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# The North Carolina Banking Institute Symposium on the Foreclosure Crisis: Municipalities Fight Effects of Foreclosure with Litigation and Neighborhood Stabilization Program Grants

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## **The North Carolina Banking Institute Symposium on the Foreclosure Crisis:\* Municipalities Fight Effects of Foreclosure with Litigation and Neighborhood Stabilization Program Grants\*\***

### I. INTRODUCTION

As foreclosure forces millions of Americans to leave their homes, their abandoned properties become the new homes to crime, toxic waste, vermin and insects, and an increased risk of fire.<sup>1</sup> Along with such blight, abandoned homes negatively impact surrounding homes' values.<sup>2</sup> This combination of decreased home ownership, home occupation, and property values significantly reduces tax revenues to cash-strapped state and local governments.<sup>3</sup> Experts predict that foreclosure blight could ultimately cost governments hundreds of billions of dollars.<sup>4</sup> Some

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1. Creola Johnson, *Fight Blight: Cities Sue to Hold Lenders Responsible for the Rise in Foreclosures and Abandoned Properties*, 2008 UTAH L. REV. 1169, 1182-83, 1198 (2008) (promoting nuisance litigation as opposed to individual proceedings as a solution to the foreclosure blight). See, e.g., Raymond L. Pianka, *Nuisances*, [http://www.clevelandhousingcourt.org/hc\\_rd\\_g.html](http://www.clevelandhousingcourt.org/hc_rd_g.html) (last visited Feb. 6, 2010) (explaining the need for Cleveland residents to maintain their homes). Abandoned homes lead to an increased presence of drug dealers, gangs, and prostitutes, and an increased murder rate. The "Broken Windows Theory," first introduced by criminologists James Q. Wilson and George Kelling, explains this pattern and suggests that minor disrepair or a showing of vacancy creates the assumption that the home is in a state of disorder and lacks supervision. The projection of chaos spreads and individuals feel less inhibited to commit crimes. *Id.*

2. G. THOMAS KINGSLEY, ET AL., *THE IMPACTS OF FORECLOSURES ON FAMILIES AND COMMUNITIES* 17 (2009), [http://www.urban.org/UploadedPDF/411909\\_impact\\_of\\_foreclosures.pdf](http://www.urban.org/UploadedPDF/411909_impact_of_foreclosures.pdf).

3. Johnson, *supra* note 1, at 1181; Joseph Schilling, *Code Enforcement and Community Stabilization: The Forgotten First Responders to Vacant and Foreclosed Homes*, 2 ALB. GOV'T L. REV. 101, 111-12 (2009) (explaining the significant costs to the community that abandoned homes pose).

4. Raymond H. Brescia, *Tainted Loans: The Value of a Mass Tort Approach to Subprime Mortgage Litigation*, (Legal Studies Research Paper Series No. 16, 49 2009), 78 U. CIN. L. REV. (forthcoming 2010) [hereinafter Brescia, *Tainted Loans*], available at <http://ssrn.com/abstract=1420792> (advocating the mass tort actions in litigation against banks); Raymond H. Brescia, *Subprime Communities: Reverse*

cities have sought to address the cost of foreclosures by seeking to hold mortgage lenders accountable in court for the maintenance costs and lost tax revenue associated with foreclosure blight.<sup>5</sup> Litigation, however, has been relatively unsuccessful to date.<sup>6</sup> Furthermore, even when cities prevail against lenders in court, the time and cost associated with litigation makes it an inefficient means of addressing foreclosure blight.<sup>7</sup> The Neighborhood Stabilization Program (NSP), however, has shown promising signs of providing cities a way to address foreclosure blight.<sup>8</sup>

Part II of this Note will describe the various litigation approaches that cities have used to address foreclosure blight.<sup>9</sup> Part II will also explain the shortcomings of such approaches and conclude that litigation is ineffective as a primary strategy to address foreclosure blight.<sup>10</sup> Part III will explain why the NSP is a novel and innovative solution for cities facing increasing numbers of abandoned homes in the wake of the foreclosure crisis.<sup>11</sup> The Note concludes in Part IV that while the NSP has shortcomings in its current form, Congress should improve the program and fund it on a recurring basis to provide cities with a sustainable way to address foreclosure blight.<sup>12</sup>

## II. LITIGATION TO FIGHT IMPACT OF FORECLOSURES

Cities have used a variety of legal theories to sue banks to recoup lost tax revenues and to allay increased maintenance costs

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*Redlining, the Fair Housing Act, and Emerging Issues in Litigation Regarding the Subprime Mortgage Crisis*, 2 ALB. GOV'T L. REV. 164, 168-70 (2009).

5. Johnson, *supra* note 1. Mass litigation or large-scale litigation in this capacity allows cities to sue lenders for thousands of abandoned properties in a single suit.

6. *See infra* Part II, pp. 258-67. *See generally id.* (discussing the shortcomings of individual proceedings and illustrating the lack of success of mass litigation).

7. *See infra* Part II, pp. 258-67.

8. *See infra* Part III.A, pp. 268-71.

9. *See infra* Part II, pp. 258-67.

10. *See infra* Part II, pp. 258-67.

11. *See infra* Part III, pp. 267-73. *See also* Kathryn E. Johnson & Carolyn E. Waldrep, Note, *The North Carolina Banking Institute Symposium on the Foreclosure Crisis: Overview*, 14 N.C. BANKING INST. 191, 208-12, (2010) (explaining background on the foreclosure crisis and the legislation that enacted NSP).

