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Pay for Success and Blighted Properties

Insights and Opportunities for Funding Vacant Property Reclamation and Neighborhood Stabilization

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Urban blight (i.e., the existence of deteriorating, substandard, vacant, and abandoned properties) continues to affect thousands of communities across the country, contributing to declining housing values, increases in crime, and overall neighborhood disinvestment and distress. As the first responders tasked with addressing urban blight, local governments and nonprofit partners often have insufficient funds and capacity to prevent, abate, demolish, or reclaim the constant influx of vacant and abandoned properties. This brief explores how innovative funding models, specifically pay for success, can engage new partners and investors and provide local communities new funding sources to address the immediate and long-term impacts of blighted properties.

Overview

What Are Blighted Properties?

Blighted properties arise through complex factors usually associated with urban decline (e.g., poverty, crime, demographic change, or poorly performing schools) and regional and city economic distress (e.g., underemployment, deindustrialization, poor infrastructure, and property foreclosures). Moreover, urban blight as a concept reflects a long legacy of racial redlining and other discriminatory policies that negatively affected African American communities through disinvestment.[1] Regardless of the drivers of blight in a city, large swaths of blighted homes can lead to cycles of disinvestment in which the presence of blighted homes inhibits (or justifies the lack of) future investment. This disinvestment leads to

continued population loss as residents leave these communities for areas with greater opportunity, further reinforcing the cycle of disinvestment. As communities lose residents, they lose the economic base and tax base to support the local economy and government services, accelerating decline.

BOX 1

Blight versus Vacancy versus Abandonment

Although "blight," "vacancy," and "abandonment" are sometimes used interchangeably, they refer to different situations. **Blight** is a nebulous term fraught with a complex racial history. It originally applied to slum housing to describe negative public health effects associated with substandard housing and later was used as legal justification for urban renewal of predominately African American neighborhoods. Today, blight refers to a broad category of properties that experience disrepair, vacancy, abandonment, foreclosure, and environmental contamination. Vacancy and abandonment are more precise terms. **Vacancy** refers to properties that are not occupied but may have active ownership. Some properties are vacant through normal market turnover (i.e., the house may be waiting to be sold or rented). Vacancy becomes an issue when the property loses active ownership or stewardship and becomes a public nuisance (e.g., the property deteriorates or becomes neglected and in a state of constant disrepair, or the neighborhood or block has many vacant properties). **Abandoned properties**, on the other hand, have no active owner and typically have become uninhabitable, structurally unsafe, or beyond repair.[a]

[a] Joseph Schilling, Katie Wells, Jimena Pinzon, and John Kromer, *Charting the Multiple Meanings of Blight: A National Literature Review on Addressing the Community Impacts of Blighted Properties* (Alexandria: Virginia Tech Metropolitan Institute, Vacant Property Research Network, 2015).

Nationally, thousands of homes are vacant and abandoned, though the scale of the problem can be difficult to quantify. Following the housing market crisis, the number of vacant housing units increased from 9.5 million to 12 million between 2005 and 2010 (Mallach 2018). Vacancy and abandonment are usually more pronounced in select parts of the country—including older industrial "legacy cities" such as Cleveland, Ohio (40,000 vacant lots and buildings); Youngstown, Ohio (26,000); and Detroit, Michigan (164,000)—that have lost many residents over several decades (Mallach 2018). The complex causes of population loss and decline in legacy cities include issues of race, redlining, disinvestment, and mass migration. Many of these cities have thousands of abandoned homes and properties, an issue exacerbated by the housing crisis and 2008 recession (Mallach and Brachman 2013). The housing market crisis also led to widespread foreclosures in other cities that did not have a history of deindustrialization. The result is cities having more infrastructure—homes, roads, and businesses—than is justified by the remaining population. This brief focuses on vacancy and abandonment in legacy cities, but the challenges and strategies are relevant for cities such as Atlanta, Kansas City, Memphis, and Saint Louis, which have stronger housing markets and where vacancy and abandonment remain concentrated in certain neighborhoods.

An effective blight remediation strategy needs to be flexible and include various approaches depending on the individual property and the neighborhood's needs and opportunities. Some strategies

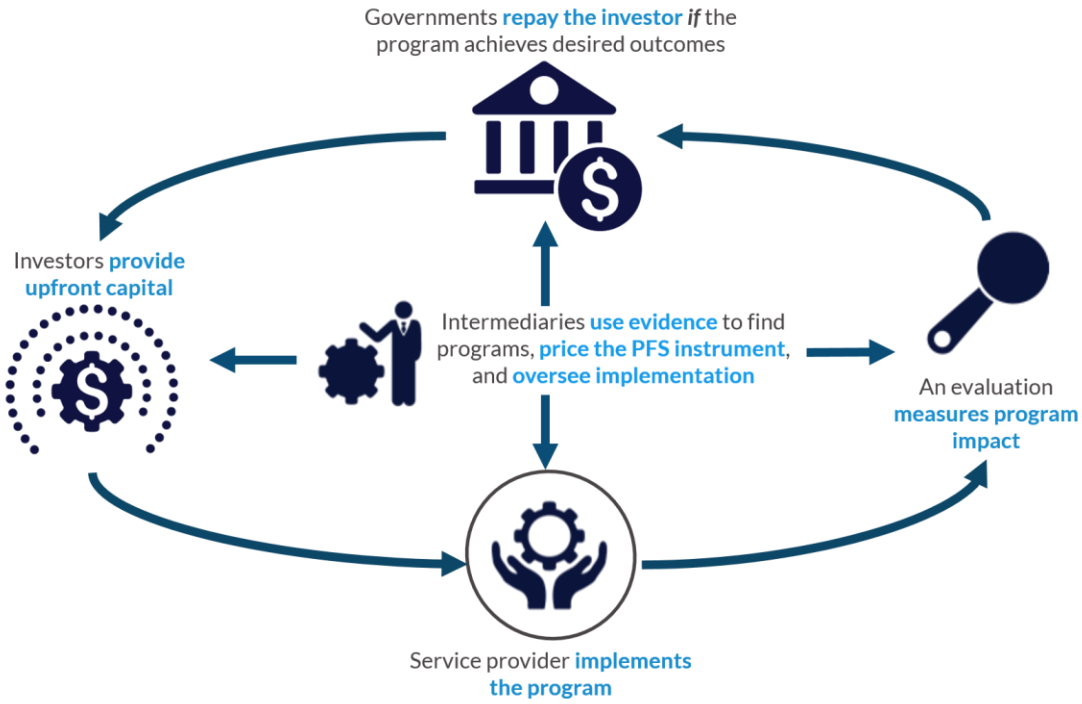
are preventive (e.g., code enforcement), while demolition, civil receivership and disposition, and other regulatory reforms (e.g., streamlining the property tax delinquency system and instituting land bank authorities) provide new reclamation capacities and make it easy for properties to return to productive use. Other strategies infuse money into communities to stabilize housing markets so they do not tip into hypervacancy or engage in targeted demolition. These strategies include homebuying incentives and support to current homeowners to make modifications and improvements. Finally, in neighborhoods with pervasive problems, large-scale revitalization and redevelopment may be necessary. Moreover, in any community with vacant and abandoned properties, cities can support urban greening programs and land banking.

