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# The Mortgage Foreclosure and Financial Market Crises – Implications for Smart Growth and Community Development

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As the New Year begins with great uncertainty and cautious optimism, we reluctantly reflect on the convergence of unprecedented events in 2008: the housing market collapse; a deepening economic recession; dramatic budget cuts for state and local governments; and wildly fluctuating energy costs that triggered widespread chaos in global financial markets. And when Barack Obama and a new Congress take the reigns of power on January 20, 2009, dramatic federal action seems almost essential to get our country out of this mess. What do these events and trends mean, or could they mean, for the companion fields of smart growth and community development? Does this signal the end of sprawl as we know it? Will more cautious investors, lenders, and developers turn to small and compact projects with more modest returns? Will a national stabilization trust facilitate the transformation of thousands of vacant and foreclosed homes into opportunities for neighborhood stabilization and revitalization? Will transportation lead a new federal infrastructure and jobs initiative not seen since the days of the Great Society or the New Deal? Let's gaze into the crystal ball and imagine the possibilities.

**The Foreclosure Crisis, the Financial Crisis, and the Community Impacts**

For the better part of 2008, mortgage foreclosures (predominately on single family homes) were at their highest levels in recorded history; and for the first time since the Federal Reserve began keeping track in 1945, Americans owed more on their houses than the value of what they owned.[1] Currently more than one million American families have lost their homes to foreclosure and, according to data from the Mortgage Bankers Association, banks are now in the process of foreclosing on 1.5 million more.[2] Unfortunately, evidence suggests that the peak of this crisis has yet to come. The greatest number of subprime adjustable rate mortgage (ARM) resets took place between August and October of 2008. Assuming that mortgage holders unable to make higher payments enter delinquency immediately after their rates reset, and foreclosure six months after that, some optimistic experts believe the rate of foreclosure will reach a peak around March 2009.[3] Unfortunately, another wave of interest-only or payment option ARMs (not subprime) will continue resetting through 2011.

In September 2008, the collapse of the housing market and subsequent credit crunch caused a near collapse of global financial markets, leading to the failure, merger, or conservatorship of several large United States-based financial firms, declines in various stock indexes, and a number of European bank failures. Today, a global financial crisis is upon us, and while the foreclosure and financial crises have had undeniable impacts on the welfare of American families, the economic and social impacts of these crises on properties, neighborhoods, and communities may turn out to be even greater. Local governments must attempt to cope with massive numbers of vacant properties, the increased costs of police surveillance, fire protection, and code enforcement associated with these properties, and the implications of reduced tax revenues and federal support for city budgets.[4]

As residential mortgage foreclosures continue to skyrocket, the number of vacant properties has reached record levels in the hundreds of thousands.[5] Widespread vacancy and abandonment is occurring not only in struggling cities such as Detroit and Cleveland, but also in booming sunbelt communities in the Las Vegas and Phoenix areas, and in suburban counties near Atlanta and Washington, D.C. However, the costs of foreclosures are particularly high for weaker market cities, where, in many cases, servicers do not even bother to complete foreclosure sales, believing that the cost of foreclosure outweighs the value of the property.

**Policy Implications for Community Development and Smart Growth – The Challenges and Opportunities**

For the immediate future, the economic and fiscal crisis confronting state and local governments will likely translate into short-term setbacks in the advancement of smart growth outcomes. However, the convergence of these crises also affords us tremendous opportunities to further the goals of more livable and sustainable communities through Smart Growth policies. Let's explore the positive and negative policy ramifications of the crises.

*State and Local Budgets*

More foreclosures translate into lower property values and less property tax revenues for state and local governments. A slump in home building also means fewer impact fees and building permit revenues at a time when the demand for many state and local government services exceeds local capacity. As budgets tighten, state and local governments will have fewer staff members and fewer resources to implement existing smart growth programs and policies. This climate of fiscal austerity will also make it difficult to launch new initiatives. Planning departments are often the first to get cut in lean budget years, resulting in fewer resources being devoted to activities such as rewriting codes and updating comprehensive plans to translate into better outcomes for smart growth and community development.

However, tightened budgets also present an opportunity for policymakers to reevaluate existing fiscal structures and plan for the future. The time is ripe for discussions about how to reform the way we fund local governments, so that they depend less on property and sales taxes, and rainy day funds are set aside to address budget shortfalls. Conversations about regionalism are also pertinent; as local governments struggle to balance budgets, they should explore options for joint service agreements whereby two or more local governments partner to provide services. Moreover, the metropolitan policy agenda of encouraging cross-jurisdiction collaboration and perhaps city-county consolidations to save resources and address regional issues becomes an increasingly appealing option—municipal law experts predict that we will see many municipal bankruptcies in the next two to three years.

