Divorcing Power and Responsibility:
How National Policies Have Shaped Local Policy Responses to Foreclosures

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In recent years the United States has witnessed mortgage foreclosure rates not seen since the Great Depression. According to one estimate, between 10 and 13 million American homeowners will go through foreclosure by 2014. Because foreclosures were the central cause of the economic downturn, most of the national conversation has been about their macroeconomic effects and impacts on broader financial markets. But foreclosures also have local effects, leaving behind disrupted families, devastated communities, distressed municipalities, and damaged regions. My focus here is on efforts to deal with the local place effects of foreclosures; I say little about the impact of foreclosures on the national economy and deal with the impacts on individuals and families only indirectly.

I examine foreclosure responses through the lens of “resilience.” Resilience is essentially the ability of a subject to bounce back from a stress or challenge and return to pre-stress functioning. At this point, resilience is more than a metaphor but less than a theory. As a conceptual framework, however, it suggests hypotheses worth testing. The central hypothesis of resilience theory explored here is the tension between efficiency and resilience. A region may maximize wealth accumulation by concentrating resources on one or a few industries where it has a comparative advantage. But such specialization can make the region less resilient to the challenge of changing consumer demand or new competition stemming from technical innovation or globalization. Other things being equal, as reported in Hill, et al in this volume, a region with more diverse export industries will be more resilient than an economy that relies on

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1 This is a shortened and slightly revised version of a paper that will appear in Urban and Regional Policy and Its Effects, ed. By Margaret Weir, Nancy Pindus, and Howard Wial (Washington, DC: Brookings Institution Press, forthcoming).
3. Resilience is gaining increasing prominence in the social sciences. Between 1997 and 2007 the annual references to the term “resilience” in the Social Science Citation Index increased by more than 400 percent (Swanstrom, 2008).
only a few export industries. Similarly, large-scale production with extensive specialization of labor may make an organization more efficient, but it also may make it less flexible and less able to alter organizational routines in response to an external challenge. Using these insights of resilience theory, I explore here the question of whether national actors have enhanced or detracted from local resilience in the face of foreclosures.

Local resilience is constrained by the “opportunity space,” the economic, legal, and institutional conditions that either expand or constrict opportunities for effective local responses.\(^5\) The opportunity space within metropolitan areas is shaped by state and national actors. A good example is the length of the foreclosure process, which is largely determined by state law. States with nonjudicial foreclosure processes (not overseen by the courts) reduce the time from first foreclosure notice to sheriff’s sale, giving the borrower and foreclosure counselors less time to raise funds or modify the mortgage.\(^6\) Of course, local actors may have ample opportunity space but they may not take advantage of it. In other publications I have focused on what explains why some regions and local actors have been more resilient in the face of foreclosures than others.\(^7\) Here, I focus here on how national actors, private as well as public, shape the opportunity space at the local level. I conclude with recommendations on how national policies can enhance local resilience.

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\(^5\) Swanstrom, Chapple, and Immergluck (2009, pp. 4-5).
\(^6\) Foreclosure processes that are too long can also be problematic. Long foreclosure processes discourage families from seeking loan reinstatement, because they have an incentive to stay in the home rent free during the long legal process. Cutts and Merrill (2008) argue that there is a “sweet spot” in the length of the foreclosure process around the state average of 120 days.
\(^7\) See Swanstrom, Chapple, and Immergluck (2009); Swanstrom, Chapple, and Immergluck (2011).
The “data” to support my argument come from the rapidly growing literature on foreclosures and on case studies of local responses that I, along with colleagues from around the country, have conducted. As part of the Building Resilient Regions project, I conducted a series of interviews in St. Louis and Cleveland and my co-authors did likewise in Chicago, Atlanta, Riverside-San Bernadino and the East Bay area. I have also been fortunate to be present at two gatherings organized by the National League of Cities at which local practitioners discussed their responses to foreclosures and I participated in a forum in Washington, D.C., on foreclosures organized by the Brookings Institution. I also draw on the growing literature and websites on local best practices by organizations such as the National Housing Conference and Living Cities.

The evidence for my argument is largely qualitative and based on case studies. To my knowledge, no one has devised a quantitative measure of local resilience to foreclosures, nor have any rigorous national studies been conducted, with controls, to determine what local actions lead to successful outcomes. My focus is on what local actors have done -- on the process of resilience, not on the successful outcomes. I study resilience capacity, not resilience outcomes. I

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9. For the second NLC gathering, in April 2010, I wrote a memo on the St. Louis response to foreclosures and five other scholars wrote similar memos on their metropolitan areas (Michael Rich, Atlanta; Geoff Smith, Chicago; Liz Strom, Tampa-St. Petersburg; Claudia Coulton, Michael Schramm, April Hirsh, Cleveland; and Gary Painter, Riverside-San Bernadino). I draw freely on these memos. They are available from the authors. For a synthesis of the findings from the NLC meetings, see Swanstrom and Brooks, 2010.
have little hard evidence on whether these local actions contributed to successful outcomes – understood as foreclosures prevented or damage from existing foreclosures minimized. Indeed, as Tom Kingsley has noted, “there is a lack of solid research literature on such [local foreclosure] policies and their results.”\textsuperscript{10} With a few exceptions, we simply do not know what local actions make a difference.\textsuperscript{11} Nevertheless, it stands to reason that local actors who are resilient – i.e., able to shift organizational routines, redeploy assets, and strategically target foreclosure prevention and mitigation efforts on key neighborhoods will achieve more successful outcomes.

**NATURE OF THE FORECLOSURE CHALLENGE FOR PLACES**

Every foreclosure is a challenge, or stressor, for the individual or family involved. By forcing people out of their homes, foreclosures disrupt social networks and school performance. By damaging credit scores, foreclosures weaken people’s ability to access credit, or even rent an apartment or get a job. The ability of people to bounce back from a foreclosure depends on the strength of their social networks, their financial resources, and their psychological resilience.

Similarly, foreclosures are challenges or stressors for places. In the case of individuals resilience could be defined as the ability to return to the normal state of functioning before the disturbance or foreclosure occurred. But what would resilience look like in the case of places? For a neighborhood that was in bad shape before foreclosures we would not want to say that returning to the status quo represented resilience. The ecological concept of resilience differs from the engineering concept of resilience in that it accommodates the possibility of multiple

\textsuperscript{10} Kingsley (2010); Kingsley, Smith, and Price (2009).

\textsuperscript{11} An important exception is the Urban Institute evaluation of the National Foreclosure Mitigation Program (NFMC) foreclosure counseling program, which it concludes had positive outcomes. Although the program is federally funded, it is usually implemented by local NeighborWorks organizations. See Mayer and others (2009 and 2010).
equilibria. Resilience can mean that an ecosystem adapts to a drought, for example, with a new mix of drought-resistant flora and fauna. Similarly, in the face of foreclosures resilient neighborhoods need not return to their prior state but in many cases will need to reinvent themselves in order to achieve successful outcomes.

It is not enough to say, however, that resilience could aim at many different outcomes. How would we know successful place-based resilience to foreclosures if we saw it? The essence of the foreclosure challenge for places, I argue, is an imbalance between housing demand and supply. A period in which demand far outstrips supply and housing prices soar is followed by a vicious cycle of foreclosures and plummeting housing prices that leaves a swath of social destruction in its wake. Basically, a successful neighborhood would be one that was able to avoid huge swings in housing prices and establish a healthy balance between the supply of and demand for housing.

According to economic theory, free markets automatically producing a balance of supply and demand. Negative feedback acts like a thermostat guiding the system toward equilibrium: as demand for housing increases, for example, the supply of housing expands to meet the new demand, moderating price increases and bringing supply and demand back into balance.

The foreclosure crisis, however, contradicts market theory. The foreclosure crisis cannot be understood by linear processes or by automatically self correcting feedback loops. Foreclosures must be understood in terms of system dynamics: reinforcing loops of positive feedback that produce oscillating imbalances of supply and demand that can lock people and places into destructive cycles of boom and bust. The main outlines of the process are clear: based on a flood of credit and lax underwriting standards, demand for housing soared from the

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13. For an introduction to system dynamics thinking, see Richardson (1999).
late 1990s to 2007. The supply of housing, however, being quite inelastic, failed to keep pace with rapidly rising demand and housing prices climbed rapidly, especially in metropolitan areas with artificial constraints on supply, such as restrictive zoning.\textsuperscript{14} Nearly everywhere, house prices increased more rapidly than economic essentials, such as growth in productive capacity and incomes. Monthly housing costs grew as a proportion of income – a trend which in the long run is unsustainable.\textsuperscript{15} Normally, if households take out loans that are unsustainable, they will default and quickly go into foreclosure. Rapid price appreciation, however, covered over the unsustainability of the loans: if borrowers were unable to meet monthly payments, they could simply refinance or sell the home to pay off the loan. The market should have also self-corrected as investors refused to buy bad loans, thus cutting off the supply of mortgage capital.\textsuperscript{16} The story of the voracious appetite of investors for subprime mortgages, obscured by complex securitization practices and corrupt ratings agencies, is too familiar to be told here.\textsuperscript{17} Suffice it to say that the market was not self correcting and a reinforcing cycle of easy credit, rising demand, and soaring home prices was set in motion.

