



*Remarks at the Federal Reserve  
Conference on REO and Vacant Property  
Strategies for Neighborhood Stabilization*

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**[Slide 1]**

I'm very happy to be here today, to take part in a conference on topics of such importance. Housing has played a central role in the financial crisis and the subsequent economic difficulties that we have been experiencing now for more than three years.\*

This conference brings together people from around the country who have been on the front lines looking for solutions to mitigate the personal and societal costs of mounting foreclosures, and the buildup of REO properties. By gathering together, we can learn from each other's successes – and also from each other's well-intentioned failures.

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\* *Of course, the views I express today are my own, not necessarily those of my colleagues on the Board of Governors or the Federal Open Market Committee (the FOMC).*

I expect we will learn that a single solution may not work in all regions of the country. What seems promising in Cleveland and in other cities in the northern Midwest may not be the best solution for New England, or for Southern California. The reason, I suspect, is that the effects of the housing and financial crisis on any community depend, importantly, on the attributes of the community. For example, how susceptible is the population to extended spells of unemployment or other income disruptions? How healthy was the local economy and industry before the crisis? And how well-equipped are local nonprofit and governmental institutions – and civic leaders – to respond to the fallout from the crisis?

**[Slide 2]**

My comments today will focus on the foreclosure and REO problem in my region – New England. In particular, I want to ask how best to understand the problem: Is it a housing problem that affects all communities similarly? Or is it a foreclosure and REO problem that affects all communities in a similar way? Or is the problem better understood as a crisis that is reflected differently in each community, and thus requires solutions that are very likely to differ, across communities?

I'll just take a moment to preview my remarks. I will first show that New England locations, defined by zip codes, with a high concentration of REO properties have (not surprisingly) incurred larger declines in home prices than zip codes with lower REO concentrations. I will then highlight that many of these same communities were areas that faced challenges even before the foreclosure crisis – challenges that made these communities more likely to suffer disproportionately the consequences of the crisis.<sup>1</sup>

I will then touch briefly on research and policy implications. In particular, do we need more holistic approaches to addressing this crisis? Should there be more state and federal revenue sharing focused on providing flexible funds to the communities most affected? My answer to both of these questions is a yes. But I would also argue that we need to not only explore alternative solutions, but also do a much better job of establishing which solutions work – and then try to replicate effective solutions on a larger scale.

## **How Should the Foreclosure Problem Be Framed?**

### **[Slide 3]**

Finding the right solution requires asking the right question. So I want to begin by asking, what is the question we are trying to answer?

To that end I suggest we do a little exercise. We might gain some insight into how the attendees at this conference are framing the question by looking at the non-profit organizations on the program. What is their key focus? If we assume the name of an organization was chosen to indicate its central mission, by noting the keyword in the name we may learn something about their primary focus. On the agenda for this conference, five non-profit organizations have “community” or “neighborhood” in their names; two have “housing”; and one has “foreclosure” or “REO.” Most of you are no doubt focusing on rising foreclosures and REO properties, but it seems that you see these through the “lens” of community. However, it is less clear that public policies have been similarly aligned.

### **[Slide 4]**

To help illustrate why the framing of a problem is important, we should consider what the focus might be if we assume different primary objectives.

- If one looks at the problem as primarily a foreclosure and REO problem rooted in the housing bubble, the solutions will tend to emphasize mitigating the foreclosure problem or accelerating the disposition of REO properties. Some will also advocate for a reconsideration of the legal system’s approach to personal bankruptcy and foreclosure.
- If, instead, one views the problem as being primarily a housing problem, you might address the problem differently. You might focus on solutions that result in sustainable home ownership. For example, what should be the minimum down

payment on a house, and what financing approaches would result in sustainable home ownership? The solutions to this sort of a problem might be focusing on financial education, addressing predatory home financing, and redefining appropriate underwriting standards. The availability of affordable rental housing might also be a focus.

- If the problem is seen through the lens of community, however, foreclosure may be viewed as a symptom of broader problems affecting neighborhoods – such as high concentrations of unemployment, elevated crime rates, and poor code enforcement. Let me be clear; I am not saying that “the community is the problem,” but rather that, in this view, different communities will experience problems differently because of their different characteristics, requiring different solutions in many cases. The public policy solution for this problem may be to have more general revenues available for non-profits and local governments to address the problem in a more holistic fashion.

**[Slide 5]**

Clearly there are elements of all three in the current crisis. This is a foreclosure problem. This is a housing problem. This is a community problem. However, as I just illustrated, the solutions may be somewhat different, depending on how one frames the problem. So, we should ask, do we have the right balance as we think about the best way to address a serious – and I would argue multifaceted – public policy problem? My own view is that too little focus has been on community problems because the focus has been more targeted to housing and foreclosures.

## **Evidence from New England**

### **[Slide 6]**

As we consider these questions, I'd like to share with you some evidence from New England – and in particular Greater Boston.