What Is Pay for Success?

Pay for success (PFS) is an innovative financing and contracting model in which governments (or other end payors) pay for a program only upon achieving desired results. In the PFS model, investors provide the up-front capital for others, typically nonprofit service providers, to carry out a program. Investors are repaid—with interest—only if the project achieves certain predefined outcomes. These outcomes are selected based on the improvements that governments want to see and should be based on the evidence base for the intervention and population being served. The value tied to the outcome—that is, the amount the government will pay per unit of outcome achieved—is based on expected social benefits or the potential to reduce costs for government.

FIGURE 1

Pay for Success Process



The first US PFS project launched in 2013, and about two dozen have followed since. These projects have addressed various issues, including recidivism, homelessness, early childhood development and education, and workforce development. Common outcomes, depending on the program, include reductions in recidivism, increases in job placements, improvements in housing stability, and improvements in maternal and child health. For example, Denver launched a PFS project in 2016 to expand permanent supportive housing for people experiencing chronic homelessness who are also frequent users of city services. The project will serve 250 people and repay investors based on participants' housing stability and the reduction in the days they spend in jail. (For more information on this and other projects, visit the website of the Urban Institute's Pay for Success Initiative at pfs.urban.org.)

PFS can help address intractable problems with high up-front costs and develop solutions that carry risk (e.g., successful elsewhere but new to this city). But not all projects are a good fit for PFS. Projects with a weak evidence base or that do not lend themselves to evaluation do not make sense because they carry too much risk or may be difficult to measure. Governments should consider the following (Milner et al. 2016):

- the strength of the evidence for the program and the underlying theory of change
- the service provider's capacity to carry out the program
- the ability of existing datasets to support feasibility analysis, transaction structuring, implementation, and evaluation
- alignment with government needs and priorities
- alignment with other public systems
- availability and interest of investors to support the project

Even when a project is well suited, the PFS process may dissuade local officials. Developing a PFS project can be lengthy and complicated and require many stakeholders to sign off on a project. In addition, PFS is not "free money." Although it secures up-front funding and shifts risk from the government to investors, the government is required to repay those investors, with interest, should the project meet its targets. This means that using PFS is likely more expensive than simply paying for the project outright. **Governments should weigh a project's costs and benefits before proceeding and decide if the access to up-front capital and a shift in risk is worth the additional costs.** Projects with demonstrated success in a given locality and funds to implement it in that locality would not typically require PFS.

Why Consider Pay for Success to Reclaim Vacant and Abandoned Properties?

With vacancy and abandonment, access to up-front capital may be worth the additional costs for many cities. Depending on the city's size and the types of properties targeted, the estimated cost of addressing vacancy and abandonment can range from hundreds of millions to billions of dollars. In Detroit, for example, it could cost up to $2 billion to rehabilitate all the city's vacant and abandoned

residential, commercial, and industrial properties (Detroit Blight Removal Taskforce 2014). Similarly, Flint, Michigan, has funds to pay for only 20 percent of the cost to rehabilitate almost 20,000 properties (Imagine Flint, n.d.). Because PFS taps into investor capital, it could be used to address some of this capital shortfall, though the government would still need to repay the investors at the end of the project.

The scale of the problem outstrips the available resources to address it. The revenue sources that are available—generally drawn from local general funds or federal sources such as the Community Development Block Grant Program—must compete with other local services and funding priorities. The political and policy competition makes these revenue streams fluctuate and be unreliable. Following the housing market crisis, the federal government provided new resources to address the dramatically increased number of vacant properties nationwide. The Neighborhood Stabilization Program, managed by the US Department of Housing and Urban Development from 2010 to 2016, awarded local governments housing rehabilitation funds based on number of foreclosures. Additionally, the US Department of the Treasury oversees the multibillion-dollar Hardest Hit Fund, which provides resources to state governments for foreclosure prevention, neighborhood stabilization, and demolition programs to remediate vacant, foreclosed, and blighted homes. The Hardest Hit Fund, first announced in 2010, provided $7.6 billion to the 18 hardest-hit states, plus the District of Columbia, to develop locally tailored programs to assist struggling homeowners. On February 19, 2016, an additional $2 billion was allocated to the fund as a part of the Consolidated Appropriations Act of 2016. By the end of 2016, participating states had disbursed about $5.8 billion of the $9.6 billion, but this steady flow of federal dollars to support demolition seems to be slowing down as the federal government shifts priorities.[2] Most allocations to local governments, typically through state housing finance agencies, are now declining compared with the program's peak four or five years ago. Funding is scheduled to sunset in 2020.

