

# New England Community Developments

Emerging Issues in Community Development and Consumer Affairs

## What *Do* the Neighbors Think? Assessing the Community Impact of Neighborhood Stabilization Efforts

*By Erin M. Graves, Federal Reserve Bank of Boston*



As a qualitative researcher, I believe that essential to understanding the socio-economic conditions of the population I am studying is to experience those conditions for myself. The ideal experience would be to become part of the population through years of immersion, which is not often practical professionally or personally. Still, when I began trying to assess the impact of a foreclosure intervention policy on Boston's high-foreclosure neighborhoods, which are also its poorest, most crime-filled

and racially segregated, I knew I needed to be there, if not day and night, at least day after day.

The federally funded Neighborhood Stabilization Program (NSP) gave the City of Boston several million dollars to acquire, rehabilitate, and resell abandoned, foreclosed homes in high-foreclosure neighborhoods. The federal government required grantees to acquire foreclosed properties within "areas of greatest need" (which HUD also refers to as "target areas"). The low-income

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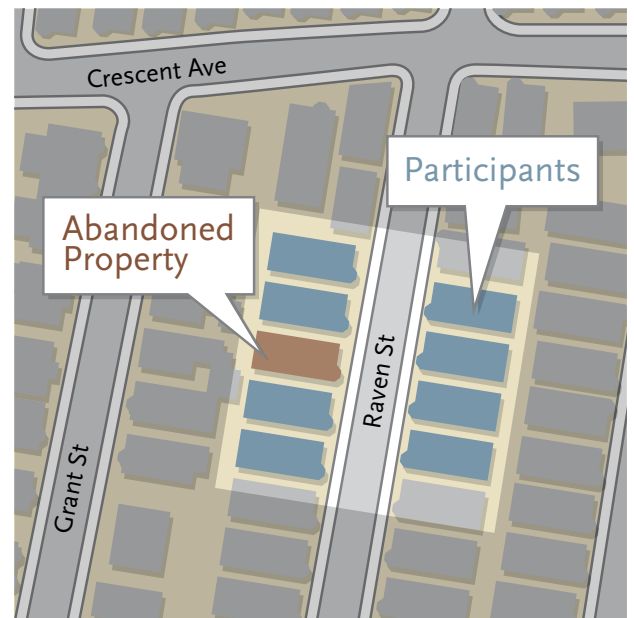
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neighborhoods of Dorchester and Roxbury fulfilled these criteria with less than a fifth of all housing units, but nearly 50 percent of the foreclosures.<sup>1</sup> These two neighborhoods also had disproportionate crime rates: in 2009, 17 of the 33 homicides from firearms in Boston occurred in Dorchester and Roxbury, despite the fact that just 1/5 of the population lived there.<sup>2</sup> Similarly, 35 percent of the violent crimes and 24 percent of the property crimes occurred in these two neighborhoods.<sup>3</sup>

The NSP sought to limit what Mallach calls “secondary effects of the mortgage crisis—the economic and social impacts on properties, neighborhoods and communities.” Mallach suggests that these will actually affect people more strongly than foreclosure itself.<sup>4</sup> Attempts to quantify the impacts, such as the changes to property values of nearby homes, are underway. For example, HUD engaged Abt Associates to conduct a large-scale study to be completed in 2014. However, I know of no attempts to assess the impact of the program based on residents’ perspectives on neighborhood-level social capital and social disorder, which are indications of neighborhood social stability. My question was whether the policy would have an impact on neighborhood social stability. Neighborhood social stability matters in part because it is linked to price stability: high residential turnover coupled with neighborhood distress lowers home prices.<sup>5</sup> To reach residents and learn about the level of social stability, I decided to go door-to-door in the target areas and administer the standardized and validated “Sense of Community” survey, which assesses residents’ perceptions of social capital and social disorder. I targeted both the group of homes receiving the NSP intervention and a control group of abandoned foreclosed homes in the neighborhood. I augmented the survey with two open-ended qualitative questions.<sup>6</sup> In addition to the eight properties acquired with NSP funds, I identified eight more abandoned, foreclosed properties in the neighborhoods, which serve as the control group. I intend to administer this survey longitudinally; the first round prior to the intervention and the second round after the intervention is completed. This method will allow me to assess changes in residents’ perceptions of social stability. Therefore I am presenting preliminary findings reflecting themes from the first round of surveys and a discussion of how these themes might relate to policy formation.

Believing that the rehabilitation intervention would have the greatest impact on those who live closest to an abandoned building my research colleague and I included all residents of buildings directly abutting, one house away, and directly across the street. **Figure 1** below illustrates a typical block and the houses that would have been considered. Exceptions were made, for example, when upon

Figure 1: Typical Study Neighborhood



Source: Federal Reserve Bank of Boston

visiting the block we noted that a house outside the above criteria had a very clear view of the abandoned house. The first set of properties we considered our “treatment” population and the second set we considered the “control” population. The number of buildings in our survey totaled 141, and these buildings were almost exclusively 2 and 3 unit buildings, for a total of 275 households.

We attempted to conduct an in-person interview at every unit in our universe. Based on a resident list maintained by the City of Boston, we estimated 538 qualifying adults living in the 275 households. We rang the doorbell or knocked. If someone answered, we introduced ourselves and explained the survey. We administered the survey to willing residents over 18 in the entryway or in some instances inside the respondent’s home. We compensated all participants with a money order for \$20. For the few residents who were not interested, we removed the unit from our list. If no one answered the door, we left a flyer with our phone number. We visited neighborhoods

and conducted surveys between the hours of 2pm and 8pm on weekdays and Sundays in June and July 2011. We administered 58 surveys, reaching about 10 percent of qualified adults and about 20 percent of our target households. We also assessed the physical condition of all 141 parcels using a parcel condition worksheet.

