officials will be forced to make some hard choices about which communities should receive assistance. We maintain that those officials should be explicit and strategic about those choices.

Many economists might counter that the government should not be spending any resources on such place-based efforts to help markets recover; because such investments are distortionary and may only serve to increase land prices. We agree entirely that the most effective path to neighborhood stabilization is preventing foreclosures and helping at-risk borrowers and tenants stay in their homes. However, many neighborhoods have already suffered property value declines, instability, and deterioration because of foreclosures, and there will continue to be strong political pressure to provide support to

help rebuild these areas. Put simply, place-based, neighborhood stabilization programs will continue to exist; our aim is to offer some guidance in how to target them.

### General Principles for Targeting

In his companion paper, Raphael Bostic offers some useful, broad recommendations for urban policy related to neighborhoods. We supplement and adapt these to come up with our own list of six principles for targeting neighborhood revitalization efforts (four of which hold for all levels of government and two of which apply to federal government only):

#### *Principles for All Levels of Government:*

- *Concentrate efforts in particular areas to yield maximum total benefit*
- *Support environmentally sustainable investments*
- *Avoid exacerbating segregation and poverty concentration*
- *Leverage private dollars*

#### *Additional Principles for Federal Spending:*

- *Encourage coordination with broader regional policies*
- *Incentivize sound local planning practices*

While these principles may not be terribly controversial in the abstract, it's useful to spend some time justifying and explaining them, because they are often contested as applied to particular programs, and may sometimes point in opposite directions. In terms of concentrating efforts, state and local governments too often spread federal dollars

widely around their communities (Phillips and White, 2008). Despite the political expediency of giving all eligible communities some aid, in a world of limited resources, spreading dollars around will lead to investments that are likely to be far too small to address the underlying blight in most areas. Thus, localities should instead strategically target a few neighborhoods for assistance and concentrate investments in the communities where they will yield the maximum benefit.

As for environmental sustainability, there is growing evidence that housing construction and land use patterns significantly affect the nation's energy consumption and environmental quality (Glaeser and Kahn, 2008; Schauwecker, 2008). Targeting construction and rehabilitation activity to locations that decrease auto dependency (as many believe that transit oriented development does), is likely to be a critical component of the battle against climate change. At the very least, the government should surely not be making things worse by subsidizing the building and renovation of homes so distant from jobs and other opportunities that even the private sector would not invest in them absent any government incentives. While it is difficult to second-guess what the private sector would do absent government intervention (and far from clear that the private sector would build efficiently if unregulated, given the over-supply of housing created in the latest real estate boom), there are a variety of sustainability metrics that can guide local governments' investments in foreclosed homes. Access to transit, distance to the central business district or other areas of employment, and density, for example, all provide some guidance about which foreclosed homes are in areas more likely to respond to assistance and survive the foreclosure crisis.

The third principle relates to poverty concentration. Many critics have charged that federal housing programs—and the public housing program in particular—have increased, rather than lessened, the concentration of poverty (Carter, Schill, and Wachter, 1998; Hirsch, 1983). By encouraging large-scale public housing developments that almost exclusively house very-low-income tenants, and allowing virtually all these developments to be sited in very-low-income neighborhoods, federal housing policy generally has steered subsidized tenants to extremely low-income and high-poverty communities. The federal Neighborhood Stabilization Program (NSP) should not repeat that mistake by funding the rehabilitation of foreclosed homes for use as affordable housing in predominantly high-poverty communities. Instead, the federal, state and local governments must be vigilant about unintended consequences its neighborhood stabilization investments may have for both racial and economic segregation.

The fourth principle suggests that governments at all levels should also use their leverage to invite other resources to the table so that taxpayer dollars can go further. With its deeper pockets, the federal government is particularly well-positioned to leverage private and local government support.

In the case of federal government investments, we recommend two other forms of leverage. First, the federal government should use its resources to encourage localities to coordinate their efforts to stabilize neighborhoods. The multiplicity of local governments may invite innovation – but sometimes local governments can work at cross-purposes, adopting policies that are in their own narrow self-interest but that undermine the goals of their neighbors. Plus, state and local governments can also learn

a great deal from each other's experiences, which is especially critical in the context of new challenges like the foreclosure crisis.