The housing bubble in which demand far outstripped supply was unsustainable and was inevitably followed in 2006-2007 by a vicious cycle in the opposite direction: foreclosures suddenly flooded the market with a supply of homes driving down prices, which left more people vulnerable to foreclosure, further driving down prices (Figure 2). In addition, burned by foreclosures, lenders tightened their underwriting standards, further depressing effective demand for homes, reinforcing the cycle of falling prices and rising foreclosures. And as home prices

\textsuperscript{14} Glaeser, Gottlieb, and Gyourko (2010).
\textsuperscript{15} U.S. Department of Housing and Urban Development (2010, p. 38).
\textsuperscript{16} Of course, another market mechanism that should have prevented the crisis was that investors should have been unwilling to invest in risky mortgages destined to fail on the secondary market, thus choking off mortgage credit and moderating demand. Federal Reserve Board Chairman Alan Greenspan clearly believed, at the time, that market mechanisms would correct any imbalances and the benefits of increased homeownership were worth the risk of foreclosures (Greenspan 2007). He later admitted he was wrong.
\textsuperscript{17} For an insightful account, see Immergluck (2009a).
plummeted, consumer spending fell, increasing unemployment and tipping more households into foreclosure. With bad mortgages leveraged 20 and 25 times through financial devices like credit default swaps, mortgage foreclosures pulled a huge amount of available capital out of the economy, dragging down the national and even the global economy.

Besides market failures at the national level, foreclosures also involve market failures at the local level that impose significant costs on places. The literature identifies three main local spillovers of foreclosures (negative effects on peoples and households who are themselves not involved in a foreclosure): 1) declining property values; 2) crime and social disorder; 3) local government fiscal stress and deteriorating services. This is not the place to discuss the full range of local spillovers, but a quick survey will demonstrate that local spillovers are significant indeed.

*Figure 2: Vicious Cycle of Foreclosures*

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18. This categorization is taken from Kingsley, Smith, and Price (2009), a valuable synthesis of the research on the local spillover effects of foreclosures.
Declining Property Values

Scholarly research has consistently found a negative impact of foreclosures on the market value of homes located within approximately one-eighth of mile (660 feet) of a foreclosure. The Center for Responsible Lending estimates that by 2012 ninety-two million households will suffer declines in property values totaling $1.2 trillion. One of the most broadly based studies covering 628,000 repeat sales transactions in 13 states found a negative impact of 1.3 percent on properties located within a 300 foot radius of a foreclosure and a drop of 0.6 percent within the 660 foot radius. A study of St. Louis County foreclosures between 1998 and 2007 found a drop of about 1.0 percent in the sales prices of properties located within one-eighth mile of a foreclosure. In a study of Chicago, Immergluck and Smith found a drop in market value within the one-eighth mile radius that varied from 0.9 percent to 1.8 percent. Using the conservative Immergluck and Smith estimate (0.9 percent), the Center for Responsible Lending (CRL) calculated that on average nearby homeowners will lose about $5,000 in value per foreclosure.

Social Disorder and Crime

Involuntary displacements caused by foreclosures disrupt social connections and deplete social capital. Children are in many ways the most disturbing innocent victims of foreclosure. When they are pulled out of one school and put in another their learning is disrupted. According to one estimate, 1.952 million children were impacted by foreclosures as a result of subprime

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22. Immergluck, and Smith (2006a)
loans made in 2005-2006.\textsuperscript{24} This imposes huge costs on families, communities, and schools. Frequent residential moves can increase violent behavior in high school by 20 percent and reduce the chance of graduating from high school by more than 50 percent.\textsuperscript{25} Foreclosures can also damage the health of children, negatively affecting diet and healthy body weight. Involuntary displacement puts stress on families, leading to higher rates of divorce, child abuse, and addictive behaviors.\textsuperscript{26}

Foreclosures are also associated with crime. According to “broken windows” theory, signs of disorder in a neighborhood, as small as a broken window that is not fixed, encourage crime.\textsuperscript{27} Foreclosures, especially when the home lies vacant and not properly maintained (such as tall grass or trash out front), can create a sense of disorder in a neighborhood and encourage crime. Research has confirmed this connection. A study of Chicago found that for each 1 percentage point increase in the foreclosure rate, the number of violent crimes in a census tract increases by 2.33 percent.\textsuperscript{28} A study by the Charlotte-Mecklenburg Police Department found that both violent and property crime rates were higher in the high-foreclosures neighborhoods compared to neighborhoods that had not yet experienced high rates of foreclosure.\textsuperscript{29}

\textit{Local Government Fiscal Stress and Deteriorating Services}

The impact of foreclosures on local governments is double-edged—both on the revenue and expenditure side. On the revenue side, foreclosures shrink revenues. The impact of foreclosures on property taxes is especially significant. Once assessments catch up with

\textsuperscript{24} Lovell and Isaacs (2008).
\textsuperscript{25} Rumberger (2003).
\textsuperscript{26} The literature on the costs of involuntary displacement is large. For a recent synthesis, see Fullilove (2004).
\textsuperscript{27} Kelling and Coles (1996).
\textsuperscript{28} Immergluck and Smith, 2006B.
\textsuperscript{29} Bess (2008).
declining property values, governments will be forced to increase property tax rates to maintain revenues. Additionally, local governments will have to deal with increased tax delinquencies and failure to pay utilities.

At the same time that revenues are declining, local governments face increased costs as employees miss work, productivity declines, and families seek additional social services. These indirect costs are difficult to estimate but researchers have measured the direct costs of foreclosures on local governments. The best scholarly study on the cost of foreclosures to municipalities examined Chicago, quantifying costs of foreclosure based on five scenarios.\footnote{Apgar and Duda (2005).} If a property goes into foreclosure and is quickly put back on the market, the researchers estimate it will cost the local municipality only $430. At the other end, if the foreclosure leads to vacancy and abandonment, ultimately requiring demolition, the cost to the local municipality soars to $34,199.

In sum, foreclosures have significant spillover effects on surrounding property owners, households, and local governments. Market theory is correct: rational actors will not take into account the spillover effects of foreclosures and therefore local actors will need to intervene to protect the public. Foreclosures become especially challenging when the spillover effects begin to reinforce one another in positive feedback loops. The spillover costs of foreclosure vary significantly from place to place. The negative impact of foreclosures on places depends on foreclosure density and the strength of the local housing market. Dispersed foreclosures in strong housing markets have minimal effects. Concentrated foreclosures in weak housing markets can have devastating effects. In strong markets, robust demand insures that the relatively small number of foreclosed properties will quickly be purchased and re-occupied. Other than an unusually large number of “For Sale” signs, a casual observer driving through the
neighborhood may see little change. On the other hand, concentrated foreclosures in weak markets generate reinforcing processes of neighborhood decline (Figure 3) marked by obvious signs of distress, such as vacant and boarded up houses.

![Figure 3: Foreclosures and Reinforcing Processes of Neighborhood Decline](image)

Reinforcing processes of neighborhood decline are rooted in the fact that real estate markets are highly social or interactive. The self-correcting equilibrium of market economics is based on rational actors making independent decisions. If housing prices rise above the inherent characteristics of the neighborhood (condition of stock, amenities, location relative to jobs, etc.), then presumably buyers, seeing better opportunities, will move out of the market and bring prices back down to equilibrium. But as the growing literature on behavioral economics has taught us, market actors do not always act rationally or independently. Economic decision makers are

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31. But the costs to individuals and families can still be considerable. Indeed, in strong market metropolitan areas foreclosures may be harder on families because affordable replacement housing is more difficult to obtain than in a weak market. For a review of the relatively thin scientific research on the effects of foreclosures on families and individuals, see Kingsley, Smith, and Price (2009).

32. For an insightful application of behavioral economics to the foreclosure issue, see Barr, Mullainathan, and Shafir (2008).
prone to social contagion in which they follow the herd rather than make cold-hearted rational decisions based on the merits of each case. This is especially true in the case of real estate markets where the value of one property depends so much on what happens to neighboring properties. Admittedly, market fundamentals will always reassert themselves in the long run. But as Keynes once remarked, “In the long run we’re all dead.” It is like having a thermostat that brings your home back to 70 degrees, but only after forcing you to swelter in 100 degree heat for weeks.