I based the parcel condition worksheet on the Project on Human Development in Chicago Neighborhoods. Though the worksheet anticipated that we would observe “groups of people hanging out,” “drug use,” and “drug dealing” on our target blocks, we soon realized that none of these were frequent enough to make our parcel condition survey meaningful. The signs of distress were more subtle – poorly maintained lawns or debris on porches. So despite being among Boston’s worst areas in terms of crime and foreclosures, these neighborhoods seemed rather ordinary during our daytime visits. In addition to visiting the 16 blocks we targeted, we spent time in restaurants and stores. Though patrons and employees sometimes offered us hospitality, we were most often treated with indifference and occasionally suspicion. One day, I remarked to my co-researcher that though we had passed a large and often-crowded city park with a new-looking and colorful playground a number of times, I had never before noted its name – Harambee Park. However, several days later, many people would hear of Harambee Park, where a 4-year-old boy was shot while on the playground by a gang of young men. I relate this episode to suggest what living on these target blocks might feel like – most of the time neighborhood life is rather prosaic, but is occasionally punctuated by alarming anti-social behavior that too frequently concludes tragically.

When residents either did not answer their doors or were not home, we attempted to contact them through a mailing.<sup>7</sup> Using both the in-person and mail-in outreach methods, we interviewed or surveyed 148 residents from 263 households. Of those, 82 contained qualitative responses (58 in-person interviews and 24 write-in responses). All but two participants were people of color, most self-identified as “Black/African American,” but others identified as Trinidadian, Jamaican, or Haitian. Additional residents classified themselves as Latino, Hispanic, Puerto Rican, or Dominican.

## Preliminary Findings

While our full results will not be available until late 2012, after our second round of surveys following NSP intervention, a number of interesting trends among qualitative and policy-related responses are worth relating now. I analyzed the qualitative responses using the software NVivo, which allows coding themes. I developed an initial set of themes based on the two qualitative questions: general impression of the neighborhood and factors they believed influenced home price. Additional themes included aligning demographic groups (e.g., similarities in perspectives of homeowners versus renters or women versus men).

One observation was immediately obvious. While we intended to talk to residents about abandoned, foreclosed homes, the topic that most interested them was neighborhood stability, especially crime in general and gun violence in particular.

### “Wow, it’s a foreclosure. Nobody knows about it.” — Male Renter

The residents who did answer their doors often welcomed us, unsolicited, into their homes, where we would listen to their responses. Three interrelated themes appeared in those interviews and mail-in written responses. First, residents did not view the abutting abandoned, foreclosed home as a primary threat to neighborhood stability. Second, residents expressed a strong belief in the power of but their alienation from public and private institutions such as city government and banks. The third theme centers on how residents of unstable neighborhoods define social and spatial boundaries to make themselves feel secure. After examining these three themes, I will explain how they might influence policy formation.

### Resident Views of Abandoned, Foreclosed Homes

The target areas were neighborhoods with many abandoned homes<sup>8</sup>, some on the same street as the foreclosed properties in question. Moreover, the neighborhoods contained many additional vacant parcels. Thus, with so many distressed properties in the neighborhood, it may not be that surprising that many residents did not know the home had been foreclosed on. As one male renter commented, “Wow, it’s a foreclosure. Nobody knows about it.”<sup>9</sup>

For those who did know of the foreclosure, several explained it as an outcome of an individual



problem rather than a sign of a community issue. Though some explanations included real estate deals gone bad and “swindling” by banks, speculation did not include how these individual problems might relate to larger neighborhood issues such as house prices or crime. Some residents did recall negative activity in the foreclosed home such as trespassing and large amounts of trash, and their response to it, including calling the police, city inspectors, and

abandoned, foreclosed homes and vacant lots on the same block, suggesting that they viewed abandoned lots as an equal, if not greater, threat to neighborhood stability. For example, one middle aged female renter referenced the vacant lot next door to her (the foreclosed home abutted her on the other side). She commented of that vacant lot, “there goes your sense of community.” Resident concerns included the accumulation of trash and the lack of intervention from the City of Boston, which several thought could improve the neighborhood.

### **Other Threats to Neighborhood Stability**

While foreclosed homes did not generate much commentary, other neighborhood problems, especially crime and antisocial activity, did. Residents expressed concerns regarding assaults, drug dealing and addiction, home and auto break-ins, prostitution, and gang activity in their neighborhoods, though not in relation to the foreclosed homes. Moreover, while residents referenced a variety of criminal and antisocial activity, many also recalled specific incidents of gun violence. Different residents would frequently recall the same instance of gun violence on or near their block. Residents on nearly half of the blocks we visited (seven of 16) related some episode of gun violence, ranging from learning about a shooting, to hearing shots, seeing people lying in the street after being shot, to actually having bullets penetrate their apartment walls. As one female homeowner recounted, “Believe it or not, I have literally witnessed three people lying in the street after being shot. I don’t know if you’ll recall in the news, Halloween they shot someone. Another holiday they shot, it was a teenage boy.”<sup>10</sup> The fact that many residents from many target blocks had witnessed gun violence near their homes may explain why they did not see foreclosed homes as a salient threat to the neighborhood. Compared to an abandoned home, especially a securely boarded up one where little observable criminal activity took place, gun violence poses a much greater neighborhood threat.

### **The Role of City and Community Institutions in Neighborhood Stability**

While crime and disorder may be seen as community-level problems, many believe these issues require a municipal response from police and city services. Respondents made comments regarding the performance of police and other institutional actors charged with maintaining social stability. First,



City Hall. One middle aged female renter told us that one day she saw several children come running out of the foreclosed home. She called the police and a neighborhood group. Soon thereafter, “They came and boarded it up.” She had not observed any activity at the property after that event.