### **[Slide 7]**

The first chart provides REO per square mile in three New England states by zip code and compares that with the change in the median housing sales price from 2005 to 2008 for the same zip code. As you can see in the chart, in areas with a lower concentration of REO there is not a strong correlation with changes in median sales price. However, as the concentration of REO increases there is a much stronger correlation with median sales price change. Zip codes with higher concentrations of REO tend to have seen larger declines in median sales price.

Let me be quick to acknowledge the open question of causality. We are doing more statistical work to try to understand the causality in the REO-concentration and house-price relationship. That work needs to also control for factors such as population density.

### **[Slide 8]**

The next figure highlights that high concentrations of REO are not the only problem afflicting those communities. Zip codes with four or more REOs per square mile also have higher property crime rates, higher rates of low birth-weight babies, higher unemployment rates, and weaker small business activity. Note that all these charts are for the time period that generally precedes the foreclosure crisis, so these communities were already challenged.

**[Slide 9]**

Indeed, the next figure highlights that children in these communities were being impacted even before the dramatic increase in foreclosures. Communities that would eventually have four or more REO properties per square mile had higher high school drop-out rates and higher failures in statewide math tests.

It is hard to imagine that dramatic increases in foreclosure rates would not exacerbate these problems. A foreclosure is likely to mean not only a loss of home, but also a disruption in where, or whether, kids are in school. Since foreclosure is often related to unemployment, marital stress, or physical ailments, the foreclosure is likely to make it difficult for even the most determined student to excel. The impact of the foreclosure crisis on children is something we are trying to better understand at the Boston Fed.

The bottom chart on slide 9 highlights that these communities have a large gap between their municipal service needs and their ability to raise revenues to pay for those needs (...the so-called “fiscal gap”). A recent study at the Boston Fed highlights that non-school revenue sharing in Massachusetts is not well aligned with communities’ fiscal gaps.<sup>2</sup> Changes in revenue sharing are critical to helping those communities address their problems. Potentially, a federal revenue sharing program at the national level that focuses on these communities could help. These funds could be provided in a flexible way so they could target those areas of most importance – since local governments may be in a better position to determine if the funds should be directed to more teachers, more code enforcement, more police, or more assistance to non-profit organizations that are making a difference in their communities.

**[Slide 10]**

Now, since a picture is worth a thousand words, I would like to show you some maps that demonstrate how clusters of REO are associated with a host of other community problems.

The next five figures [Slides 11, 12, 13, 14, 15] show the community patterns in the data. Those communities with very high REO per square mile also fare poorly in many other dimensions. Many communities are performing poorly in all the criteria illustrated in the figures. If these are community problems, we may need to search for community solutions.

### **Implications for Research and Policy**

#### **[Slide 16]**

The patterns in these data imply a need for more holistic approaches to the problem. This is not a one-size-fits-all foreclosure or housing problem; these are community problems. Of course, I am showing you examples from New England and one needs to examine how similar or dissimilar the patterns are in other regions.

But it seems, in sum, that communities with some of these challenging attributes are likely to experience higher rates of foreclosure and REO. And the same communities experience greater hardships in the face of rising foreclosures and REO.

Rather than treating the symptom – the high REO problem – we need to better understand how to resolve the more general problems in communities that lead to higher concentrations of REOs and exacerbate the effects of high REOs. However, the challenge of finding holistic solutions is significant, and longstanding.

I am encouraging Boston Fed staff to work to better understand how foreclosures and REO can exacerbate problems in troubled communities – and to look for data that can better determine which solutions work, under which circumstances. For example, we have been examining the issues and barriers keeping the city of Springfield, Massachusetts from prosperity, with an eye to assisting Springfield and also sharing the lessons more broadly. As part of that work we have examined the factors that have helped other similar cities around the country achieve a greater degree of resurgence.<sup>3</sup>

I am particularly encouraging my staff to look at how foreclosures affect children. While not responsible for the foreclosure problem, children may be affected by its consequences for years to come, if it prevents them from meeting their potential in school and eventually in the labor force.

**[Slide 17]**

While more research needs to be done on the communities, and on which solutions work, we should also reflect on how we are spending our public policy dollars. Are they appropriately balanced to the problems of housing, foreclosure, and community need? If a more holistic approach is needed, states and the federal government may need to examine the most effective and efficient way to address the broader problems in these communities, including potentially looking at revenue sharing that provides a flexible way to address the fiscal gap faced by many of our hard-pressed communities.

Thank you. I believe we are now proceeding to the next session on the conference agenda.

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**NOTES:**

<sup>1</sup> Since New England housing prices were less variable than those in other regions, its foreclosure problems may be slanted towards areas with secular problems.

<sup>2</sup> See “Does Springfield Receive Its Fair Share of Municipal Aid? Implications for Aid Formula Reform in Massachusetts”, New England Public Policy Center Working Paper No. 10-4, by Bo Zhao with Marques Benton, Lynn Browne, Prabal Chakrabarti, DeAnna Green, Yolanda K. Kodrzycki, Ana Patricia Muñoz, and Richard Walker, available at [www.bos.frb.org](http://www.bos.frb.org).