Second, federal funds should encourage the adoption of sound planning laws and practices, which may be critical to effective use of federal support. There is no agreement at present on what planning laws and practices are best, so the federal government may not be able to condition federal funds upon particular practices until it has done more to support research and education about best practices in planning. But there is increasing recognition that land use planning is more effective when it is well-coordinated with transportation and infrastructure planning, when it encourages developers to provide housing consumers with a variety of housing types and price points to choose from, and when it requires development at densities that can support transit and reduce vehicle miles traveled for work, daily tasks, and entertainment. The federal government can encourage local governments to adopt such practices; for example, competitive funding could take into account whether the targeting of foreclosure funds is being coordinated with planning underway in the metropolitan planning organizations required by the Intermodal Surface Transportation Efficiency Act of 1991.

### Concentrated Foreclosures

The problem of concentrated foreclosures is now well-known, so our description will be brief. As of October 2008, The Low Income Support Corporation (LISC) estimated that over 700,000 loans had fallen into bank ownership, and many more are entering the foreclosure process and are at risk of foreclosure (LISC, 2008). Figure 1 shows trends in national foreclosure rates. We hope that the Administration's anti-

foreclosure plan will prevent a number of at-risk loans from falling into foreclosure, but prior to the announcement of the Administration's plan, Credit Suisse estimated that an additional 8 million foreclosures would occur in the next four years (2008). Given the large number of properties that are already in bank ownership, and the next wave of foreclosures that is likely to come, it is clear that the problem of vacant foreclosed properties (which often are "real estate owned", or "REO", which means that the lender took title to the property rather than letting it be sold to a third party at auction, and has been unable to sell the property) is here to stay, at least for a while.

Moreover, while foreclosures are occurring at elevated rates around the country, the crisis is hitting some communities especially hard, particularly in the sunbelt and the rustbelt. And within those metropolitan areas, foreclosures tend to be highly concentrated in particular neighborhoods, often working class minority communities.

Figure 2 shows a map of foreclosure notices in New York City. In 2008, 56 percent of foreclosure notices were issued on properties that were located in just ten of New York City's 59 community districts. Nine out of the ten hardest hit neighborhoods are more than 70% non-white. Other analyses show that foreclosures and REO properties are concentrated in other cities and metropolitan areas as well (Coulton, Mikelbank, and Schramm, 2008; Gerardi and Willen, 2009; Immergluck, 2009). The implication is that while foreclosures are widespread, foreclosure-related neighborhood decline is far more pronounced in particular communities. Significantly, existing evidence also suggests that such concentrations of foreclosures are likely to do more damage to community fabric and property values than an equal number of foreclosures that are equally spread around communities, because while a small number of foreclosures do little to undermine

property values in a neighborhood, significant concentrations do reduce property values (Schuetz, Been, and Ellen, 2008).

### Implications for Neighborhood Stabilization Programs

#### *Challenges Localities Face in Spending Already-Allocated Federal Funds Wisely:*

As part of the Housing and Economic Recovery Act (2008) passed in the summer of 2008, Congress appropriated \$3.9 billion to be distributed, according to a formula based on the number of foreclosures, to communities to support the acquisition, renovation, and disposition of abandoned and foreclosed properties. Unfortunately, early evidence suggests that the funds may not be being spent as effectively as they might be.

One key issue is capacity. One third of grantees received NSP allocations that were more than three times the size of their annual community development block grant (CDBG) allocation; some communities in Florida received grants that were 20 times their annual allocations. Moreover, the recipients are required to spend the funds in 18 months, even though they are likely to face considerable difficulty in identifying suitable properties, and in negotiating the acquisition of the properties from servicers (who themselves lack capacity to address the many properties in their portfolios that are in default, and may be unsure of their authority to accept steeply discounted offers for the properties).