Foreclosures are not randomly distributed within metropolitan areas. Subprime and predatory lending, which is highly correlated with foreclosures, was concentrated. Foreclosures are correlated with each other in space. Predatory loans, the root cause of the crisis, were not sold; they were aggressively marketed – especially in minority neighborhoods. They were not marketed to the poorest areas but primarily to moderate- and middle-income minority neighborhoods. Prior to the wave of foreclosures, many of these neighborhoods had enjoyed revitalization, often due to the hard work of community development corporations (CDCs). Ironically, this hard work in pushing up market values may have attracted subprime lenders.33

Concentrated foreclosures can set in motion a cycle of decline that destroys place-based assets: financial capital, physical capital, and social capital.34 Foreclosures wipe out home equity, depriving families of the capital to pay for education or start a business. When vandals ransack foreclosed homes, breaking windows and ripping out the copper wiring, the physical

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33. For example, Slavic Village, the epicenter of the foreclosure crisis in Cleveland, had one of the most active and successful CDCs in the area.

34. Homes equity represents 60 percent of the total wealth of middle-class households. Before the recent wave of foreclosures, African American household wealth was less than one-tenth of white households (Shapiro 2004, p. 47 and 107). There is every reason to believe that the wave of foreclosures wiped out proportionally more home equity among African American households than among whites. See Kochar and Gonzalez-Barrera (2009) and McCue (2009).
capital of the neighborhood is devalued. And households that are forced to move lose many social connections. Social capital is destroyed.

In sum, the fundamental challenge for places is that foreclosures can generate significant spillovers that can create reinforcing cycles of decline, destroying the financial, physical, and social capital accumulated in places. Neighborhoods then become “stuck”, unable to renew themselves or serve as springboards for individuals and families to succeed. Instead of springboards, they act more like quicksand.\textsuperscript{35} The severity of the foreclosure challenge varies significantly across and within metropolitan areas. The greatest challenge is in weak market areas with concentrated foreclosures.

**FORECLOSURE PREVENTION: CHALLENGE OF LOAN MODIFICATIONS**

The foreclosure challenge is different in one important way from the challenges addressed by resilience studies in other fields. In the field of ecology, for instance, the stressor or challenge, such as a hurricane or drought, is viewed as external, or exogenous. The challenge is taken as given; the only question is how the ecosystem reacts to the challenge and reestablishes equilibrium. Foreclosures, however, are not an act of nature; they are a product of human action. By far the most effective action by local actors would have been to limit the primary cause of foreclosures, subprime and predatory lending. When cities did act to regulate predatory lending, however, courts ruled that they lacked home rule powers for that purpose or that state laws preempted local laws.\textsuperscript{36} Similarly, when states stepped in to regulate risky lending, they were preempted by federal laws. Finally, competing federal regulators engaged in a “race to the bottom” that gutted regulation of predatory lending. Successful venue shopping by the mortgage lending industry within the federal government and across federal, state, and local

\textsuperscript{35} For an analysis of the idea of “stuck” neighborhoods, see Ashton, and Schnell (2010).

\textsuperscript{36} Frug and Barron (2008, p. 196).
governments undercut efforts to regulate subprime lending.\textsuperscript{37} In our terms, the actions of state and federal governments shrunk the opportunity space for local actors to prevent foreclosures.

Preventing foreclosures with their massive spillovers on local communities is much more difficult after subprime and predatory loans have been originated than before. How effective local actors could have been if given the opportunity is open to question. Local governments may have been reluctant to tighten lending standards because, after all, they benefit from the rising home prices and tax revenues that resulted from lax lending standards.\textsuperscript{38} In any case local actors were not given the authority to regulate subprime and predatory lending and found themselves in the situation of having to respond after bad loans had already been made.

At the local level, foreclosure “prevention” is a misnomer because, as we have seen, local actors have little authority over the primary cause of foreclosures – predatory loans. Foreclosure prevention at the local level means mostly helping homeowners already in the foreclosure process to stay in their homes by reducing monthly payments through a loan modification. Aided by federal grants local actors, particularly housing nonprofits, have been quite resilient in responding to the need for loan modifications by creating housing counseling networks with broad public outreach. However, the rate of loan modifications has been disappointingly low. Once again, the local opportunity space for resilience was shrunk by the actions of national actors, in this case largely by the policies of remote mortgage servicers.

\textsuperscript{37} The story of the failed efforts of local, state and federal regulators to limit subprime lending is told in U.S. Department of Housing and Urban Development (2010) and more completely in Immergluck (2009a). I draw freely from these accounts. For the concept of “venue shopping” see Baumgartner and Jones (1993).

\textsuperscript{38} I thank Howard Wial for this point. Clearly, federal action to limit predatory lending practices would have been the best protection against foreclosures. The Bureau of Consumer Financial Protection, which was authorized in July 2010 as part of the Dodd-Frank financial reform legislation backed by President Obama, will regulate mortgage lending. As a consumer agency under the Federal Reserve but not dependent on fees from regulated institutions, the new bureau may be able to avoid the venue shopping by banks that undermined past federal regulatory efforts.
Strong arguments can be made for loan modifications, not just from the viewpoint of protecting the public but also from the viewpoint of protecting private investors in mortgages. As we have seen, the public has a strong incentive to prevent foreclosures, given their large spillover effects, especially for weak market areas with concentrated foreclosures. Taking into account the transaction costs and loss in home values following foreclosures, investors in mortgage-backed securities would be better off in many cases to modify loans to enable borrowers to stay in their homes and continue making lower monthly payments. Loan modifications can be win-win for the lender and the borrower. Despite the powerful public and private interests in favor of loan modifications, however, the rate of loan modifications has been low. Vertical disintegration of mortgage financing market has pulled key decisions about loan modifications out of the hands of local lenders and put them into the hands of remote servicers. Constrained by hyper-rigid mortgage pools, lacking adequately trained employees, and with a business model biased in favor of foreclosures, loan servicers have often acted against the interests of investors and refused to modify loans.\textsuperscript{39} Taking into account the public interest, or the spillovers of foreclosures, the rate of loan modifications falls even further below the social ideal.

Investors in mortgages lose a great deal when a mortgage goes through foreclosure. Estimating these losses is difficult because they vary so much in different parts of the country and under different scenarios. Clearly, however, the losses are high. Loss severities have been estimated at about 50 percent for prime mortgages and 70 percent for subprime mortgages.\textsuperscript{40} According to one study of subprime loans going through foreclosure, about 42 percent of the loss was due to legal fees, sales commissions, maintenance expenses, and missed mortgage payments.

\textsuperscript{39} Hyperrigid is not my term but is taken from Gelpen and Levitin (2009).
\textsuperscript{40} Cordell and others (2009, p. 7).
About 44 percent of the loss was a deadweight loss—a decline in the value of the home for which there is no compensating gain by anyone else. Part of the loss is due to the general decline in prices. Part is due to vandalism and stripping. And a significant part is due to the stigma that a foreclosure sale puts on a property—which is estimated at about 28 percent below equivalent standard sales. A study of 900 subprime loans estimated the cost to investors of foreclosure at over 50 percent. With an average principal balance of $190,000 that means a loss of about $95,000 on each foreclosure. That leaves a great deal of room for the lender and borrower to negotiate a win-win loan modification.

The deadweight loss to private investors is much more severe in weak market metropolitan areas. In the city of Cleveland, for example, most properties that go through foreclosure are taken over by the bank, so-called real-estate owned properties (REOs). In 2007 properties sold by banks in Cleveland fetched only 13 percent of their estimated market value before foreclosure filing. In 2008, 80 percent of properties sold out of REO in Cleveland’s East Side sold at extremely distressed prices of less than $10,000. In the Cleveland area property losses by foreclosed properties now exceed a billion dollars. In those situations you would think investors would be highly motivated to cut their losses by modifying loans for borrowers who can still make monthly payments.

The public sector has an additional motive to prevent foreclosures because of the massive negative spillovers discussed earlier. It would especially make public policy sense to prevent

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41. Cordell and others (2008, p. 12)
42. Cordell and others (2009, p. 8).
43. Coulton, Schramm, and Hirsch (2010).
44. If the re-default rate on loan modifications is high, it will not be in the interest of investors to modify loans. The default rate on HAMP modifications, which reduce monthly payments to 31 percent of income, is only 11 percent after nine months. See Making Home Affordable Servicer Performance Report Through September 2010: http://www.financialstability.gov/docs/Sept%20MHA%20Public%202010.pdf (accessed November 10, 2010). Re-default rates would be even lower if the principal of loans was reduced to bring them more in line with housing values.
foreclosures in “transitional areas” where risky loans are concentrated and foreclosures could set in motion reinforcing cycles of decay.\textsuperscript{45} Some of these spillovers are quantifiable, such as losses by nearby property owners, but many are difficult to quantify. The existence of nonmonetary benefits of stable homeownership is indicated by the fact that homeowners put a value on staying in their homes even when it does not make economic sense. Studies have shown that only a small minority of homeowners who are underwater, owing more on their homes than they are worth, walk away from their homes in a so-called strategic default.\textsuperscript{46} This suggests that homes are not just a financial investment but have substantial “use values” that are nonfungible and nonportable, such as community identity, accumulated social capital, and a satisfying daily routine.\textsuperscript{47} Parents, with good reason, are reluctant to pull their children out of local schools in order to achieve a financial benefit. In short, the economic and noneconomic spillovers of foreclosure make a powerful argument for public interventions to prevent foreclosures.