12. *See infra* Part IV, pp. 273-74.

associated with foreclosed and abandoned properties.<sup>13</sup> They involve both civil and criminal proceedings regarding individual properties and mass litigation suits seeking to hold property owner(s) responsible for multiple properties in a single action.<sup>14</sup> While litigation may compensate cities and states for lost tax revenue and maintenance costs, these methods are an inefficient and ineffective means of providing relief to blighted cities.<sup>15</sup>

#### A. *Individual Proceedings*

Civil suits by cities against individual properties often involve nuisance abatement actions.<sup>16</sup> Cities may have standing to pursue public nuisance claims under statutory or common law.<sup>17</sup>

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13. Johnson, *supra* note 1, at 1187; Brescia, *Tainted Loans*, *supra* note 4, at 47-48; *see, e.g.*, *City of Cleveland v. Ameriquet Mortg. Sec., Inc.*, 621 F. Supp.2d 513 (N.D. Ohio 2009) (attempting to hold twenty investment banks for public nuisance created by foreclosed homes); *Complaint, Mayor and City Council of Baltimore v. Wells Fargo Bank, N.A.*, 631 F. Supp.2d 702 (D. Md. 2008) (No. L08CV 062), *available at* 2008 WL 117894 (alleging that lenders had engaged in reverse redlining giving rise to increased foreclosures and causing harm to the City).

14. Johnson, *supra* note 1, at 1195-98; *see also infra* Part II.A-B.

15. *See generally* Johnson, *supra* note 1, at 1198 (arguing that individual proceedings are too costly and time consuming to adequately address problems caused by foreclosed and abandoned properties).

16. Johnson, *supra* note 1, at 1187; *see also* Katherine C. Engel, *Do Cities Have Standing? Redressing the Externalities of Predatory Lending*, 38 CONN. L. REV. 355, 382 (2006) (“Public nuisance claims are an age-old tool used by government entities to pursue lenders who engage in unlawful and unsavory lending practices.”). Often, city officials have difficulty finding a party responsible for the foreclosed or abandoned property because “the complexities of the foreclosure process and the national and global nature of the lending industry.” Schilling, *supra* note 3, at 124-25.

17. Engel, *supra* note 16, at 384-85. *See e.g.*, N.C. GEN. STAT. § 19-2.1 (2009) (stating that parties with standing include a “county [or] municipality”); OHIO REV. CODE ANN. § 3767.41 (2009) (indicating that parties with standing include a “municipal corporation [or] township”); *Camden County Bd. of Chosen Freeholders v. Beretta U.S.A. Corp.*, 123 F. Supp.2d 245, 265 (D.N.J. 2000) (holding that “municipalities such as Camden County have general statutory and constitutional standing to sue in order to abate public nuisances”). In some jurisdictions, other parties, including nearby property owners, may also bring an action for nuisance abatement; *see, e.g.*, N.C. GEN. STAT. § 19-2.1 (stating that parties with standing include “the Attorney General, the district attorney, county, municipality, or any private citizen of the county”); OHIO REV. CODE ANN. § 3767.41 (indicating that parties with standing to bring abatement actions include a “municipal corporation, township, neighbor, tenant, or nonprofit corporation”). *See also* Johnson, *supra* note 1, at 1189 (discussing standing in public nuisance claims).

These suits often arise in connection with receivership proceedings and tax foreclosure actions.<sup>18</sup>

Receiverships do not result in a transfer of legal title, but allow for the appointment of a receiver to supervise rehabilitation of the property.<sup>19</sup> A receiver is only appointed when neither the owner of the property nor other interested parties have rectified the nuisance following a judicial order.<sup>20</sup> To some degree, this combination of nuisance abatement and receivership is effective because the property owner(s), rather than the community, will bear the financial burden of maintenance and rehabilitation costs.<sup>21</sup>

By contrast, cities may initiate foreclosure proceedings when other efforts to collect property taxes or nuisance code violation fines have failed.<sup>22</sup> Foreclosure proceedings allow cities to acquire title to the abandoned properties.<sup>23</sup> Problematically, some of these foreclosure actions may last more than three years.<sup>24</sup> When compared to receiverships, foreclosure proceedings are an ineffective solution because they leave the city, rather than the owner, with the financial burden of maintaining an abandoned property.<sup>25</sup> Furthermore, while individual civil proceedings and the acquisition of vacant homes are useful in combating the effects of foreclosure, the relative cost and time required for individual proceedings outweigh their benefits.<sup>26</sup>

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18. Johnson, *supra* note 1, at 1187.

19. *Id.* at 1188-89.

20. *Id.* at 1191 (discussing receivership under Ohio state law); see generally James J. Kelly, Jr., *Refreshing the Heart of the City: Vacant Building Receivership As a Tool for Neighborhood Revitalization and Community Empowerment*, 13 J. AFFORDABLE HOUSING 210, 218 (Winter 2004) (noting that receiverships are only allowed where the petitioning party can establish that the nuisance has gone unabated).

21. Johnson, *supra* note 1, at 1193-94.

22. *Id.* at 1192-93 (explaining foreclosure proceedings under Ohio state law).

23. *Id.* at 1188-89.

24. See *id.* at 1194.

25. See *id.* at 1192; Kelly, *supra* note 20, at 211 (arguing that placing blighted properties in receivership is critical to rehabilitating neighborhoods negatively affected by the mortgage crisis). In some states, local governments can recover costs associated with nuisance abatement via an abatement lien; however, "abatement's upfront costs act as a disincentive for code enforcement to use against foreclosed homes as they have limited budgets and the increasing uncertainty of recovering those costs against insolvent lending institutions." Schilling, *supra* note 3, at 122.

