Essay: Current and Future Challenges to Local Government Posed by the Housing and Credit Crisis,

Alan Weinstein

Cleveland State University, Cleveland-Marshall College of Law, a.weinstein@csuohio.edu
CURRENT AND FUTURE CHALLENGES TO LOCAL GOVERNMENT POSED BY THE HOUSING AND CREDIT CRISIS

Alan C. Weinstein

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" Associate Professor and Director of the Law & Public Policy Program at the Cleveland-Marshall College of Law and the Maxine Goodman Levin College of Urban Affairs at Cleveland State University.
The ongoing problems in the housing and credit markets, caused by a toxic combination of wholesale deregulation of financial markets by the federal government and imprudent lending and investment practices by financial institutions, pose significant challenges to local and state government officials. Some of these challenges are obvious. How will cities cope with an unprecedented number of foreclosures at the same time that state and local tax revenues are decreasing? When will access to credit ease in a municipal bond market that has constricted as a result of both general credit concerns and questions about the companies insuring those bonds? As the magnitude and seriousness of the current financial crisis becomes clearer, these obvious concerns may prove to be only the precursor to daunting new challenges. This article discusses the implications of the current financial crisis for local governments.

I. HOW DID WE GET HERE?

The current financial crisis is the latest version of an all too familiar scenario: corporations and individuals seeking to maximize profits exploit markets that have insufficient regulatory safeguards to protect shareholders and the public. In just the past two decades we have seen this scenario play out twice previously with disastrous results. First, in the Savings & Loan scandal of the late 1980s and early 1990s, and second in the corporate accounting scandal exemplified by the collapse of the Enron Corporation in 2001. We are now in the midst of an Act Three whose potential repercussions appear to dwarf the prior two.

The current crisis has its roots in the housing market. Starting in the late 1990s, Wall Street investment bankers seeking to maximize profits, and "Main Street" mortgage brokers seeking to increase their income, entered a housing market marked both by an unprecedented ease of the availability of credit to homebuyers and lax government regulation. Traditionally, most home

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3 Michael E. Stone, Pernicious Problems of Housing Finance, in A Right to Housing: Foundation for a New Social Agenda 82, 85 (Rachel G. Bratt et al. eds., 2006) (discussing problems surrounding housing finance). See also R.
mortgages were issued from banks or savings institutions that held and serviced those same mortgages. These thrift institutions based their lending on relatively strict standards that considered the borrower's income, credit rating and amount of down payment, because they remained at risk for the borrower's default for the life of the loan. This traditional system began to change dramatically about a decade ago. In the late 1990s, real estate was seen as undervalued in relation to other assets. At the same time, investment bankers and mortgage brokers were transforming the mortgage loan industry. An ever-increasing number of mortgage loans were originated by mortgage brokers, rather than traditional lending institutions. Many of these mortgages were so-called subprime loans, often made with little or no regard to the suitability of the mortgage for the particular borrower or the borrower's ability to repay. In too many instances, particularly in minority low-income neighborhoods, there was outright fraud by mortgage brokers and appraisers.

This transition was fueled in large part by the introduction of securitization into the home mortgage market. Simply put,
securitization is the creation and marketing of bonds based on pools of mortgages that are "sliced and diced" into pieces and then "bundled" into investments.11 These mortgage-backed securities proved extremely attractive to investors, many from outside the United States, largely because they offered high rates of return combined with claims that these instruments had been structured to shield purchasers from much of the risk of default.12 As demand for mortgage-backed securities increased, the mortgage industry scrambled to find ways to increase the supply of new loans. It soon came up with ever-more exotic forms of adjustable-rate mortgages (ARMs); dramatically increased the number of subprime loans (i.e., loans to borrowers with lower credit scores); and took numerous other steps to extend credit to borrowers who had previously been unable to obtain home mortgages.13 Borrowers could obtain a mortgage with little or no proof of income and with little or no down payment.14 A prospective homeowner could take out a second mortgage at the time of purchase, make interest-only payments for up to fifteen years, skip payments by reducing equity or, in some cases, obtain a mortgage that exceeded the home's value.15