Additionally, contrary to accounts in the popular press, we rarely heard reports of crime in foreclosed homes. Most residents did not express concern that the properties were a target or magnet for crime. One possibility is that measures to secure abandoned homes, such as boarding them up, sufficiently dissuade trespassing. As noted before, these neighborhoods have many abandoned homes. Thus while an abandoned home may create an opportunity for illicit activity, with 99 abandoned homes littering the high foreclosure neighborhood landscape, there are possibly more opportunities than there are opportunists. However, even when foreclosed homes were not secured, our respondents did not offer many reports of trespassing on these premises.

Many residents made a connection between

many expressed confidence in the legitimacy and competence of the police and city officials but stated that their area is underserved. One young adult male renter noted that, “I feel like my neighborhood could be better if there was more cops in it.”<sup>11</sup> Others complained about the performance of the police. However, no one argued that the police were not competent or trustworthy, which suggests that the institution is still legitimate in residents’ eyes.

Additionally, many view local community organizations as effective in confronting some neighborhood problems and in communicating community concerns to city-level actors. Residents reported participating in a variety of activities including meetings, neighborhood watches, marches, vigils, email list serves, and neighborhood clean-ups, often organized through their place of worship. Other residents expressed the belief that neighborhood participation is necessary to bring about positive change and that people should become more involved. Many residents see building connections between local and municipal organizations as crucial in promoting neighborhood stability. One female homeowner “belongs to the neighborhood association which has monthly meetings and get a lot done, for example, they got stop signs. There is a community officer who reports to the group on the monthly crimes. Encourages everyone to call 911 if they see anything.” Both homeowners and renters tended to report successful collaborations between local organizations and the police in maintaining social stability, citing examples dealing with crime, intimidation, and even late-night noise.

Nevertheless, some residents did express a sense of institutional abandonment and alienation. A few communicated their frustration with government services, beyond the city’s inability to maintain abandoned lots, as discussed above. One young woman believed that her community’s inability to effectively confront instability was “because the state’s an ass.” However, banks were one institution for which residents expressed an almost uniform lack of confidence and sometimes outright disdain. Residents often criticized connections between banks and government regarding foreclosures. Others placed the blame for foreclosures squarely on banks, mirroring general public frustration. For example, one resident complained, “I wish banks and other lenders could work with owners to avoid these problems.”

### **Stability and Sense of Community**

It may not come as a surprise that residents spoke of their neighborhoods in positive terms nearly as often as they expressed negative views. Sometimes the negative and positive perspective would be contained in the same sentiment. For example, a young male resident noted, “I love the neighborhood with the exception of prevalent drug dealing and prostitution that occurs around the corner.”<sup>12</sup> In reviewing survey responses, it became clear that many residents draw careful distinctions between well-intentioned insiders and poorly behaved outsiders. Such comments follow a pattern in which residents define safe areas as those inside their block, which they see populated by well-meaning neighbors. They contrast this to areas outside the block as populated by dangerous and threatening outsiders. Another resident vouched for her side of the street commenting, “We haven’t had any trouble, as you say, where we can see. The other side is a different story.” Another female renter phrased it more directly, “I find that lots of things happening in the area are done by outsiders.”

It occurred to us that the distinctions might actually be coded language for racial and ethnic differences. These neighborhoods once housed mainly African Americans, but the demographics are now shifting to include Haitians, Jamaicans, Trinidadians, Somalians, Puerto Ricans, and Dominicans. However, in reviewing the racial

### **“I wish banks and other lenders could work with owners to avoid these problems.” — Resident**

and ethnic identity and owner/tenant status of the respondents who made distinctions between insiders and outsiders, no clear pattern emerges.

Residents also made distinctions about insiders and outsiders according to housing tenure, classifying homeowners as insiders who maintained stability and renters as outsiders who threatened it. Homeowners and renters both described homeowners as committed, responsible, and admirable community members and compare them favorably to renters, whom they tend to view as temporary and more likely to engage in disruptive or even criminal behavior. For example, an older male renter maintained a positive view of his block explaining, “there’s homeowners and they seem to keep it up.”

However, respondents did not always assume that long-term residents are homeowners. Residents repeatedly referred to long-term residents as a source of stability without directly referencing their ownership status. Respondents sometimes attributed neighborhood stability to residents' long-term presence.

**We visited many homes that contained three generations of the same family. These residents expressed a heightened sense of responsibility for maintaining not only neighborhood stability but also the well-being of their family members.**

Respondents did, however, make class distinctions based on income, at least where subsidized housing was concerned. As one older male renter explained, "And I don't like to generalize and category people, but the closer you get to the public housing, and to the, yeah, the closer you get to the end with public housing it's always a problem at that end. Where the private homes are you never see any police come down here, never any fights any argument, you know none of that outlandish language used. Or anything. It's very pleasant on this end." Complaints regarding public housing include higher crime rates, police often being called, arguments and fights, and noise in general. Respondents also opposed the development of supportive housing in the neighborhood, whether a group home for mentally ill adults, halfway houses for young people aging out of foster care, or housing for the homeless.

The ultimate insiders in these neighborhoods are the intergenerational households. We visited many homes that contained three generations of the same family. These residents expressed a heightened sense of responsibility for maintaining not only neighborhood stability but also the well-being of their family members. The multi-generational nature of some households is another explanation for why people choose to remain in otherwise unstable neighborhoods.

It is not immediately obvious how residents' distinctions between insiders and outsiders relate to neighborhood stability or inform foreclosure intervention. Yet the fact that the theme of insider/outsider arose with such frequency when residents were asked about abandoned foreclosed homes suggests that residents do make such a connection.

The insider/outsider duality may in fact suggest why residents choose to remain in unstable neighborhoods: They view them as both good and bad places to live.

