

Forefront

New Ideas on Economic Policy from the FEDERAL RESERVE BANK
of CLEVELAND

A close-up photograph of a hand holding a white credit card. A red pen is pointing to the card number. The card has a barcode and the word 'MARK' visible at the bottom. The background is dark and out of focus.

Making Financial Markets Safer for Consumers

INSIDE:

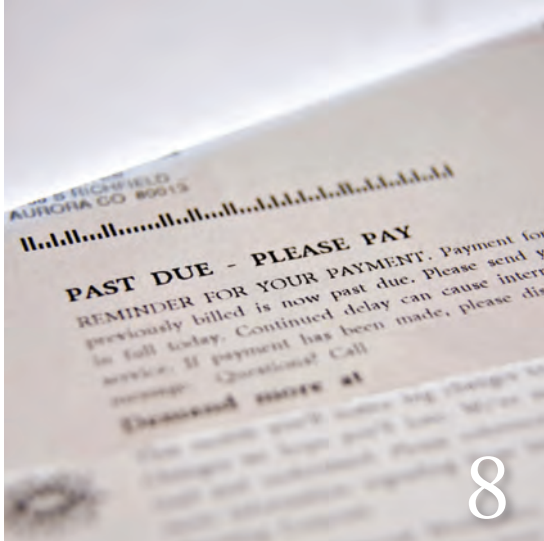
How to Rein in
Systemically Important Institutions

The Curious Case of
Cleveland's Foreclosure Rate

Q&A with Urban Economist
Matthew Kahn

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View: Can Foreclosures Be a Neighborhood's Best Friend?



Mary Helen Petrus,
Community Development
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Rampant foreclosures present a dichotomy for communities. On the one hand, foreclosure can deal a crushing blow to the American Dream of homeownership, and it certainly can accelerate the decline of neighborhoods. But often overlooked is the other hand: Foreclosure can sometimes serve as a useful tool to stave off community blight. Using the proper legal tools, older industrial cities can use foreclosure to acquire property that otherwise would become vacant or abandoned. As a result, crisis can be transformed into opportunity—the rare opportunity to rethink redevelopment and land use.



Mark Wiseman, attorney and former director of the Foreclosure Prevention Program in Ohio's Cuyahoga County, once described the foreclosure process as akin to cutting sacks of sand from an air balloon's gondola. These sacks are the debt and title disputes weighing down the property. As they are severed, the property is unleashed. Wiseman argues that communities need to get organized about setting more of these balloons free—and they can do it with foreclosure.

I am not talking about forcing people from their homes. I am talking about homes that have been long abandoned, or that are very likely to become abandoned, and are stuck in legal limbo. Consider what happens in a so-called “toxic title” situation. First, the homeowner leaves the property as soon as the lender starts the foreclosure process. Then, as the property deteriorates from lack of care, the lender halts foreclosure proceedings because the underlying home has lost so much value that it's not worth pursuing the action. In the end, government officials have a difficult time figuring out who should be held accountable—the absent homeowner or the disinterested lender. Even in cases when homeowners want to surrender their property, they often can't do so because of title complications. If enough properties get locked in toxic-title limbo, entire neighborhoods can quickly fall into disrepair.

The fact is, foreclosure in many cases is the only tool that communities have at their disposal to reclaim and reuse abandoned property. Tax foreclosure—that is, when governments launch the foreclosure process because a property is delinquent on taxes—is a particularly useful tool. It has been endorsed by the City of Buffalo and the National Vacant Properties Campaign as a way for land banks to acquire vacant and abandoned properties that are saddled with unpaid liens.



Foreclosures of unoccupied property can help clear the way for something weak-market cities need more than homes: safe, open space.

But foreclosure is far from a perfect tool for clearing title. As the housing crisis has unfolded, public perception about the personal tragedies associated with foreclosure has tended to sway legislators to impose restrictions on the process. The danger with this perception is that we risk losing sight of foreclosure's relationship to property acquisition and reuse.

The stigma of being associated in any way with encouraging foreclosure, which many envision strictly as efforts to remove people from their homes, understandably makes neighborhood development groups skittish. Even so, when houses are vacant and abandoned, foreclosure is the most straightforward way to clear title. What is really more controversial—using foreclosure in an effort to save neighborhoods, or watching vacant homes topple others nearby like dominos?

Policy Implications

To be clear, in viable neighborhoods, the focus ought to be on improving the quality and affordability of housing for the people who still live there. This could be done by rehabbing homes and improving rental housing stock and supply.

For nonviable neighborhoods, a completely different prescription is needed. The key is to create better legal tools to clear title—ways that do not depend on the self-interest and timing of debt collectors. Among them:

- Quiet title actions, in which governments go to court to “quiet” any and all other claims to a property's title
- Laws to facilitate nuisance abatement through receivership, in which courts can assign an overseer to repair or improve vacant properties
- New rules making it easier for willing homeowners to forfeit their properties so that governments can take stewardship
- Processes for tax foreclosures that don't have to go through the courts

All of these methods should be further explored. In the meantime, instead of waiting until all collateral value is lost on foreclosed properties, communities should enforce housing codes more rigorously, make mortgagees responsible for the condition of abandoned property, and regulate property transfers when properties have serious code infractions on record. Of course, these strategies can be difficult for cash-strapped communities to achieve in practice. We in Cleveland are all too familiar with the painful and expensive process of trying to locate title holders to hold them accountable.

The rewards can be worth the struggles, however. Foreclosures of unoccupied property can help clear the way for something weak-market cities need more than homes: safe, open space. Too many homes now in foreclosure should be demolished because of obsolescence or profound disrepair. Communities and policymakers should explore ways to facilitate demolition through adequate funding mechanisms. Moreover, it's time to discard the old operating assumption of “if we build it, they will come.”

Our challenge—and perhaps the silver lining in the foreclosure crisis for the Fourth Federal Reserve District—is making the leap from a traditional community development model to one featuring sustainable redevelopment designed to promote truly viable neighborhoods. These are the essential ingredients of healthy communities in weak-market regions. ■