Another issue is a failure to target. In part because it is so difficult to acquire foreclosed properties, many localities are spreading their funds in a fairly scatter-shot way around communities, based upon acquisition opportunities rather than a coordinated,

long-term strategy. In hard-hit areas, it is unlikely that such modest, dispersed investments will do much to stabilize neighborhoods.

A third problem is that few communities have been able to use NSP funds to leverage private investments, which limits the potential impact of the NSP funds. In part, the need to spend the funds quickly limits communities' ability to work with foundations and non-profits to develop and reach agreement on a more coordinated, leveraged, strategy. The lack of capacity also hinders efforts to coordinate investments and strategies. Finally, the shifting and rapidly unfolding nature of the crisis makes long-term, coordinated strategies especially difficult to achieve.

*The Next Round of NSP Funding:*

These issues should be moderated in the second round of funding. As part of the American Recovery and Reinvestment Act (2009), signed into law in February 2009, the federal government enacted a new round of neighborhood stabilization funding, again aimed at mitigating the neighborhood impacts of the foreclosure crisis. This time around, there are \$2 billion in funds available, which are being allocated through a competition (Notice of Fund Availability (NOFA) Docket No. FR-5321-N-01). The simple fact that the funds will be awarded through a competition allows the federal government to set guidelines for funding and incentivize particular kinds of investments. The published NOFA suggests that in selecting grantees, the federal Department of Housing and Urban Development (HUD) will give priority to grantees with demonstrated capacity and experience in coordinating stabilization efforts, who "invest funds in programs and projects that will revitalize targeted neighborhood(s) and reconnect those targeted

neighborhoods with the economy, housing market, and social networks of the community and metropolitan area as a whole,” and who convincingly marry demonstrated need in their targeted area with their strategy for stabilization (NOFA).

Much uncertainty remains about how these priorities will be implemented in practice. We offer the following suggestions to guide HUD’s review of the proposals it receives, to steer state and local governments and nonprofits who are working to define their target areas and refine their strategies for stabilizing neighborhoods (either to compete for the new funding, or to maximize the effectiveness of their use of the first round of funding), and more generally to inform governments in the future who wish to target resources for stabilizing neighborhoods hard hit by foreclosures or abandonment and physical distress more generally.

*Concentrate efforts where markets can recover*

As noted above, many local governments are spreading their NSP dollars widely across their communities, without much attention to strategic targeting (Phillips and White, 2008). Given the difficulty in identifying owners, negotiating with servicers, and ultimately acquiring vacant, REO properties, it is understandable that many localities have simply taken the properties they can get, regardless of whether they are concentrated in the same neighborhood. Yet, acquiring and renovating one foreclosed home on a block filled with other abandoned homes, for example, is likely to do little to turn that neighborhood around.

More fundamentally, the same amount of investment will deliver a greater marginal benefit in some communities than in others. In the context of the foreclosure

crisis, we think investments in property acquisition and rehabilitation are likely to have the greatest marginal impact in transitional neighborhoods where market recovery is plausible but not assured. If the probability of market recovery is strong, the neighborhood likely will recover without public investment. If the probability of market recovery is really weak, the best strategy for the neighborhood's foreclosed and abandoned properties may not include rehabilitation. But in transitional neighborhoods that still have strengths that give them some market appeal, targeted NSP funds for rehabilitation could help prevent the neighborhoods from tipping over into decline. Our hypothesis, based on empirical research we have done in NYC, is that in certain transitional neighborhoods, investments to rebuild blighted housing can help to revitalize distressed neighborhoods by eliminating the negative externalities of abandoned properties. (Schwartz et al, 2006).

This is not to say that more distressed areas should be neglected entirely. But the extremely weak neighborhoods, in which upwards of 25 percent of properties are vacant, were typically beset by problems well before the advent of the foreclosure crisis. These communities cannot be helped with the relatively low levels of support that will be provided through NSP funds. Moreover, the last thing these markets arguably need is to bring more housing units on line, which is likely to weaken housing prices further. Instead, activities in these neighborhoods should focus on stepped-up code enforcement, demolition and greening. Difficult and controversial as the conversation will be, some communities should talk through whether some of their neighborhoods will need to shrink in size, and if so, what the best way to implement that decision will be.