The main argument against public support for loan modifications to prevent foreclosures is the risk of creating a moral hazard: helping homeowners who took on risky debt could encourage more risky behavior in the future. This is a valid concern. It is difficult to estimate the effect of loan modifications on future household behavior but the substantial private and public benefits of loan modifications, I argue, outweigh concerns about moral hazards. First, the explosion of risky mortgages was less related to risky consumer behavior and more tied to deceptive lending practices by mortgage brokers. Sudden risky behavior by borrowers does not explain the timing of the crisis; the emergence of risky, exotic mortgage products does. Many

\textsuperscript{45} For a definition and empirical identification of “transitional areas” see Mallach (2008) and Goldsean (2008).
\textsuperscript{46} A study of all homeowners in Massachusetts, for example, found that in the early 1990s only 6.4 percent of borrowers who were underwater ended up in foreclosure. Cited in U.S. Department of Housing and Urban Development (2010, pp. 15-16). The Housing and Urban Development report cites a number of other studies to support this finding.
\textsuperscript{47} For an explication of the concept of use values, see Logan and Molotch (1987).
borrowers did not know what they were agreeing to when they signed a mortgage. Education of borrowers about the risks of subprime lending is helpful but given the complexity of mortgage instruments, the best way to limit future risky lending is to regulate risky and unsustainable lending practices, such as negative amortization, yield-spread premiums, no-doc loans, and exploding ARMs. Given the serious spillover effects of foreclosures, especially concentrated foreclosures in weak markets, it makes sense to act quickly to minimize the damage. A firefighter does not first ask whether the homeowner was smoking in bed before putting out the fire.

Resilience can be defined as the ability to respond to a challenge by 1) redeploying assets or expanding organizational repertoires; 2) collaborating within and across public, private, and nonprofit sectors; 3) mobilizing or capturing resources from external sources.\(^48\) Using this definition, local actors, especially housing nonprofits have been quite resilient. They shifted employees from housing rehabilitation and other activities to foreclosure counseling. This effort was greatly aided by the National Foreclosure Mitigation Counseling (NFMC) program funded by the federal government and administered through NeighborWorks America. Counselors received HUD-certified training in the intricacies of the home financing, usually funded by scholarships. NFMC counseling agencies provide free counseling to homeowners who are in trouble, not only helping them to avoid foreclosure but also advising them in the event of a foreclosure on how to find replacement housing and access social services. Up to December 2009 $475 million had been appropriated, mostly for grants to local counseling agencies that receive between $150 and $350 per client depending on the extent of the counseling.\(^49\) On

\(^{48}\) Swanstrom, Chapple, and Immergluck (2009, p. 4).

\(^{49}\) For helping with HAMP applications, counseling agencies can now receive up to a maximum of about $500. Congress appropriated additional funds for the program in 2010 ($59.5 million) and 2011 ($67.7 million).
August 12, 2010 NeighborWorks America announced that more than one million homeowners facing foreclosure had received counseling.

A good example of resilient local efforts to prevent foreclosures is the Homeownership Preservation Initiative (HOPI) in Chicago. Begun in 2003, HOPI included Neighborhood Housing Services of Chicago, many local CDCs, nonprofit counseling organizations, legal services providers, the City of Chicago, and local foundations. HOPI used the City of Chicago’s 311 nonemergency hotline to link homeowners to counselors. By May 2008 HOPI reported it had prevented 1,700 foreclosures.

Foreclosure prevention has been vigorous in other metropolitan areas, as well. In 2005 Cuyahoga County launched a foreclosure initiative that included nine housing nonprofits, numerous municipalities and a number of lenders. Funds from Temporary Assistance to Needy Families (TANF) and fees from tax delinquent properties were shifted to foreclosure counseling. The County invested almost $2.5 million in the program up to 2008 and raised about a half a million dollars from local foundations and banks. Between March 2006 and February 2007 the program reported preventing 1,497 foreclosures. The city of St. Louis has now invested more than $1 million in foreclosure prevention, including the creation of a foreclosure rescue fund that can make small payments to help homeowners secure a loan modification. Foreclosure counseling agencies in St. Louis partnered with the local public television station (KETC) to create programs and a local website to encourage people to seek help. The KETC initiative was later duplicated in twenty-five cities around the country with the help of grants from the Corporation for Public Broadcasting.

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50 Swanstrom, Chapple, and Immergluck (2009).
51 In November of 2009 St. Louis received a Silver Award for Municipal Excellence from the National League of Cities (giving $1,000 to the charity of its choice).
52 Swanstrom (2010).
The capacity of local actors to engage in foreclosure prevention varies significantly. CDCs have been “first responders” in the wake of the foreclosure epidemic. Unfortunately, many suburban areas hard-hit by foreclosures lack robust networks of CDCs. Chicago responded to this gap by creating a regional HOPI, RHOPI, which was led by NHS, Chicago Community Trust, and the Federal Reserve Bank of Chicago. The RHOPI foreclosure counseling task force developed a report mapping gaps in access to housing counseling agencies, which was used to better target counseling resources. Significant foundation and government funding for counseling in the Chicago area has filled many gaps. But this is not true in other metropolitan areas.

In 2010, the Urban Institute published preliminary findings of its evaluation of the NFMC counseling program. The study uses rigorous methods to isolate the effect of counseling, comparing approximately 180,000 households that received foreclosure counseling with a control group of 155,000 similar households that did not receive counseling. The researchers found counseled homeowners were 70 percent more likely to “cure” a foreclosure than those who had not received counseling. Counseling also produced a 45 percent increase in the likelihood that a modification would be sustained. Additionally, the Urban Institute study concluded that loan modifications received by homeowners through the NFMC program resulted in significantly reduced monthly mortgage payments after a loan modification (-$267), thereby further decreasing the likelihood of re-defaults and foreclosures.

Research supports the conclusion that foreclosure counseling can help keep families in their homes. However, the success of foreclosure counseling at best only chips away at the margins of the problem. The Urban Institute study calculated that 32,000 NFMC clients “cured”

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53. Swanstrom, Chapple, and Immergluck (2009) provides GIS maps of the location of housing nonprofits in metropolitan areas, showing their central city concentration.
their foreclosure than would have happened if they had not received counseling. Using the HUD estimate that each foreclosure generates costs of about $37,000 researchers we could estimate that the foreclosures prevented by NFMC counseling produced benefits of about $1.2 billion. As I discuss above, the benefits of foreclosure prevention are considerably higher than this if the nonmonetary costs to households and places are counted. It should also be noted that, even if they are not able to keep clients in their homes, counselors provide benefits by facilitating a short sale and referring them to appropriate agencies to find a new place to live or access social services. In any case, at a cost of $475 million, it is clear that the NFMC counseling program had a positive benefit-cost ratio.

Most people do not enjoy the benefits of taxpayer-funded counseling. One study found that about half of households that went through foreclosure never even communicated with their servicer.55 Early communication increases the likelihood of staying in your home and foreclosure counseling increases this. The authors conclude that “the availability of the service [foreclosure counseling] is low relative to the need.”56 Given the huge economic and social costs generated by foreclosures, it seems clear that the federal government should have invested more in foreclosure counseling. Local actors who have invested their own resources in foreclosure counseling have probably reaped social and economic benefits beyond the costs.

The problem with foreclosure counseling is that it does not get close to addressing the magnitude of the problem. The Urban Institute estimates that 32,000 foreclosures were prevented through foreclosure counseling. When foreclosures are running at over 1 million a year, 32,000 is only a drop in the bucket. The resilience of the foreclosure counseling system is

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low in absolute terms – relative to the need to prevent foreclosures in order to stabilize the supply and demand for housing in local communities.