Several other factors fueled the process and planted the seeds for the current crisis. In the wake of the economic jolts caused by the dot-com bust in 2000 and the reaction to the 9/11 attacks in 2001, the Federal Reserve under Alan Greenspan reduced interest rates to historic lows and kept them there for several years, making mortgage financing rates extremely attractive. As with any "hot" market, investors gave into the temptation to speculate by leveraging their investments. Both institutional investors in the securitized mortgages and real estate speculators purchasing homes followed the same strategy. Buy the asset – whether bond or house – with a little bit of your own cash and lots of borrowed funds – e.g., a $5,000 down-payment on a $500,000 house – and then reap a windfall profit by selling the house six months later for $550,000, turning your $5,000

11 Engel & McCoy, supra note 9, at 2045, 2049; Possible Responses to Rising Mortgage Foreclosures: Hearing Before the Comm. on Fin. Serv., 110th Cong. 4 (2007) (statement of Sheila C. Bair, Chairman, Fed. Deposit Ins. Corp.).
12 Engel & McCoy, supra note 9, at 2046.
14 Paul, supra note 13.
15 See, e.g., JOINT ECON. COMM., supra note 8.
investment into $50,000. As long as the underlying assets were increasing in value, things were fine. But once values began to slip, speculators found they owed more than the asset could yield after sale. When that happens to housing speculators, the home ends up in foreclosure. When it happens to a hedge fund that borrowed $99 million of the $100 million purchase price for mortgage-backed bonds that then lose thirty-five percent of their value, the result is the collapse of the fund.

The positive side of these developments was a significant increase in the rate of home ownership, from 64.2% in 1994 to 69.2% in 2004, the highest percentage of home ownership ever recorded by the U.S. Census Bureau. As subsequent events have shown, however, many of these new homeowners were highly susceptible to changes in their economic position and the housing market. So long as the housing market remained strong, with increasing prices and brisk sales, homeowners who faced a steep increase in their mortgage payments when their ARM's low "teaser-rate" expired could simply re-finance, or even sell, to avoid becoming delinquent on their payments. But when the housing market began cooling off in 2006, and there was an increase in both short and long-term interest rates, many homeowners were unable either to refinance or sell and were left with no option but to default on their mortgages.

In December, 2007, the Mortgage Bankers Association (the Association) reported that home foreclosures were at their highest level since the Association had begun reporting such data in 1971, with over 900,000 households, representing 2.04% of all mortgages, in the foreclosure process at that time. Home foreclosures and the rate of homes entering the foreclosure process have continued reaching record highs in 2008. In early September, the Association reported that at the end of the second quarter of 2008 the percentage of loans in foreclosure had risen to 2.75%; the seasonally adjusted rate of mortgages entering the foreclosure process that quarter was 1.19%, almost double the rate (0.65%) seen in the second quarter of 2007; and the mortgage delinquency rate for all mortgages (the percentage of loans

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delinquent ninety or more days) was 6.41%, the highest rate since the Association began its current method of measuring delinquency status in 1979.18

The foreclosure crisis and accompanying collapse of the housing market have had unanticipated repercussions throughout the economy. Access to credit tightened dramatically during the summer of 2007—as a result of growing uncertainty about the true value of the various financial instruments created to further the securitization of mortgage debts.19 Not long after, we learned that major bond insurers were on the verge of default, further tightening access to credit.20 By the spring of 2008, the effects of the collapse of the housing and mortgage credit markets had wreaked havoc in capital markets and among Wall Street investment banking firms in ways not seen since the first years of the Great Depression.

In March, Bear Stearns was taken over for pennies on the dollar by J.P. Morgan in a “rescue” scheme orchestrated by the Federal Reserve Bank, which included the Fed’s pledge of credit for Bear Stearns’s bad investments.21 Six months later, in September 2008, this country experienced turmoil among its financial institutions not seen, once again, since the Great Depression. On September 8th, the federal government announced that it was taking control of the nation’s two largest mortgage finance institutions, Fannie Mae and Freddie Mac. The two mortgage giants would operate under a federal conservatorship administered by the Federal Housing Finance Agency, newly-created for just that purpose.22 Less than a week later, on September 14th, persistent rumors that the Wall Street investment bank Lehman Brothers was in perilous financial condition proved well-founded when the firm filed for bankruptcy