26. Johnson, *supra* note 1, at 1198. See also ALAN MALLACH, RESTORING PROBLEM PROPERTIES: A GUIDE TO NEW JERSEY'S ABANDONED PROPERTY TOOLS 68 (2005), available at <http://www.hcdnj.org/mc/page.do?sitePageId=81510&orgId=>

Individual criminal nuisance actions against lenders are also used in limited circumstances to mitigate expenses associated with abandoned properties.<sup>27</sup> For example, housing court judges in both Cleveland, Ohio and Buffalo, New York have ordered lenders to pay fines for code violations.<sup>28</sup> In Cleveland, these fines have been as high as \$50,000 per property; in Buffalo the fines have been as much as \$15,000.<sup>29</sup> Banks that do not pay the fines may be restricted by a lien from buying or selling properties in the future.<sup>30</sup> In Cleveland, public nuisance actions have been tried *in absentia* when the lenders fail to appear and the court has entered default judgments against them.<sup>31</sup> The Ohio Court of Appeals, however, held that a corporate defendant could not be tried *in absentia* where the defendant had not authorized the proceeding and had never appeared before the court.<sup>32</sup> Although, in *Cleveland v. Destiny Ventures, L.L.C.*,<sup>33</sup> decided just three months earlier, the court held that a corporate defendant could be tried *in absentia* even though the defendant did not appear for either the plea or the trial following notice that the trial would proceed if an agent

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hcdnnj (noting that in New Jersey, many proceedings “[demand] that the municipality or entity go through a legal procedure that involves spending funds not only on legal expenses, but also for title searches, notices and the cost of preparing a rehabilitation plan to be submitted to the court.”); Brescia, *Tainted Loans*, *supra* note 4, at 17 (noting that “[a]ggregation of claims has made the cost of bringing such litigation far less expensive for plaintiffs”).

27. Johnson, *supra* note 1, at 1195-97.

28. *Id.* In addition to imposing fines, Judge Nowak of Cleveland has declined to evict some homeowners in eviction actions brought by the lenders who failed to comply with the default judgments entered against them. Michael Orey, *Dirty Deeds*, BUS. WK., Jan. 3, 2008, available at [http://www.businessweek.com/magazine/content/08\\_02/b4066046083770.htm](http://www.businessweek.com/magazine/content/08_02/b4066046083770.htm). This action provides an incentive for lenders to ensure that foreclosed properties do not become nuisances and that they are kept “in good condition until a buyer can be found.” *Id.*; Johnson, *supra* note 1, at 1196.

29. Johnson, *supra* note 1, at 1196.

30. Orey, *supra* note 28.

31. See e.g., *Cleveland v. Destiny Ventures, L.L.C.*, No. 91018, slip op. (Ohio Ct. App. Sept. 11, 2008), available at 2008 WL 4175026 (affirming conviction *in absentia* of corporate property owners’ violation of municipal codes); *Cleveland v. Wash. Mut. Bank*, 179 Ohio App.3d 692 (2008) (overturning conviction *in absentia* of corporate property owners’ violation of municipal codes).

32. *Wash. Mut. Bank*, 179 Ohio App.3d at 694-95.

33. *Destiny Ventures*, No. 91018, slip op. at 3.

failed to appear.<sup>34</sup> The Ohio Supreme Court has granted appeals in both cases to resolve the split.<sup>35</sup>

While the cities of Buffalo and Cleveland have seen some benefits from these criminal actions,<sup>36</sup> other cities should consider the costs and benefits of such an approach. Individual criminal nuisance actions are time consuming and costly because they require an independent lawsuit for each property.<sup>37</sup> Furthermore, there is no indication that courts in other jurisdictions will follow Buffalo and Cleveland's lead. The costs and uncertainty associated with individual actions suggest that cities should explore other avenues to deal with substantial foreclosure blight.

### B. *Mass Litigation*

Cities have also employed various legal theories in mass-litigation suits against lenders and servicers with the goal of recovering lost tax revenue and maintenance costs<sup>38</sup> to minimize the financial strain arising from the rehabilitation of abandoned homes and decreasing property tax revenue.<sup>39</sup> Proponents of a

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34. *Id.*

35. *Cleveland v. Destiny Ventures, L.L.C.*, 902 N.E.2d 32 (2009) (granting appeal to the Ohio Supreme Court); *Cleveland v. Wash. Mut. Bank*, 907 N.E.2d 1193 (2009) (granting appeal to the Ohio Supreme Court). *See also* Joan Mazzolini, *Corporate Owners Owe Housing Court Millions*, CLEVELAND PLAIN DEALER, Jan. 16, 2010, at B3, available at 2010 WLNR 1009202 (describing the split and noting that both cases are now before the Ohio Supreme Court).

36. *See supra* p. 261 and notes 27-31.

37. Johnson, *supra* note 1, at 1195-97.

38. Brescia, *Tainted Loans*, *supra* note 4, at 49; Donna Leinwand, *Cities Sue Home Lenders*, USA TODAY, May 15, 2008, available at [http://www.usatoday.com/money/economy/housing/2008-05-15-lenderssued\\_N.htm](http://www.usatoday.com/money/economy/housing/2008-05-15-lenderssued_N.htm); *see infra* pp. 263, 265 and notes 42, 51, 56.

39. Julie Kay, *Empty Homes Spur Cities' Suits*, 30 NAT'L L. J. 1 (2008), available at 5/5/2008 Nat'l L.J. 1, (Col. 1). States are also trying to combat foreclosure costs via mass litigation. *See generally* David Streitfeld & John Collins Rudolf, *States are Pondering Fraud Suits Against Banks*, N. Y. TIMES, Nov. 3, 2009 at B1, available at 2009 WLNR 21915697. Some Attorneys General have alleged that lenders committed fraud by marketing and selling loans that could not be repaid. *Id.* Illinois Attorney General, Lisa Madigan, filed a suit against Wells Fargo alleging predatory lending in violation of Illinois civil rights laws. *Id.* Meanwhile, Attorney General of Arizona, Terry Goddard, remarked that he would prefer a better solution to the foreclosure crisis than a victory in the courtroom, but he believes that litigation is the only viable solution at this point. *Id.* Goddard said that at first, the states tried to use the threat of *Cuomo v. Clearing House* as a "tool to be persuasive with the banks, . . .

mass-litigation approach to addressing foreclosure blight argue that consolidating actions is cost-saving.<sup>40</sup> While mass litigation may be more economical than individual suits, municipalities have had little success in these matters.<sup>41</sup>