Sociologists have long sought to determine why residents remain in disadvantaged neighborhoods (beyond the lure of low rents). Early-20th-century sociologists somewhat optimistically labeled these neighborhoods "zones of transition,"<sup>13</sup> suggesting a dynamic process in which residents would move through on their inevitable climb up the economic and social ladder. As the 20th century progressed and many residents remained in this "zone of transition" for multiple generations, Gans suggested that residents were "trapped" by structural forces.<sup>14</sup> More recently, the Urban Institute began to label low-income neighborhoods, hoping to tap into what causes residents to remain in disadvantaged neighborhoods.<sup>15</sup>

However, explaining why residents remain in unstable neighborhoods is different from understanding how residents function in neighborhoods they themselves see as unstable, dangerous places. The patterns that emerged in our survey sample may indicate how residents cope with instability. When explaining neighborhood conditions, many residents employ social and spatial boundaries, between good and bad places, between "us" and "them," and between insiders and outsiders, perhaps similar to how many urban residents distinguish safe places from unsafe ones. For residents of highly unstable neighborhoods, however, these boundaries are more tightly drawn, encompassing perhaps a street, a section of the street, or sometimes just the dwelling unit itself.

### **Social Stability and Public Policy**

I believe that the distinctions residents make between insiders and outsiders provides a window into understanding the relationships among household stability, neighborhood stability, and the role of public policy. Household or individual stability is the result of consistency and predictability, which allow household members to thrive. From an individual or family stability perspective, living in highly unsafe and unstable environments makes no sense; the family would be far better off moving to a safe, predictable environment. Yet for complex reasons, many residents stay. Conversely, from a community perspective, residential turnover erodes stability. Many studies show that high residential turnover

is closely correlated with higher levels of crime and lower quality of life. The community is better off the longer its members stay.

This situation might seem like a paradox: while it is in an individual's best interest to leave an unstable neighborhood, it is in the community's best interest that he or she stays (assuming that the individual is not a source of neighborhood problems). However, the situation is actually a justification for policy intervention to break the familiar vicious cycle: creating safe, stable communities encourages families to stay, and families who stay are critical in ensuring stability and stability. Residents who remain in unstable neighborhoods contribute to neighborhood stability. Insights from residents about how they maintain a sense of stability suggest how residents make staying tolerable and how policy can enhance the tolerability of unstable places.

Residents of unstable neighborhoods construct a sense of safety by dividing their communities both spatially and socially into areas of positively influencing insiders and negatively influencing outsiders. Making spatial distinctions, such as viewing their part of their block as a safe zone and making social distinctions between those seen as committed to neighborhood safety and those who are not, appears to help residents cope with living in unstable communities. This coping mechanism could be enhanced through policy intervention.

Together, these findings suggest that effective neighborhood stabilization in low-income neighborhoods should support foreclosure remediation in several ways. While it is too soon to make recommendations for Boston's program in particular (and I know of no similar studies with which to compare results), I will draw some simple conclusions – while attempting to avoid generalizations.

First, policy needs to support the linkages residents make between social stability and price stability. Policies must do more than promote the creation of desirable dwelling units; they must foster neighborhood environments where people choose to stay. This includes helping residents expand their spatial and social boundaries of whom they consider inside and outside the "safe zone." This may involve simple measures like rethinking the "block party" approach, which may reinforce insular thinking. Instead cities should encourage residents to meet neighbors from a wider radius. At the target block level, placing homeowners in NSP homes may signal

to the community that the city believes this is a place worth investing in.

Second, policy needs to recognize that residents in highly distressed neighborhoods see far greater threats to neighborhood stability than home foreclosure: gun violence ranks Number One. Nevertheless, even vacant lots appear to increase Boston residents' sense of unease more than vacant homes do. Boston is fortunate that most residents endorse police and city power. Stabilization policies can enhance governance through augmented police presence, vigilant code enforcement, and priority responsiveness to citizen complaints. All of these actions will increase residents' confidence that the City is committed to supporting distressed communities.

Third, policies need to capitalize on the strength of neighborhood and municipal organizations and promote connections between them. Though some of the residents we interviewed participate in neighborhood organizations, many view local and city institutions as effective. Policy makers might do well to visit these neighborhood organizations, arrange collaborations with them, and solicit residents' ideas about how to confront neighborhood problems. In any event, policy should actively support community governance, encouraging neighborhood organizations to convene meetings and events that embolden residents to broaden their boundaries and regain a sense of control over the larger neighborhood.

**Many studies show that high residential turnover is closely correlated with higher levels of crime and lower quality of life. The community is better off the longer its members stay.**

Hopefully, the information presented here might call into question some seemingly untested assertions, such as one made by the Vacant Properties Campaign that, "by all accounts vacant properties are a curse. Just ask anyone who lives next to a drug den, a boarded-up firetrap or a trash filled lot."<sup>16</sup> Or the assumption that "the growing crisis in vacant and abandoned properties, communities are increasingly saddled with empty, deteriorating houses that devalue neighboring properties, attract crime, and demoralize neighborhoods."<sup>17</sup> We talked to people in distressed neighborhoods about abandoned properties near them. While residents



felt concerned about neighborhood conditions, these concerns often extended far beyond the abandoned property. It might be that neighbors living in less socially distressed neighborhoods would express more concern about foreclosed properties. Our follow-up survey next year will tell us more about how formerly abandoned properties (now renovated and occupied) affect residents' sense of neighborhood stability. We can also compare these reactions to those of residents who live next to the control properties, some likely to remain abandoned, and others possibly rehabilitated through the private market. By comparing residents' reactions before and after the intervention, we hope to gain a fuller understanding of the impact of the foreclosure intervention policy.