The main reason for the low rate of foreclosure prevention is that servicers are reluctant to modify many loans. In order to address this problem, the Obama administration launched the Making Home Affordable (MHA) Program in March 2009 which was designed to help 7-9 million households. Over 85 percent of all mortgages are covered by the program.\textsuperscript{57} Intended to strengthen the ability of homeowners and local counselors to negotiate sustainable mortgage modifications, the program has two main components—a Home Affordable Refinance Program (HARP) for homeowners whose loans are held by the government-sponsored entities, and a $75 billion Home Affordable Modification Program (HAMP) designed to produce sustainable loan modifications for loans held by conventional lenders. Of the two, HAMP has the greatest potential to reduce foreclosures, and it also has been the most disappointing. The main components of the program are incentives to servicers to modify loans and requirements to bring monthly payments down to 31 percent of household income.\textsuperscript{58} Despite the fact that there were almost 3 million eligible delinquent loans, as Figure 4 shows, through May 2011 only 731,000 permanent modifications had been started.

For those who do receive a modification under HAMP the savings can be significant. The median monthly savings for borrowers in permanent modifications is $520.68, or 36 percent of their monthly payment before modification.\textsuperscript{59} Although HAMP has reduced monthly payments it has done little to reduce principal owed. In fact, it is common to increase overall

\textsuperscript{57} Cordell and others (2009).
\textsuperscript{58} The program offers three payments to servicers paid at different stages of the modification process totaling $3,000, as well as payments to subsidize the mortgage to bring monthly costs of the loan down to 31 percent of the borrower’s income.
mortgage debt by capitalizing unpaid interest and payments in arrears into the loan amount due in a balloon payment at the end of the loan. Borrowers are made more resilient in the short term but in the long term they may be less resilient as they still face crushing debt and often a home that is worth less than the mortgage. HAMP has been structured so that it has little if any negative effect on lenders’ balance sheets. Instead of co-responsibility for lending excesses, final responsibility rests on the shoulders of the homeowners.  

Figure 4: Permanent Modifications Under HAMP, 2009-2011

The main reason for dismally slow pace of loan modifications is that the incentives offered by HAMP are not great enough to counter servicer incentives to delay or proceed to foreclosure. Resilience theory helps to explain this result. As we noted earlier, according to resilience theory specialization and increased scale can increase efficiency at the expense of resiliency. Local housing nonprofits are small and did not have a highly developed internal division of labor. They were able to quickly shift employees and alter organizational routines to

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60 Ashton (2010).
focus on foreclosure counseling. Highly specialized and remote loan servicers, on the other hand, were rigid instead of resilient. Over time, the servicers had become large, specialized organizations highly efficient at collecting and distributing mortgage payments. “As a result of the consolidation in the industry, servicers have realized large economies of scale in payment processing and collections, so that the costs of servicing have trended down over time.”

Loss mitigation, or loan modification, however, is less subject to economies of scale and did not fit the servicers’ business model. Loan modification is labor-intensive and requires detailed knowledge of local housing markets to determine whether a loan modification is in the interest of the investors. It was as if employees at MacDonald’s were suddenly asked to provide haute cuisine.

The robo-signing scandal that erupted in the fall of 2010 gave further proof of the inadequacies of the loan servicing industry. As foreclosure volume increased, loan servicers outsourced the paperwork to specialized law firms. Called “foreclosure mills” by critics, these law firms were paid modest fees, e.g., $1,200 per foreclosure, but with high volume and low-level employees doing most of the work, supervised by a few lawyers, they could be quite profitable. Foreclosure mills were known to have hired teenagers and hair stylists to document complex paperwork. Robo-signers signed affidavits testifying to the validity of 10,000 or more documents in a month. Clearly, they had no chance to read them, let alone determine their legal validity.

Loan modifications have also been constrained by the pooling and servicing agreements (PSAs) that govern pools of mortgages. Over 90 percent of mortgages initiated in recent years

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have been securitized. Gelpern and Levitin call the PSAs “Frankenstein contracts”—brilliant human creations that come back to haunt us because we have no way of stopping the destruction they wreak. “The continuing foreclosure epidemic holds an important lesson for the future: even where rigidity makes perfect sense for the contracting parties, widespread barriers to modification can unleash catastrophic social consequences.” Contracts should be difficult to break, the authors stress, however, “private contracts must not be read to interfere with legitimate public policymaking.” They cite numerous instances, including corporate bonds and policies initiated in response to the foreclosure crisis of the Great Depression, where contracts were renegotiated in order to protect the parties involved and the broader society. As the HUD report to Congress concluded, “[T]here is growing consensus that the rules governing securitization can and do limit the flexibility of servicers to pursue modifications, even in situations where an aggressive modification would benefit both the borrowers and the investors.”

Finally, the incentives of servicers written into their contracts motivate them to proceed to foreclosure or stretch out the process rather than modify a loan. Servicers are paid a fee which is based on the unpaid principal balance of the loans in the pool and therefore, other things being equal, they do not want to refinance loans or reduce the principal owed. Services make money on loans in default, through late fees and “process management fees.” If a loan goes

66. The rigidities of PSAs come in many different forms. PSAs sometimes simply limit the number of mortgages that can be modified. Another problem is that the mortgage pools are owned by thousands of investors from all over the world and in many cases modifying loans requires the consent of each investor to modify its right to receive principal and interest payments. Modifying a particular loan can affect different investors differently because they invest in different “tranches” or slices of the overall pool. The result can be so-called “tranche warfare.”
through foreclosure, servicers recover all their expenses before any of the investors get paid.
Servicers get paid nothing for the loss mitigation work they perform.

To sum up, the policies and practices of national decision makers, private as well as public, have constricted the opportunity space for local actors to modify loans, prevent foreclosures, and stabilize local housing markets. Decisions about loan modification have been pulled out of the hands of knowledgeable local actors and placed in the hands of national servicers who lack the expertise and the local knowledge to act effectively. In addition, servicers have conflicts of interest with the mortgage investors, for whom they supposedly work, and with the public. Relying almost entirely on carrots, or incentives, to change behavior the HAMP program has been remarkably ineffective. A good example is the net present value (NPV) calculation, which participating servicers are required to conduct, and which is designed to determine if the owners of the mortgage would be better off modifying the loan or proceeding to a foreclosure. Large servicers, whose servicing book value exceeds $40 billion, may use their own default and redefault rates and they do not have to publicly defend them. Even smaller servicers have the right to adjust the standard discount rate set by the federal government, up to 2.5 percentage points, which can have a huge effect on whether the NPV calculation will support a loan modification. 69 As noted earlier, in many instances loan modifications would be in the best interest of the investors, primarily because of the large drop in value following a foreclosure. Servicers, however, can easily manipulate the NPV calculation to justify foreclosure over loan modification.

Congress and the Obama Administration chose foreclosure prevention/loan modification policies that were all carrots and no sticks. As Lester Salamon has observed, policy tools that are

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69. Cordell and others (2009, p. 28).
noncoercive often are more politically popular but less effective in achieving policy goals.\textsuperscript{70} The Making Home Affordable program is more effective at protecting the balance sheets of the banks than at keeping people in their homes or protecting neighborhoods. It would appear that incentives to servicers would have to be very generous to significantly raise the loan modification rate. More coercive policies would be more effective at less cost. Including mortgages in bankruptcy proceedings, so-called “cram down” legislation, would put pressure on servicers to modify loans because otherwise judges could force them to accept much less than the face value of the mortgage from bankrupt homeowners.\textsuperscript{71} The federal government could have performed the NPV calculations itself, or required that they meet certain standards, and then \textit{required} loan modifications where the NPV calculation supported such action.\textsuperscript{72} Such “sticks” would have greatly increased the opportunity space for local foreclosure counselors to modify loans, keep families in their homes, and stabilize neighborhoods.

\textbf{NEIGHBORHOOD STABILIZATION IN THE WAKE OF FORECLOSURES}

Largely lacking the power to prevent foreclosures, local actors find themselves in the unenviable position of trying to minimize the damage from foreclosures after they occur. As discussed earlier, foreclosures generate significant spillover effects that are quite localized and can quickly generate positive feedback cycles that can lead to neighborhood decline (Figure 3). Effective post-foreclosure resilience requires intervening early in so-called “transitional” areas where concentrated foreclosures could trigger market declines or even contagious abandonment. Successful resilience will be measured not by how many families were helped or how many

\textsuperscript{70} Salamon (2002, p. 26).
\textsuperscript{71} In the first year of the Obama Administration, cram-down legislation passed in the House but was defeated in the Senate.
\textsuperscript{72} Having said this it is worth noting that an objective NPV calculation only takes into account private interests in loan modifications. A social NPV calculation that took into account the huge negative spillover effects of foreclosures would mandate many more loan modifications as being in the public interest.
homes were put back on the market but by the ability to stabilize the supply and demand for housing in marginal neighborhoods. In short, place-based resilience must involve a market recovery strategy.\textsuperscript{73}

Market recovery strategies must adapt to the conditions of regional housing markets and submarkets. The foreclosure challenge varies—both among metropolitan areas and within them. The recent wave of foreclosures flooded across a metropolitan landscape that varied in market strength. Some metropolitan areas, driven by robust job growth and high levels of immigration, have a perpetual housing shortage relative to demand. As a result, the so-called sand states, such as Florida, Arizona, and California, experienced huge run ups of housing prices in the boom followed by precipitous price declines. Because of the underlying strong market, however, they have experienced relatively low levels of vacancy and abandonment due to foreclosures. Local actors may only need to enforce housing codes strictly and make sure that temporarily empty homes do not end up blighting the neighborhoods. Place-based resilience in the wake of foreclosures is more difficult in weak market metropolitan areas. In areas where demand is already lagging behind supply, suddenly dumping foreclosed properties onto the market only makes the situation worse and can lead to contagious abandonment.