Identifying the transitional neighborhoods where market demand is strong enough to make the acquisition and rehabilitation of foreclosed properties an effective strategy is no small task, of course. Local governments and non-profits should take into account measures of quality of life and market demand for each eligible neighborhood, such as access to parks; access to subways; crime rates; the performance of local schools; poverty rates; new building activity; and recent price trends. These indicators measure both the opportunities provided to local residents, as well as the market demand for the neighborhood.

*Support environmentally sustainable investments*

There is a growing consensus in the planning field about the value of creating sustainable communities, which are both walkable and transit-accessible. In the context of targeting funds to rehabilitate abandoned and distressed housing, we think those goals suggest that policy-makers deciding between two otherwise identical neighborhoods should choose to rebuild housing in the denser, more walkable neighborhood with accessible public transportation. Similarly, policy-makers should consider strategies to create the density needed to support transit-oriented neighborhoods, such as assembling parcels of several marginal low density single family homes to allow the development of higher density multi-family housing. Not all density is equally conducive to more efficient transit, so such assemblages should be strategically planned and coordinated to produce lineal, rail-supportive densities (Cervero, 2009).

*Avoid exacerbating segregation and poverty concentration*

Some fair housing advocates have voiced concern that the Neighborhood Stabilization Program's requirement that 25 percent of grants must be spent to benefit households earning less than 50% of the area median income runs the risk of further concentrating poverty by creating affordable rental housing targeted to very low income households in distressed, lower income areas. This argument assumes that all or most neighborhoods hard hit by foreclosure are high poverty areas. Table 1 shows the distribution of all census tracts in the United States that are eligible for the second round of Neighborhood Stabilization funds according to their poverty rate.<sup>1</sup> On the whole, they are communities with higher poverty rates than other areas, but many are relatively prosperous areas. Over a third of tracts eligible for NSP II activities have poverty rates under 10 percent. Given the distribution, we suggest that localities and nonprofits developing rental housing for lower income households should target these efforts to the relatively lower poverty areas, or areas that in other ways offer opportunities, such as good schools and/or access to employment.

#### *Work to Attract Other Sources of Support*

To stretch taxpayer dollars further, local government officials should work to leverage other public funding and private contributions and investments in neighborhood recovery efforts. Although there is currently little private capital going into distressed neighborhoods, investors may be willing to invest if they feel the total level of public and private resources flowing into an area is sufficient to make recovery likely. Private investors might provide capital for acquisition, rehabilitation or perhaps affordable mortgages for new homebuyers.

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<sup>1</sup> The formula used to determine eligibility in the first round was similar.

At the federal and state level, the government should give priority to communities that can leverage other forms of support, such as governmental transportation or infrastructure investments, foundation grants, or private development proposals, for neighborhood stabilization.

*Encourage coordination with broader regional policies*

While neighborhood stabilization is inherently local, there nevertheless may be opportunities for coordination and cooperation. For instance, there may be economies of scale in supporting a regional effort to negotiate with servicers to purchase REO properties. It also might make sense for localities to coordinate their targeting efforts so that they might focus on neighboring communities. Similarly, it may be most efficient for localities to coordinate their efforts to focus on neighborhoods along a transit line that crosses jurisdictional boundaries. Jurisdictions also may benefit from identifying areas in which demolition, rather than rehabilitation, of homes of marginal value and conversion of the land to parks or wetlands could provide significant regional environmental benefits.

*Incentivize sound local planning practices*

Finally, neighborhood stabilization is likely to be far more successful if localities coordinate stabilization efforts with reforms of their regulatory processes (Mallach 2009). These might include laws that establish vacant property registries (and quickly fine property owners for code violations), require point-of-sale inspections to ensure that new owners address any code violations, and facilitate tax foreclosures. The federal and state

governments can encourage those innovations by giving funding priority to communities that adopt such regulatory reforms. Similarly, priority should be given to communities that can demonstrate that they are likely to obtain any required development or building permits quickly, in order to provide incentives to communities to lift land use regulatory barriers.