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## Endnotes

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- 4 Mallach, A, 2009, "Stabilizing Communities: A Federal Response to the Secondary Impacts of the Foreclosure Crisis" Washington: Brookings Institution.
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- 6 To view the survey, please see Appendix A: Survey Instrument on the NECD webpage: <http://www.bostonfed.org/commdev/necd>.
- 7 Please see Appendix B: Methodology, for a detailed description of the methods used to recruit participants.: <http://www.bostonfed.org/commdev/necd>
- 8 City of Boston's "2010 Distressed and Abandoned Buildings Report" listed 99 properties as vacant or abandoned in our target neighborhoods.
- 9 For more resident quotes, see Appendix C: "Resident Views of Abandoned, Foreclosed Homes": <http://www.bostonfed.org/commdev/necd>
- 10 For more resident quotes, see Appendix D: "Other Threats to Neighborhood Stability": <http://www.bostonfed.org/commdev/necd>
- 11 For more resident quotes please see Appendix E: "The Role of City and Community Institutions in Neighborhood Stability": <http://www.bostonfed.org/commdev/necd>
- 12 For more resident quotes, please see Appendix F: "Stability and Sense of Community": <http://www.bostonfed.org/commdev/necd>
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# New Ideas for Old REOs: A Disposition Framework for Marketing REOs for Rental Properties

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## Introduction

In response to the continued influx of foreclosures into the housing inventory, the Obama Administration is soliciting policy makers and community developers for new strategies to put the foreclosed properties owned by housing agencies Fannie Mae and Freddie Mac back into productive use.<sup>1</sup> The administration specifically requested proposals for converting properties into rental units. We believe that if converting some units to rental ultimately becomes part of the approach, properties should be selected based on some basic criteria that follow both sound economic practice and public policy goals. The purpose of this article is to outline a framework for government-sponsored enterprises (GSEs) like Fannie Mae and Freddie Mac as well as private owners to identify which foreclosed properties would be most appropriate for rental and which would remain more appropriate for homeownership. We then demonstrate how such a disposition framework could be applied, using Massachusetts as an example.

## Background

An unprecedented number of foreclosed properties has accumulated in the wake of the housing crisis. According to the Federal Reserve Board, as of August 2011, 500,000–600,000 of the 2 million vacant properties for sale in the United States are in banking parlance called “other Real Estate Owned” (REOs).<sup>2</sup> When concentrated, vacated properties make the neighborhood a less desirable place to live.<sup>3</sup> While not among the hardest-hit states, Massachusetts is not immune from this phenomenon. Since 2006, foreclosure rates have risen here as in the rest of the country. As of August 2011, according to Federal Reserve Bank of Boston analysis of registry data from the Warren Group, lenders owned 6,196 properties in Massachusetts. This figure is merely a point-in-time estimate, as foreclosures flow into

the REO stock and REO sales flow out. A separate analysis conducted by the Massachusetts Housing Partnership finds as of October 1, 2011, a total of over 29,000 units in distress (a number that includes not just already-foreclosed properties, but also units for which a foreclosure petition has been filed or an auction has been scheduled). The rest of this brief will use the 6,196 properties as a baseline for REO counts, but one should realize they represent just a fraction of likely future REOs.

In principle, the post-foreclosure process is a straightforward market transaction. The seller prepares the property for sale, markets it, and accepts the best offer from a prospective buyer. Yet several factors complicate this seemingly simple process. In many cases, the government owns the property in default, having insured or guaranteed the original mortgage. These foreclosed properties may be in indeterminate condition, lie in disrepair, or have a questionable chain of title. Indeed, according to a literature review conducted by the Federal Reserve Bank of Atlanta, several empirical studies suggest that foreclosures trade at a discount compared with neighboring properties.<sup>4</sup> Neighbors may have strong preferences about the current state and future use of a property that affect their own housing values.<sup>5</sup> In the current underwriting climate, some would-be buyers may lack appropriate creditworthiness. Overall, there may be diminished expectations about a rise in future house prices and, hence, weak demand. The community or region may have use needs, such as for rental or more affordable housing, that may differ from previous uses. Sellers may find it difficult to price accurately in certain neighborhoods or may be willing to wait and hold rather than sell at current prices.

While the post-foreclosure process has made it difficult for homes to be resold as homeownership units, several aspects of the current housing market point to an increased demand for rental units. In

a recent speech, Fed Governor Elizabeth Duke cited the strengthening demand for rental housing nationally.<sup>6</sup> In growing numbers, households are seeking rental housing because, for one thing, they face tighter mortgage conditions. Families who have gone through foreclosure often seek single-family rentals (See Federal Reserve Board research by Raven Molloy and Hui Shan<sup>7</sup>). Others rent for a period of time when they move to a new job, or perhaps after a job loss. Young adults often rent for years prior to becoming homeowners, and the impact of the recession may delay their ability to enter the market. The Federal Housing Finance Agency's recent focus on obtaining information from the private sector about how to convert REOs to rentals and the recent release of a white paper on housing policy by the Federal Reserve Board that discusses the conversion of REOs to rental<sup>8</sup> provide evidence of broad policy interest.

In Massachusetts, affordable housing is limited in quantity and by community. The share of Massachusetts housing units that are affordable dropped to 9.1% in 2011 from 9.3% in 2006.<sup>9</sup> The state is famously supply-constrained because of restrictive zoning and land-use policies.<sup>10</sup> It does allow state overrides of local exclusionary zoning, and while this had led to increased construction, many towns still have a limited supply of rental housing.<sup>11</sup> Statewide, much of the affordable-housing stock is concentrated in places that may have negative spillovers from the lack of a mixed-income resident population like poor schools or infrastructure.<sup>12</sup> While Massachusetts urban centers already offer a diversity of housing choices, the state's suburbs are dominated by homeowners in single-family homes that are unaffordable to those of low or moderate income.<sup>13</sup> One reason for the lack of affordable housing is the issue of "expiring-use subsidies." A study by the Community and Economic Development Assistance Corporation found that the end of the 40-year program offering low interest rates to developers in exchange for maintaining affordability, in combination with the end of other rent-subsidy contracts, could lead to the loss of over 14,700 units from peak levels by the end of 2012.<sup>14</sup>

While achieving a market-clearing transaction is still important for government-owned foreclosed properties, this article argues that designating some REOs as affordable rentals could be justified in both

economic and policy terms. Government ownership, market uncertainty, and community needs make it advisable to apply a simple set of conditions that guide how to dispose of properties and how to determine appropriateness for rental. These considerations could be applied whether the property is owned by the government or a private lender, as they may coincide with the most valued use of the property. This article will describe a few simple rules by which disposition could occur, in particular as applied to government-owned properties, which serve the dual objectives of taxpayer return and public policy goals. However, as this analysis shows, even if sensible criteria are followed, the resulting number of properties that can be identified as appropriate for rental falls far short of solving the REO problem.