18 Press Release, Mortgage Bankers Ass’n, Delinquencies and Foreclosures Increase in Latest MBA National Delinquency Survey (Sept. 5, 2008).
21 See Landon Thomas Jr., Swinging Optimism and Dread on Wall Street, N.Y. TIMES, Mar. 19, 2008, at C1 (revealing the conflict between stakeholders surrounding J.P. Morgan’s takeover of Bear Stearns).
protection after federal officials refused to bail-out the firm as it had Bear Stearns six months earlier. On the same day, the venerable brokerage giant Merrill Lynch was acquired by Bank of America. One day later, September 15th, news came that the giant insurance company, A.I.G., was facing crippling losses, and only an unprecedented infusion pledge of up to $85 billion in loans over two years by the Federal Reserve Bank saved the firm from imminent collapse.

The A.I.G. bailout apparently confirmed to world financial markets that the American financial system was in danger of collapse and could be rescued only if the federal government adopted a more comprehensive strategy to deal with the problem. The markets were sending clear signals to Washington that ad hoc rescue decisions on a firm-by-firm basis were an inadequate response and Washington adjusted its strategy. On September 19th, Treasury Secretary Paulson proposed an unprecedented $700 billion "bailout" scheme for the nation's financial institutions. Following days of tense negotiations between – and within – the Republican and Democratic Congressional leadership, the leaders and the President agreed to a revised rescue plan, but it failed to win approval when brought to a House vote on September 29th. The markets signaled their disapproval: the Dow Jones Industrial Average fell nearly 800 points and credit markets tightened even more. After further revision in the Senate, which overwhelmingly approved its version of the scheme on October 1st, enough House members switched their vote to approve the measure when it came back for a second vote on October 3rd.

24 Id.
31 David M. Herszenhorn, Bush Signs Bill – House Votes 263 to 171 –
II. SHORT TERM EFFECTS OF THE CRISIS FOR LOCAL GOVERNMENT

A. Revenue Shortfalls

The most obvious repercussion from the housing/credit crisis for local government is its affect on municipal revenues. Homeowners who are in default on their mortgages or in foreclosure are often also defaulting on their property taxes or are in tax foreclosure, so real property tax proceeds are depressed. Further, tax proceeds from properties whose owners are current on their mortgage will also be negatively affected because the decline in property value will lead owners to seek a reduction in their property tax assessments; the same thing will occur when someone buys a home for less than its current valuation for tax purposes. The steep drop in housing sales also means that proceeds from real estate transfer taxes are significantly reduced.

The housing/credit crisis also reduces sales and income tax revenue. Homeowners with mortgage problems will normally cut back on other spending in an effort to avoid default, and may choose to accumulate some savings, rather than spend, if default cannot be avoided. Even homeowners without mortgage problems are likely to reduce spending. First, as homes are the most valuable asset for most families, the reduction in home value makes them feel less wealthy and reduces their ability to tap into the home's equity—factors that lead households to cut back on expenditures.\(^3^2\) Even households that have significant assets in addition to their homes will likely have seen a significant decline in their investments over the past two years, another factor which tends to reduce spending. Second, many households will react to more difficult economic times by targeting any "surplus" dollars to debt reduction. All of the above results in a reduction in spending and therefore a reduction in general sales tax revenues. Cities that rely heavily on "targeted" sales tax proceeds from largely discretionary purchases such as tobacco, alcohol, entertainment, hotels and restaurants, may suffer even larger reductions. Finally, the housing/credit crisis, along with soaring energy prices, have now led to a serious economic downturn and rising unemployment,\(^3^3\) so municipal


\(^{33}\) The U.S. Bureau of Labor Statistics reported in September that the
income tax revenues are also in steep decline.

