

**In the Blind Spot: The Federal Government's Intervention
in the Housing Crisis in Suburban California**

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Abstract

The federal government responded to the foreclosures crisis by implementing several policies. The Neighborhood Stabilization program (NSP) in 2009, a mitigation policy, aimed at helping local governments to buy, rehabilitate and sell foreclosed homes to mitigate the effects of the foreclosures in the most affected neighborhoods.

This paper focuses on the allocation methodology used in this program to explain why some of the most affected places in California didn't receive adequate funds to fight foreclosures. The initial version of the NSP targeted mainly the largest cities, but left suburban municipalities—yet deeply affected by the foreclosures—with reduced or delayed funds. The use of estimations of foreclosures number to allocate the money, as well as the lack of cooperation between suburban local governments also participated to inefficiently allocate the NSP money, and suggests that urban policies need to be adapted to better fit the change of urban structure in the US.

In the Blind Spot: The Federal Government's Intervention in the Housing Crisis in Suburban California

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The recent subprime crisis—the main trigger of the Great Recession of 2007—resulted in a dramatic rise in foreclosures in the United States. From 2007 to 2012, more than 7 million American families were evicted from their homes (Schwartz 2014). Subprime loans, the main cause of the foreclosures, initially affected specific fringes of the American population. Studies show that African Americans and Hispanics were overrepresented as victims (Gruenstein Bocian, Li, and Ernst 2010; Kaplan 2009) due to discriminatory practices and predatory lending,¹ explaining why subprimes were highly concentrated in minority neighborhoods even before the 2000s (Immergluck 1999; 2009).

Even though poor neighborhoods showed very high foreclosure rates, studies show that “*the highest subprime densities are found in census tracts with the lowest poverty rate*” (Kingsley and Pettit 2009). Additionally, recent suburbs—long perceived as not affected by the socioeconomic issues concentrated in the cities—were also deeply affected, most specifically where housing bubbles inflated rapidly before bursting (Immergluck 2010), especially in Arizona, Nevada, and California (Kingsley and Pettit 2009).

Although the subprime crisis raised national and international issues due to the globalization of the financial system, its impacts were critical at the regional and local level. In the most affected neighborhoods, homeowner evictions contributed to an increased vacancy rate and led to degradation of the living environment.² Moreover, high concentrations of foreclosures contributed to price decreases in surrounding properties (Immergluck and Smith 2006), sometimes encouraging people to strategic default.

Given the extent and the complexity of the housing crisis, only the federal government had the economic and political capacity to implement policies to help people facing foreclosures and to reduce the effects of the concentration of bank-owned properties in the most affected places. The federal government followed different strategies (Immergluck 2013; Schwartz 2014). The first types of interventions were prevention policies, aiming at helping homeowners with sub-

¹ This barely legal practice provided bad quality loans to borrowers without informing them of the real characteristics and conditions of repayment and often led to foreclosures. David H. Kaplan, “Saisies immobilières et prêts à taux variables dans les quartiers: quelques exemples américains,” *Hérodote*, 1 (2009): 81–103.

² Foreclosed homes are sometimes vandalized by people scraping metal and breaking through walls to take electric wires and copper pipes.

prime loans to obtain a mortgage modification to avoid foreclosure.³ The second type of strategy was mitigation policies, providing resources to the most affected local governments to help them deal with foreclosed homes. Despite all the measures deployed between 2007 and 2012, federal policies had limited impacts on the crisis, especially mortgage modification programs (Immergluck 2013; Kiel 2012; Schwartz 2014).

Most studies on federal interventions in the crisis focus principally on prevention policies—such as mortgage modification programs—to understand their lack of effectiveness (Immergluck 2013, Kiel 2012) and to offer solutions to improve in the future. On the other hand, this paper focuses on a mitigation policy, the Neighborhood Stabilization Program (NSP), and more particularly on the allocation methodology in its first version, NSP1, in 2008 in California. Its goal is to provide a better understanding of the mechanisms of the allocation methodology. More precisely, its purpose is to understand why the federal government ignored several of the most affected communities, specifically in the northern San Joaquin Valley⁴ and the Inland Empire in California, while others, also among the most affected in the US, received limited funds. Moreover, this situation raises questions about the federal response to the crisis and the adaptation of urban policies in the context of rising poverty in the suburbs.

This paper first examines how federal policies failed to address the crisis in several communities. Second, verification is provided that this failure is linked to HUD's methodology. And third, solutions implemented after the two early plans to better distribute the funds to fight foreclosures are presented.

Presentation of NSP1

NSP1 was part of the Housing and Economic Recovery Act (HERA) of 2008. This very large federal program included mortgage modification programs (HOPE for homeowners) and new regulations for mortgage brokers (Secure and Fair Enforcement for Mortgage Licensing Act), which could be categorized as prevention policies.

NSP1, on the other hand, is a mitigation policy and was not designed to directly help households. NSP funds were instead allocated to local governments to help them to reduce the effects of foreclosures. Local governments could use this money to buy, rehabilitate, and sell foreclosed homes, create land banks, provide low equity loans, and demolish blighted structures to stabilize the housing market.

Funds were supposed to target the “hardest hit areas,” but local governments had a certain degree of freedom in using those funds. For instance, Stanislaus County officials decided to buy and rehabilitate foreclosed homes to sell them to first-time homebuyers. In another example, Modesto initially aimed at using those funds to lend money to first-time homebuyers to help them to buy and repair foreclosed homes, but eventually gave those funds to nonprofit organizations that bought and rented foreclosed homes. Further, Lathrop, in San Joaquin County, also used those funds to help a NGO buy, fix, and sell eight foreclosed homes.

³ In 1933 already the federal government created the Homeowners' Loan Corporation to purchase distressed mortgages and prevent foreclosures following the Great Depression. This lending practice has nevertheless been discriminatory and inefficient, at least in the case of Cleveland. See Brennan 2011.