The City of Cleveland sought to hold more than twenty notable investment banks liable by classifying foreclosure blight as a public nuisance.<sup>42</sup> In this case, *City of Cleveland v. Ameriquest Mortgage Securities, Inc.*,<sup>43</sup> the City alleged that the defendant banks encouraged irresponsible subprime lending through securitization, which inevitably increased foreclosures.<sup>44</sup> The court found that because the plaintiff alleged that the defendants were maintaining a qualified public nuisance,<sup>45</sup> the plaintiff must

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but their waterfall of excuses, the abysmal number of modifications, tells us persuasion is not working . . . we're moving much closer to litigation." *Id.*

40. Brescia, *Tainted Loans*, *supra* note 4, at 20.

41. *See infra* pp. 264-66 and notes 47-61. *But see* *City of Minneapolis v. T.J. Waconia*, No. 27CV0887880 (Hennepin Co., Minn., Dist. Ct. 2008). Minneapolis alleged that a developer "engaged in a fraudulent residential real estate scheme to inflate housing prices, took the profits, and then left the area blighted with foreclosures." LEXIS NEXIS, BACKGROUND ON CITIES ATTEMPT TO RECOUP FORECLOSURE COSTS FROM LENDERS/DEVELOPERS, LEXISNEXIS EMERGING ISSUES ANALYSIS (June 2009), *available at* 2009 Emerging Issues 3756. The City won and a third-party receiver was given possession of the properties. *Id.* Minneapolis was the first and only city to date to experience success with such a suit. *Id.* Nevertheless, many experts are hesitant to classify this as a victory since now the city is responsible for maintaining and rehabbing the 141 properties without an award of funds to rehabilitate them. *Id.*; Leinwand, *supra* note 38.

42. *City of Cleveland v. Ameriquest Mortg. Sec., Inc.*, 621 F. Supp.2d 513, 516 (N.D. Ohio 2009) (granting motion to dismiss). The other defendants in this action are: Bank of America, N.A.; Bear Stearns & Co., Inc.; Citibank, N.A.; Citigroup Global Markets, Inc.; Countrywide Securities Corporation; Credit Suisse First Boston LLC; Credit Suisse (USA), Inc.; Deutsche Bank Securities, Inc.; GMAC-RFC Holding Company; Goldman Sachs & Co.; Greenwich Capital Markets, Inc.; HSBC Securities (USA), Inc.; JP Morgan Acquisition Corp.; Chase Bank USA, N.A.; Merrill Lynch, Pierce, Fenner & Smith, Inc.; Morgan Stanley & Co., Inc.; Novastar Mortgage, Inc.; Option One Mortgage Corporation; Washington Mutual Bank; Wells Fargo Bank, N.A.; Wells Fargo Asset Securities Corporation. *Id.*

43. *City of Cleveland*, 621 F. Supp.2d 513.

44. *Id.* at 516.

45. Under Ohio law, a public nuisance is one that creates "an unreasonable interference with a right common to the general public." *Id.* at 521 (quoting *Brown v. Scioto County Bd. of Comm'rs*, 87 Ohio App. 3d 704, 712 (4th Dist. 1993)). A qualified nuisance is one that "imposes liability for otherwise lawful actions 'so negligently or carelessly done [sic] as to create a potential and unreasonable risk of harm, which in due course results in injury to another.'" *Id.* at 521 (quoting *Metzger v. Pa., Ohio, & Detroit R.R. Co.*, 146 Ohio St. 406, 410 (1946)).



establish the traditional elements of a negligence claim.<sup>46</sup> The case was dismissed in part because the court found that the defendants did not create a public nuisance because subprime lending is a regulated activity and the defendants had complied with those regulations.<sup>47</sup> Furthermore, the court held that the defendants' encouragement of securitization was too attenuated to the alleged damages to have proximately caused injury to the City.<sup>48</sup> The allegations in Cleveland's case were so unique that the dismissal sheds little insight into courts' treatment of other municipal claims against lenders and property owners.<sup>49</sup>

Adopting a similar strategy, the City of Buffalo filed suit against thirty-six lenders in *City of Buffalo v. ABN Amro Mortgage Group, Inc.*<sup>50</sup> The plaintiffs alleged that the banks'

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46. *Id.* The elements of a negligence claim are: duty, breach, proximate causation, and damages. *Id.*

47. *Id.* at 526-27.

48. *Id.* at 533-34. The case was also dismissed because state law forbids municipalities from regulating mortgages and because the claim was barred by the economic loss doctrine. *Id.* at 517-18, 526. See also OHIO REV. CODE ANN. § 1.63 (2009) ("The state solely shall regulate the business of originating, granting, servicing, and collecting loans and other forms of credit in the state and the manner in which any such business is conducted, and this regulation shall be in lieu of all other regulation of such activities by any municipal corporation or other political subdivision. Any ordinance resolution, regulation, or other action by a municipal corporation or other political subdivision to regulate, directly or indirectly, the origination, granting, servicing, or collection of loans or other forms of credit constitutes a conflict with the Revised Code . . . is preempted."). The Ohio Supreme Court announced the economic loss rule as follows: "[I]n the absence of injury to persons or damage to their property, economic losses may not be recovered in the tort theories of strict liability or negligence." *Queen City Terminals v. Gen. Am. Transp. Corp.*, 73 Ohio St. 3d 609, 614 (1995) (citing *Chemtrol Adhesives, Inc. v. Am. Mfrs. Mut. Ins. Co.*, 42 Ohio St. 3d 40, 44-45 (1989)).

49. *Brescia, Tainted Loans, supra* note 4, at 48 n.142.