B. Increasing Costs

While the housing/foreclosure part of the crisis has reduced revenues, it is also increasing costs for cities. Many cities, especially those in low/no-growth areas, rightly believe that it is in their long-term interest to spend money to try to prevent foreclosures and property abandonment and to monitor vacant properties (or even provide minimal exterior maintenance, e.g., grass-cutting) in an effort to maintain neighborhood stability and prevent even further reductions in property values. That belief is validated by published research demonstrating that the value of surrounding properties declines by 0.9% on average for each foreclosed house in the vicinity, with the decline even greater in low-income neighborhoods at 1.44%. Based on that research, the Center for Responsible Lending has estimated that homeowners living near foreclosed properties will see their property value decrease on average about $5,000. The Center's most recent forecast, in January 2008, projects that nationally, foreclosures on subprime home loans originated in 2005 and 2006 will lead to a loss of value for 40.6 million neighboring homes, with the resulting decline in house values and tax base from nearby foreclosures totaling $202 billion.

Abandoned and vacant properties also impose higher police, fire, and sanitary costs on cities, particularly those with older housing stocks and weak housing demand. Such properties, if not appropriately secured, can quickly become targets for vandals or


36 CENTER FOR RESPONSIBLE LENDING, SUBPRIME SPILLOVER: FORECLOSURES COST NEIGHBORS $202 BILLION; 40.6 MILLION HOMES LOSE $5,000 ON AVERAGE 1 (2008).

37 Id.
havens for squatters or criminals, further accelerating neighborhood decline. Abandoned properties are fire hazards and can also become public safety hazards requiring demolition at significant cost. When a house burns or is demolished, the resulting vacant lot can easily become a free dumping ground for trash and debris. To help avoid these costs, cities must devote significant resources to an “early-warning” system that will identify vacant and abandoned properties in a timely manner and then respond appropriately. It is clearly the better approach, but still results in increased costs at a time when revenue is decreasing.

A number of cities have taken aggressive action to address property abandonment. In Cleveland, which has a Housing Division as part of its Municipal Court, the presiding judge has used the court’s exclusive jurisdiction to hear nuisance abatement cases brought pursuant to the state’s receivership statute\(^\text{38}\) to address property abandonment.\(^\text{39}\) The receivership statute authorizes a receiver to take control of a residential structure that has become a public nuisance and abate the nuisance while recovering its costs through a super-priority lien.\(^\text{40}\) An important feature of the statute is that the receiver need not be the plaintiff; a community nonprofit corporation or any other qualified property manager may be appointed as the receiver.

Buffalo, New York, has addressed its abandoned property problem by suing twenty-eight national mortgage lenders to force these companies to take responsibility for properties that were abandoned after the companies initiated foreclosure and forced the occupants to leave.\(^\text{41}\) Several cities in South Florida are levying daily fines against mortgage banks if they fail to maintain properties on which they have foreclosed.\(^\text{42}\) In Southern California, some cities have adopted legislation that requires

\(\text{\footnotesize 38 OHIO REV. CODE ANN. § 3767.41(B)(1) (LexisNexis 2005).}\)

\(\text{\footnotesize 39 See Charu Gupta, Stealing Home: Slavic Village Combats the Effects of Foreclosures at the Street Level While Waiting for Solutions, CLEV. FREE TIMES, June 29, 2007, available at www.freetimes.com/stories/15/8/stealing-home (noting that the number of court-ordered receiverships in Cleveland has increased since 2005).}\)

\(\text{\footnotesize 40 OHIO REV. CODE ANN. § 3767.41(B)(1), (H)(2)(a).}\)

\(\text{\footnotesize 41 Jonathan Epstein, City Sues Lenders Over Forgotten Houses: Buffalo Wants Them to Pay for Demolition When Owners Are Forced Out After Foreclosure, BUFF. NEWS, Mar. 1, 2008, at D1.}\)

\(\text{\footnotesize 42 Polyana da Costa & Terry Sheridan, Ugly Side Effect: Municipalities Struggle to Clean Up Dilapidated Properties Abandoned After Foreclosure Actions, PALM BEACH DAILY BUS. REV., Mar. 18, 2008, at 1.}\)
owners, banks and other lenders to register vacant and abandoned homes in foreclosure with the city, and imposes an obligation to secure and maintain the homes. Failure to register, or a violation of the ordinance, subjects the lender to fines of up to $2,500.43

