REO & Vacant Properties: Strategies for Neighborhood Stabilization, September 2, 2010
Reserve Bank President Perspective: Sandra Pianalto

Sandra Pianalto:
Thank you, Alicia for that nice introduction and I want to thank all of you for being here today. And for participating in this very important conference. As a Federal Reserve Bank president and policy maker, I can't emphasize enough how valuable your efforts are in helping to improve the conditions in our communities throughout this country. And I support your efforts wholeheartedly. And I'm also very delighted to see our publication be on the REO publication that so many of you in this room have contributed to.

This conference and the REO publication are just an example of the commitment and work that we've been involved with. The leadership for this work comes from the very top of our organization. I can tell you that our chairman Ben Bernanke and Governor Betsy Duke especially have been so committed an engaged in these efforts and also I am so pleased that we have to support their efforts and our efforts a very talented and dedicated staff here at the board led by Sandy Braunstein. They have – and I know all of you already know this -- and I know all of you know here in this room they have a passion for this work that is just tremendous. And that passion also is spread throughout the Federal Reserve system. And we have had so much focus and effort in this area. So I'm pleased that we're having this conference and I'm pleased today that we're going to be talking about some of the solution that our work, our research efforts have come up with. And this morning, Eric and I are going to highlight different experiences that we've had from our two Federal Reserve districts, but even though our experiences are different, I can tell you that we both -- our banks have been working very hard to deal with the pressing issues of REO and vacant properties. In Cleveland, I'm very fortunate to have a staff, as Alicia mentioned, that has been very engaged in these efforts for long before this crisis began. And we've been very fortunate, I've been very fortunate to have our community affairs efforts led by Ruth Clevinger who is here today and was moderating a panel yesterday, through her staff, very dedicated and strong staff. We have been able to hit the road running as this crisis unfolded because as has been said we've been engaged in our efforts for some time and I'll comment about that. And our staffs have been using a variety of tools to address the current needs and you know to assist us, our communities to the greatest extent possible. And while the reserve banks have limited authority in this area, you know, we have been actively researching these issues. And we're also using our capacity as conveners to, you know, foster collaboration among lenders, property owners, public officials, and community groups. And as I said, we've been engaged in this, the system has been engaged in these efforts for a long time, but we've brought a great deal of focus to these efforts in the past couple years. Charlie Evans mentioned that last night in his comments.

And you know, some examples of that is the Federal Reserve community affairs function cosponsored more than 280 foreclosure related events across the country over the past couple years. And 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 Governor Betsy Duke spoke eloquently about some of the problems we're facing in Cleveland as well as some of the efforts we've already taken to deal with them. This morning I'm going to give you a fourth district perspective and as you know, I think many of you know, the fourth district includes all of Ohio, the western half of Pennsylvania, the eastern half of Kentucky and the panhandle of West Virginia. And the REO problems in the communities within that district are very severe. And the resources, as you can imagine, during these tough economic times are quite limited. But the need for assistance is strong and immediate. So this morning I'm going to explain some of the weaknesses that we face in our area, in our region but also talk about some of the strengths that we found in our district, and then I'm going to talk about some of the ideas that have emerges from our bank's outreach efforts and finally I'll describe a new proposal to use the Community Reinvestment Act's flexiblity to channel the REO problem.

So let me begin with the weaknesses we face in the district and some of the strengths we found. One major weakness and I know this is obvious to everyone at this point is that our district is a weak market region and when I say weak market, I'm referring to just the long term loss of overall population. As well as migration within our region to areas outside of our central cities. In Cayuhoga County where Cleveland is located, we lost 7 percent of our population from the period of 2001 to 2009. Between that same period, 2001 to 2009, total private employment in Cayuhoga County fell by 14 percent. And we struggle tremendously with stubbornly high unemployment rates. So these weak market trends left a serious excess of housing in our region well before the housing crisis got under way nationally. In some parts housing sales began to weaken as early as 2004. So simply put Ohio's problems are more entrenched because they're tied to structural weakness in our economy, not just cyclical weakness. As population declines and job losses increase, a major by product of course, is vacancies in residential and commercial properties. And of course, the housing and foreclosure crisis made this problem that already existed much worse. And I'm sure many of you have heard that Cleveland has been 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 in 114 days in 2006 to 954 days in 2010. Of course, you know, the longer a property remains vacant, the more collateral damage is done to the property values nearby. And it doesn't take long for neighborhoods to suffer from increased crime, arson and blight. And so we're still very far from a recovery in the housing market in our region. The losses and the hardships in our neighborhoods that they've been experiencing is just staggering, and in many low income communities, decades of progress that we were making prior to this crisis has just been wiped away.