In this hypothetical Massachusetts case, we review the 6,196 REOs, demonstrating that a property's best and highest use depends on market and policy considerations. We use the Disposition Framework found in **Figure 1**. Given the request for information, we apply a framework to GSE-owned properties (though the framework could be applied to REOs in general) to determine whether properties meet a series of criteria that guide decision making.

In **Figure 1** below we outline how the framework could be used to determine which properties are suited for affordable rentals. In this particular case, only the left-most branch of the "decision tree" is fully described with property counts, but each branch can be followed along the framework in similar fashion. All property data and counts in this section come from the Boston Fed analysis of data, as described in the methodology.

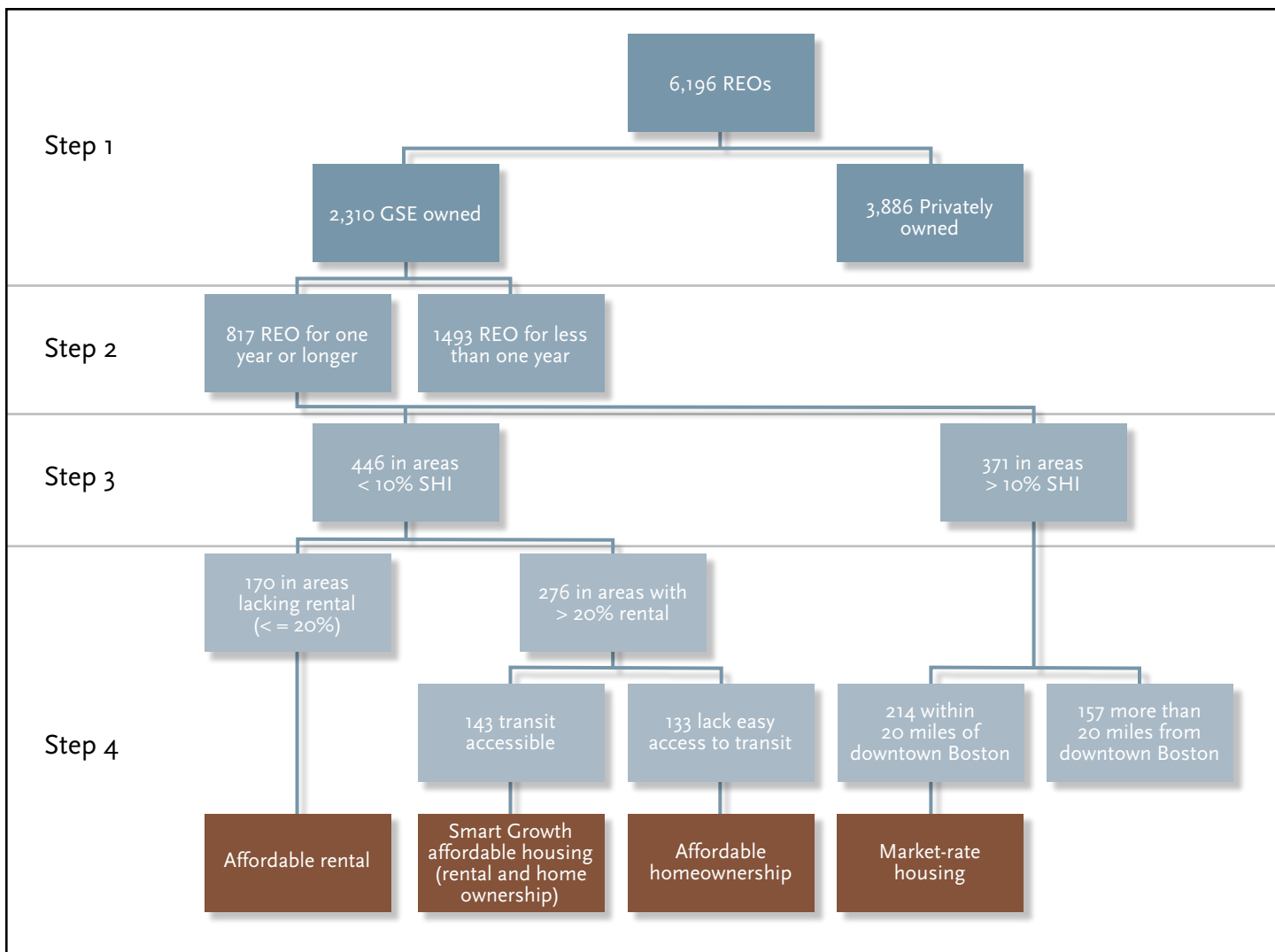
### **Step 1: Determine whether the REO is GSE-owned or privately owned.**

**Rationale:** In July 2011 the Obama Administration issued a request for information to augment the current disposition practices for REOs held by government-sponsored entities (GSEs) Fannie Mae and Freddie Mac (as well as those held by the Federal Housing Authority).