Until the summer of 2008, federal efforts to address the growing problems faced by cities were notable only by their absence. In July 2008, after much criticism from local government advocates for the federal government's failure to address the foreclosure problem, Congress enacted, and the President signed, the Housing and Economic Recovery Act of 2008.44 Title III of the Act established the Neighborhood Stabilization Program (NSP) to provide grants to every state, and to local governments that met the qualifying criteria, to purchase foreclosed or abandoned homes and to rehabilitate, resell, or redevelop these homes in order to stabilize neighborhoods and stem the decline of house values of neighboring homes.45 In September, the Federal Department of Housing and Urban Development (HUD) announced how its distribution formula had allocated the $3.92 billion in federal aid authorized in Title III to address the aftermath of the crisis by following Congress' direction that grants be targeted to areas based on the number/percent of foreclosures, sub-prime mortgages and mortgage defaults and delinquencies.46 Based on the formula, Florida received the most money ($541 million), followed by California ($530 million), Michigan ($263.5 million) and Ohio ($258 million).47 Local officials have criticized this effort as too little too late, in light of the needs in those areas hit hardest by the foreclosure problem, such as Cleveland, Ohio.48

46 Id.
47 This information, along with information for other states in the U.S., is available at http://www.hud.gov/offices/cpd/communitydevelopment/programs/neighborhoodspg/.
48 Id.; See Stephen Koff & Gabriel Baird, Ohio Gets Millions to Target Housing U.S. Money to Help Rehab, Raze Homes, PLAIN DEALER MOBILE NEWS,
C. Access to Credit

One of the earliest, and unanticipated, effects of the economic crisis was the constriction of credit for local and state government as a result of the unprecedented lowering of credit ratings for the companies that insure municipal bonds. Municipal bond insurers, who entered the market in the early 1970s, have become an increasingly common feature of municipal bond finance. In 1980, only three percent of municipal bond issues were insured, but by 2007, sixty percent of all issues were insured. The enormous growth in the use of bond insurers stems from the fact that the credit rating for an insured municipal bond is based on the credit of the insurer rather than the underlying credit of the issuing municipality. Since bond insurers traditionally enjoyed the highest credit ratings, issuing insured bonds was attractive for any governmental issuer with a lower credit rating because they would not have to pay a higher interest rate as a risk premium.

As more local and state governments issued insured bonds, competition among insurers for the growing business increased and profit margins declined. In search of increased profits, municipal bond insurers entered new markets, including the novel mortgage backed securities being created on Wall Street. We now know that neither the insurers nor the credit rating agencies really understood the risks posed by these novel, and increasingly complex, security instruments. When the real estate market nosedived, leading to soaring default and foreclosures rates, these securities proved to be far riskier than anyone had believed, and the bond insurers suddenly faced huge unanticipated liabilities. As losses mounted among bond insurers, the credit rating agencies lowered the insurers' ratings which, in turn, lowered the ratings – and raised the interest rate

49 See, e.g., David Cho, Municipal Bond Deals Squeezed by Credit Crisis, WASH. POST, Nov. 29, 2007, at A01.
on the municipal bonds they insure.\textsuperscript{52}

The growing problems in the financial and credit markets that came to a head in September 2008 have further constricted access to the municipal bond market. In early October, the New York Times reported that cities, other local governments, and even states, had been effectively shut out of the bond market since mid-September.\textsuperscript{53}

Many cities thus face a nasty confluence of decreasing revenues and increasing costs of borrowing. Some, including Chicago and Miami-Dade County, have chosen to forego planned bond issues rather than face the prospect of having to pay higher interest rates.\textsuperscript{54} But cities that have imminent refinancing deadlines on existing short-term borrowing do not have the option of delaying and have no choice but to pay higher interest rates.\textsuperscript{55} Plus, when cities forego borrowing for capital projects, they exacerbate their declining revenue situation because they are also foregoing the increased income and sales taxes that the economic spin-off from their capital spending would have provided.

