REO and Vacant Property Strategies for Neighborhood Stabilization: Reserve Bank Presidents’ Perspective

Introduction
Thank you all for being here to participate in this important conference. As a Federal Reserve Bank president and monetary policymaker, I cannot emphasize strongly enough how valuable your efforts are in helping to improve conditions in our communities. I support your efforts wholeheartedly, and I am delighted to see the new, comprehensive REO publication that so many of you have been involved with.

I know that Eric Rosengren and I will highlight different experiences from our two Federal Reserve Districts, but we both are working hard to deal with the pressing issues of REO and vacant properties. Our staffs are using a variety of tools to address current needs and to assist our communities to the greatest extent possible.

While the Reserve Banks have limited authority in this area, we have been actively researching problems in the housing markets. We are also using our capacity as conveners to foster collaboration among lenders, property owners, public officials, and community groups.

For example, last year, the Federal Reserve's Community Affairs function sponsored or co-sponsored more than 280 foreclosure-related events across the country. By the end of this year, we will have sponsored five national conferences on housing and mortgage markets; financial literacy and education; neighborhood stabilization; and mortgage policy.

Yesterday morning, Governor Duke spoke eloquently about some of the problems being faced in Cleveland, as well as some of the efforts being taken to deal with them. This morning, I will give you the Fourth Federal Reserve District perspective on REO. Just for your reference, the Fourth District includes all of Ohio, western Pennsylvania, eastern Kentucky, and the panhandle of West Virginia. As you may know, the REO problem we are facing is severe, resources are limited, and the need for assistance is immediate.

I'll begin by explaining some of the weaknesses we face and the strengths we have found in the Fourth District.

Then I'll discuss some of the ideas that have emerged from our Bank's research and outreach efforts related to the housing crisis.

Finally, I'll describe a new proposal to use the Community Reinvestment Act's flexibility to channel more resources to REO
I. Weaknesses and Strengths in the Fourth District

So let me begin with the weaknesses we face and the strengths we have found in the Fourth District.

One major weakness is that our District is a weak-market region. When I say "weak-market," I am referring to a long-term loss of population, as well as migration within the region away from our central cities.

In Cuyahoga County, where Cleveland is located, we lost 7 percent of our population between 2001 and 2009.

Also, our region's unemployment rates have remained stubbornly high.

Between 2001 and 2009, total private employment in Cuyahoga County fell by more than 14 percent. The county's current unemployment rate stands at 9.7 percent.

These weak-market trends left a serious excess of housing well before the crisis began.

For example, in some parts of Ohio, housing sales began to weaken as early as 2004. Simply put, Ohio's problems are more entrenched because they are tied to structural weaknesses and not just cyclical weaknesses in the state's economy.

As population declines and job losses increase, a major by-product is vacancies in residential and commercial properties. Of course, the housing and foreclosure crisis has made this already bad problem much, much worse.

I am sure some of you have heard Cleveland described as "the epicenter of the foreclosure crisis." In the City of Cleveland alone, the average number of days that properties sit vacant has skyrocketed from 114 days in 2006 to 954 days in 2010.

Of course, the longer properties remain vacant, the more collateral damage is done to property values nearby, and it doesn't take long for neighborhoods to suffer from increased crime, arson, and blight.

We are still far from a recovery in the housing markets in our region. The losses and hardship that our neighborhoods have experienced is staggering. In many low-income communities, decades of progress have been wiped away during the past few years.

Fortunately, we have found that our region has some real strengths to help combat these weaknesses. We are blessed with a collaborative and sophisticated community development culture. Our local elected officials, community-based organizations, and financial institutions have been working together effectively for many years. They share a wealth of expertise, longstanding partnerships, and a solid commitment to community reinvestment. And they have been able to achieve some real results.

For example, in recent years the City of Cleveland has negotiated a large number of lending commitments and investments with designated depository banks through its Community Reinvestment Initiative agreements.

CRA investments have brought creative re-use of land in urban neighborhoods. One outcome is the new Renaissance at Fairfax Park, a $6 million, multi-family building project featuring high-quality...
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that was not designed to address the immediate needs of troubled borrowers or the housing counseling agencies that represent them.

In recent months, we have discovered the main reason that most borrowers cite for needing assistance is loss of income as a result of the weak economy. So we know that loan modifications alone won't be enough to address the housing crisis.

Over the past couple of years, our research and outreach have led us to focus on two areas that can help us deal with foreclosures and vacant and abandoned properties in weak-market areas: the Neighborhood Stabilization Program (NSP) and the Community Reinvestment Act (CRA).