50. Complaint, *City of Buffalo v. ABN Amro Mortgage Group, Inc.*, (N.Y. Sup. Ct. 2008) (No. 2008002200). The other defendants in the action are: Alden State Bank; American Business Credit, Inc.; Ameriquest Mortgage Company; Bank of America, NA; Bank of New York Trust Company NA; Bankers Trust Company of California, NA N/K/A Deutsche Bank National Trust Company; Beal Bank SSB; Centex Home Equity Company LLC n/k/a Nationstar Mortgage LLC; The Chase Manhattan Bank; The Chase Manhattan Bank, n/k/a/ JP Morgan Chase Bank, National Association; Citibank N.A.; Citifinancial Inc.; Citifinancial Mortgage Company, Inc.; Citimortgage, Inc.; The Cit Group/Consumer Finance, Inc.; Cityscape Corp; Credit-Based Asset Servicing & Securitization, LLC; Deutsche Bank National Trust Company; Empire Development LLC; EMC Mortgage Corporation; FCI National Fund II, LLC; First Union National Bank n/k/a Wachovia Bank of Delaware; GE Capital Mortgage Services, Inc.; IMC Mortgage Company; JP Morgan Chase Bank, n/k/a JP Morgan Chase Bank, National Association; Keybank National

failure to maintain fifty-seven newly-acquired foreclosed homes created a public nuisance and alternatively that these lenders violated local ordinances pertaining to the maintenance of homes.<sup>51</sup> The City estimated that the properties cost Buffalo approximately \$2 million in maintenance costs and demolition costs.<sup>52</sup>

Buffalo has two main problems in pursuing this action.<sup>53</sup> First, abandoned properties are often still in the borrower's name when the suit is filed because the bank never foreclosed on the property.<sup>54</sup> Second, because mortgages were often securitized, it is difficult to ascertain who currently owns the mortgage.<sup>55</sup> This case is still pending.

The City of Baltimore used a different strategy by accusing Wells Fargo of reverse redlining,<sup>56</sup> a practice of targeting a specific community with abusive lending practices.<sup>57</sup> The City alleged that Wells Fargo disproportionately marketed and sold subprime loans

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Association; Longbeach Mortgage Company; Manufacturers and Traders Trust Company; Mortgage Electronic Registration Systems, Inc. c/o Merscorp, Inc; Nationscredit Financial Services Corporation; Norwest Bank Minnesota NA, n/k/a Wells Fargo Bank of Minnesota; Option One Mortgage Corporation; The Provident Bank d/b/a PCFS; United Companies Lending Corp.; Washington Mutual Bank FA n/k/a Washington Mutual Bank. *Id.* See also Jason Szep, *Cities Grapple with Surge in Abandoned Homes*, REUTERS, Mar. 25, 2008, <http://www.reuters.com/article/idUSN1162941020080325> (describing Buffalo's lawsuit against banks as well as the effects foreclosed homes have had on the city).

51. Complaint, City of Buffalo, *supra* note 50; see also Brescia, *Tainted Loans*, *supra* note 4, at 48. The City of Cincinnati, Ohio has also pursued a similar public nuisance claim against Deutsche Bank and Wells Fargo to force them to maintain four vacant buildings. Dan Monk, *City Sues Deutsche Bank, Wells Fargo*, BUS. COURIER OF CIN., Dec. 24, 2008, <http://cincinnati.bizjournals.com/cincinnati/stories/2008/12/22/daily45.html>.

52. Szep, *supra* note 50.

53. See generally *id.* (discussing potential problems with the City's lawsuit against the lenders).

54. *Id.*

55. *Id.*

56. Complaint at 1-2, *Mayor and City Council of Baltimore v. Wells Fargo Bank, N.A.*, (D. Md. 2008) (No. L08CV 062), available at 2008 WL 117894; see also Brescia, *supra* note 4, at 179 (explaining that reverse redlining occurs where there is demand for credit by borrowers, and where borrowers have limited knowledge of credit products and few lending options). The City of Memphis recently filed a similar suit against Wells Fargo. Michael Powell, *Federal Judge Rejects Suit by Baltimore Against Bank*, N.Y. TIMES, Jan. 9, 2010, at A11, available at 2010 WLNR 463412.

57. Brescia, *supra* note 4, at 179-80 (explaining reverse redlining in the context of the Fair Housing Act).

in African-American and Latino communities with terms that compared unfavorably to loans marketed to white communities.<sup>58</sup> The City argued that not only would such acts constitute a violation of the Fair Housing Act, but also that such practices lead to increased foreclosures in minority communities, causing blight and financial harm to the City.<sup>59</sup> The court dismissed the case in January 2010, stating that Wells Fargo was only responsible for a “negligible portion” of the vacant homes in Baltimore.<sup>60</sup> The court noted that “the alleged connection [between Wells Fargo’s lending practices and inner city blight] is even more implausible when considered against the background of other factors leading to the deterioration of the inner city, such as extensive unemployment, lack of educational opportunity and choice, irresponsible parenting, disrespect for the law, widespread drug use, and violence.”<sup>61</sup>

One case, *City of Minneapolis v. T.J. Waconia*,<sup>62</sup> is as an exception to the general trend of cities’ unsuccessful suits to address foreclosure blight. In this case, Minneapolis sued a developer for an illegal scheme to increase the prices of more than 140 homes that it had purchased and flipped.<sup>63</sup> The city alleged that by increasing prices in this manner, T.J. Waconia caused the substantial foreclosures and resulting blight in the neighborhood.<sup>64</sup> Within two weeks of filing suit, the court granted a stipulated agreement to award damages and to appoint a receiver to manage and clean up the properties.<sup>65</sup>

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58. Complaint, Mayor and City Council of Baltimore, *supra* note 56.

59. *Id.* Baltimore claims that Wells Fargo violated sections 3604 and 3605 of the Fair Housing Act. *Id.* at 13.