\section*{II. LONGER TERM EFFECTS OF THE CRISIS FOR LOCAL GOVERNMENT}

Predicting the future, at least without a reliable crystal ball, is a perilous endeavor, particularly because we are facing a financial crisis with an unprecedented amount of uncertainty as to the extent of either its causes or effects. It may well be that the $700 billion bailout will calm the financial markets, be sufficient to prevent further collapses among insurers, banks and investment houses, and perhaps even prove to be far less costly to taxpayers than its $700 billion price tag when assets acquired by the federal government over the next few weeks or months at steep discounts are later sold at a profit. Such a "soft landing" is

\begin{footnotesize}
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\item[54] Cho, \textit{supra} note 49. The same is true for state bond issues. See, e.g., Jay Miller, \textit{Muni Bonds Suddenly Face Tepid Reception}, CRAIN'S CLEV. BUS., Sept. 29, 2008, available at http://www.cranesleveland.com/article/20080929/MOBPRINT/309299963/1086 (showing that Ohio, for example, in late September, delayed a $300 million bond issue due to lack of investor interest).
\item[55] Miller, \textit{supra} note 54.
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far from certain, however. The bailout seeks to stabilize the financial and credit markets primarily by purchasing mortgage-backed securities, the worth of which is highly suspect. But these are not the only securities of questionable value that have been created in recent years. The most recent report on the country's financial markets from the Office of the Comptroller of the Currency, issued September 26, 2008, noted that U.S. financial institutions held over $15 trillion in credit default swap derivatives at the end of the second quarter of 2008, and the value of all financial derivatives held by these institutions was $182 trillion.\textsuperscript{56}

Without getting overly technical, financial derivatives are financial instruments whose values depend on the value of other underlying financial instruments, such as commodities, stocks, bonds, or mortgages.\textsuperscript{57} These instruments are designed to lower financial risk and/or leverage capital to any given financial actor. However, they carry with them the potential for increased systemic risk if financial markets are significantly disrupted.\textsuperscript{58} Former Federal Reserve Board Chairman Alan Greenspan acknowledged this risk in 1999 while discussing the explosive growth of derivatives over the previous decade.\textsuperscript{59} In the 2002 Annual Report of the Berkshire-Hathaway Corporation, Warren Buffet expressed grave concerns about derivatives, describing them as "time bombs, both for the parties that deal in them and the economic system,"\textsuperscript{60} and sounding alarms about the systemic risks that accompany an increased concentration of derivatives trading by a small number of financial institutions and a proliferation of increasingly exotic forms of derivatives.\textsuperscript{61} Both of these conditions now exist.\textsuperscript{62}

\textsuperscript{58} Alan Greenspan, Remarks before the Futures Industry Ass'n: Financial Derivatives (Mar. 19, 1999).
\textsuperscript{59} Id.
\textsuperscript{61} Id. at 15.
\textsuperscript{62} The report issued Sept. 26, 2008 by the Office of the Comptroller of the Currency noted that derivatives trading is now concentrated in a small number of financial institutions. OCC, supra note 56. See, e.g., Gretchen Morgenson, In the Fed's Cross Hairs: Exotic Game, N.Y. TIMES, Mar. 23, 2008, at BU1 (noting that the growth and proliferation of derivatives of every sort has long been noted
Even if we do not see further turmoil in the financial and credit markets caused by failures in the derivatives market, it is not at all clear that the bailout legislation will provide much assistance to local governments other than the effect of "a rising tide lifts all ships." Arguably, the greatest help the federal government could provide to local governments — outside of increasing the direct financial support provided by the Neighborhood Stabilization Program — would be to stabilize the housing market by actions that would stem the tide of foreclosures and resulting property vacancies. Theoretically, an easy way to accomplish this would be for the federal government to use the control over the assets acquired in the bailout to restructure mortgages in default.

As noted in a recent New York Times article, however, because of the securitization of mortgages into large pools from which bonds were issued with different levels of seniority to investors throughout the world, it is unlikely that the federal government will acquire all of the bonds that were issued from any given pool of securitized mortgages. Since modification of the underlying mortgages in the pool would normally require the approval of all holders of the affected mortgages, then the mortgages could not be modified if that approval cannot be obtained for the reasons suggested.

Another approach to modifying the terms of defaulting mortgages would be to change the federal bankruptcy law to include primary residences, so that bankruptcy judges could modify these mortgages in much the same way that they modify the terms for other creditors of the debtor in bankruptcy. Democrats have been pushing for that change, but without success to date.

In light of all of the above, and assuming that there is not a systemic economic collapse similar to the Great Depression, it seems fairly clear that cities like Buffalo, Cleveland and Detroit, by observers).