Fortunately we found that in our region, we also have real strengths and those strengths are helping to combat some of these weaknesses we're seeing. We're blessed with a collaborative and sophisticated community development culture, our local elected officials, our community-based organizations and our financial institutions have been working together effectively for years. As I said our housing crisis started long before the national housing crisis, so in some ways that got us more ready to work together to address some of these issues that's in other parts of the country. These groups have shared a wealth of experience and long standing partnerships in a solid commitment to community reinvestment. So they've been able to achieve some real results even in these very, very challenging and tough times. 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 reuse of land in our urban neighborhoods. One example that one outcome is a new what's called the new Renaissance at Fairfax park. It's a $6 million multifamily building project that is for seniors and you know, this project is (audio cutting in and out) this project sprang up from formerly blighted area in that community. Also what was once a steel manufacturing plant in Cleveland has been transformed into what's now called steel yard commons and it's a million square foot shopping center that has brought not only a much more attractive structure in that area, but it's brought new jobs because it's brought real retail jobs and also many services to the residents in that area. Another example the Cayuhoga County land bank that was formed last year by partnerships among county offices, the city of Cleveland, suburban officials and again the community development corporations is another example of the collaboration that has brought tremendous results. Through the land bank, the county can reclaim vehicle ant and abandoned properties for productive reuse. The land bank has reacquired properties through a number of partners GSEs and financial institutions that hold foreclosed properties and also in partnership with individual property owners and nonprofit organization organizations. And this land bank is the lead agency in implementing $40 million in neighborhood stabilization program funds along with partners in Cayuhoga County, the city of Cleveland and the Cayuhoga Metropolitan Housing Authority. And you can read more about the land bank in the publication. There's an article, by Tom Fitzpatrick from our bank and it's -- I hope, it's an informative article and I hope you find it informative also. Of course, despite these successes that I'm pointing to, there's just a tremendous amount of work that remains in our hard hit communities in Ohio.

So now I'd like to discuss some of the ideas that have emerged from the efforts related to the housing crisis. Many other reserve banks at our bank it's been all hands on deck dealing with this issue, not just our community affairs department that's been out there working on this issue. As Charlie mentioned yesterday, our research departments have been engaged with this along with supervision staff. With the problem of the size and complexity that we face, it became pretty clear that there wasn't going to be a one solution fits all. It was going to take multiple efforts and multiple solutions to come up with solutions to this crisis. And our research effort has led us to understand that the housing market collapse is -- again, some of this is obvious to so many in this room -- but it's a destructive cycle. In our region mortgage delinquencies led to a higher number of foreclosure which led to an oversupply of housing which then led to home prices depreciating and borrowers and financial institutions taking on big losses. To break this cycle, it was clear that we were going to have to have a coordinated set of policies and these policies were going to have to deal and address many points of break down in this process.

And we also realized that as we were rolling out some of the policies that we were going to have to make sure that they were helping in an intended way because as we've seen, some policies just weren't as effective and weren't working in the way they were intended. So each time we found some policies and efforts weren't working, it was important for us to step back and address and bring new ideas to the table. And you've all been very supportive and helpful in making that happen. One example of that is that in the early stages of this housing crisis, researchers thought that loan modification would be the appropriate answer to address the situation. But unfortunately after conducting a series of public events we found only a small percentage of distressed loans have been modified successfully. I know you talked about that yesterday. And we found that obviously some of the failure was due to loan servicers operating with a business model that just wasn't designed to address the immediate needs of troubled borrowers. So in recent months we've discovered that obviously the main reason that people are finding themselves in foreclosure and needing assistance is due to the employment crisis. So the loan modification enough wasn't enough to address the housing crisis. Over the last couple years, our research at the Cleveland Federal Reserve Bank let us to then focus in on two areas that we thought would be more promising in addressing some of the issues that we face in our region and those two areas that we thought would be more promising, and those two areas are the neighborhood stabilization program and the Community Reinvestment Act. You obviously talked about the NSPC yesterday, and you're well aware of the reason it was put in place was to help communities acquire distressed properties and put them back to productive use. And we learned a lot about NSP program when our bank partnered with the Federal Reserve Bank of Richmond to conduct a series of surveys in our respected regions, and we learned more about what was working and what wasn't working. And our goal was to find ways so that the NSP program could be used more effective to address the programs in our neighborhoods. And we shared what we learned with the Richmond Fed and Cleveland learned with the Department of Housing and Urban Development. And I commend HUD in its responsiveness in using the information that we shared with them to make the changes that communities needed to the NSP program. And the changes that they've made I think are going to make the program much more effective because of the changes that they are willing to make from our suggestions. Looking ahead, it's clear more needs to be done to take advantage of the NSP program. Our case studies and research found that there needs to be a lot of up front comprehensive planning. It can't just be a onetime, this it, look at this and address the problem. It really does take a lot of comprehensive planning. We heard that yesterday from the practitioners and our panelists where these funds are being most effective is where there is a comprehensive long term plan for the use of these funds.