⁴ The northern San Joaquin Valley in California has among the highest rates of foreclosures in the country. From 2005 to 2012, this region cumulated 82,063 foreclosures (16.5% of the housing units) according to DataQuick.

Several studies have pointed out the limitation of the NSP1 (Immergluck 2013; Mallach 2009; Schwartz 2014): funds were too low to be really effective in the most affected communities, and the program had too many restrictions—notably concerning the price local governments could pay to acquire foreclosed properties—to be efficient. Additionally, local governments had only 18 months to spend the funds but often didn’t have enough staff to properly implement the program in this timeline. Aside from those issues of program design, the funds’ allocation methodology is also critical to explain why several of the most affected communities didn’t receive adequate funding to mitigate the effects of the foreclosures.

The Issue of Fund Distribution

The funds’ distribution varied depending on the place. For instance Berkeley received only \$177,335,⁵ compared to \$33 million for Los Angeles. Several cities did not receive any money, while others received it via a county consortium. The differences in the allocated funds are explained by the variation in the number of foreclosures in the cities, but the disparities are very important if we divide the amount received by the number of foreclosures between January 2007 and July 2008.⁶

For instance, local governments received only \$852 per foreclosed home in Santa Barbara County, but almost \$7,000 in Kings County.⁷ Additionally, some of the most affected places—such as Perris in Riverside County (1,870 foreclosed homes, 10.36% of the total housing)—did not receive any funds from NSP1.

The city of Merced is also a good example of the issue of distribution of funds among local governments. Located in Merced County,⁸ this city attracted the attention of national and foreign newspapers, such as *Le Monde*, which described it as the epicenter of the crisis in California.⁹ Indeed, between 2006 and 2010 the city of Merced concentrated 3,787 foreclosures for 27,000 housing units (accounting for around 14% of the total housing units) and 1,334 foreclosures between January 2007 and July 2008 (around 5%).

Despite its situation and the attention of the media, the city only received \$2 million for NSP1.¹⁰ Additionally, the payment of those funds has been delayed because the amount initially calculated was too small to be directly allocated by HUD.¹¹

⁵ The funds allocated to the city of Berkeley came from the HCD, this point will be expanded later in this paper.

⁶ Reference period used by the HUD

⁷ The date used for the number of foreclosed homes is provided by DataQuick, via Rand California unless specified otherwise.

⁸ Merced County is one of the poorest counties in the state: 21.8% of the population lives below the poverty level, compared to California’s average of 14%. The unemployment rate in 2010 was nine percent higher than the state average. <<http://quickfacts.census.gov/qfd/states/06/06047.html>>. In addition, Merced County is one of the counties most affected by foreclosures in California, with almost one in five houses foreclosed (18.03%) between 2006 and 2012.

⁹ Nicolas Boursier, “Dans la Californie en dépression, les souffrances de Merced En Californie, la chute de Merced, épiceutre de la crise des subprimes,” *Le Monde*, March 2009, 1 and 6.

¹⁰ And nothing for the NSP2.

¹¹ Local actors had to wait for the Department of Housing and Community Development of State of California (HCD) to receive funds. See further in this paper.

Federal funds are critical for a small city like Merced, which does not have the financial means to cope with the crisis alone. Like many communities with concentrated foreclosures, the city of Merced suffered a rapid decrease in fiscal resources. Indeed, before the crisis, a large part of its income relied on the property tax, which is linked to housing prices, and on a property transfer tax.¹² When the housing bubble burst, the decline in housing prices and sales caused a major decline in the two fiscal resources.¹³

City officials and municipal employees claimed that their situation was unfair. Masoud Niroumand, Merced's Housing Program Manager, said HUD "screwed up" its fund allocation in the NSP1.

Why Did HUD Miss Some Communities?

The disparities bring up the question of the methodology HUD used to allocate federal funds. Why some of the most affected places, like the city of Merced, the county of Merced, or Perris did not receive funds from HUD? Did HUD make mistakes, as the Merced city housing program manager argues, or was the lack of financial support to small municipalities an intentional consequence of HUD policies?

In fact, choices by federal actors explain the inequality of funds directed to local administrations. In order to better understand the reasons for the differences, I will focus my analysis on the methodology used by HUD to allocate NSP1 funds to local administrations.

Description of the Methodology Allocation

State level distribution

Congress established the basic rules for fund allocations, and directed HUD to distribute the NSP funds in two steps (see "Figure 1). In the first step, funds are allocated among the states. In the second step, funds are distributed to local jurisdictions within each state. The state allocation formula was designed to provide at least 0.5 percent of the federal funds to each state, so every state received at least \$19.6 million no matter its number of foreclosures. This means that one fourth of the total funds—\$1 billion— was allocated this way.¹⁴

This may seem unfair, but small states are often favored in comparison to large ones because of their overrepresentation in the Senate. Federal policies are regularly the result of compromises reached through pork barrel politics that allocate money to specific congressional districts to obtain the support of their elected official and pass the funding measure.¹⁵