Beyond having access to new funding sources, governments can also benefit from shifting the risk for new programs and the delay in the payment that comes with PFS and other performance-based strategies. Under these financing and contracting tools, governments would pay only after the property has been addressed, which means the government is paying only after it has realized the value associated with stabilizing or rehabilitating the property. Depending on the program's structure, that could mean after a house is sold or after a vacant lot is transformed into a community garden. Critically for PFS, the short-term economic and financial benefits that could come with addressing vacancy and abandonment are substantial for local governments. The next section goes into more detail, but the costs and lost revenue to city governments can be millions of dollars a year. For example, Immergluck (2015) estimated that Atlanta incurred between $1.67 million and $2.96 million annually in direct service costs (e.g., code enforcement, police, and fire) and lost $2.7 million in property tax revenue because of declining property values. Although they are not without risks and challenges, these potential cost savings and increased revenue present a substantial opportunity for PFS because they can be used to pay back investors.[3]

Costs Associated with Blighted Properties

Vacant and abandoned properties can impose direct and indirect costs to city governments, local neighborhoods, and residents. A 2005 analysis of vacant properties in Chicago found that when a foreclosed home became vacant, that home could impose as much as $34,000 in direct costs to local government agencies and as much as $220,000 in indirect costs to surrounding property owners (Apgar, Duda, and Gorey 2005). Although economic costs vary by city and by region, they generally fall into one of four areas: direct property maintenance costs, code enforcement program costs, police and fire costs, and lost property tax revenue.

Before describing the costs associated with blighted properties, it is important to note a few things. First, these costs do not cover the negative externalities associated with vacant and abandoned homes, such as negative impacts on a person's physical and mental health as well as overall community health (de Leon and Schilling 2017). Second, although the hope is that the local government can recover many of these costs, capturing costs, particularly for a PFS project, can be difficult. We focus on costs that evidence suggests are direct cost savings for a local government, but the actual savings a government may see are likely to vary from the numbers presented below because of local conditions and variables that cannot be accounted for. Moreover, many costs may accrue to individuals or other noncity or county agencies. It is important to contextualize these costs and be aware that these costs are not certain.

Property Maintenance Costs

Cities spend money every year maintaining vacant and abandoned properties through such activities as cutting grass, removing trash or junk, and boarding homes. Studies of the cost to securing and maintaining vacant properties found that the cost can range from $233 to $1,744 per property. Following the housing crisis, a Government Accountability Office (GAO) study found that federal agencies spent $1,744 per property in 2010 to maintain real estate owned properties under their control. The main postforeclosure costs were for trash removal and yard maintenance (GAO 2011). Studies of the cost to maintain vacant properties in individual cities find similar costs. A 2010 study of city-owned vacant and abandoned properties in Philadelphia found that the city spent $20 million annually to maintain 40,000 properties, about $500 per property (Econsult, Penn, and May 8 Consulting 2010). In 2010, Chicago spent about $875,000 to secure 627 properties, just under $1,400 per property, and Detroit spent $1.4 million to secure 6,000 properties, about $233 each (GAO 2011).

Code Enforcement Costs

Local government code enforcement programs incur numerous costs throughout the administrative and legal processes they deploy to address substandard, vacant, and abandoned properties and their spillover effects. Code enforcement operational costs include the staff labor and computer systems to handle citizen complaints and property inspections. Given the complexities of property ownership, code enforcement programs often spend additional resources investigating and tracking down parties

responsible for the property (e.g., owners, banks, and mortgage servicers). Depending on the vacant property inventory, many cities have special vacant property coordinators and inspector teams that focus exclusively on vacant properties. Cities also administer vacant property registration ordinances to identify property owners and establish and enforce property maintenance standards. Despite these regulatory efforts, many cities are forced to take formal enforcement actions, sometimes litigation, that incur additional staff and legal costs. Cities can also exercise their public nuisance abatement powers that enable them to use city work crews or their private contractors to board and secure or demolish vacant properties that pose immediate threats to public safety. Although in most cities and states these costs can be assessed against the property, they are often not recovered by the city or take significant time and resources to collect.

Police and Fire Costs

Vacant and abandoned properties can attract crime, and studies show that the presence of vacant homes can lead to an increase in crime. A study in Pittsburgh found that foreclosures and vacancies can drive crime in the surrounding area (Cui and Walsh 2014). The authors established this relationship by comparing violent crime within 250 feet of the property with the space 250 to 350 feet away and found the adjacent area had a 19 percent increase in violent crime. Moreover, they found that crime in the immediate surrounding area dropped after the property is reoccupied. Many of the negative effects of crime come without a direct financial cost (but are no less important), but the financial costs can be substantial and include downstream considerations such as incarceration and costs to the victim (McCollister, French, and Fang 2010). Moreover, Klein (2017) estimated, using the 19 percent figure from the Pittsburgh study, that over one year, an abandoned property will result in $14,000 in costs associated with crime based on injury to the victim, criminal justice system costs, crime career costs (e.g., decreased productivity on the part of the person who committed the crime), and other intangible costs.

Many vacant and abandoned homes are also at risk for catching fire, which can have significant spillover costs to surrounding homes. A 2009 Baltimore study found that each vacant property increased annual police and fire expenditures *directly* by almost $1,500. This estimate was based on 911 call data, the location of known vacant and abandoned properties, and police and fire department budgets.[4] At that time, Baltimore had approximately 19,000 vacant properties for a total annual cost of about $28 million.

Lost Property Tax Revenue

One of the largest "costs" to government is lost property tax revenue. For many local governments, property taxes are the primary funding source for municipal operations. In 2016, local governments collected $487 billion in property taxes, about half of their own-source general revenue.[5] Vacant and abandoned properties suppress property tax revenue in two ways: First, there is the direct loss in property tax from the property that is likely not providing any tax revenue, particularly if the owner is unknown or absent. Second, vacant and abandoned properties can indirectly reduce property tax

revenue by reducing the value of the surrounding properties, reducing the amount of revenue the local government can collect.