<sup>3</sup> See “Reinvigorating Springfield’s Economy: Lessons from Resurgent Cities” by Yolanda K. Kodrzycki and Ana Patricia Muñoz with Lynn Browne, DeAnna Green, Marques Benton, Prabal Chakrabarti, David Plasse, Richard Walker, and Bo Zhao and other work available at <http://www.bos.frb.org/commdev/springfield/>

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Washington, DC

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# A Key Question:

*Are we addressing  
a **housing** problem,  
a **foreclosure** problem,  
or a **community** problem?*

# Focus Matters

## An exercise...

- A search of keywords represented in the names of non-profits at this conference:
  - “Community” or “Neighborhood” – 5
  - “Housing” – 2
  - “Foreclosure” or “REO” – 1
- The ranking seems right in the titles, but may differ from the policy responses

# How You Frame the Problem Affects the Solutions You Propose

- If a **foreclosure** problem –
  - Focus on avoiding or mitigating foreclosures
  - Possibly focus on legal proceedings ... improve legal framework for foreclosure and bankruptcy
- If a **housing** problem –
  - Change to more sustainable financing model
  - Focus on a sustainable home ownership model
- If a **community** problem –
  - A more holistic approach – State/Federal Revenue Sharing
  - Focus on communities with *clusters* of REO/foreclosures

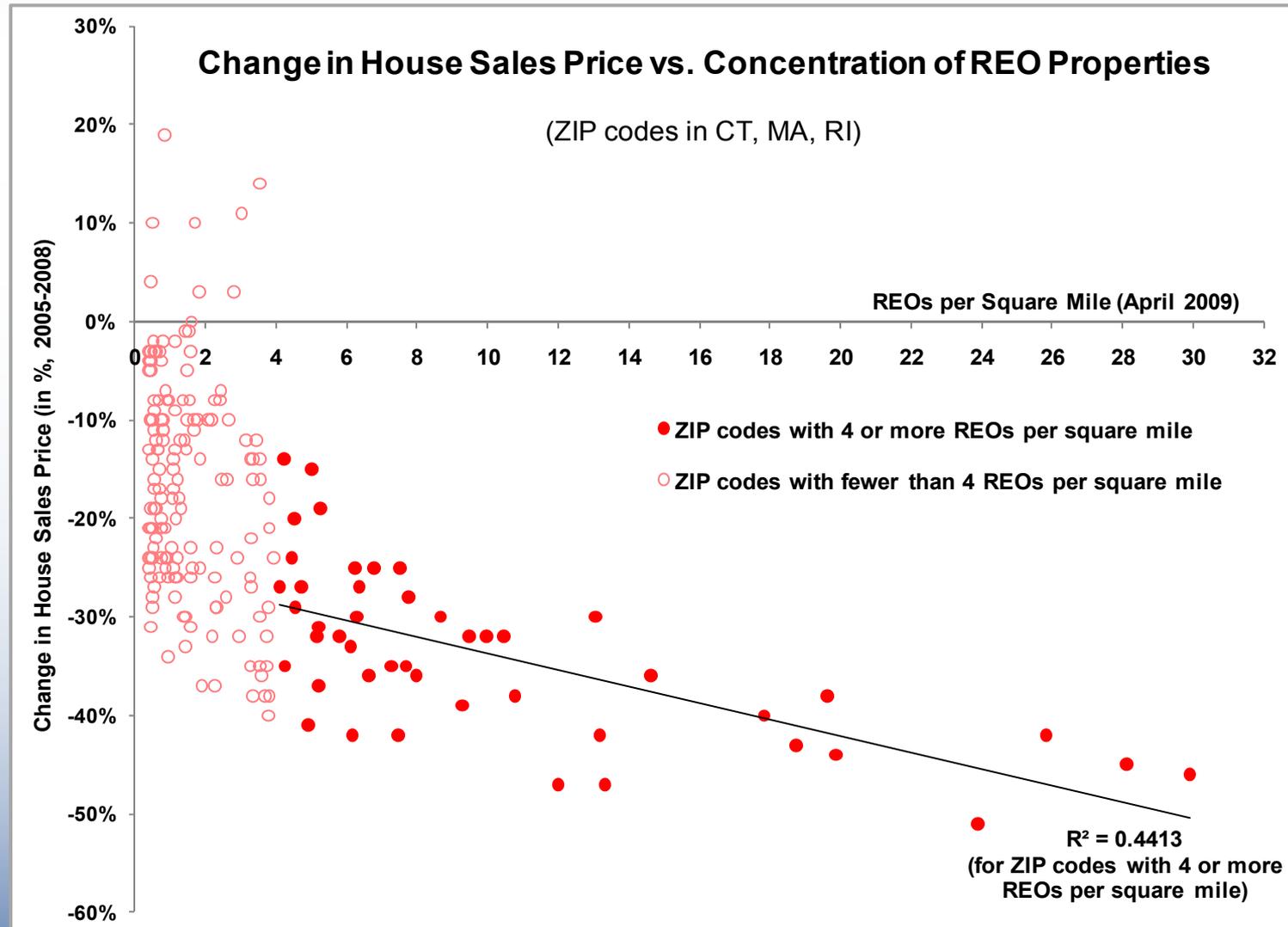
# Are We Framing The Right Problem?