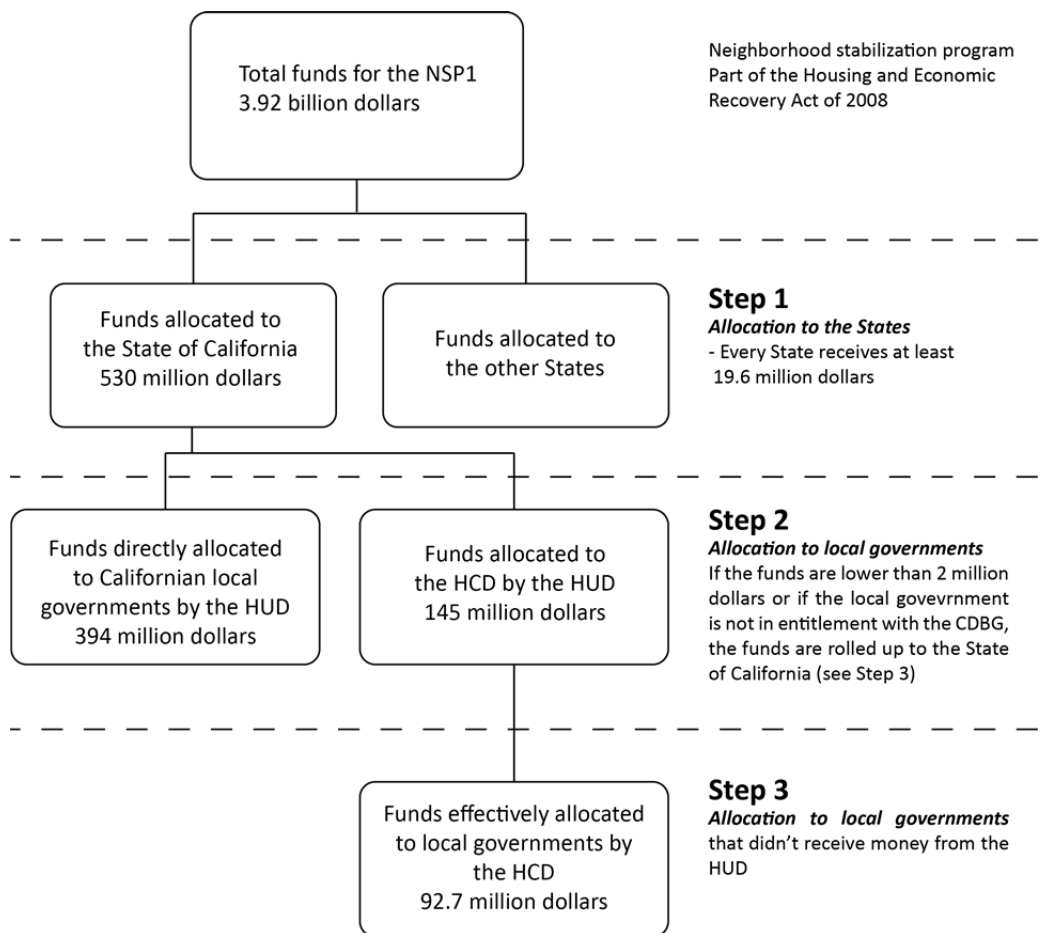
¹² This type of income skyrocketed before the crisis, thanks to an increase in the housing price.

¹³ Most cities cut their budgets and reduced their staff to compensate the decrease of their fiscal resources, but it wasn't enough. The city of Stockton, unable to pay its debts, filed for bankruptcy protection under Chapter 9 in 2012.

¹⁴ "Notwithstanding any other provision of this Act or the amendments made by this Act, each State shall receive not less than 0.5 percent of funds made available under section 2301 (relating to emergency assistance for the redevelopment of abandoned and foreclosed homes). US Congress, "Housing and Economic Recovery Act" (2008).

¹⁵ Local actors provided criticisms for this allocation methodology early on, especially in the northern San Joaquin Valley. US Fed News, "San Joaquin County Board of Supervisors Member Gutierrez Testifies on Effects of Foreclosure Crisis on Neighborhoods in California's Central Valley Before House Panel," US Fed News, September 2008.

Figure 1. Diagram of the Organization of the NSP1



In the case of NSP1, fund distribution among the states is based on a formula that allocates 70 percent based on the number and percent of foreclosures, 15 percent for subprime loans, 10 percent for loans in default, and 5 percent for delinquent loans.¹⁶ This method produced major inequalities in compensation. For example, the amount allocated per foreclosed home varied from \$859 in Virginia to \$12,770 in Wyoming, an average of \$1,335 per foreclosed home.

Local Allocation Formula

Once state allocations are calculated, a second formula is applied to distribute the funds to local governments (Figure 2). This formula is based on two variables: the number of foreclosures and the vacancy rate in census tracts with more than 40 percent of high-cost loans—meaning that vacancy rate is only taken into account in census tracts where high-cost loans¹⁷ are concentrated.¹⁸

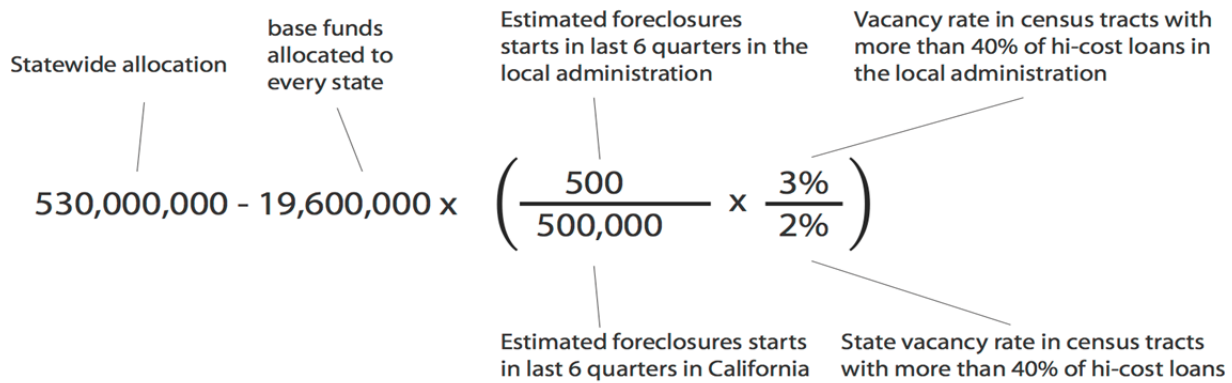
¹⁶ The vacancy rate is also taken into account.