The magnitude of the lost revenue varies by jurisdiction. A study in Toledo, Ohio, found that vacant properties led to $2.7 million in lost tax revenue directly associated with the property and $2.7 million in additional lost tax revenue because of the negative effects of vacancy on surrounding property values (Immergluck et al. 2016). Another study of lost revenue in Philadelphia found nearly $70 million in back property taxes on vacant homes, an amount that increases by about $2 million a year. Additionally, there was a nearly $3.6 billion reduction in household wealth because of negative spillover effects (Econsult, Penn, and May 8 Consulting 2010).

Possible Strategies to Reduce Blighted Properties

PFS and other performance-based funding strategies cannot fix many of the underlying issues that drive disinvestment, but they can be used to support projects that target specific instances of abandonment. Local context matters when communities devise their responses to vacancy and abandonment and their negative neighborhood impacts. Given the diverse challenges surrounding vacant and abadoned properties, no single funding strategy can solve all the challenges. Communities should coordinate and customize various policies and programs that often cut across city and county agencies and engage nonprofits and community-based organizations. Effective vacant property reclamation efforts often engage and include local residents and consider the property's physical realities, the strength of the local housing market, and the city's long-term goals. Additionally, local policymakers should consider relevant state and local legal authorities and city and county capacities, as they can limit policy and program options when addressing blighted properties.

Local governments should keep in mind that not all worthwhile strategies to address vacancy and abandonment make sense for PFS. The model works best where there is a clear intervention with measurable benefits and outcomes that can trigger potential repayment (Milner et al. 2016). The most effective PFS project would occur within a defined geography where measuring impacts is easier compared with a citywide strategy. Also, because PFS requires working with investors and requires aligned interests, it is important to identify relevant investors who have a strong interest in supporting short- and long-term community benefits that could flow from reclaiming vacant properties, such as reductions in crime and improvements to community health and residents' physical and mental well-being.

A good starting point is to reflect on the body of work about vacant properties. Many cities have already inventoried the location and condition of their vacant and abandoned properties. Though vacancy and abandonment constantly change, these inventories provide a good starting point for cities to identify properties and neighborhoods to focus on. Many communities then leverage these inventories to devise citywide blight campaigns, charters, and actions plans. These action plans often include a mix of worthwhile strategies, and in this brief, we focus on strategic demolition and

rehabilitation because of their potential to unlock the costs savings, tax revenue increases, and other nonfinancial benefits highlighted previously.

Demolition and Greening for Improving Vacant Land

Strategic demolition of vacant and abandoned properties involves data-driven collaboration for tearing down dilapidated housing for which there is little or no market demand. Although not all homes should be torn down, the oversupply of housing in many legacy cities has reduced the demand and value for homes that may be salvageable. By tearing down homes without market demand, cities can stabilize local housing markets and reduce the costs outlined above, particularly costs for code enforcement, property maintenance, and police and fire services dispatch. Furthermore, if paired with urban greening projects (e.g., stabilizing vacant lots or creating rain gardens or parks), the city may be able to increase adjacent and surrounding property values, add valuable community assets, and improve public health.

A PFS-funded strategic demolition project could capitalize on existing plans by using PFS as a vehicle to raise capital to carry out demolition and related property stabilization activities. The project would be relatively straightforward for cities with significant experience tracking costs and managing demolition initiatives but that lack the up-front capital to expand the program. The city would still need to develop a consistent process to identify the target geography (e.g., blocks or neighborhoods) and prioritize which properties would be targeted through the PFS project. A good starting point would be in cities that have detailed property condition surveys and inventories of their vacant and abandoned properties, as that would set the stage for identifying potential neighborhoods and which properties make sense for demolition or for rehabilitation.[6]

The PFS project must also engage and collaborate with neighborhood residents and relevant nonprofits and community-based organizations, as well as with citywide community and economic development plans and policy goals. Ideally, the demolition activities should be paired with interim urban greening strategies that can stabilize neighborhoods and markets along with midrange reuse opportunities for turning some of these vacant lots into parks, gardens, urban farms, and green infrastructure that can increase property values for surrounding homes, improve public health, and improve water quality through reductions in impervious surfaces.

THE COST AND PROCESS TO DO DEMOLITION

Demolition can require various physical and legal considerations.[7] The process must also factor in health implications and be carried out in a manner that properly disposes of the waste material and does not negatively affect the surrounding neighborhood. Costs vary depending on the type of building, the type of construction, the presence of lead and asbestos, and location. Wood-framed and detached houses are typically cheapest to demolish. According to a GAO study, the cost to demolish a single-family detached home typically ranges from $4,800 to $7,000 (GAO 2011). Toledo, Ohio, which has city-run demolition crews, spent about $6,000 per building to demolish 285 buildings in 2011. Rowhomes, particularly when built using brick in such cities as Baltimore and Philadelphia, can be more expensive to take down. In Baltimore, the price per home can range from $27,000 to $40,000. A major

contributing factor to the cost of demolishing rowhomes is the need to shore up the walls of the remaining homes, which can cost about $14,000 (Mallach 2012). Additionally, the local government, land banks, or the nonprofit developer can incur substantial legal costs to research property ownership, prepare property assessment or title reports, clear the title of outstanding liens and encumbrances, and record the requisite legal documents. Court hearings and appearances are also necessary, even if the owner cannot be found or does not appear. If the previous owner or lender contests these activities, there could be litigation that would demand more legal resources and costs.

BENEFITS AND REPAYMENT

Selecting the outcomes for repayment and deciding how much money will be repaid is a key component of designing a PFS project. A "good" outcome is one that aligns with the evidence base for the intervention, aligns with end payor interests, and can be easily tracked, usually through administrative data. A demolition-focused PFS project would likely select several outcomes and outputs to provide incentives for results. Outcomes could be linked directly to expected cost savings (e.g., a reduction in maintenance costs or a reduction in police calls), increases in value (e.g., property taxes), or other nonfinancial benefits that the government values (e.g., improved public health).[8] Often in PFS, these outcomes operate as a percentage change. For example, a 10 percent reduction in maintenance costs could yield a specific payment to investors, with greater reductions yielding higher payments.