63 See HUD, Methodology, supra note 45 (describing the Housing and Economic Recovery Act of 2008).


65 Id.

66 In Chapter 13 bankruptcies, which are most commonly declared by individuals, debt on a primary residence may not be restructured. 11 U.S.C. § 1322(b)(2) (2006). A bankruptcy court may "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence . . . ." Id. (emphasis added).
which were already suffering from weak employment and housing markets before the current crisis, will have far more serious and prolonged effects than cities like Las Vegas and Phoenix which had strong economies before the current crisis.

Cities that enjoyed a relatively good employment rate and housing market before the crisis will suffer the short term effects discussed above and a depressed housing market for some time as excess inventory is slowly absorbed. Once the economy begins to recover and these cities begin to produce new jobs again, however, they will attract new residents and their housing markets will slowly rebound. The outlook for cities whose economies were weak before the crisis is far less bright.

In these “weak market” cities, the “current” crisis actually began much earlier.

Cleveland, Ohio, for example, was one of the first cities to face a serious problem in its housing market. There, the combination of a weak housing market, job losses, and abusive “predatory lending,” led to a significant spike in foreclosures – and sharp increases in the number of abandoned properties – beginning in 2003. As early as 2000, however, community groups were seeing their neighborhood revitalization efforts undermined by unscrupulous mortgage brokers who flooded vulnerable – and largely minority – neighborhoods with “high-risk loans, many of which were predatory and fraudulent.” The problem was further exacerbated by an epidemic of property “flipping” by speculators.

Cities like Cleveland face only difficult choices. Cleveland itself has 10,000 abandoned homes and there were more than 27,000 foreclosures in surrounding Cuyahoga County over the last two years. Both the city and the county have been losing population for decades: between 2000 and 2007, Cuyahoga County “lost more people—both in numbers and as a percentage

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68 See, e.g., Lind, supra note 10, at 239 (providing a first-hand look at certain Cleveland neighborhoods devastated by the mortgage finance system).
69 Id. at 238-39.
70 Id.
71 Jerry Zremski, Swamped by a Subprime Tsunami – Cleveland Hit Hard by Mortgage Crises, but Buffalo Appears to Have Been Spared, BUFF. NEWS, Mar. 7, 2008, at A1.
of its population—than any of America’s 100 largest counties.”

There is little expectation that these trends will slow, let alone reverse.

Other cities that face similar demographic trends have little choice but to adopt a strategic planning and investment approach. It will simply be impossible to “save” all neighborhoods that have been devastated by property abandonment. Limited resources should be deployed strategically, paying close attention to which neighborhoods have the existing housing stock and community amenities to compete for a pool of purchasers that had been shrinking even before credit standards tightened. Inevitably, this strategy will leave significant areas where parcels are abandoned, unmarketable or vacant. Cities facing that inevitability may want to consider working with other local government officials to establish a multi-jurisdiction land reutilization authority—a land bank—to assist in the recovery of such land, an approach pioneered by the Genesee County Land Bank Authority in Flint, Michigan.

CONCLUSION

The current housing/credit crisis poses serious problems for local government. In the short run, cities will face diminished revenues, increased costs, and restrictions on access to credit. Moreover, these three factors are likely to exhibit a negative synergy, with each exacerbating the problems of the others. In the longer run, and assuming that we can avoid a depression-like financial crisis, cities that have been faring well economically are likely to recover from the current difficulties relatively quickly once the economy rebounds and growth-induced housing demand reduces the current over-supply. The picture is far less rosy for “weak market” cities that were struggling with weak job and

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74 The critical features of the Genesee approach are: a county-wide scope, financial self-sufficiency, efficient procedures for clearing titles, protection of owner-occupants in tax foreclosures, and land reutilization based on benefit to the public. See generally Genesee County Land Bank, http://www.thelandbank.org/aboutus.asp (last visited Oct. 10, 2008) (describing how the Genesee County Land Bank has taken advantage of new tax law in Michigan to stabilize and revitalize the City of Flint).
housing markets even before the current crisis. These cities will face difficult choices about where to invest diminished resources and will need to look at new approaches, such as land banking, to revitalize neighborhoods devastated by the fallout from the crisis.