- Clearly all three are elements of this crisis
- However, my own view is that too little policy focus has been on *community* problems because the focus has been on *housing* and *foreclosures*

*A housing problem,  
a foreclosure problem,  
or a community problem?*

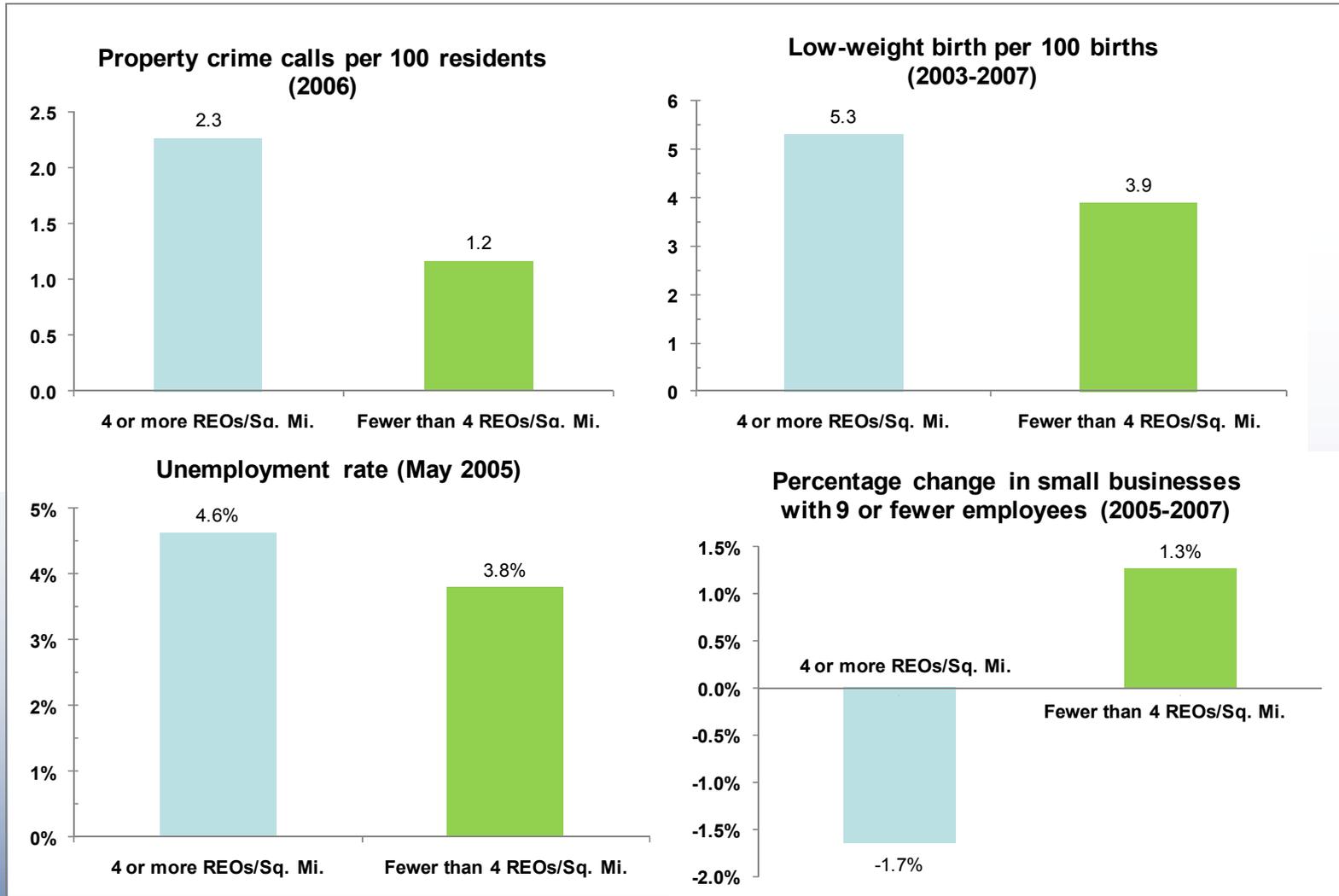
**Let's examine some evidence,  
From New England and Greater Boston...**