¹⁷ High-cost loans data is provided by the Reserves Home Mortgage Disclosure Act and based on the Federal Reserve Board definition. Under this definition, a loan is considered “high cost” if the annual percentage rate (APR) is higher “than 1.5 percentage points for a first-lien loan or 3.5 percentage points for a

local allocation = statewide allocation - 19,600,000 x

$$\left(\frac{\text{local estimated foreclosures starts in last 6 quarters}}{\text{state estimated foreclosures starts in last 6 quarters}} \times \frac{\text{local vacancy rate in census tracts with more than 40\% of hi-cost loans}}{\text{state vacancy rate in census tracts with more than 40\% of hi-cost loans}} \right)$$

Figure 2. NSP1 Local Allocation Formula



$$= 125,400,000 \times (0,001 \times 1.5) = \$765,600$$

The funds allocated aim at specific situations, in specific places: the goal is to allocate money to local governments that have both foreclosures and vacant homes in neighborhoods that concentrated subprime loans. This explains why the rate of foreclosures was not the only variable used to distribute the allocation to local governments.

In an additional part of the formula, HUD added other conditions to allocate money: If the grant calculated for a local government is less than two million, funds are automatically rolled to the state, which is then in charge of allocating the money to local governments. Moreover, HUD does not calculate grants for communities that do not receive money for the Community Development Block Grant (CDBG) program.¹⁹

Let's take the example of a virtual local administration in California to better understand the allocation methodology. Based on the state allocation formula, the total amount granted to California is \$530 million. At the state scale, suppose there are 500,000 foreclosed homes, and an

subordinate-lien loan” compared to the average prime mortgage.” This definition changed just two weeks before the enactment of the Housing and Economic Recovery Act of 2008, which allocated money for the NSP.

See <http://www.ffiec.gov/hmda/pdf/HMDA_2009Disc_Changes.pdf> for the complete definition.

¹⁸ Funds are not allocated to census tracts, but to the local governments based on data provided at the census tract scale. Additionally, the vacancy rate cannot count for more than 30 percent of the local allocation.

¹⁹ I will get back to this critical question later in the paper.

average of two percent of vacant homes in census tracts with more than 40 percent of high-cost loans. Suppose now that the virtual administration counts 500 foreclosed homes and experiences an average of 3% of vacant homes in its census tracts with more than 40% of high-cost loans.

The formula is applied as follows:

This virtual local government should receive \$765,600. Since the grant calculated is inferior to two million dollars, this local administration would not receive funds from the HUD, and would have to wait from the HCD to get the money, if any.

Origins of inequality

Estimations vs. Observed Data

Different points in this allocation methodology can cause inequalities in sharing the funds. The first reason relies on a miscalculation of one of the variables used as factors to allocate the money. The number of vacant homes and high-cost loans used above is observed data and is very probably accurate, while the number of foreclosed homes is an estimate. HUD says estimates are necessary to obtain comparable results among territories because private data and local data lack homogeneity (HUD 2008). To predict foreclosures, HUD used the evolution of the housing price; the evolution of unemployment, and the percentage of high-cost loans. HUD indicates that the correlation between the estimations and the actual figures for the entitled communities is high (0.866) even at the level of jurisdictions (HUD 2008).

I evaluated the accuracy of the estimates by comparing the figures provided by HUD and those provided by DataQuick via Rand State Statistics. Contrary to HUD's data, DataQuick figures are collected from public sources, principally county assessors' offices and county recorder's offices and are very accurate.²⁰

Major differences appear between the two datasets (see Table 1). At the county scale and California-wide, HUD estimates 2.13 times more foreclosures than DataQuick counts. Overestimations are generally *relatively* higher for counties that have few foreclosures. In Plumas County, for example, HUD's foreclosure estimate was nine times higher than the figures provided by DataQuick (110 estimated foreclosures, compared to 12 according to DataQuick). That was also the case for Trinity County (4.38 times higher), Siskiyou County (5.27) and Mono County (7.13), which have all very few foreclosures in absolute value.²¹ As a result, if the gaps are high in percentage, they are in fact low in absolute value (a difference from 44 to 150 foreclosed homes between HUD's estimations and DataQuick figures).

For larger counties, smaller gaps in percentage means much larger differences in absolute value. For instance, in Los Angeles County, HUD estimates 88,606 foreclosures compared to 28,591 according to DataQuick, meaning a difference of 60,015 units between both datasets.

Additionally, gaps between HUD's and DataQuick figures are not the same in all the counties. In the northern San Joaquin Valley, HUD still overestimates the number of foreclosures in comparison with DataQuick figures. This overestimation is lower than the California average: at

²⁰ Information collected from a DataQuick employee. Information available on Rand website: "This database contains the number of foreclosures of all homes, condos/ townhouses, and single-family homes. Foreclosure numbers reflect that from strictly recorded Trustee's Deeds or when the property is actually taken back by the bank. Each county uses a set of codes to identify condos and townhomes; DataQuick News standardizes these definitions to report single-family and condos/townhouse data."

²¹ According to DataQuick, Del Norte County did not have a single foreclosed home from January 2007 to June 2008.