Market conditions also vary \textit{within} metropolitan areas. Overbuilding on the suburban fringe can cause geographical booms and busts that destabilize housing submarkets in outer-ring suburbs as well as central cities. Many central cities in the northern manufacturing belt have suffered from weak demand for housing and resulting vacuances and abandonment for decades. Inner-city decline is not primarily the result of a weak regional economy but of imbalances of supply and demand within regions that results in vacancy and abandonment at the end of the filtering chain. In many metropolitan areas, more houses are built on the suburban fringe than

\textsuperscript{73} Ashton and Schnell (2010).
there are new households in the region. In the 1990s, for example, the city of Buffalo produced 3.89 more units of housing for every new household formed in the region.\textsuperscript{74} The inevitable result of such overbuilding is vacant and abandoned housing. One of the tragedies of the recent foreclosure tsunami is that it inundated communities that had pulled themselves up with focused community development efforts over many years. Concentrated foreclosures wiped out decades of hard work. As little as 3 to 5 percent abandoned properties can lead to contagious abandonment.\textsuperscript{75}

Overbuilding on the suburban fringe generates its own problems. Foreclosure rates are high in inner cities but in most metropolitan areas foreclosure rates are higher in one or more suburban counties.\textsuperscript{76} Exurban areas with so-called “drive ‘til you qualify” mortgages have suffered from a build-up of REOs (bank-owned properties).\textsuperscript{77} A study of 40,000 mortgages in Chicago, Jacksonville, and San Francisco found a statistically significant correlation, after controlling for income, between the likelihood of mortgage foreclosure and neighborhood vehicle ownership rates.\textsuperscript{78} This is not surprising because working families making from $20-$50,000 a year spend a higher proportion of their incomes on transportation (29 percent) than on housing (28 percent) and the further they live from work the higher the transportation burden.\textsuperscript{79}

The resilience literature suggests what types of neighborhoods will be more resilient to the foreclosure challenge. Areas with a diverse portfolio of housing types, transportation choices, and easier access to jobs and amenities will be more resilient. According to William Lucy neighborhoods built before 1940 have retained their housing values better than areas built

\textsuperscript{74} Bier and Post (2006).
\textsuperscript{75} Mallach (2006, p. 9).
\textsuperscript{76} Lucy (2010).
\textsuperscript{77} Immergluck (2009b).
\textsuperscript{78} Reported in National Resources Defense Council (2010).
\textsuperscript{79} Lipman (2006).
between 1945 and 1970 when developers tended to separate uses and build large numbers of similar, often quite small, homes. “Pre-1940 neighborhoods (certainly not all of them, but many) were widely varied in their housing types and quality, nearly always were more accessible, sometimes were in prime areas, including close to downtown jobs, and became attractive places to remodel or to demolish and rebuild.”

Housing policy is generally focused on affordability and production. In weak market areas beset by foreclosures, however, a focus on producing affordable units will not address the problem of reinforcing cycles of decline. Indeed, fixing up and marketing abandoned homes may only lead to abandonment in some other part of the city. A market recovery strategy requires shifting focus from properties to places. If there is an oversupply of housing, a demolition strategy in the worst off areas helps bring supply and demand into balance in the stronger areas.

Besides limiting supply, market recovery programs in weak market areas must boost demand. Success requires becoming a community of choice where people want to live in sufficient numbers to replace the normal population turnover. Healthy demand for housing in an area depends not just on the quality of the housing stock, but on an array of other factors, such as good schools, access to jobs, public spaces, and safety. An effective market recovery strategy requires what is frequently called “cross-silo” planning. Ultimately, what matters is market confidence. Are homeowners confident enough about an area to invest in their homes? Housing investment is like a game of prisoner’s dilemma: if everyone invests they can be

80 Lucy (2010, p. 64).
81 This has come to be known as “right sizing.” City governments, such as those of Detroit and Youngstown, have come to believe that they need to depopulate parts of the city in order to support renewal in other parts of the city.
82 For an early seminal statement on the need for a market recovery strategy in weak market areas, see Brophy and Burnett (2003).
83 Buki & Schilling (2010).
confident they will get a good return on their investment; but if one person invests alone, he or she will almost certainly not get back the investment upon sale of the home. The importance of market confidence suggests the need to act quickly to address signs of disorder, like high grass or broken windows in a foreclosed home. Market stability is not only possible in wealthy neighborhoods; working class neighborhoods can be stable if there is a high level of market confidence.

**THE FOG OF FORECLOSURES: DATA AND LOCAL EMPOWERMENT**

If the foregoing analysis of the foreclosure challenge is correct, interventions need to be precisely targeted across time and space. Local actors need to intervene early in the process—before foreclosures have set in motion reinforcing processes of decline. Second, local actors need to identify areas where interventions could make a difference. This means “transitional” communities that had healthy demand but where concentrated foreclosures could tip the area into contagious abandonment and decline. For these reasons, real time, fine-grained data on the foreclosures are necessary for effective local interventions. Without sophisticated data systems local actors are often in a “fog”—groping forward based on inconsistent and out-of-date data.\(^{84}\)

The foundation of an effective market recovery strategy is identifying transitional neighborhoods. This is not an easy task. The Reinvestment Fund in Philadelphia has pioneered using cluster analysis to identify transitional neighborhoods.\(^{85}\) This requires collecting a wide range of housing data at the block group or neighborhood level. A statistical analysis is then performed (cluster analysis) to identify which neighborhoods are performing similarly.

\(^{84}\) Good data is also crucial for putting the foreclosure issue on the public’s agenda. As Deborah Stone (1998, p. 187) has observed, “The process of counting something makes people notice it more….” In metro area after metro area, visually arresting GIS maps showing the growth and spread of foreclosures across a region have been crucial in garnering public attention. For a discussion of local agenda setting, see Swanstrom, Chapple, and Immergluck (2009).

\(^{85}\) Goldstein and Closkey (2006).
Neighborhoods can be arrayed from the strongest to the weakest, with transitional areas in the middle. Cluster analysis requires a wide array of parcel-based data and a skilled analyst. The technique is not automatic. It requires knowledge of local markets in order to identify the number of clusters and final results must be evaluated in the context of developments not captured by the data, such as where a new school or grocery store is being built.

The foreclosure challenge is a complex process that rolls out over time and space. There are at least seven stages that are important to track: 1) loan origination; 2) delinquency; 3) foreclosure notice; 4) sheriff’s sale; 5) disposition of bank-owned (REO) properties; 6) vacant units; 7) abandoned properties. After a REO sale by the bank, for example, local actors need to know whether the property was bought by an owner-occupier, a local housing nonprofit, a local investor, or a national speculator. The foreclosure challenge is constantly changing so responders need up-to-date data to adjust their policy responses. If local actors know the location and timing of different kinds of loans, they can anticipate foreclosure trends. Many subprime loans began to reset to higher interest rates in two years but Alt-A loans often have resets after about five years. To anticipate when neighborhoods will be hit with more delinquencies and foreclosures, local actors we need to know how many Alt-A loans were originated and when they will reset. They also need to be able to disaggregate the data to small geographies. Housing markets are local and processes of contagious abandonment are very local. Research has shown that foreclosures damage property values in a circle with a radius of about one-eighth mile or 660 feet (see earlier discussion of spillover effects on surrounding homeowners). To track the spillover effects of foreclosures we need data at the census tract level and smaller – even down to the block or parcel level.
Simply counting foreclosures is difficult because of data inadequacies. National data on subprime lending were not collected until 2004 when HMDA reporting was expanded to include information on high-cost loans. In retrospect, these data were crucial in putting the issue before the public and making the connection between subprime loans and foreclosures. These data, however, do not include ARMs and do not tell who originated the loan—among other flaws. Data on completed foreclosures are even weaker. Because the foreclosure process is regulated by the states, the process varies and the data recorded are often not comparable. In order to get meaningful data, labor-intensive cleaning and compiling of data is necessary. Because there is no national data depository on foreclosures, the private sector has stepped in. RealtyTrac is a private firm that is often relied upon for foreclosure counts, but its data are notoriously uneven and unreliable. Local actors frequently use it anyway because it is free. McDash Analytics, now CoreLogic, has compiled more accurate data but they are expensive. One of the major reasons why local actors often operate in a “fog of foreclosures” is because mortgages and foreclosures are essentially a private transaction and public access to accurate data is limited.