# Falling home prices correlate with the prevalence of REO



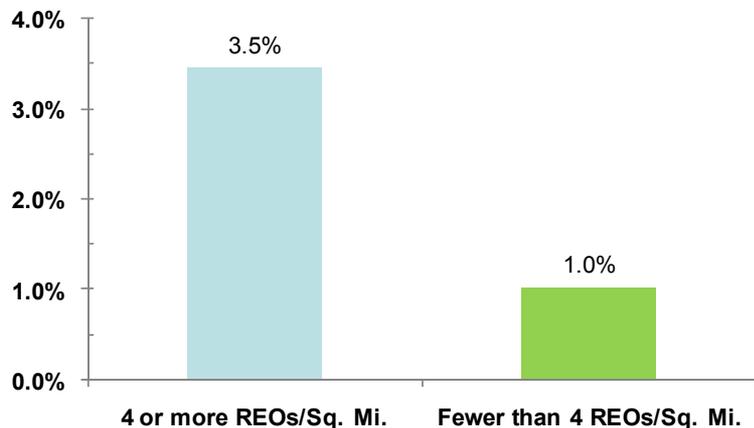
Source: Federal Reserve Bank of Boston, based on raw data from the Warren Group and LPS Applied Analytics

# Communities with a high concentration of REO properties were faring worse by measures of public safety, public health, and economic vitality

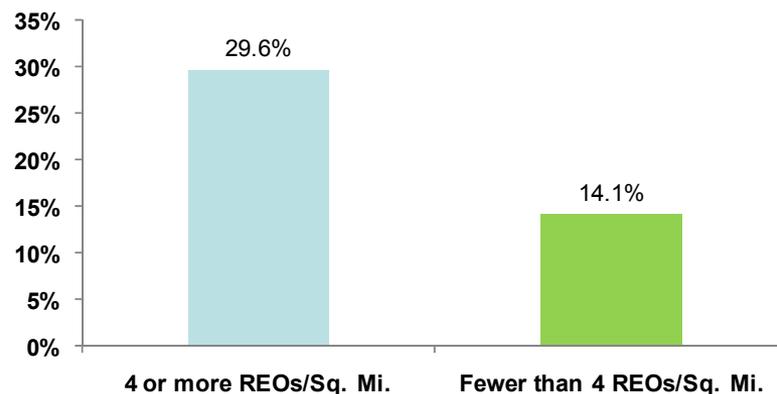


# Communities with a high concentration of REO properties were faring worse by measures of education and municipality fiscal capacity

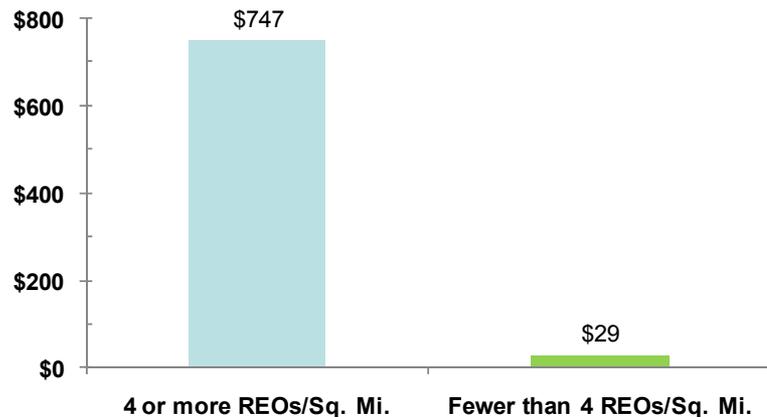
High school dropout rate (2005-2006)



Percent of students who failed statewide standardized math test (2007-2008)



Fiscal gap in municipal revenue capacity and revenue need (FY 2007, per capita)