**Data:** As of August 2011, in Massachusetts the GSEs owned 2,310 properties and private lenders owned 3,886.

**Method:** The Warren Group, a private Boston-based real estate research firm, collects public record foreclosure petitions and deeds filed with county and

Figure 1: Disposition Framework



Source: Federal Reserve Bank of Boston

city governments and posted in regional newspapers, as required by law. We identified REOs as properties that met the following conditions: the property had undergone foreclosure; a lender rather than an individual had taken ownership of the property; and no other real estate transactions had been recorded since. To identify GSE-owned REOs, we exported [imported?] a list of all lenders on record with the Warren Group and flagged those that were government-sponsored enterprises. This process allowed us to register multiple forms of abbreviations for these entities. Finally, we checked our current stock of REOs against this list.

**Step 2: Assess risk of future market failure.**

**Rationale:** Properties that have remained REOs for more than a year undergo steeper price discounts than those that remain REOs for a shorter time, possibly from the deterioration in value.<sup>15</sup> Consider

as well that many REO properties may lie vacant for months or longer prior to foreclosure,<sup>16</sup> possibly exerting negative effects on neighbors and communities for longer periods of time.<sup>17</sup> An unknown number of these properties have also been listed for sale, and so though “tested” for homeownership markets, they did not appeal to prospective buyers. (However, other long-term REO properties may have title issues or other problems that prevent them from being transferred out of REO for any purpose, whether homeownership or rental. Some unknown number of properties could have covenants that prohibit rental.)

**Data:** 1,493 properties have been REO for less than a year, so a market-based resolution may still occur. However, this means 817 properties have been REO more than one year; a quarter of those have already been lender-owned for 417 days or longer.

**Method:** We calculated REO duration by

subtracting the date the lender took ownership of the property from August 31, 2011, the date this REO inventory was updated. We know only the duration of REO ownership and do not have data on whether and for how long the property was listed for sale.

### **Step 3: Determine location of properties in relation to affordability need**

**Rationale:** The Massachusetts Department of Housing and Community Development requires that at least 10% of each municipality's housing be affordable and registered in the state's subsidized-housing inventory (SHI). At present, 312 of 351 communities fail to meet this cutoff. There is considerable debate about whether this reflects resident opposition to density and affordable housing or else the lack of available, affordable land.

**Data:** Looking at the 6,196 REO properties in Massachusetts, over half (3,469) are located in communities that fail to meet the affordable housing goal. Looking solely at GSE-owned properties, which have public-policy goals in addition to return-on-investment goals, 446 REOs are located in Massachusetts towns that fail to meet affordable housing goals.

**Method:** We used the Department of Housing and Community Development's (DHCD's) Subsidized Housing Inventory, which reports what percentage of a municipality's housing units are affordable, to identify which communities failed to provide their "fair share" of affordable housing (i.e., 10% of units). We used Geographic Information System mapping and latitude/longitude information for each REO to determine whether it fell in a municipality that met its affordable housing requirement.

### **Step 4: Determine which areas also lack rental**

**Rationale:** There are many reasons to anticipate increasing demand for rental housing in Massachusetts (even market-rate housing). According to data from Census 2010, 2.4% of Massachusetts rental housing is vacant and available for rent, compared with 3.1% for the nation. Tightened underwriting standards since the onset of the housing crisis make qualifying for homeownership more difficult. In addition, although demand for homeownership persists, expectations about future prices may induce more households to rent. Conversely, communities that have more than one-fifth of their housing units as rental, especially places that are already meeting

affordability goals, may have other housing needs. Given the importance of a mixed-income population (i.e., avoiding the challenges created by the concentration of poverty), these places could benefit from market-rate rental or homeownership options that attract or retain more middle-income households. In terms of the demand for affordable rentals, the 2011 America's Rental Housing report from the Harvard Joint Center for Housing Studies showed that in Massachusetts, the share of renter households that are "severely burdened" — those that pay more than half of their income for rent and utilities — has risen over the past decade. From 2000 to 2009, the share of renter households that are severely burdened rose from 19.7% to 24.8% in metro Boston, from 20.1% to 24.2% in metro Springfield, and from 18.0% to 21.1% in metro Worcester.<sup>18</sup>

**Data:** 170 REO properties are in places where less than 20% of housing units are rentals and less than 10% of housing is affordable, have been on sale for over a year, and are owned by GSEs.

**Method:** We used the latest available American Community Survey data [date] to assess what proportion of each municipality's housing units are rental. We used Geographic Information Systems mapping to identify which REOs were located in towns with less than 20% rental housing.

This step progression through the framework would be undertaken for other properties that meet the alternative criteria. This would result in an additional quantity (beyond 170) of REO properties targeted for rental.

## **Additional Framework Considerations, Outcomes, and Concerns**

### **Transit Accessibility and Proximity to Jobs**

Other criteria on the framework include transit accessibility, which supports smart growth/transit-oriented development policies. The primary advantage of transit access is job access, but there are other benefits. Indeed, transit-oriented development — the creation of compact, pedestrian-friendly neighborhoods with mixed-use development that does not require an automobile — is drawing increased policy attention. For example, Massachusetts General Law Chapter 40R, the Smart Growth Zoning and Housing Production Act of 2004, offers Massachusetts municipalities financial incentives for creating compact residential and mixed-use



zoning districts that are subject to local control over design. Currently, 33 municipalities have approved 40R districts and four additional municipalities have applications pending.