And in our outreach effort, we have again seen that that's where the NSP funds are most effective.

That community leaders have to look outside of the traditional ways that they might look at funding like this or approach funding like this.

NSP is a great tool. But communities obviously can't take advantage of this tool and the money without first being able to identify who owns the distressed properties and who owns them with clear titles to them. Community groups would like to acquire the distressed properties for reuse either as new rehab housing or for green space but it takes time to track down the owners and then it takes time for that to happen, and neighborhood recovery efforts just can't go forward and they suffer as properties are sold in bulk to out of town investors, many of whom are flippers. And even if community groups can acquire these vacant properties in time, the community often needs additional resources obviously to rehab the properties and to pay delinquent taxes. The community groups who have engaged with our bank in conversations about how do you make that happen, over the last two years, we found through those conversations that one potential way of addressing some of these problems is to use the CRA. And using CRA as an incentive for a financial institutions to maintain REO properties and then to sell it to responsible investors. However, when we talked about using the CRA, it wasn't immediately obvious how we could do this. After all, bankers and community leaders and academics alike told us that in the age of Internet banking, CRA rules are just insufficient. We all know that our history with CRA has been that CRA credits get awarded to banks that focus on neighborhoods where they have a branch presence but that it's clear in a situation and environment like today, you know, banks might be only distressed properties outside of their CRA assessment areas. So in addition we also learn CRA was meant to advance credit to low and moderate income properties so that mortgages and homes could be purchased. And what we found though in this situation, the best way to serve these low and moderate income neighborhoods was to help them acquire and tear down properties, not necessarily to advance more credit, to own new property. So fortunately we learned as we did more work that the CRA does have enough flexibility, the act the way it was written does have enough flexibility so we could use it in more creative ways and our research staff and community staff put their heads together and came up with a proposal to use CRA through   not having to revise the act but to revise some of the regulations around CRA. Rand through some of that thinking it has led to a CRA proposal by the four regulatory agencies. The comment period for that has just ended and I think through this proposal, I think we're going to have some good outcomes. First we suggested that giving banks more CRA credit if they would shift some of the resources that they usually devote to CRA activities where they have branches to areas where dispositions in the weakened markets so technical recruiters could be focusing CRA presence there and they don't have to have physical presence in those markets. That was the first suggestion.

And the second suggestion was we said banks should be able to claim CRA credit for acquiring and tearing down rehabbed and distressed properties. And I'm very pleased again that the recent CRA rule changes proposed by the four regulatory agencies are very close in spirit to our proposals. I think the proposed changes would amend CRA regulations to more support those communities that have these high foreclosure issues. So the interagency proposal I think is going to be   is consistent with some of the work that our bank staff has done and the work that we've been hearing through our outreach efforts for so many of you. But it's clear that the CRA is just one cool and as so many of you have said throughout the day yesterday and I'm sure we'll hear today, it's going require numerous interventions if we're going to really address the concerns and the magnitude of the foreclosure crisis. And I know I speak for all of us in the Federal Reserve system when I say we feel a great sense of urgency in getting the housing market back on its feet. We indeed know that a healthy housing sector is so critical for the overall economy and for a sustainable economic recovery. The federal system is decentralized and it's been helpful obviously throughout our history but it's been extremely helpful to us during this housing crisis. Because it gives us on the ground people throughout the country to work with so many of the community groups, so many of you. And through that outreach again we've been able to come up with numerous ideas and solution that's we will hear more about today. We're going to continue obviously to help and support the community leaders and policy makers throughout our research activities. And I know that each of you that have taken the time to be part of this conference, to contribute to the publication that we've released on these issues, I know that you're critical in the making policy solutions to this enormous task in revitalizing the housing sector a success.

So I think all of you for your hard work and your creativity and your dedication to this very important cause. And now I'll turn the program over to Eric.