Table 1. Number of Foreclosures Estimated by the HUD and Foreclosures Figures Provided by DataQuick per County

County	HUD estimated number of foreclosures	Number of foreclosures—DataQuick	Ratio	Difference ratio with CA average
Alameda	13,979	5,741	2.43	0.30
Alpine	5	2	2.50	0.37
Amador	267	121	2.21	0.07
Butte	1,514	532	2.85	0.71
Calaveras	435	260	1.67	-0.46
Colusa	252	144	1.75	-0.38
Contra Costa	14,383	9,314	1.54	-0.59
Del Norte	103	0	—	—
El Dorado	2,262	713	3.17	1.04
Fresno	12,091	4,324	2.80	0.66
Glenn	203	89	2.28	0.15
Humboldt	474	116	4.09	1.95
Imperial	2,447	828	2.96	0.82
Inyo	40	12	3.33	1.20
Kern	13,480	6,214	2.17	0.04
Kings	1,439	212	6.79	4.65
Lake	597	443	1.35	-0.79
Lassen	174	62	2.81	0.67
Los Angeles	88,606	28,591	3.10	0.97
Madera	2,178	1,104	1.97	-0.16
Marin	686	335	2.05	-0.09
Mariposa	86	29	2.97	0.83
Mendocino	316	112	2.82	0.69
Merced	5,913	3,514	1.68	-0.45
Modoc	33	6	5.50	3.37
Mono	57	8	7.13	4.99
Monterey	4,428	2,336	1.90	-0.24
Napa	849	452	1.88	-0.26
Nevada	494	227	2.18	0.04
Orange	22,648	9,754	2.32	0.19
Placer	4,621	2,372	1.95	-0.19
Plumas	110	12	9.17	7.03
Riverside	48,200	28,218	1.71	-0.43
Sacramento	24,223	16,486	1.47	-0.66
San Benito	699	466	1.50	-0.63
San Bernardino	43,175	18,623	2.32	0.18
San Diego	28,103	16,139	1.74	-0.39
San Francisco	1,473	496	2.97	0.84
San Joaquin	17,901	9,630	1.86	-0.28
San Luis Obispo	1,252	596	2.10	-0.03
San Mateo	2,436	1,161	2.10	-0.04
Santa Barbara	2,894	1,477	1.96	-0.17
Santa Clara	8,982	3,940	2.28	0.15
Santa Cruz	1,367	601	2.27	0.14
Shasta	1,669	619	2.70	0.56
Sierra	24	10	2.40	0.27
Siskiyou	195	37	5.27	3.14

Solano	8,343	4,230	1.97	-0.16
Sonoma	4,026	2,121	1.90	-0.24
Stanislaus	12,851	6,618	1.94	-0.19
Sutter	1,553	712	2.18	0.05
Tehama	525	194	2.71	0.57
Trinity	57	13	4.38	2.25
Tulare	4,921	1,767	2.78	0.65
Tuolumne	309	135	2.29	0.15
Ventura	7,636	3,445	2.22	0.08
Yolo	1,969	932	2.11	-0.02
Yuba	1,408	806	1.75	-0.39
California Total	421,361	197,451	2.13	0.57

the state’s scale, HUD estimates 2.13 times more foreclosures than DataQuick, but only by 1.68, 1.86 and 1.94 times more for Merced, San Joaquin, and Stanislaus County (see Table 1).

The difference between both data sets is important at the city scale too. In the city of Los Angeles, HUD estimates 3.4 times more foreclosures than DataQuick reports (31,330 estimated foreclosures, versus 9,200 for DataQuick). HUD also largely overestimates the number of foreclosures in San Diego, Fresno, Long Beach, and Oakland. In Merced, Los Banos, Lathrop, Tracy, Stockton, Modesto or Patterson, HUD also overestimated the number of foreclosures, but at a lower rate than California average (see Map 1).

The map shows both HUD’s estimations and the figures provided by DataQuick. Overestimations clearly vary depending on the place. Large cities in southern California, Bay Area (Oakland, San José), and Fresno show very high overestimations. Stockton and Modesto do not. In Sacramento, one of the most affected cities in California, the estimation of foreclosures is smaller than the number of foreclosed homes observed by DataQuick. Small communities, such as Patterson and Lathrop or Los Banos, in Stanislaus, San Joaquin, and Merced County face the same situation, with lower overestimation than the average for the other cities in California.

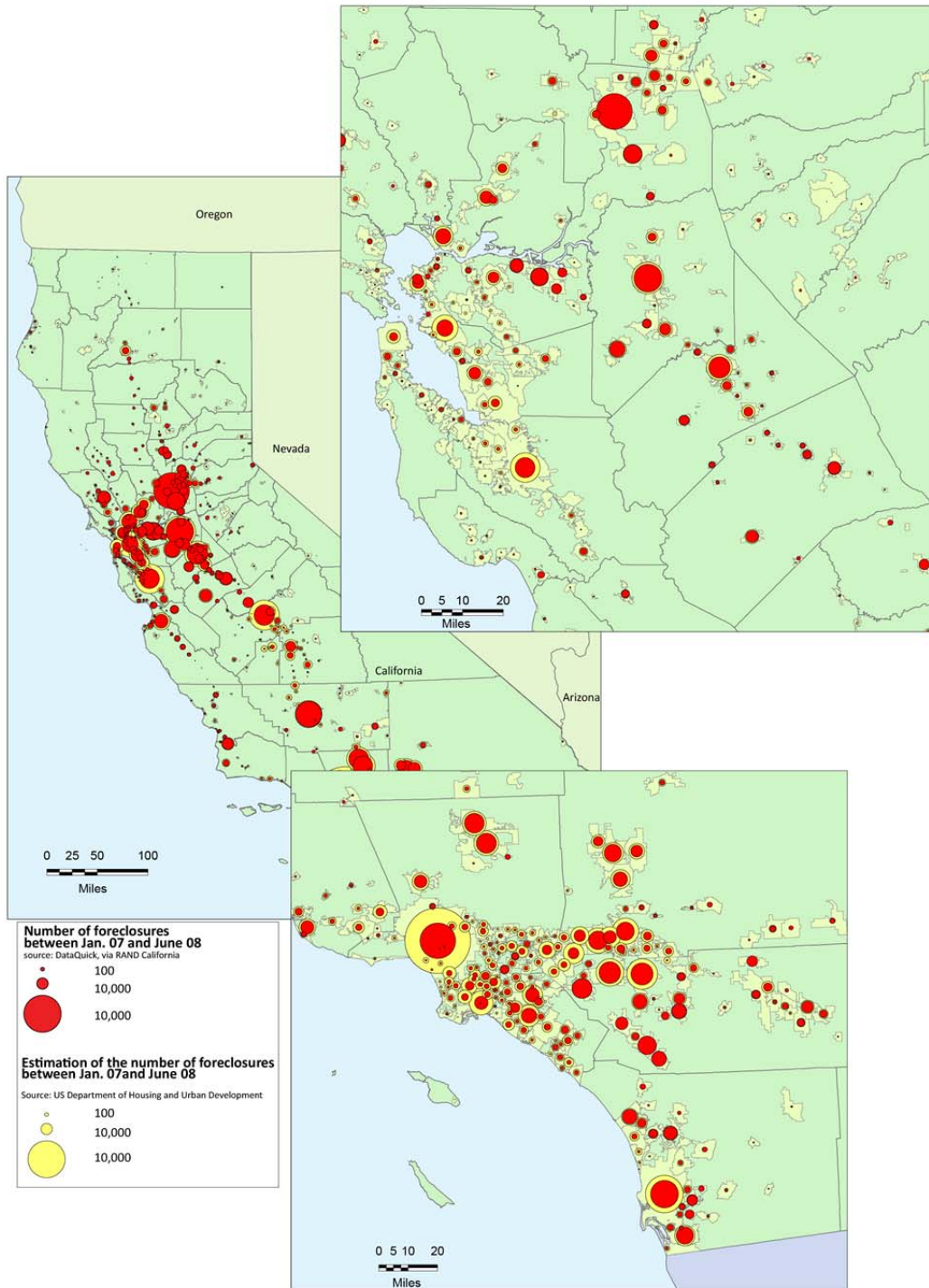
The accuracy of the number of foreclosures is crucial to ensure a fair distribution of the funds. Since the allocation of funds to local governments relies in part on the share of foreclosures in the total number of foreclosed homes, an overestimation for a specific jurisdiction reduces the money received by other places, causing disparities in the distribution of funds. I have contacted HUD multiple times, but have been unable to directly talk to the persons in charge of this part of the program, and each time I have been referred to the online documentation, without further explanation.²²