The redevelopment of transit-accessible REOs into affordable rentals could be combined with other planned development to form the basis of a Chapter 40R proposal to the Massachusetts Department of Community and Housing Development. REOs in other locations highly suitable for future applications for Smart Growth designation could include them as part of a Chapter 40R zoning district application. Beyond the potential for easier and less expensive redevelopment of properties that are located near transit, investing to put transit-accessible REOs back into productive use may reduce financial risk compared to investing in REOs located in sprawling neighborhoods. This is because transit availability can reduce commuting costs and/or keep them stable as gas prices rise. The Federal Reserve Bank of Atlanta found in 2009 that long commute times for drivers was a risk factor for REO accumulation in suburban areas. The author concluded that “It may be unwise to spend scarce resources attempting to redevelop residential patterns that may not be highly sustainable in the context of ... higher long-term energy and transportation costs.”<sup>19</sup>

Roughly half of all current REOs are transit-accessible (3,051), defined as being located within one quarter mile of services provided by the Massachusetts Bay Transportation Authority (MBTA) or Regional Transit Authorities. GSEs own 1,100 of these properties. In terms of proximity to jobs available in Boston, 2,135 REOs (whether transit-accessible or not) are within 20 miles of Boston.

#### **Additional Paths to Affordable Rental Outcomes**

Progression through the framework for other properties meeting the alternative criteria would result in an additional quantity (beyond 170) of REO properties targeted for rental. For example, there are areas that lack affordable housing options but nonetheless have over 20% rental, meaning they meet their rental burden. However, there may be additional capacity for affordable rental in those areas that are also transit-accessible, for the reasons stated above. These properties could be marketed for Smart Growth affordable rental.

#### **Additional Paths to Market Rate Homeownership, Affordable Homeownership, and Smart Growth Homeownership Outcomes**

According to this framework, the majority of properties would be designated for homeownership, and depending on economic and policy concerns, some of the REOs would be marketed as market-rate homeownership, others as affordable, and still others would be appropriate to be used to meet state policy goals for Smart Growth. The most valuable properties likely remain suitable for market rate homeownership. As of August 2011, 359 Massachusetts REOs had values over \$400,000. These would almost certainly be best marketed as homeownership units.

If the lender determines that the highest economic use is homeownership, there are still policy considerations. REOs close to public transit might be marketed as Smart-Growth opportunities for homeownership, made affordable to more families through reduced automobile costs. Lower-value REOs may be marketed as affordable homeownership units, particularly in municipalities that do not meet their affordable-housing goals. If a GSE owns the REO, a case may be made to develop it as an affordable homeownership unit to meet public policy goals. This would result in a lower return to taxpayers, yet might make economic sense compared with the cost of developing new sources of affordable housing.

**Roughly half of all current REOs are transit-accessible (3,051), defined as being located within one quarter mile of services provided by the Massachusetts Bay Transportation Authority (MBTA) or Regional Transit Authorities.**

#### **Additional Considerations in the Disposition Framework: Program Design and Proximity to Other Properties**

The Obama Administration’s request for information implicitly acknowledges the difficulty (and costs) involved in converting to rental where sites are scattered. From a property manager’s perspective, such conditions make maintaining properties expensive. However, having studied working models internationally, such as Circle Housing’s ownership of over 63,000 scattered properties in the United Kingdom,<sup>20</sup> the Housing Partnership Network has

proposed acquiring and managing 25,000 units of single-family REOs owned by the Federal Housing Administration and GSEs.<sup>21</sup> Under the proposal, the organization would work in at least 25 metro areas, with properties developed as affordable rentals. A map of Massachusetts reveals clusters centered in

**Figure 2: REO Densities**

Municipality	Count
Boston	61
New Bedford	53
Lynn	46
Springfield	29
Revere	27
Brockton	25
Lowell	24
Haverhill	23
Lawrence	23
Gardner	20

Municipalities where you can locate 10 or more REOs within walking distance of each other (no two are more than 1 mile apart)

Source: Federal Reserve Bank of Boston

places like Boston (61 REOs), New Bedford (53), Lynn (46), and Springfield (29), where properties are within a one-mile radius of one another, demonstrating opportunity for similar schemes (See **Figure 2**). For a fuller discussion of program design considerations under a government-facilitated REO-to-rental effort, see a recent Federal Reserve Board white paper entitled *The U.S. Housing Market: Current Conditions and Policy Considerations*.<sup>22</sup>

## Conclusion

The large number of GSE-owned REOs presents a unique opportunity to designate properties for use after foreclosure according to economic and policy concerns. For some properties, this would mean developing them as market-rate or affordable rental housing. Our analysis proposes using a series of criteria to determine which properties may be appropriate for rental.

Communities that offer a mix of housing options may be among the most readily adaptable to changing economic circumstances and demographic trends.<sup>23</sup> A diversity of property types, tenure choices, and affordability levels helps combat economic segregation and can provide the workforce housing needed for teachers, firefighters, and police.<sup>24</sup>

Increased housing choices could also provide the Commonwealth's growing senior population with more "age in place" options. Workers would be able to relocate rapidly in response to employment conditions without the high costs associated with buying a single-family home. Although the impact of negative equity on housing mobility is hotly debated as a source of unemployment, allowing for future mobility might be important if regional or local economic conditions take divergent recession-recovery paths. Living in a rental apartment provides flexibility to a family that is downsizing because of foreclosure, unemployment, or underemployment<sup>25</sup>.

According to multiple local analyses,<sup>26</sup> such as those conducted by the Metropolitan Area Planning Council and the Dukakis Center for Urban and Regional Policy at Northeastern University, the current housing crisis suggests a need to increase the availability of rental housing, especially affordable units. However, the relatively small number of rental properties as compared to the aggregate number of foreclosures shows that rental conversion is not the single solution to the foreclosure problem or the rental problem. Rather, it might be seen as a policy tool that can increase, however modestly, the supply of rental housing in underserved rental markets. In Massachusetts, this is especially the case in communities that lack such options.

Our framework for both private lenders and government policymakers can determine whether to position foreclosed properties for rental or for homeownership. While this analysis was conducted for Massachusetts, the framework may apply to other states with similar market characteristics and demand. These analytic techniques are not meant to dictate the use of any particular property but can inform policymakers and lenders who own properties about needs and opportunities to address those needs effectively to meet both market demands and policy concerns.

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## Endnotes

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