Good data are also needed after loan origination in order to prevent people from going into foreclosure and being forced from their homes. Research has shown that contacting people early in the process facilitates better outcomes. Probably because of the stigma of foreclosure, people often do not take action to avoid foreclosure by talking to their servicer or seeking counseling. As a result, it is important to reach out to people who are facing foreclosure. In order to do this, counseling agencies need data on where loan delinquencies are concentrated. Thus, for example, it would be useful to have data on loan delinquencies as a precursor to a foreclosure notice. The Mortgage Bankers Association conducts a survey of mortgage
delinquencies but it is not disaggregated to small geographies and, therefore, cannot guide foreclosure counseling agency outreach efforts.

Data are equally important in the post-foreclosure process. Here, once again, the fog can be thick. Data on the number and duration of REO properties are an excellent indicator of market recovery. The accumulation of REO properties in specific areas indicates a weak market and possible contagious abandonment. Dan Immergluck states the problem bluntly: “Data on foreclosures and post-foreclosure properties, such as REO, are not compiled on a regular, uniform basis by any public agency at a multistate level.”

Forced to use a private national database, Immergluck found that REO properties are not just accumulating in central cities in weak market metropolitan areas but also in distant “drive-‘til-you-qualify” suburbs in strong market metros. After a property is sold out of REO, local governments often do not even know who owns it and, therefore, they cannot hold the owner accountable for cost of maintenance—such as grass cutting or board-up of vacant properties. Vacancy data would also be useful in determining which neighborhoods are vulnerable to contagious processes of abandonment and decay. The United States Postal Service has data on vacancies but they have many flaws.

Despite the obstacles some regions have developed sophisticated regional data utilities that expand the opportunity space for local actors. Under the leadership of the Northeast Ohio Community and Neighborhood Data for Organizing (NEO-CANDO) at Case Western Reserve University, the Cleveland metropolitan area has developed one of the best data collection and analysis systems in the nation. NEO CANDO gathers neighborhood data for 17 counties in Northeast Ohio and makes them available to the public on its Web site. Established in 1992, NEO CANDO has a strong support from area foundations and has played a key role in the

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86. Immergluck (2009b, p. 3)
rethinking of community development in Cleveland from a bricks-and-mortar orientation to one focused strategically on fortifying markets in a handful of transitional neighborhoods.

The sophisticated regional data system in Cleveland is more the exception than the rule. This is because under the present rules of the game developing a sophisticated regional data system is expensive, labor-intensive, and politically challenging. The first problem is that the private nature of foreclosure data and the fragmented collection of parcel-level data at the state and county level means that every metropolitan area must reinvent the wheel, cleaning and organizing the data in an expensive and time-consuming process. Because there is little profit in doing it, creating a regional data utility requires significant public or foundation funding. Moreover, much of the parcel-level data are controlled by county assessors who are concerned about tax rates and assessment practices, not public policy. Many are underfunded and the data are not digitized, requiring laborious hand entry. Some counties sell the data. Acquiring access to these data at a reasonable cost and on a regular basis requires negotiating political deals with each county.87

The solution to the problems of data on foreclosures is a policy of “targeted transparency.”88 Targeted transparency policies have five essential characteristics:

- Mandated public disclosure
- By corporations or other private or public organizations
- Of standardized, comparable, and disaggregated information
- Regarding specific products or practices
- To further a defined public purpose.89

89. Fung, Graham, and Weil (2007, p. 6).
When problems are widely dispersed across the nation or locally variable, two characteristics of the foreclosure challenge, a policy of targeted transparency makes the most sense. Governments act as “stewards of transparency policy by compelling disclosure of needed information when participants cannot obtain it, fostering common definitions and accurate metrics, and providing feedback and analysis to encourage transparency improvement.”

A good example of targeted transparency is the 1975 Home Mortgage Disclosure Act (HMDA). Motivated by fears of redlining and discrimination in lending, HMDA required federally regulated lenders to report on the loans they made by census tract; later, they were required to report on the race of applicants and loan recipients. The 1977 Community Reinvestment Act (CRA) required regulated lenders to “meet the credit needs of their communities.” Community-based organizations have used HMDA data to challenge the banks and during the formal period of the challenge the lending institution is prohibited from merging or opening new branches. In order to avoid negative publicity and stop the challenge, banks often have negotiated community lending agreements in which they agree to lend to low-income and minority neighborhoods. According to the National Community Reinvestment Coalition, between 1992 and 2000 the value of CRA agreements totaled $1.09 trillion. A study by the Federal Reserve Board concluded that CRA opened up new profitable business opportunities for banks and CRA loans generally performed as well as non-CRA loans.

HMDA, originally designed to address the problem of redlining, could be reformed and expanded to address the problem of greenlining. First, HMDA needs to be extended from federally regulated institutions to all mortgage lending. Data should be reported in a common

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format and standardized way to track mortgage lending from loan origination to REO sales so that they can be disaggregated to small geographies, preferably census tracts or smaller. In addition, data should be reported in real time so that actors can keep pace with fast-changing trends. The Internet enables data to be shared almost instantaneously with users. In addition, HUD should work to require county assessors to share parcel-level data in a standardized and digitized form. There is no reason why each county should record and store parcel-based data in a different way. HUD could condition grants on developing statewide common property reporting requirements. In order to facilitate digitizing data HUD should consider competitive grants to states or county assessors.93

Once the necessary data are made available in a common format and on a timely basis there still is the problem of regional actors developing the analytical capacity to manipulate the data in meaningful ways. Regional data clearinghouses, like NEO CANDO, have developed in metropolitan areas across the country, usually by university-led groups. Community foundations have played key roles in developing regional data clearinghouses. However, many regions lack strong community foundations. National organizations like the National Vacant Property Campaign, the National Neighborhood Indicators Project, and Living Cities have played the role of national intermediaries in promoting regional data capacity, but capacity varies tremendously across regions. HUD should consider start-up grants for regional data clearinghouses. Modest amounts of funding could leverage meaningful increases in data gathering and analytical capacity.

93 HUD will also need sophisticated regional data system to evaluate National Stabilization Program (NSP) grants. This will require an understanding of the NSP interventions and an analysis of housing market dynamics that will enable researchers to isolate policy effects from normal neighborhood trajectories. See Kingsley, Smith, and Price (2009, p. 43).
The primary federal policy to help areas to rebound from foreclosures is the aptly named Neighborhood Stabilization Program (NSP). Originally funded at $3.92 billion under a formula grant, a second phase of competitive grants (NSP2) received an additional $1.92 billion, and in 2010 another $1 billion was authorized for formula grants. Most of the money has been used to buy foreclosed properties, fix them up, and put them back on the market. The program is small relative to the need. Under NSP 1, for example, St. Louis County, Missouri, received $16.5 million ($9.3 as a direct allocation from the federal government and $6.2 million allocated from the state of Missouri). At $100,000 per home, this is enough to buy, improve, and sell about 165 properties. In a county which had almost 4,516 completed foreclosures in 2010 this means the funds could treat only 3.7 percent of the foreclosed properties.\textsuperscript{94}

Given the low level of NSP funding relative to the need, it is clear that funds need to be strategically targeted to make a difference.\textsuperscript{95} Spreading the funds around, the so-called peanut-butter approach, risks wasting taxpayers’ money when market dynamics overwhelm rehabilitated homes. Instead, investments must be concentrated on “transitional” neighborhoods where foreclosures could tip a previously stable area into decline.\textsuperscript{96} Transitional neighborhoods are areas with strengths but where the negative spillovers of foreclosure could multiply. This is where NSP funds can produce the biggest bang for the buck.

NSP rules shrunk the opportunity space for neighborhood stabilization by impeding the ability of local actors to tailor the program to local conditions. Under NSP 1, for example, recipients were required to spend the funds only on foreclosed properties. But if the goal of the

\textsuperscript{94} Of course, if the properties are sold the NSP funds can be recycled so that more properties can be helped over the long run.

\textsuperscript{95} For evidence on the need to target expenditures to achieve market recovery, see Galster, Tatian, and Accordino (2006).