Additional Conditions to Receive Funds Directly from HUD

Aside from the problem of estimation, another condition prevented small jurisdictions from receiving a fair share of the NSP funds. As seen earlier, HUD decided that:

²² “HUD is not in a position to know about other data sets and therefore cannot comment on differences in the data. HUD PD&R does not believe it can add anything to this line of inquiry and refers you to previously published explanations.” (Personal communication with a HUD representative).

Map 1. Foreclosures and Estimations of Foreclosures between January 2007 and June 2008



a grantee must receive a minimum amount of \$2 million to have adequate staffing to properly administer the program effectively. In addition, fewer grants will allow HUD staff to more effectively monitor grantees to ensure proper implementation of the program and reduce the risk for fraud, waste, and abuse.

Many of the most affected areas, such as Los Banos in Merced County, are small municipalities. In absolute value, the number of foreclosures in those areas is not as high as in large cities, such as Oakland and Los Angeles; but their foreclosure rate is extreme. The problem is that local administrations must be entitled under the CDBG (*Community Development Block Grant*) to be eligible for the NSP program and receive funds directly from the federal administration (HUD 2008).²³ Entitlement for the CDBG is based on different criteria.²⁴

Eligible Grantees are as follows:

- principal cities of Metropolitan Statistical Areas (MSAs);
- other metropolitan cities with populations of at least 50,000; and
- qualified urban counties with populations of at least 200,000 (excluding the population of entitled cities) are entitled to receive annual grants.

As a result, small jurisdictions were victims of a threshold effect. They had to wait to get the money from the state to fight foreclosures in their area and received few or delayed funds despite their inability to fight the crisis on their own.

HUD initially endorsed this policy. During the event organized in Los Angeles to explain the allocation of the NSP1 funds, HUD representatives used Merced as an example to illustrate why some areas cannot directly benefit from the NSP1 program despite their situation (Richardson 2008).²⁵

Why no funding for Merced?

- Merced is NOT an entitlement under the regular CDBG program, thus a grant was not calculated.
- Had a grant been calculated, it certainly would have been well above \$2 million.

Merced's housing program manager challenged this explanation, arguing that even though Merced County is not an entitlement community, Merced City is, and should have received funds directly from HUD. He explained during the interview that HUD acknowledged having "screwed up" in the way the funds have been allocated, but it was impossible for them to go back because giving money to Merced meant taking money from another local government.

The threshold of \$2 million, and the necessity of being an entitlement community with the CDBG program, ruled out many small communities such as Merced, Los Banos, and Perris. Larger municipalities, such as Modesto, which had lower foreclosures rates but a higher number of foreclosed homes, received adequate funds as a part of the NSP1 (respectively \$12 million and

²³ "Two step allocation - substate allocation. Substate allocations work like a mini-formula. The appropriation amount is the amount calculated for the statewide allocation. A new formula is then applied to divide that "pie" among the CDBG eligible grantees within that state."

²⁴ http://portal.hud.gov/hudportal/HUD?src=/program_offices/comm_planning/community_development/programs/entitlement.

²⁵ This quote comes from the PowerPoint document used during the presentation.

\$8 million). Small communities, such as Tracy in San Joaquin, or Patterson in Stanislaus, were able to receive federal funds via their consortium. But many other small communities, in politically fragmented areas, where there were no consortiums, did not receive federal funds because of a threshold effect. Additionally, HUD overestimated more foreclosures in areas in entitlement with the CDBG program than in places that are not in entitlement (1.8 times versus 1.65).

As a result, the amount of funds allocated is much lower for places that received money through the state than for those that received it from the federal government (see Figure 3).

A HUD representative with whom I exchanged emails admitted that the formula allocation for the NSP1 wasn't perfect and was one of the reasons small communities did not benefit from better support. This formula was not the result of a random choice.