A project could also select metrics that stand as proxy measures for the expected results. For example, if the government was reasonably confident that tearing down a vacant house would reduce costs and increase tax revenue, a simple repayment outcome could be the number of homes torn down. This is easily monitored with data systems, and the repayment amount could be based on either the costs associated with demolition or the expected cost savings (e.g., no longer having to inspect the property or respond to citizen complaints) that result from removing the vacant and abandoned structure. Although there are still costs to cities to maintain empty lots, those costs are less than those for maintaining vacant or abandoned buildings. Costs could be reduced further by transferring or selling these new vacant lots to adjacent homeowners for side lots or turning the property over to the community for use as a garden.

Given the costs of blight, cities might see enough financial value to justify a PFS project on the merits of cost savings and increases in tax revenue alone. A study by Griswold and coauthors (2015) found that four years' worth of demolitions in Cleveland resulted in a total benefit of $78.9 million against a total cost of $56.3 million, for a $22.6 million net benefit. An important caveat to the study, though, is that only strong markets (moderate to high functioning) saw positive returns on investment. The net benefit in less well functioning markets was negative.

LEVERAGING URBAN GREENING

Governments could further compound the program's benefits by providing incentives to create green space, a sorely lacking amenity in many urban neighborhoods, by including outcomes linked to various urban greening strategies. Although the financial benefits will take time to capture, research shows that urban green space can improve physical and mental health and reduce morbidity by reducing stress and

supporting physical activity (Barton and Rogerson 2017; Braubach et al. 2017). Urban greening includes various interim and permanent reuse opportunities (e.g., urban agriculture, stormwater control, parks, trails, and open space).[9] Greening vacant lots with modest stabilization treatments can generate value to the city indirectly through property value increases to the surrounding properties (e.g., which can translate to increases in property tax revenue and public cost savings in property maintenance). A 2005 study of Philadelphia Green, a vacant lot greening program in the New Kensington neighborhood, found that simple vacant lot improvements increased surrounding property values up to 30 percent, which translated into a neighborhood wide gain of $12 million. Adding in tree planting led to a 10 percent increase in property value, a $4 million gain (Wachter 2005).

Another potential outcome could be tied to environmental benefits, such as air and water quality improvements. Trees planted on vacant lots can add to a community's tree canopy and reduce carbon dioxide. Vacant lots could include green infrastructure, such as rain gardens, that remove impervious surfaces from cities. Impervious surfaces, including roads, driveways, and sidewalks, do not absorb rainwater and instead direct rainwater into storm drains. This becomes a problem in cities that operate using combined sewer systems in which rainwater and sewage mix. During thunderstorms or other periods of intense rain, combined sewer systems can overflow, dumping sewage into rivers and streets. A project that reduced the amount of rainwater channeled into the sewer system would be valuable.

BOX 3

DC Environmental Impact Bond

In 2016, the District of Columbia Water and Sewer Authority launched a $25 million environmental impact bond to expand green infrastructure and improve water quality. A third of DC is serviced by a combined sewer system that results in an annual average of 2 billion gallons of combined sewer and rainwater, called combined sewer overflows, flowing into the Potomac and Anacostia rivers during heavy rains. By building green infrastructure such as rain gardens, green roofs, and rain barrels, DC hopes to reduce this stormwater runoff, which will reduce the amount of combined sewer overflows entering local waterways. The funding mechanism will run for 4.5 years and repay investors based on reductions in runoff. For more information, see "DC Water Environmental Impact Bond," Urban Institute, accessed June 24, 2019, https://pfs.urban.org/pfs-project-fact-sheets/content/dc-water-environmental-impact-bond.

Home Rehabilitation and Property Redevelopment

The scale and concentration of property abandonment in some neighborhoods makes it difficult for communities to consider rehabilitation and redevelopment. For many legacy cities that have lost many residents and jobs, it makes little financial sense to rehabilitate and repair vacant homes. But in neighborhoods with better functioning housing markets and connections to good jobs and schools, rehabilitation and redevelopment may be possible but often requires interventions and resources from government or philanthropy.[10] Many of these stable neighborhoods have a demand for housing, but the

costs of rehabilitation and redevelopment may exceed the sale price, which locks out private developers. A recent Reinvestment Fund market value analysis of housing markets in legacy cities found that between 40 and 50 percent of a city's population live in what are considered midmarket neighborhoods. Midmarket neighborhoods can have low, but still healthy, sale prices but can also have vacant and abandoned homes. In Baltimore, for example, the share of the housing stock in these neighborhoods that was vacant ranged from 1 to 5 percent while the median sale price ranged from $40,000 to $100,000 (Goldstein, Schrecker, and Rosch 2016).

BOX 4

PFS, Asthma, and Substandard housing

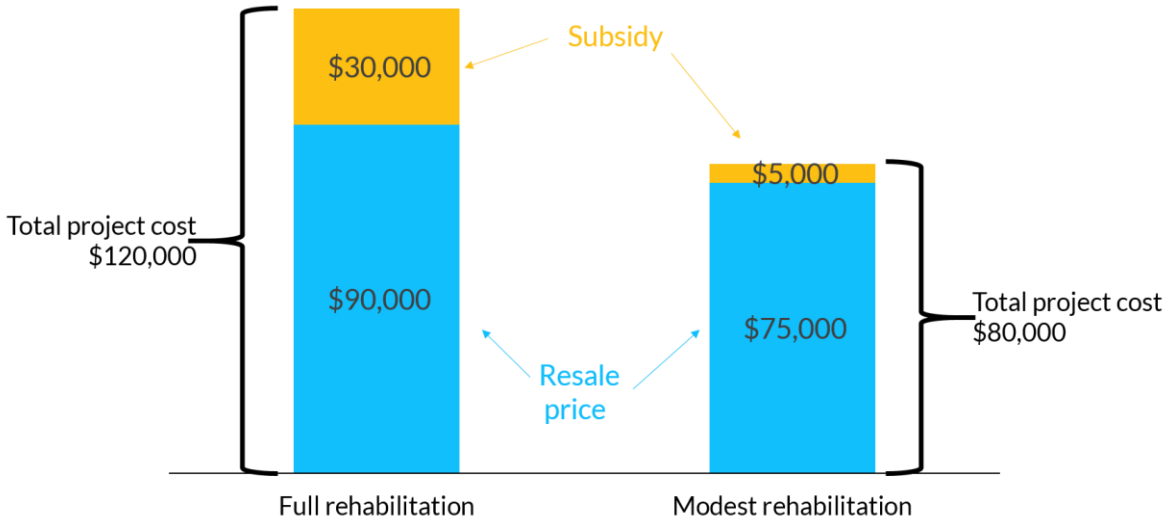
Many families experience poor health because they live in homes with substandard conditions. One particularly vulnerable group is children with asthma who may experience asthmatic episodes caused by triggers in the home, such as mold, pests, and dust. In addition to causing negative effects on children's health, these episodes can cause children to miss school and show up in the emergency room or hospital. Several communities have explored the feasibility of using PFS to deploy home-based interventions, such as those used by the Green and Healthy Homes Initiative (GHHI), to improve housing conditions for families with children who have asthma. GHHI's model includes education, energy efficiency upgrades, and home improvements that remove known triggers to reduce the frequency of asthmatic episodes. Although the project has not launched, a GHHI-led feasibility study of an asthma-focused PFS project in Memphis, Tennessee, found that the cost savings from reductions in health care use is great enough to justify the intervention's cost.[a]