\textsuperscript{96} See Goldstein (2008) and Mallach (2008).
program is “neighborhood stabilization,” local actors should have the freedom to spend the money on nonforeclosed properties if they are key to market recovery. Under NSP 1 at least 25 percent of the funds had to be used for housing families whose incomes did not exceed 50 percent of the area median income. Such a requirement, however, will shrink the opportunity space if a community needs to concentrate on attracting working class and middle-income households in order to stabilize housing demand. NSP required that the funds be allocated within 18 months, even though neighborhood stabilization requires a much longer time frame. This is not the place to go into a full-scale critique of the NSP program except to say that giving recipients more freedom to pursue a market recovery strategy would make sense. At the same time, requiring recipients to concentrate resources in neighborhood strategy areas would also help, partly by helping communities to overcome political pressures to spread the money around, what Anthony Downs called the “law of political dispersion.”

The sophistication required to develop and implement an effective market recovery strategy raises the issue of local capacity. There are two general kinds of capacity. One could be called “administrative capacity”, which refers to the ability of local NSP recipients to spend the money in a timely fashion while still meeting all regulations. Implementation of NSP requires a daunting array of competencies: identifying foreclosed properties and contacting the new owners, negotiating a purchase price that meets federal requirement to pay below appraised value, assessing the need for rehabilitation and evaluating whether the combined costs of purchase and rehab will keep the house affordable, assessing the demand to purchase or rent rehabbed homes, finding homebuyers or renters who meet the guidelines, clearing title, and meeting environmental regulations, such as those on lead or brownfields.

Many recipients of NSP funds, especially suburban governments, have little or no experience buying and rehabbing properties. Just getting the money out the door in a timely fashion is a challenge. In May 2010 HUD estimated that as much as $1 billion of the $3.92 billion would be unobligated by the deadline and would have to be reallocated by HUD.\footnote{The final amount of unobligated funds appears to be much lower, on the order of 5 percent. See \textit{Community Development Digest}: \url{http://www.housinganddevelopment.com/cdd/index.php?mod=spub&str=2153} (accessed November 13, 2010.)} To HUD’s credit, it has revised the rules to speed up implementation and has worked with local recipients to increase their administrative capacity.

The second type of capacity, what I call “strategic collaborative capacity”, is in even shorter supply. Strategic collaborative capacity refers to the ability of an NSP recipient not just to spend the money in a timely fashion but to develop and implement a targeted market recovery strategy. Strategic collaborative capacity requires collaborating across 1) policy functions, 2) sectors (public, private, nonprofit), and 3) governments.

1. \textit{Cross-functional} collaboration is required because sustaining housing demand depends not just on housing but on other policy functions, including schools, transit, police, and parks.

2. \textit{Cross-sectoral} collaboration is required because local governments lack the local knowledge to implement neighborhood stabilization programs effectively. An effective market recovery strategy requires identifying blocks where a few lower-quality homes or foreclosures are pulling down the values of a significant number of higher quality homes.\footnote{Buki and Schilling (2010).} Nonprofit community development corporations (CDCs) possess the political legitimacy and block-by-block knowledge of housing markets.
needed for effective market recovery. The cooperation of real estate agents and lenders is also necessary to sustain market confidence.

3. *Cross-governmental* collaboration is needed because small suburban governments lack the scale and expertise to implement effective market recovery strategies and because transitional neighborhoods need to be connected to regional job opportunities. Moreover, smart growth policies that limit suburban development aid the success of neighborhood recovery in weak market regions.

Strategic collaborative capacity varies tremendously, both across and within metropolitan areas. Collaborative capacity is based on trust, which, in turn, depends on a history of collaboration. As Robert Putnam has observed, unlike financial capital which is depleted with use, social capital is enhanced with use; the more you use it, the more you have. Every time two actors collaborate to achieve a mutually beneficial outcome, it becomes easier to trust that the parties will live up to their obligations the next time. Some regions have robust networks of housing nonprofits and long histories of collaboration across the public, private, and nonprofit sectors. Community foundations have played key roles in developing this capacity in metropolitan areas such as Chicago, Minneapolis, and Cleveland.

In 2008 Living Cities, a partnership of leading national foundations, initiated a $5.25 million, ten-city pilot program to support promising initiatives to mitigate the effects of concentrated foreclosures on urban neighborhoods. For the most part, this was a capacity-building program. Living Cities supported Neighborhood Progress, Inc. (NPI) in Cleveland to develop its Strategic Investment Initiative (SII), one of the most promising market recovery

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101. For an evaluation of the Living Cities initiative, see Mayer and Temkin (2009).
projects in the nation.\textsuperscript{102} NPI identified six neighborhoods (expanded to nine in 2010) where NSP and other funds will be concentrated. The neighborhoods were picked because they are “transitional,” possessing strengths such as new schools or retail centers that can be built on, and having strong CDCs able to coordinate a sophisticated market recovery strategy. The goal is to demolish 100 homes, redevelop 121 vacant homes, and prevent 100 homeowners from losing their homes through foreclosures. With thousands of foreclosures being dumped on an already weak housing market, there is no guarantee of success.\textsuperscript{103} But without a targeted strategy the chances of success would be practically nil.

In short, uneven strategic collaborative capacity is a huge barrier to effective local resilience in the wake of foreclosures. Federal policy should pay much more attention to developing regional collaborative capacity.\textsuperscript{104} HUD faces a dilemma: formula grants, such as NSP1, risk funding jurisdictions lacking administrative and collaborative capacity; on the other hand, competitive grants, such as NSP2, risk rewarding the “gazelles,” those regions that already have strong capacity. More funds should be committed to capacity building.\textsuperscript{105} To its credit, HUD has begun to address the capacity issue through its Sustainable Communities Grant program, which sets aside part of the funding for regions to fund collaborative processes of sustainable community planning. Originally funded at only about $100 million annually, the Sustainable Community Planning grants do not come close to meeting the need for capacity building.

\begin{itemize}
\item \textsuperscript{102} SII is supported by the City of Cleveland and the Cleveland and Gund foundations.
\item \textsuperscript{103} NPI has negotiated an agreement with servicers to freeze the foreclosure process for ninety days to prevent vacant properties from flooding their target areas in an untimely fashion.
\item \textsuperscript{104} NSP2 did include $50 million for capacity building.
\item \textsuperscript{105} For recommendations along these lines, see Brophy and Godsil (2009, ch. 4).
\end{itemize}
CONCLUSION: FEDERAL POLICY AND LOCAL RESILIENCE  According to a recent Pew Research Center Survey, “Americans are more skeptical of Washington than ever.” Even in the wake of widespread predatory lending and the abuses on Wall Street public opinion has shifted toward wanting a smaller government with fewer services. The victories of the Tea Party candidates in the 2010 off-year election are more evidence of mounting distrust of the federal government. Even though only 38 percent of respondents viewed the impact of the federal government on their lives as positive, a majority (51 percent) reported a positive view of local government. Americans trust local governments more than the federal government. The foregoing analysis suggests a way to legitimize federal policies across the partisan divide. Strong federal policies do not necessarily undermine local self reliance; they can expand the opportunity space for local actors to respond effectively to local challenges such as foreclosures.

Although the emphasis here has been on local resilience, basic regulation of mortgage lending belongs with the federal government. The greatest contribution the federal government could have made to local resilience would have been to limit the subprime and predatory lending that unleashed the foreclosure crisis in the first place. It is unrealistic to expect local or even state governments to regulate mortgage lending effectively because they have a stake in a prosperous real estate sector and rising property values and, therefore, will be biased toward loose credit standards. So long as federal regulators are freed from competing for fees from regulated entities, they should be able to represent the interests of consumers and work to support sustainable lending policies.

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The question now is how to cope with the waves of foreclosures that will continue for years into the future. We need resilient local actors, both to keep as many people in their homes as possible and to minimize the damage from completed foreclosures. As we have seen, there are many ways the federal government can help to expand the opportunity space for local actors. The federal government can put in place a system of carrots and sticks to motivate servicers to work with local foreclosure counselors to modify loans and keep families in their homes. Only the federal government has the resources to fund post-foreclosure neighborhood stabilization policies at a level commensurate with the need. Locally devised market recovery strategies involving collaboration across governments, functions, and sectors are the keys to neighborhood stabilization. Above all, the federal government needs to address the uneven administrative and collaborative capacity of local actors to devise and implement sophisticated market recovery strategies.

Finally, resilience theory suggests what kinds of places will be most resilient to future challenges such as foreclosures. According to resilience theory, diversity and flexibility are correlated with resilience. Places with a diverse housing stock that can accommodate households at different income ranges and different life stages will be more resilient than a neighborhood with only one type of housing. A neighborhood with a wide range of transportation choices (auto, transit, biking, and pedestrian) will be more resilient than a completely auto-dependent area. And a community with flexible local organizations able to track real estate trends in real time, shift resources quickly, and collaborate across sectors will be more resilient than a community without such organizations. National policies can help build such resilient places.
References


Center for Responsible Lending. 2008. *Subprime Spillover: Foreclosures Cost Neighbors $202 Billion; 40.6 Million Homes Lose $5,000 on Average.*