Representation of an Urban Crisis

Clearly, the NSP wasn't designed to assist small communities. Since the program is based on the CDBG, it was mainly designed to deal with a crisis affecting large, dense cities, and, more specifically, poor, blighted areas that were already in the scope of most urban policies. The first urban renewal policy in 1937, the Wagner-Steagall Housing Act, allocated "\$500 million for loans and grants to state and local authorities for slum clearance and housing developments, stipulating that units be designated for the lowest income third of the population" and created the US Housing Authority (Sutton 2008), embryo of HUD.

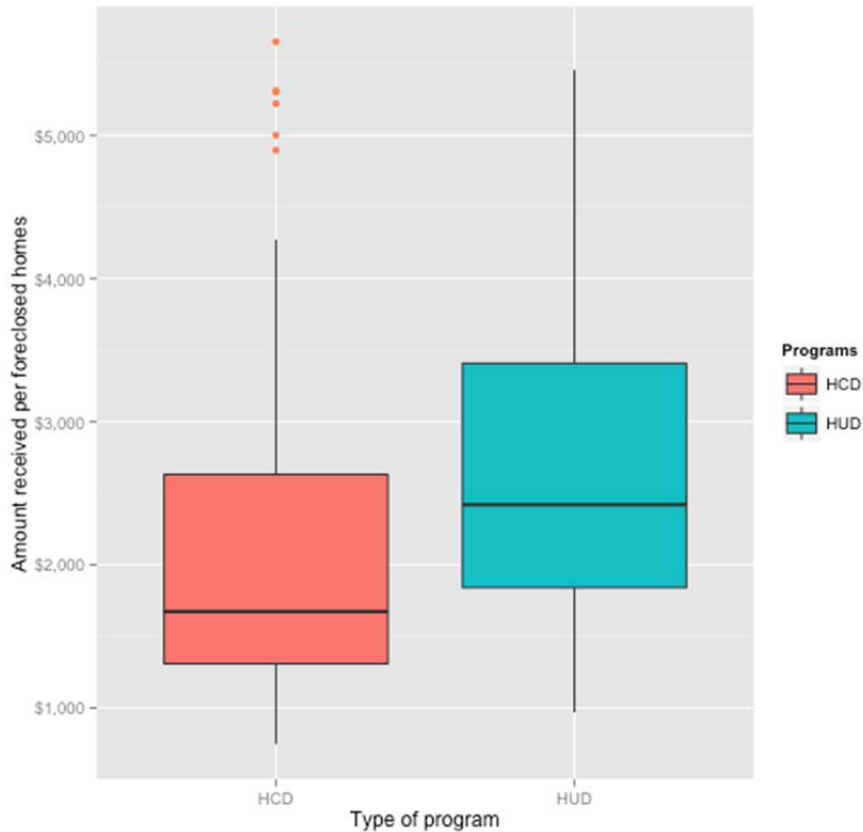
A second round of urban renewal policies followed in 1949 with the Slum Clearance and Redevelopment Act, in a context where many center cities were already suffering the effects of suburbanization and white flight. This law "authorized HUD grants to local public agencies for the acquisition and demolition of slum properties in a designated 'blighted' area of a city, and the subsequent 'redevelopment' of such areas with new, modern housing." (Thompson 2006). Conservatives and liberals both criticized this policy, the latter arguing that it displaced poor people and destroyed communities.²⁶

HUD, officially created in 1966, later implemented a more innovative and global approach to urban issues with the Model Cities program (Sutton 2008), but Richard Nixon's administration suppressed it with its "new federalism" reforms. The Community Development Block Grant (CDBG) Program, created in 1974, was the result of this change of federal policy. CDBG merged many of the former funds, reinforced devolution, and allocated direct funds to local administrations to address urban issues by themselves (Marcus 2006). CDBG's goal is more specifically to "improve housing conditions, increase the stock of affordable housing, encourage economic development and expand community services in high-poverty neighborhoods" (Marcus 2006), by "allocating annual grants to larger cities and urban counties to develop viable communities by providing decent housing, a suitable living environment, and opportunities to expand economic opportunities, principally for low- and moderate-income persons" (Sutton 2008).

Since the CDBG program inspired the NSP1, its design had important consequence on the way the funds were allocated to local administration to fight the foreclosures. As presented earlier, the CDBG program targeted large cities—more precisely the main cities of the SMSA and cities larger than 50,000 inhabitants—and counties with more than 200,000 inhabitants. The allocation of funds was initially based on a single formula including three factors: poverty, overcrowded housing, and population. A second formula—based on the percentage of pre-1940 hous-

²⁶ "Urban renewal became a prime target during a decade characterized by citizen activism" (Sutton, 2008)

Figure 3. Funds Allocated by Foreclosed Homes by Type of Program



ing, poverty, and growth lag— was added in 1978, to allocate more funds to older, declining cities. Additionally, even if CDBG is mostly designed for large cities, 30 percent of the funds are supposed to go to rural places not in entitlement (Marcus 2006).

Smaller cities, even in non-SMSA, can receive CDBG money and share around 20 percent of the funding (Bunce and Glickman 1979), but are not considered entitlement communities. These cities must compete for the funds, and most receive considerably less money than inner cities compared to their needs. Isserman (1981) demonstrated that suburbs received only seven percent of CDBG funding in 1980, whereas they include 14 percent of the people living below the level of poverty, 16 percent of the overcrowded housing, and 14 percent of older housing units. Cities received 62 percent of the funds for 39 percent of the population below the level of poverty. As a result, CDBG originally helped large cities and not small suburbs.