[a] Ruth Ann Norton, Michael McKnight, Kevin Chan, Andrew Olson, Brendan Brown, and Trent Van Alfen, *Pay for Success Financing to Address Childhood Asthma in Memphis: Feasibility Study Final Report* (Washington, DC: Corporation for National and Community Service, 2016).

A PFS-funded redevelopment project would operate similarly to the development of affordable housing in which the government subsidizes a developer to cover the difference between development costs and the expected income from selling or renting the property. The depth of the subsidy would depend on several factors, including the level of renovation the house needed and the amount the house would likely sell for. A 2013 study of rehabilitation of homes in Cleveland by the Joint Center on Housing Studies of Harvard University illustrates potential scenarios with varying levels of feasibility depending on the strength of the local housing market. In a strong but threatened neighborhood in Cleveland, researchers estimate that a full gut rehabilitation would cost about $120,000 and resell for $90,000, requiring a $30,000 subsidy. A more modest level of rehabilitation, however, costing roughly $80,000, would bring a sale price of $75,000 and thus require a $5,000 subsidy. More distressed neighborhoods would require deeper subsidies, potentially up to $70,000 a house for a full gut rehabilitation (Ford et al. 2013).

FIGURE 2

Potential Costs for Full and Moderate Rehabilitation in Stable Housing Markets in Cleveland, Ohio



Source: The authors created this figure based on the numbers from Frank Ford, April Hirsh, Kathryn Clover, Jeffrey A. Marks, Robin Dubin, Michael Schramm, Tsui Chan, et al., *The Role of Investors in the One-to-Three-Family REO Market: The Case of Cleveland* (Washington, DC: Urban Institute, 2013).

The project could also use part of the PFS capital to provide down payment assistance to new homebuyers. Baltimore's Vacants to Value program, for example, has attracted middle-income buyers to purchase rehabilitated blighted properties by providing down payment assistance. This can make the property more affordable to the homebuyer because they may need to put down only a few thousand dollars to purchase a newly renovated house.[11]

BENEFITS AND REPAYMENT

Repayment could be linked to outcomes associated with rehabilitating a house. The most obvious outcome would be a payment for every home completed and sold. Linking repayment to successful redevelopment would ensure that developers have incentives to complete the project and not simply hold the property. The city would also benefit because it pays only after the property is sold, ensuring the property has been returned to productive use with a new owner who will (hopefully) pay taxes.

Redeveloping the property would allow the government to unlock the full range of cost savings and increased tax revenue explained above. The property would no longer require direct city maintenance, would no longer attract crime, and would no longer harm surrounding properties. Perhaps most important, a property that previously provided no property tax revenue would be occupied by a new owner who would pay taxes. In Cleveland, given that the property tax rate is 1.92 percent, a new owner of the $90,000 house described above would pay about $1,728 a year in taxes, a 5.8 percent annual

return on the $30,000 investment for the full gut rehabilitation. The moderate rehabilitation would yield $1,440 annually in property taxes for a nearly 30 percent annual return. Excluding the other potential cost savings, the investment on the moderate rehabilitation would be repaid in 3.5 years on the property taxes alone. The surrounding properties would also likely increase in value, though the amount of property tax collected may change slowly.

A PFS project could also expand access to decent, affordable housing and help families use homeownership to build wealth. If the city added this as a project goal, it may need to provide a deeper subsidy to the developer to enable the property to be sold below market value to a low-income buyer. Governments could link repayment to the number of low-income buyers served based on area median income or the number of houses sold below market value. This would likely complicate the cost-benefit considerations, particularly whether the government is focused on cost savings and developing a project in which the financial benefits outweigh the costs.

LAND BANKING CAPACITIES

Complex and sometimes arcane property, real estate, tax foreclosure, and other regulatory barriers often stymie the reclamation of vacant and abandoned properties by making it difficult to efficiently acquire and transfer problem properties to responsible managers and owners. Vacant and abandoned properties can rack up fees, fines, and unpaid taxes that must be paid off during the transfer or sale of the property. In other cases, local governments cannot track down the current property owner, or the owners hide behind shell corporations, making them impossible to find, track down, or contact. Many of these properties have been through mortgage and tax foreclosure processes but without a permanent resolution. Given these and other complexities, cities may not be sure who owns the property or who is responsible for maintaining it (e.g., a bank, a financial institution, or a property preservation firm), which means there is not an easy process to clear the title to the property. Even absent these challenges, a lengthy or complex process to transfer properties can cause developers to look elsewhere.