As you know, the NSP was put in place to help communities acquire distressed properties and put them back to productive use. We learned a lot about NSP when my Reserve Bank partnered with the Federal Reserve Bank of Richmond and the National Vacant Properties Campaign to conduct case studies of different kinds of communities that receive NSP funds.

We conducted a lot of outreach with stakeholders in our region, learning more about what was working and what was not. Our goal was to find ways in which the NSP program could be used more effectively to address problems in our neighborhoods.

We shared what we learned from the field about barriers and challenges with the Department of Housing and Urban Development. I commend HUD for its responsiveness in using this information to make changes that help communities target NSP funds more effectively.

Looking ahead, even more can be done to take advantage of what the NSP can offer. Our case studies and outreach suggest that more up-front and comprehensive community planning leads to more effective use of NSP funds. We have seen how some communities are managing neighborhood stabilization issues through creative partnerships both inside city hall and with private-sector nonprofits and businesses. Community leaders are working outside traditional boundaries to help residents in need and to market NSP properties, and they are already seeing the benefits of this approach.

NSP is a great tool, but communities cannot take advantage of it without first identifying who owns the distressed properties and acquiring clear titles to them.

Community groups would like to acquire the distressed properties for reuse, either as new or rehabbed housing or for green space. But it takes time to track down owners and servicers to make that happen. Neighborhood recovery efforts can suffer as properties are sold in bulk to out-of-town investors, many of whom are "flippers."

And even if community groups can acquire the vacant properties in time, the community often needs additional resources to rehab those properties or pay delinquent taxes.

Community groups have engaged our Bank staff in many conversations over the last two years about how to deal with these issues. Our staff thought it might be possible to use the CRA as an incentive for financial institutions to better maintain REO property and sell it to responsible investors.

However, it was not immediately obvious how to do this. After all, bankers, community leaders, and academics alike told us that in the age of internet banking, CRA rules are insufficient—because they award CRA credit to banks that focus on neighborhoods where they have a branch presence. But banks might own distressed properties...
outside of their CRA assessment areas.

In addition, credit needs have traditionally been defined to include unmet demands for mortgage lending, but in weak-market regions like ours, with an oversupply of distressed housing, more lending is generally not the answer. Often, the best way to serve low- and moderate-income communities is to help them acquire, tear down, or rehabilitate vacant and abandoned properties.

Fortunately, the CRA offers the regulatory agencies some flexibility.

So our Research and Community Development staff put their heads together to produce a proposal to use the Federal Reserve’s rule-writing authority to modify the CRA regulations. And some of that thinking has led to a CRA proposal by the four bank regulators. The comment period on that proposal has just closed.

III. New CRA Proposal

Let me take a few moments now to describe how our staff sought to use the Community Reinvestment Act’s flexibility to channel more resources to REO disposition.

First, we suggested giving banks more CRA credit if they would shift some of the resources they usually devote to CRA activities where they have branches to REO dispositions in the nation’s weakest housing markets, whether or not the banks have a physical branch there.

Second, we suggested that banks could claim CRA credit for acquiring, tearing down, and rehabilitating distressed properties.

I am very pleased that the recent CRA rule changes proposed by the four federal banking agencies are very close in spirit to our proposal.

The proposed changes would amend CRA regulations to support communities affected by high foreclosures. Specifically, depository institutions would be encouraged to make loans and investments and provide services to support NSP activities in certain areas with high foreclosure and vacancy rates.

Importantly, these areas need not be inside an institution’s CRA assessment area.

The interagency proposal is consistent with everything our Reserve Bank’s staff was hearing from our outreach efforts, and I think it’s going to be a positive and creative way to use our existing rule-writing authority to fight vacancy and blight.

But the CRA is just one tool. We have learned that numerous interventions are required to address the multiple causes and consequences of the foreclosure crisis, and we will continue to focus our outreach and analysis on understanding and contributing to solutions in real time.

Conclusion-Value of Regional Reserve Banks/Importance of Outreach to Inform Policy

I know I speak for all of us at the Federal Reserve when I say that we feel a great sense of urgency in getting the housing market back on its feet. Indeed, a healthy housing sector is critical both to the overall economy and to a sustainable economic recovery.

The Federal Reserve’s decentralized structure has been a huge help in getting us started with making on-the-ground policy
recommendations across all 12 Districts nationwide. We will continue to help and support community leaders and policymakers through our research and outreach activities.

And I know that each of you here today is critical to making the enormous task of revitalizing our housing sector a success. Thank you again for all of your hard work, creativity, and dedication to this cause.