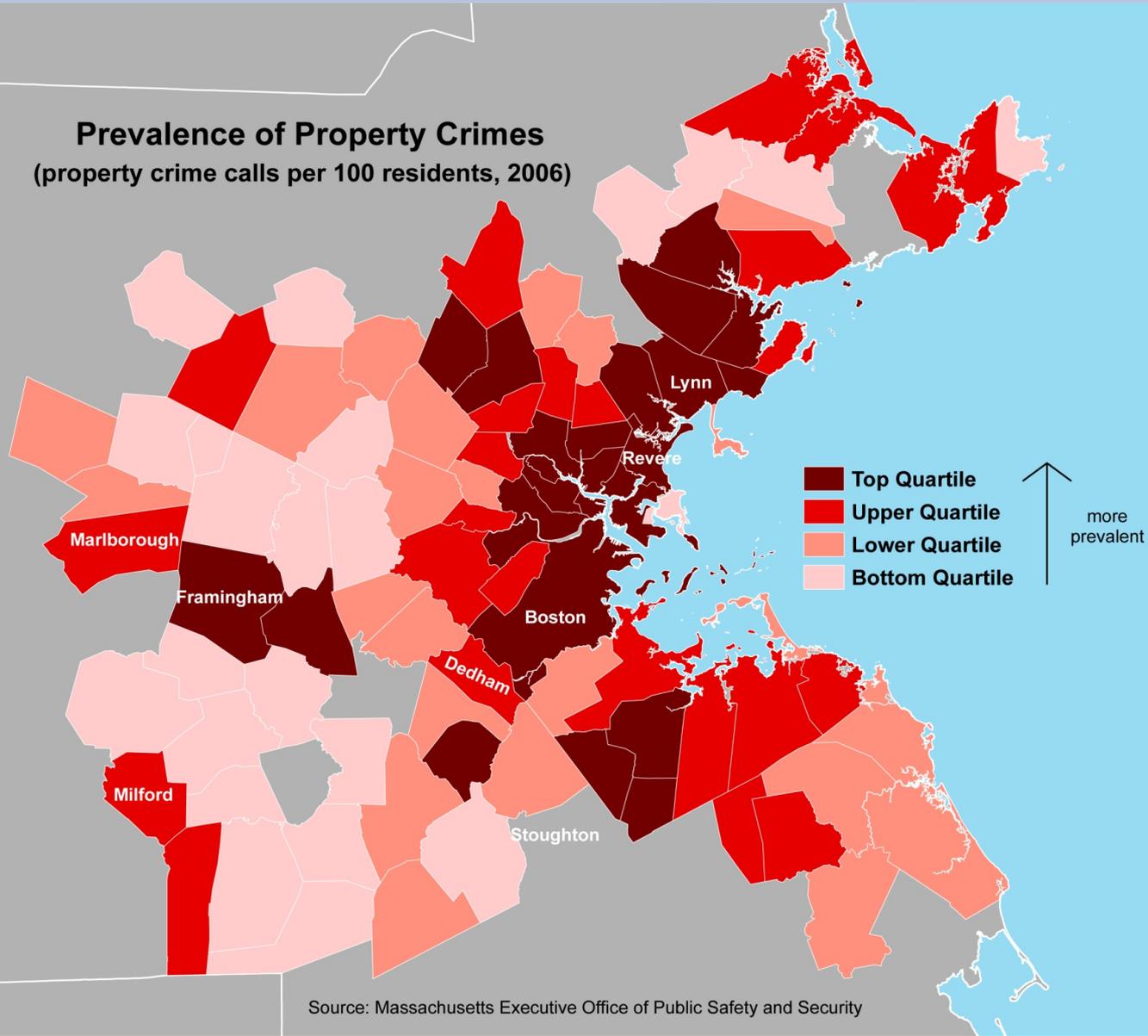


Source: Federal Reserve Bank of Boston, based on data from MA Department of Elementary and Secondary Education

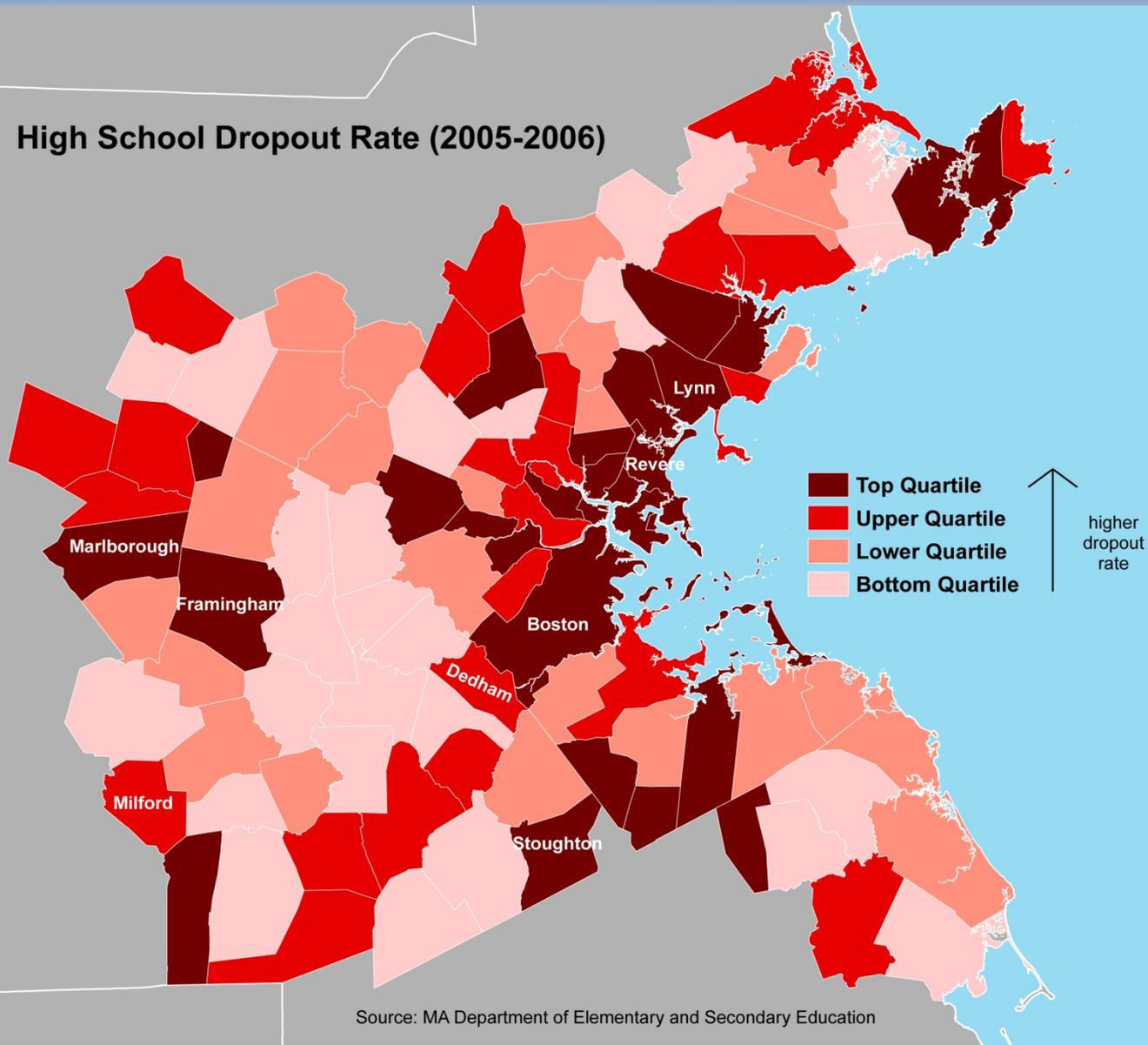
**Maps show that clusters of REO are associated with depressed home prices, but also a host of other community problems...**