### Conclusion

Foreclosures clearly generate external costs, especially when properties sit vacant and abandoned (Been, Schuetz, and Ellen, 2008). In many cases, foreclosures are concentrated in areas that have long struggled with declining demand. In these neighborhoods, any publicly-supported efforts should focus on stepped-up code enforcement and demolition. To date, the allocated federal funds, however, have been slated largely for acquisition and renovation of foreclosed properties. Our argument here is that the benefit of such investments depends critically on where they are undertaken. Thus, local officials should be highly strategic in choosing where to allocate these funds, and federal officials, in choosing which communities to support, should pay close attention to the rationale for these choices.

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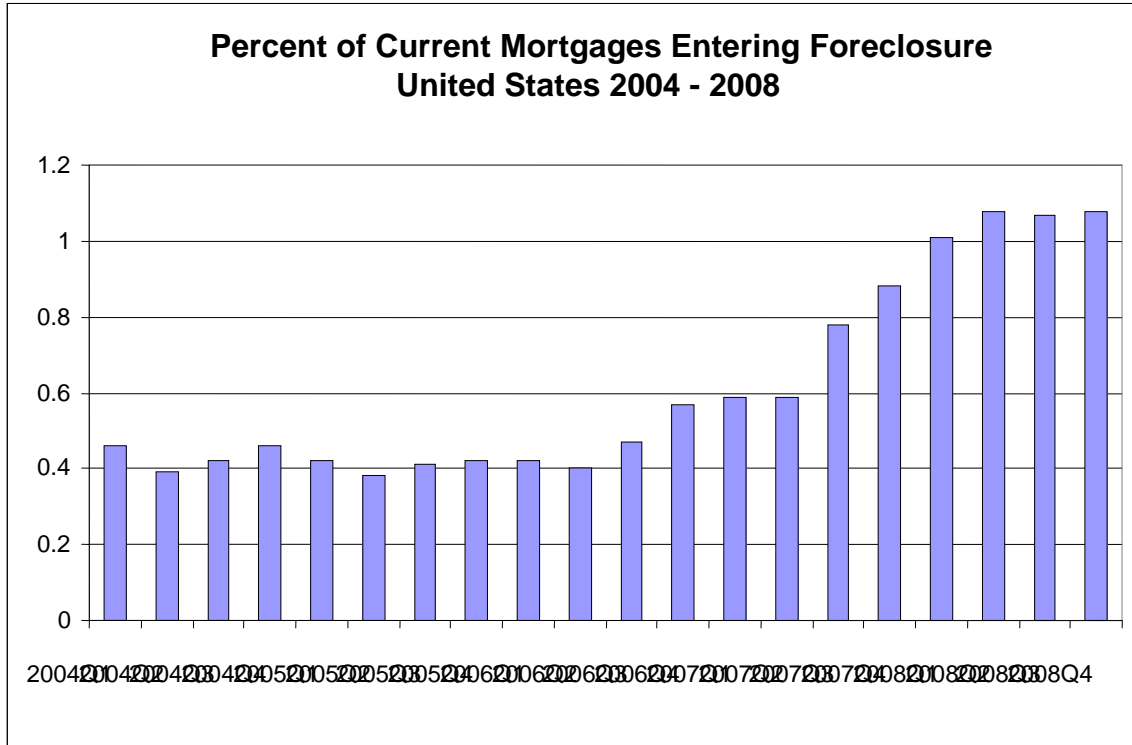
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FIGURE 1



Source: National Delinquency Survey from the Mortgages Bankers Association, Fourth Quarter 2008.