Many legacy cities are using land banking to acquire, maintain, and transfer vacant properties. Land banks are nonprofits or quasi-governmental organizations that exist to overcome obstacles to reclaiming vacant properties, including large-scale demolition, clearing legal titles, waiving fees and back taxes, and transferring properties to new owners, often to community development organizations. According to the Center for Community Progress, about 170 land banks operate nationwide, with concentrations in Michigan, Ohio, and New York.[12] Depending on the specific state legislation, a land bank can often acquire tax-delinquent or mortgage-foreclosed vacant homes before they are sold to institutional investors or property speculators and flippers. Once it acquires the vacant property, the land bank often has authority to "clear the title" from these real estate barriers. Land banks in such places as Detroit, Cleveland, and Flint have been the primary vehicle for financing or performing large-scale demolitions of vacant homes. Most land banks have a portfolio of programs and initiatives related to vacant property stabilization, urban greening, and the like, along with projects working with local developers to rehabilitate the home or demolish and reclaim the vacant property. Land banks can also hold and maintain vacant property for interim and future community reuse.

For cities considering a PFS project focused on rehabilitating vacant and abandoned properties, land banks or similar nonprofit intermediaries can play integral roles. The land bank could be the starting point for reclaiming the vacant property by leveraging its legal, development, and planning capacities to clear titles and transfer them to a new entity. Land banks could also lead property rehabilitation and redevelopment. In this scenario, capital raised through PFS can support the land bank's activities with outcome payments tied to the number of properties rehabilitated or the number of first-time or low-income buyers served.

Important Considerations

The scenarios outlined above illustrate in broad strokes how PFS could be used in strategic demolition or rehabilitation. Any project targeting vacant and abandoned properties must address strategic considerations, challenges, and issues that reflect local realities and priorities. Below are a few important considerations.

The Strength of the Local Housing Market

The type of strategy that will be feasible depends on local market considerations. Healthy functioning markets have little need for local government to support redevelopment beyond removing regulatory obstacles. The finances associated with purchasing, rehabilitating, and selling the property may be sufficient for private developers to engage in redevelopment without government assistance. Highly distressed markets may have so much oversupply of housing and so little demand that any redevelopment program may be too difficult, even with government intervention. In these communities, demolition may be more feasible. In neighborhoods in between, in which there is demand but also vacant and abandoned properties, a mixed approach of strategic demolition and rehabilitation may be possible.

Scattered-Site versus Targeted Neighborhoods

A strategic demolition or urban greening or rehabilitation project will need to determine the geography in which it operates. Cities have two basic options: targeting scattered sites citywide or operating only in neighborhoods where there are clusters or concentrations of vacant properties and abandoned homes. Although each option has pros and cons, the targeted approach would likely be more impactful and easier to evaluate. Focusing on one or a handful of neighborhoods would make it easier to account for the cost savings and increased tax revenue because any changes in municipal spending or increases within that neighborhood could be attributable to the program. A neighborhood-focused project is also better positioned to build off itself; redeveloping dozens of homes in a neighborhood likely will have a greater impact than redeveloping only one.

A scattered-site approach is still workable and may be necessary if the few vacant or abandoned properties are sprinkled across many neighborhoods. Calculating the impact, though, may require a more theoretical approach to cost savings and changes in tax revenue. The city could base expected cost

savings on what it spends, on average, per similar vacant and abandoned property citywide. Changes in property taxes would also be based on calculating a per property amount and applying it to each property. Although there are likely to be variations across properties, using an average might allow the program to balance out citywide.

Attracting Investors by Identifying Other Benefits

A project that mitigates vacant and abandoned properties is likely to be associated with benefits beyond simple changes in spending and tax revenue. Newly demolished properties could be used for green infrastructure that would likely improve water quality, and building new parks would likely improve community health. Moreover, cities could add a workforce development or job training component to the project (e.g., a construction apprenticeship or community landscaper program) that would help more residents, though it would increase complexity.

Building in outcomes that capture these additional benefits can attract potential investors, including philanthropic ones who may not otherwise be interested in the project.[13] Although investors are repaid, these returns are often below market rate, meaning that the pure financial payout to investors is likely not enough to attract them to a project. Instead, investors, philanthropic and otherwise, have supported PFS projects because of the potential societal benefits that may result, such as improving education or health. Many impact investors have cited a desire to improve their communities or support systems change as the primary driver for their investments (Walsh et al. 2017). Creating a project with these added benefits could bring in investors.

Creaming

In developing an outcomes-focused contract such as PFS, the government should consider the issue of creaming, or cherry picking. Creaming occurs if a developer takes advantage of the fact that an entire group of properties needs to be defined (e.g., all vacant properties in a city or neighborhood), but some of the properties within the group may be easier to rehabilitate or have greater market potential and become the focus at the detriment of others. The developer could exploit this fact by focusing on the properties easiest to redevelop and ignoring the harder ones. This risk is likely greater in a citywide program but could happen in a targeted program. One solution is to build a data-driven process to identify properties to ensure each property selected for demolition or rehabilitation is appropriate.

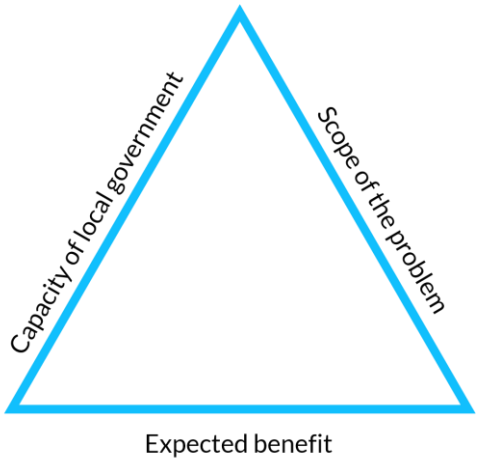
Although some projects have a risk of creaming, cities might exploit the fact that different properties require different levels of rehabilitation. Focusing on the properties easiest to rehabilitate and cheapest to demolish would allow a city to develop a PFS project with potentially less cost and greater returns. But it may make the project less impactful and work only in certain neighborhoods (e.g., the Cleveland demolition example above). If cities go this route, the decision must be deliberate, and the repayment amount should be proportional to the property's needs to ensure the city does not overpay developers.