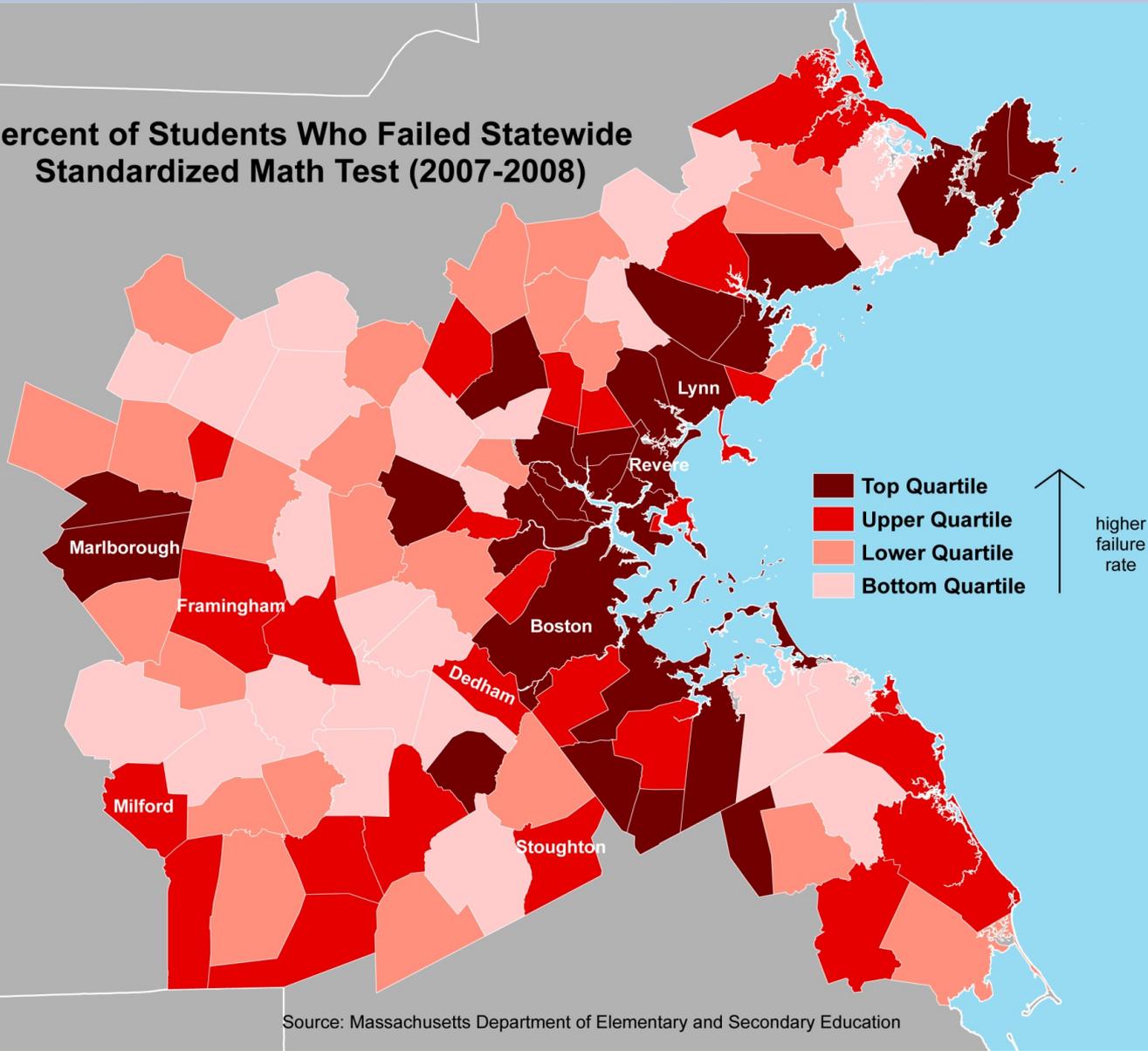
## Prevalence of Property Crimes (property crime calls per 100 residents, 2006)