60. Order Granting Motion to Dismiss at 3, Mayor and City Council of Baltimore v. Wells Fargo Bank, N.A., (D. Md. 2010) (No. JFM 1:08 CV-00062), available at 2010 WL 46401. See also Powell, *supra* note 56 (highlighting the order granting motion to dismiss); Jonathan Stempel, *Wells Fargo Mortgage Case in Baltimore Dismissed*, REUTERS, Jan 7, 2010; <http://www.reuters.com/article/idUSTRE6064WE20100107> (highlighting the dismissal of the case).

61. Order Granting Motion to Dismiss, *supra* note 60.

62. *City of Minneapolis v. T.J. Waconia* No. 27CV0887880 (Hennepin Co., Minn., Dist. Ct. 2008); see *supra* note 41.

63. Kay, *supra* note 39.

64. *Id.*

65. Press Release, City of Minneapolis, Minneapolis Gets Court Order Appointing a Receiver for 141 Homes in North Minneapolis (Apr. 16, 2008),

Generally, however, municipalities have had little success actually recovering damages via mass litigation;<sup>66</sup> thus, these suits have not produced the funds needed to address foreclosures and blight. Furthermore, these actions may diminish the banks' willingness to lend in certain areas.<sup>67</sup> John Mechem of the Mortgage Bankers Association cautions that these lawsuits are not the best way to improve cities' housing markets because "[l]enders simply won't make loans in areas where they perceive a risk of a lawsuit," and may be uncooperative regarding maintenance of vacant homes.<sup>68</sup> Given the lack of success cities have had to date and the potential negative consequences of pursuing lenders in this manner, other municipalities should consider non-litigation alternatives to deal with foreclosures.

### III. NEIGHBORHOOD STABILIZATION PROGRAM AS A SOLUTION

The NSP provides state and local governments with an alternative source of funding to address foreclosure blight.<sup>69</sup> State and local governments, nonprofit organizations, and "technical assistance providers"<sup>70</sup> have access to NSP funds as part of a comprehensive plan and collective effort to stabilize communities.<sup>71</sup> States and municipalities that received NSP funds

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[http://www.ci.minneapolis.mn.us/mayor/news/20080416newsmayor\\_minneapolisgetsforeclosurecourtorder.asp](http://www.ci.minneapolis.mn.us/mayor/news/20080416newsmayor_minneapolisgetsforeclosurecourtorder.asp).

66. See *supra* notes pp. 264-66 and notes 47-61.

67. Leinwand, *supra* note 38.

68. *Id.*

69. See U.S. Dept. of Housing and Urban Development, Homes and Communities, *Neighborhood Stabilization Program Grants* (2010), <http://hud.gov/offices/cpd/communitydevelopment/programs/neighborhoodspg/>, [hereinafter NSP Grants]. See also Johnson & Waldrep, *supra* note 11, at 208-12 (explaining the legislative background of NSP).

70. Those eligible for technical assistance grants include a state, a local government, a nonprofit organization that implements neighborhood stabilization or community development programs, a professional and technical organization that has knowledge of the NSP and Community Development Block Grants that will provide technical assistance services, or any organization including "educational services and area-wide planning organizations qualified to provide technical assistance to NSP grantees and others to carry out NSP programs." U.S. DEPT. OF HOUSING AND URBAN DEVELOPMENT, NOTICE OF FUNDING AVAILABILITY FOR 2009, Docket No. FR-5313-N-01, [http://www.hud.gov/offices/cpd/communitydevelopment/programs/neighborhoodspg/pdf/nsp\\_ta\\_nofa.pdf](http://www.hud.gov/offices/cpd/communitydevelopment/programs/neighborhoodspg/pdf/nsp_ta_nofa.pdf).

71. See NSP Grants, *supra* note 69.

have had some success mobilizing the community around efforts to mitigate the effects of foreclosures and abandoned properties,<sup>72</sup> but no further NSP funds will be awarded unless Congress authorizes additional funding.<sup>73</sup> Despite its shortcomings, the NSP should be part of a long-term federal effort aimed at rebuilding communities.

A. *Implementation of NSP Funds*

Beginning in September 2008, NSP-1 funds were allocated to state and local governments to address foreclosure blight.<sup>74</sup> In late 2009, NSP-2 and NSP-TA funding allocations commenced, allocating NSP-2 funds to state and local governments as well as non-profits and NSP-TA funds to technical assistance providers.<sup>75</sup> For example, the U.S. Department of Housing and Urban Development (HUD) allocated more than \$48.85 million<sup>76</sup> of NSP 1 funds to the State of North Carolina.<sup>77</sup> The Department of Community Assistance of North Carolina (DCA) distributed those funds to more than 20 local governments, non-profits and other organizations in early 2009.<sup>78</sup> The funding will be used in variety of ways. For example, the City of Charlotte will use its \$2.5 million grant to promote homeownership by providing down payment assistance and housing rehabilitation in neighborhoods substantially affected by foreclosures.<sup>79</sup> The Greensboro Housing

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72. See *supra* Part II.A.

73. U.S. Dept. of Housing and Urban Development, Homes and Communities, Neighborhood Stabilization Program Grants, Frequently Asked Questions (2008), [http://hud.gov/offices/cpd/communitydevelopment/programs/neighborhoodspg/pdf/ns\\_pfaq\\_all.pdf](http://hud.gov/offices/cpd/communitydevelopment/programs/neighborhoodspg/pdf/ns_pfaq_all.pdf).

74. NSP Grants, *supra* note 69.

75. NSP Grants, *supra* note 69.

76. The state received a total of \$52.1 million. Five percent of the funding was allocated to the North Carolina Department of Community Assistance to administer and monitor the program. Press Release, N.C. Dept. of Commerce, Neighborhood Stabilization Program (March 18, 2009), <http://www.nccommerce.com/en/CommunityServices/CommunityDevelopmentGrants/CommunityDevelopmentBlockGrants/Neighborhood+Stabilization+Program.htm>.