Moving Forward with a Project

PFS will not work in every situation and is not applicable to every instance of vacancy or abandonment. Cities and their project partners need to consider their options based on local data, based on relevant policy goals, and in collaboration with community priorities. One way to determine if a PFS project makes sense is to balance the city's capacity, the scope of its problem, and the expected benefit (figure 3).

FIGURE 3

Considerations for Carrying Out PFS



PFS can be complex, requiring significant local capacity among city officials and developers or among community-based organizations in carrying out the program. Cities must be able to design, develop, and implement a project and accurately estimate the economic outcomes, develop an evaluation, and track the project's results. Given these tasks and complexities, most PFS projects involve intermediary organizations that can help local governments with these roles and tasks and augment local capacity. The scope of the problem is also important: with too few homes, the numbers for PFS may not make sense because the impact would be too small, and too many homes might necessitate non-PFS solutions because the resources required may overwhelm a PFS-financed project. Finally, PFS is best applied when there is some benefit to unlock. As this brief documents, reducing blight has tremendous financial and nonfinancial benefits, but the actual benefits need to be assessed for specific cities and neighborhoods. Often, the cities with the largest problems and the greatest potential benefit have the fewest internal resources and capacity to address the problem. Conversely, places with excellent capacity may be where the problems and benefits are smallest. A successful project will balance these dimensions.

Projects should also leverage resources and layer PFS on top of existing efforts. Many cities have detailed inventories of their vacant and abandoned properties. A great starting point for a PFS project could be to update this list and identify houses and properties for demolition or rehabilitation. The specific strategy—demolition, rehabilitation, or other—can be further influenced by detailed

neighborhood market analyses that create neighborhood typologies that identify strong and weak local housing markets. Cities can engage national nonprofits and local universities to carry out these inventories, market analyses, and other costs of blight studies.

Moreover, it is important to consider how a PFS project can relate to other ongoing efforts. A city might find that strategic demolition cannot work with PFS because the cost to tear down houses is too high and the expected cost savings are too low. But the city may be able to access other resources for demolition and use PFS to finance urban greening and stabilization programs for the newly created lots. To help determine which strategies make sense and how to connect to existing resources, cities can begin with a pilot program, as is common in many PFS projects, to test assumptions and address potential obstacles. Based on the strength of the pilot, cities can court investors and look for ways to expand the program.

Conclusion

Large-scale vacancy and abandonment, whether driven by the housing market crisis or long-term structural deindustrialization, is a problem countless cities face. In many cases, the appropriate strategy is well known and the project's benefits are well documented, but the city does not have enough resources to address the problem. Developers need money up front to carry out the strategic demolition or rehabilitation project, but cities can repay only after they have realized the program's benefits. This mismatch has prevented many cities from taking care of their vacancy and abandonment issue.

Through PFS, cities may be able to overcome this mismatch. PFS allows cities to tap into investor capital to carry out a project to make up for a lack of resources. And because the model focuses on paying for outcomes achieved, cities repay only after the project is successful, which is, in theory, after they have begun to realize the program's benefits. Although no project is foolproof, PFS is designed to shift the risk of project failure. The better the chosen outcome metrics of the project align with benefits of blight remediation, the more likely the project will be successful.

Notes

[1] Discrimination and openly racist policies are part of the history of urban redevelopment and housing policy. For more information, see Rothstein (2017).

[2] "Hardest Hit Fund: Program Purpose and Overview," US Department of the Treasury, last updated October 9, 2018, https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/hhf/Pages/default.aspx.

[3] Cost savings can be tricky to capture, and the decision to engage in PFS and how to value the outcome achieved is often based on other considerations. For more information, see Hatry and coauthors (2017).

[4] Bob Winthrop and Rebecca Herr, "Determining the Cost of Vacancies in Baltimore," *Government Finance Review*, June 2009, 38.

[5] "How Do State and Local Property Taxes Work?" Urban-Brookings Tax Policy Center, accessed June 24, 2019, https://www.taxpolicycenter.org/briefing-book/how-do-state-and-local-property-taxes-work.

[6] Before carrying out any demolition or rehabilitation program, local governments should accurately account for their vacant and abandoned properties. Many cities have developed detailed inventories of every vacant or abandoned property that are continuously updated. This information is critical for determining the most appropriate course of action for a particular property. For more information, see "Property Survey," Western Reserve Land Conservancy, accessed June 24, 2019, https://www.wrlandconservancy.org/articles/tag/property-survey/; and Eric Bosco, "Battling Blight: Four Ways Cities Are Using Data to Address Vacant Properties," Harvard Kennedy School, Ash Center for Democratic Governance and Innovation, August 21, 2017, https://datasmart.ash.harvard.edu/news/article/battling-blight-four-ways-cities-are-using-data-to-address-vacant-propertie.

[7] For more information on the demolition process, see "Examples of State and Local Demolition Programs," Environmental Protection Agency, accessed June 24, 2019, https://www.epa.gov/large-scale-residential-demolition/examples-state-and-local-demolition-programs.

[8] Although the potential cost savings are important, PFS projects can target nonfinancial benefits. For more information, see Dorn, Milner, and Eldridge (2017).

[9] For more information on strategies to green vacant lots, see Heckert, Schilling, and Carlet (n.d.).

[10] In the book *On the Edge*, housing and community development experts make the case for tailoring policy and program interventions that can stabilize and revitalize a city's middle-market neighborhoods (Brophy 2016). See the website for Middle Neighborhoods at http://middleneighborhoods.org/.

[11] See "Incentives," Vacants to Value, accessed June 24, 2019, http://www.vacantstovalue.org/Incentives.aspx.

[12] For more information, see "Frequently Asked Questions on Land Banking," Center for Community Progress, accessed June 24, 2019, https://www.communityprogress.net/land-banking-faq-pages-449.php.

[13] For more information on making place-based impact investments, see "Place-Based Impact Investing Practitioner Briefs," Urban Institute, May 30, 2019, https://www.urban.org/research/publication/place-based-impact-investing-practitioner-briefs.

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