## High School Dropout Rate (2005-2006)

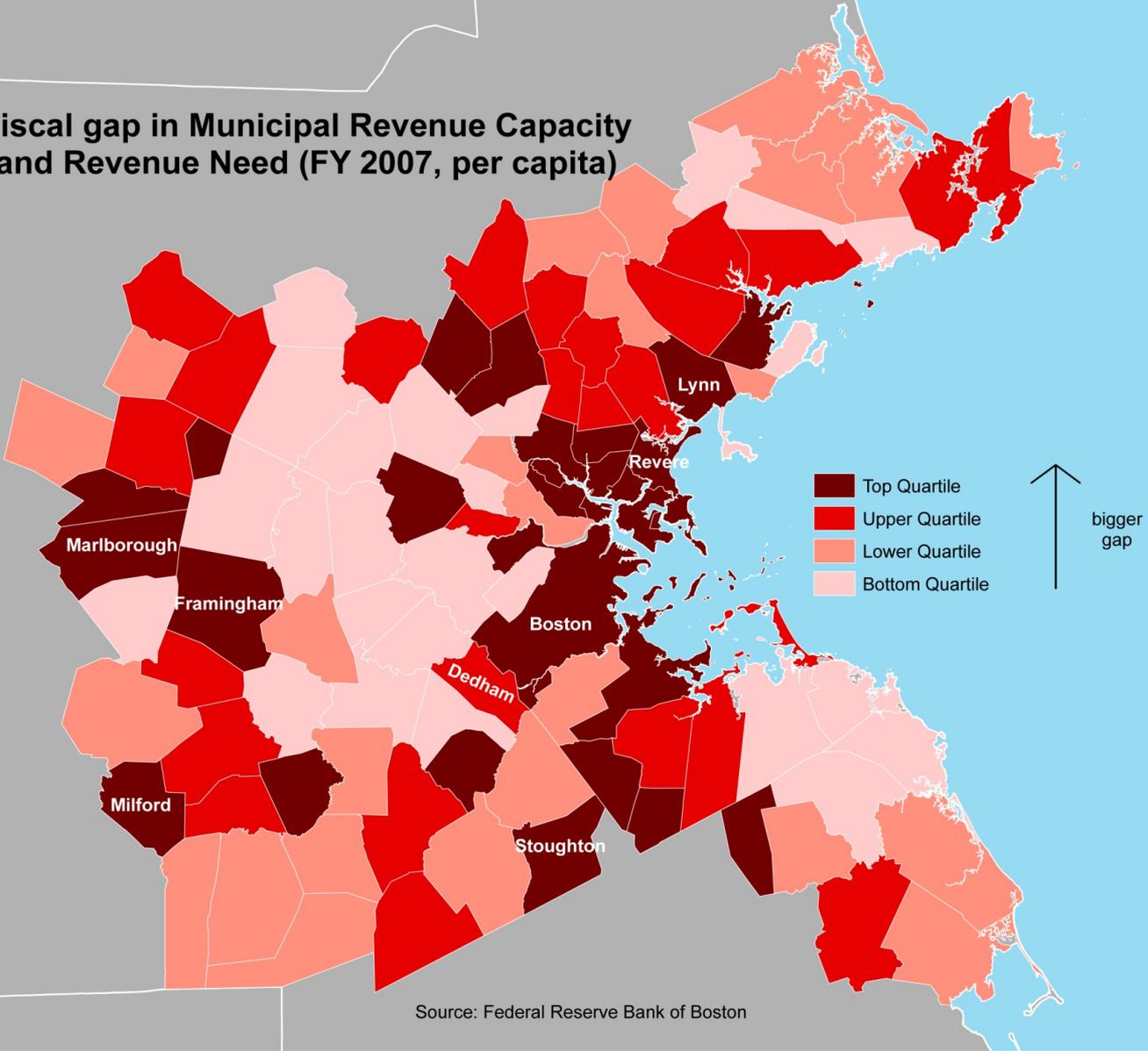


## Percent of Students Who Failed Statewide Standardized Math Test (2007-2008)



Source: Massachusetts Department of Elementary and Secondary Education

# Fiscal gap in Municipal Revenue Capacity and Revenue Need (FY 2007, per capita)



# Policy / Research Observations

- Clusters of REO are associated with depressed home prices, but also a host of **other community problems**
- **Causality** must be better understood between foreclosures/REO and other community problems – including the impact on children
- We need a more **holistic** approach

# Policy / Research Response

- More funding for holistic solutions is needed
- More research on which holistic solutions *work* is needed
- Boston Fed researchers are working to shed light on facets of the problem:
  - New study: MA funding (state aid) is not going to communities with the *most need and least capacity* to address problems
  - On-going research looking at collateral damage of crisis