77. *Id.*

78. *Id.*

79. *Id.* Charlotte received an additional \$5.4 million directly from HUD. U.S. DEPT. OF HOUSING AND URBAN DEVELOPMENT, HOMES AND COMMUNITIES, STATE AND LOCAL NSP ALLOCATIONS (current as of August 27, 2009), *available at*

Authority, a non-profit organization, will use its \$2 million grant to purchase and rehabilitate thirty foreclosed properties to make them available as affordable rental housing.<sup>80</sup> North Carolina governments, however, did not receive any portion of the \$2 billion of NSP 2 funds in January 2010 because such funding was largely focused on those states hardest hit by the mortgage crisis, including California, Florida, and Michigan.<sup>81</sup> While it is too soon to declare the program a total success, officials have high hopes for the initiatives made possible through NSP funds.<sup>82</sup>

Municipalities also received direct NSP funding.<sup>83</sup> In January 2009, Mayor Michael Bloomberg and HUD Secretary Steve Preston announced that New York City received \$24 million of NSP 1 funding.<sup>84</sup> The City embarked on a collaborative effort, partnering with community organizations to combine NSP funds with private financing and to jointly administer rehabilitative

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<http://hud.gov/offices/cpd/communitydevelopment/programs/neighborhoodspg/statelinks.cfm>.

80. Press Release N.C. Dept. of Commerce, *supra* note 76.

81. *Durham's Rolling Hills/Southside Plans Continue Without Recovery Act Funding*, U.S. FED. NEWS, Jan. 16, 2010, available at 2010 WLNR 977846. A national non-profit organization, Community Builder's Inc. received an award of \$79 million to do work in Illinois, Massachusetts, North Carolina, New York, Ohio, Pennsylvania, Virginia, and the District of Columbia. Mary Moore, *The Community Builders Lands \$79m*, BOSTON BUS. J., Jan. 15, 2010, available at 2010 WLNR 920110. \$4.6 million of that award was designated for North Carolina. U.S. DEPT. OF HOUSING AND URBAN DEVELOPMENT, HOMES AND COMMUNITIES, NSP 2 AWARDS BY STATE, available at <http://hud.gov/offices/cpd/communitydevelopment/programs/neighborhoodspg/nsp2grantchart.pdf>.

82. See, e.g., Press Release 020-09, New York City Government, Mayor Bloomberg and HUD Secretary Preston Announce Federal Approval of \$24 Million for New York City to Purchase, Rehab and Resell Foreclosed Homes to Income-Targeted New Yorkers (Jan 14, 2009), available at [http://www.nyc.gov/portal/site/nycgov/menuitem.c0935b9a57bb4ef3daf2f1c701c789a0/index.jsp?pageID=mayor\\_press\\_release&catID=1194&doc\\_name=http%3A%2F%2Fwww.nyc.gov%2Fhtml%2F0m%2Fhtml%2F2009a%2Fpr020-09.html&cc=unused1978&rc=1194&ndi=1](http://www.nyc.gov/portal/site/nycgov/menuitem.c0935b9a57bb4ef3daf2f1c701c789a0/index.jsp?pageID=mayor_press_release&catID=1194&doc_name=http%3A%2F%2Fwww.nyc.gov%2Fhtml%2F0m%2Fhtml%2F2009a%2Fpr020-09.html&cc=unused1978&rc=1194&ndi=1) (announcing collaborative efforts to rehabilitate New York communities with NSP funds); Richard McIntire, *Baltimore Receives Millions in Recovery Act Grants and Energy Stimulus Funds*, EXAMINER, Jan. 22, 2009, <http://www.examiner.com/x-27945-Baltimore-City-Buzz-Examiner-y2010m1d22-Baltimore-receives-millions-in-Recovery-Act-grants-and-energy-stimulus-funds> (discussing award and use of NSP funds in Baltimore).

83. See *infra* pp. 269 and 271 and notes 84 and 95.

84. U.S. DEPT. OF HOUSING AND URBAN DEVELOPMENT, *supra* note 81. See generally Press Release 020-09, *supra* note 82 (announcing receipt of NSP funds, implementation of housing programs, and uses of funds).

programs.<sup>85</sup> In addition to the \$24 million of NSP funds, the City expected to raise \$32 million in private financing to repay lenders once rehabilitated homes are sold.<sup>86</sup> The Battery Park City Authority Housing Trust Fund gave \$6 million to the City to secure financing.<sup>87</sup>

The money will be allocated to areas of the City most affected by foreclosures.<sup>88</sup> The City hopes to renovate 115 buildings and provide 250 to 300 families with homes.<sup>89</sup> NSP funds will also augment the Mayor's New Housing Marketplace Plan, a ten-year plan to create affordable housing units in the city.<sup>90</sup> In January 2010, the City received more than \$20 million in additional NSP 2 funds.<sup>91</sup>

New York City's Department of Housing Preservation and Development, the Center for NYC Neighborhoods, and Restored Homes will jointly administer the City's NSP funds.<sup>92</sup> The National Community Stabilization Trust will help to identify bank-owned properties that failed to sell at foreclosure auctions to determine if they should be purchased with NSP funds.<sup>93</sup> New York City's program exemplifies some of the potential strengths of this federally funded program because it puts local governments in control.<sup>94</sup> Local governments are more capable of effectively responding to foreclosures on a city-specific or even a

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85. Press Release 020-09, *supra* note 82.

86. Press Release 020-09, *supra* note 82.

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.* For more information on Bloomberg's ten-year plan, see THE CITY OF N.Y., THE NEW HOUSING MARKETPLACE, available at <http://www.nyc.gov/html/hpd/downloads/pdf/10yearHMplan.pdf>.