Inner cities have never been evenly poor, nor suburbs uniformly rich. Suburbs have housed the majority of Americans since 2000 and are increasingly diverse (Orfield 2002). Suburbs also face an increase of poverty and now count more poor people than cities (Kneebone and Berube 2013). Some authors even talk about a decline of the suburbs, accelerated by the foreclosure crisis (Leinberger 2008). On the other hand, an abundant literature suggests that cities are getting more attractive (Nelson 2006; Leinberger 2009), identifying a “fifth migration” (Fishman 2005), or even an “inversion” (Ehrenhalt 2013). This dramatic change means that tools and policies

used for the past half century no longer fit the new geography of American cities and explains why many suburban territories stayed out of the scope of public policies meant to help local governments fight the foreclosure crisis. As a result, an adaptation of public interventions to come to help small suburban communities is necessary, as Kneebone and Berube (2013) noted.

Evolution of the Programs

How the HCD Tried to Fix the NSP

As mentioned earlier, local governments deprived of HUD funds in NSP1 could receive a share of the money allocated from the state of California, via the California Department of Housing and Community Development (HCD). The HCD formula differs slightly from the one used by HUD. Unlike the federal program, California did not take the vacancy rate into account, arguing that most cities and counties do not face blight and have a waiting list for homebuyers (The California Neighborhood Stabilization Program Calculation and Distribution of the State's Allocation 2008). The HCD formula, moreover, adds the rate of foreclosure as a factor in the distribution of funds and does not use the CDBG program as a condition. Thus calculated, Merced City, Merced County, and Los Banos²⁷ received significant funds (\$2 million for Merced and Los Banos, more than \$3 million for Merced County), while they did not receive anything from HUD.

The HCD allocation did not correct all inequalities. HCD grants to cities averaged \$1,575 per foreclosed home—\$673 less than cities directly from HUD.²⁸ HCD ignored communities such as Perris (Riverside County), which ranked fifth in the rate of foreclosures in California between January 2007 and June 2008 according to DataQuick.

NSP2

The first federal policies did not slow the wave of foreclosures and were soon followed by a second plan, NSP2, in 2009. HUD implemented part of the American Recovery and Reinvestment Act (ARRA), NSP2, as a component of the CDBG program. The funds allocated were clearly inferior (\$1.93 billion) to NSP1, but could be granted to non-profit organizations and local governments. NSP2 sought to concentrate funds in the most affected areas by allocating fewer applicants. The threshold was raised from \$2 million to \$5 million for at least 100 foreclosed homes per entity.

Contrary to NSP1, the allocation methodology of NSP2 was based on a competitive application. HUD evaluated applications on criteria such as need (defined by the number of foreclosures and the number of foreclosed homes in high vacancy rate areas) and the past experience of the applicant in dealing with foreclosures or environmental considerations (HUD 2009).²⁹

Fifty-six grantees received funds nationwide. The allocation was much more unequal than for the first round of NSP1. Again, southern California received the majority of the money, with more than 70 percent of the funds allocated to the state. The city of Los Angeles alone received \$100 million, plus \$60 million for the Los Angeles Neighborhood Housing Services. Long

²⁷ Also located in Merced County and devastated by the foreclosures.

²⁸ \$2,249 per foreclosure for the HUD grantees, \$1,575 for the NSP grantee, almost 1.5 times less.

²⁹ A system based on points is used to allocate the funds, as in the allocation formula to small communities for the CDBG.

Beach, also in Los Angeles County, received \$22 million, and Santa Ana, in Orange County, \$10 million. In the northern San Joaquin Valley, only Modesto received funds, with a large amount of \$25 million.³⁰ In other words, NSP2 targeted large cities and urban counties and ignored small communities.

NPS3

The last version, NSP3, was implemented in 2009 as a part of the Dodd-Frank act. The \$1 billion NSP3 targeted the 20 percent most distressed areas, defined by an estimate of the territories having the highest percentage of homes foreclosed or in delinquency. Even if the funding was smaller than the two previous plans, targeting the 20 percent most distressed areas helped concentrate the funds in places suffering the highest rate of foreclosure.

Compared to NSP1 and NSP2, NSP3 allowed more funds for smaller communities. Merced, Indio, Richmond, and Hemet received more than \$1 million. In addition, the amount allocated per foreclosed home to small cities, counties, and to nonentitlement communities is much higher than for large cities (\$325 per foreclosed home in Merced, \$293 in Hemet, and \$294 on average for Californian nonentitlement communities, compared to \$201 in Los Angeles). A combination of a lowering of the threshold to \$1 million, and the removal of the CDBG entitlement condition helped places that did not directly receive funds for the two first rounds.

Question of the Scale of Intervention

Beyond the strict allocation methodology, the federal government had very few direct interventions in the foreclosure and housing crisis. Local administrations were the main actors in charge of allocating the funds, with a large degree of freedom, as is the case with the CDBG. The lack of centralization is nevertheless questionable during a nationwide crisis: local governments are not equal; small communities do not necessarily have the staff and the competence to face the concentrated effects of a national crisis. The political fragmentation that initially resulted and fueled suburbanization (Tiebout 1956; Rusk 1995) is now an issue for suburban communities: their small size and lack of funds and staff—aggravated by the budget cuts that followed the housing crisis—reduced their ability to deal with the crisis. Distressed communities should be able to call on the state or federal government to help, as is the case during natural disasters.

Collaboration between local governments should have been encouraged. Merging services helps reduce the cost and allows municipal employees to focus on specific issues, which is not possible in small teams. It also helps to implement policies at the right scale, especially for housing and public transportation.

Strategies developed by other countries may serve as examples for the United-States. France has 36,000 municipalities—more than all the other European countries together, for only 60 million inhabitants—yet successfully coped with political fragmentation in the 1990s. One of the most effective strategies was to give incentives to local governments to collaborate by allocating more state money to municipalities deciding to join their policies in issues such as housing or public transportation. Even if imperfect, this policy also helped to create more coherent urban policies at the metropolitan scale and to partially redistribute fiscal resources among municipalities.

³⁰ <<https://hudnshelp.info/index.cfm?do=viewgranteeAreaResults>>.

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