*Building and Construction*

The collapse of the financial market means that it will be more difficult to gain access to the capital that makes building and construction possible. In the short-term, private developers will face greater hurdles when convincing lenders to invest in mixed-use and transit-oriented projects they were often reluctant to finance before the crises. It will also be a harder for state and local governments to access bonds to capitalize infrastructure repair and improvement projects, such as roads and combined sewer overflow separations.

On the other hand, a downturn in new construction gives policymakers, planners, and residents the opportunity to think about how to direct development as the economy recovers. It allows private developers to consider new models. Shifting demographics, rising gas prices, and increased market demand for walkable urban communities have gained saliency and the foreclosure crisis has helped bring attention to overbuilding in outer-ring suburbs across the country.[6] Several regional high-performance homebuilders are on the verge of bankruptcy. As the housing development industry looks to recalibrate its model and maximize its return on investment in light of the difficulty in securing capital, and governments seek to plan for stable communities in the future, they may also more readily embrace a move towards walkable, transit-oriented, and infill development—core tenets of smart growth.

*Housing Policy*

While the foreclosure and financial crises have brought to light many failures of federal financing and housing policy,[7] they also offer an opportunity to pilot new ideas. Some commentators claim that community development leaders oversold the notion of homeownership and that housing policy must not forget affordable rental housing. The foreclosure crisis also illustrates lessons for where to build, perhaps signaling a shift away from large-scale greenfield development, an end to McMansions, and a move towards compact development, green buildings, and sustainable development. Within the field of community development, these new problems may require CDCs that have focused on building housing units through new development to shift their models and become experts at rehabilitating vacant properties instead.

Likewise, new government programs have created opportunities to strategically address issues that have been plaguing many cities for decades. This year, almost $4 billion in funding was awarded to communities through the Neighborhood Stabilization Program (NSP) to address vacant and foreclosed homes and the instability that they bring to neighborhoods (blight, crime, graffiti, vandalism, etc.). If used strategically by recipient localities, this funding has the potential to facilitate the testing of new community development strategies (e.g., land banks, land trusts, and neighborhood information systems) that can, if done in concert with each other, promote neighborhood stabilization in urban and suburban markets. It also offers the opportunity for cities to integrate these approaches into neighborhood-level housing strategies and longer-term planning that could have real benefits for smart growth and community development.

**Conclusion – Lens of Smart Growth Partners**

With hindsight, we see more clearly that while the housing market has served as the foundation of our economy for decades, a lack of federal oversight and engagement in the mortgage lending field and the absence of a cohesive federal housing policy have contributed to its collapse. The convergence of these crises also instructs us that local governments and community development organizations cannot do this work on their own. More so than at any other time since the Great Depression, all eyes will be turning

to Washington for leadership. With a new Congress and a new administration coming to the District in January, the time is ripe to forge a new federal policy agenda that facilitates smart growth development by integrating housing, infrastructure, and energy; thus, moving us one step closer to the goal of living in more healthy and sustainable communities.

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[1] Maura Reynolds, *Foreclosure rate hits record high,* The Los Angeles Times, March 7, 2008. http://www.latimes.com/news/nationworld/washingtondc/la-fi-foreclose7mar07,1,2986355.story

[2] Julie Scelfo, *The personal cost of a global meltdown,* International Herald Tribune, October 23, 2008. http://www.iht.com/articles/2008/10/23/america/house.php

[3] Robert Snigaroff, *Out of the Wood? – Denali Research Commentary on the Housing Market*, Research Review, 2008. http://www.denaliadvisors.com/researchPDF/1209761347Denali_Commentary_Housing.pdf

[4] The National League of Cities' annual study of cities' fiscal conditions released in September of 2008 showed an inflation-adjusted decrease in property tax revenues of 3.6 percent from 2007 (not to mention a 4.2 drop in sales tax revenue and a 3.3 percent drop in income tax revenue).

[5] Frank S. Alexander, *Land Banking as Metropolitan Policy,* The Brookings Institution, October 28, 2008.

[6] Christopher B. Leinberger, *The Next Slum?,* The Atlantic Monthly, March 2008. http://www.theatlantic.com/doc/200803/subprime

[7] Thomas Friedman, *All Fall Down*, The New York Times, November 26, 2008.

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