FIGURE 2

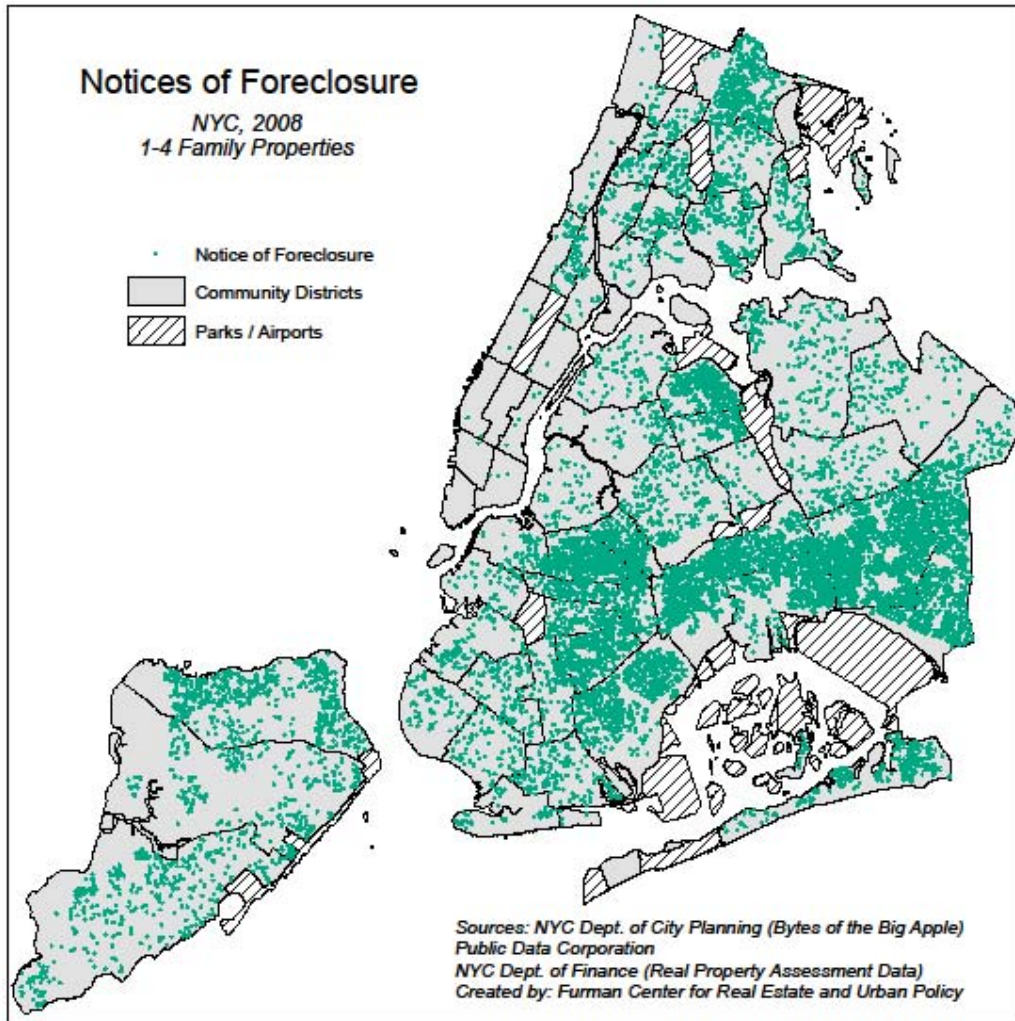


TABLE 1

Distribution of all census tracts in the United States by 2000 poverty rate  
and eligibility for NSP II funding

<b>Poverty Rate</b>	<b>Distribution of Census Tracts Eligible for NSP II by 2000 Poverty Rate</b>	<b>Distribution of Census Tracts Not Eligible for NSP II by 2000 Poverty Rate</b>
< 5%	16.60%	27.20%
5% - 10%	20.90%	28.40%
10% - 15%	16.00%	17.90%
15% - 20%	12.70%	10.50%
20% - 25%	9.70%	5.70%
25% - 30%	7.90%	3.50%
30% - 35%	6.00%	2.20%
35% - 40%	4.40%	1.40%
40% - 45%	2.90%	1.00%
45% - 50%	1.30%	0.70%
50% - 55%	0.90%	0.50%
55% - 60%	0.30%	0.30%
> 60%	0.30%	0.60%