91. Press Release 019-10, Mayor Bloomberg Announces New York City To Receive More Than \$20 Million in Stimulus Funds from U.S. Department of Housing And Urban Development For Neighborhood Stabilization (Jan. 14, 2010), available at [http://www.nyc.gov/portal/site/nycgov/menuitem.c0935b9a57bb4ef3daf2f1c701c789a0/index.jsp?pageID=mayor\\_press\\_release&catID=1194&doc\\_name=http%3A%2F%2Fwww.nyc.gov%2Fhtml%2Fom%2Fhtml%2F2010a%2Fpr019-10.html&cc=used1978&rc=1194&ndi=1](http://www.nyc.gov/portal/site/nycgov/menuitem.c0935b9a57bb4ef3daf2f1c701c789a0/index.jsp?pageID=mayor_press_release&catID=1194&doc_name=http%3A%2F%2Fwww.nyc.gov%2Fhtml%2Fom%2Fhtml%2F2010a%2Fpr019-10.html&cc=used1978&rc=1194&ndi=1).

92. Press Release 020-09, *supra* note 82.

93. *Id.*

94. See generally KINGSLEY ET AL., *supra* note 2, at 23-24 (suggesting that local governments that focus on the foreclosure blight on a local level will be more successful in addressing problems created by the mortgage crisis).

neighborhood-specific level than state government officials because state officials “are too far removed from the local scene.”<sup>95</sup> Prior to HUD’s allocation of NSP 1 funds, critics suggested that state and local governments were ill-suited to use funds effectively.<sup>96</sup> The American Recovery and Reinvestment Act of 2009,<sup>97</sup> however, may have addressed concerns about effective use of funds because it implemented a competitive bidding process for NSP 2 where awards were based in part on “project quality.”<sup>98</sup> Furthermore, organizing a community-wide initiative to address foreclosure blight, partially funded by the NSP, gives local governments the ability to address these problems efficiently and comprehensively.<sup>99</sup>

#### B. *Limitations of NSP*

While the NSP could potentially provide significant assistance to cities facing substantial foreclosure blight, the program’s prospects for success are limited by the funding previously allocated to the program.<sup>100</sup> By fall 2008, there were approximately 1.35 million foreclosed homes nationwide.<sup>101</sup> Assuming the median price of a home is \$200,000, the program could only fund the purchase of 30,000 foreclosed homes, or two percent of the total, given the \$5.9 billion allocated in NSP 1 and

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95. *Id.* at 24.

96. ALAN MALLACH, THE BROOKINGS INSTITUTION, STABILIZING COMMUNITIES: A FEDERAL RESPONSE TO THE SECONDARY IMPACTS OF THE FORECLOSURE CRISIS 21 (2009), [http://www.brookings.edu/~media/Files/rc/reports/2009/02\\_foreclosure\\_crisis\\_mallach/02\\_foreclosure\\_crisis\\_mallach\\_report.pdf](http://www.brookings.edu/~media/Files/rc/reports/2009/02_foreclosure_crisis_mallach/02_foreclosure_crisis_mallach_report.pdf).

97. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-005, 123 Stat. 217 (2009). See Johnson & Waldrep, *supra* note 11, at 208-12 (explaining background on American Recovery and Reinvestment Act of 2009).

98. EUGENE BOYD & OSCAR R. GONZALES, CONGRESSIONAL RESEARCH SERVICE, COMMUNITY DEVELOPMENT BLOCK GRANTS: NEIGHBORHOOD STABILIZATION PROGRAM; ASSISTANCE TO COMMUNITIES AFFECTED BY FORECLOSURES 8 (Mar. 13, 2009).

99. KINGSLEY ET AL., *supra* note 2, at 23.

100. Robbie Whelan, *Lull in Baltimore-Towson Metropolitan Area Foreclosures May be Temporary*, THE DAILY RECORD (Baltimore), Jul 31, 2009, available at 2009 WLNR 15013187.

101. BOYD & GONZALES, *supra* note 98, at 11.



NSP 2.<sup>102</sup> Funding must also be provided to rehabilitate purchased homes.<sup>103</sup>

While cities and states can provide extra funding, the NSP program is still insufficient to fully address the effects of the mortgage crisis.<sup>104</sup> The program is a short-term solution to a long-term problem.<sup>105</sup> Baltimore, for example, received only \$4.1 million in funding from NSP 1<sup>106</sup> and no funding, despite its application, from NSP 2.<sup>107</sup> The NSP funds will hopefully enable Baltimore to accomplish the first phase of its neighborhood stabilization project: purchasing, rehabilitating, and selling eighty-eight foreclosed homes in eleven stable, middle-class neighborhoods that are at risk of declining property values due to foreclosures.<sup>108</sup> Following the rehabilitation process, the city planned to sell abandoned or foreclosed homes that have been vacant for fewer than 200 days to low and moderate income buyers and non-profit organizations.<sup>109</sup> But because the city's application for \$5 million of NSP 2 funds was rejected,<sup>110</sup> it seems unlikely that Baltimore will be able to complete its planned projects. While Baltimore's need for government funding is less significant than

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102. *Id.*

103. *Id.*

104. Robbie Whelan, *Baltimore to Spend \$4.1M in Federal Money to Fight Foreclosures*, THE DAILY RECORD (Baltimore), Apr 9, 2009, available at 2009 WLNR 8149875.

105. See Enterprise Community Partners, Inc., *Comprehensive Foreclosure Prevention and Stabilization Approaches: Connecting the Homeownership Affordability Stability Plan to the Neighborhood Stabilization Program*, Mar. 4, 2009, [http://www.enterprisecommunity.org/public\\_policy/foreclosure\\_prevention/document/s/cfpa\\_paper.pdf](http://www.enterprisecommunity.org/public_policy/foreclosure_prevention/document/s/cfpa_paper.pdf) (stating that foreclosure problems are so significant that even with the help of NSP funds, local communities are ill-equipped to appropriately address the issue); Alan Berube & Allan Mallach, *Foreclosure and Stimulus: What's at Stake for America's Neighborhoods*, BROOKINGS, Feb. 9, 2009, [http://www.brookings.edu/opinions/2009/0209\\_stimulus\\_berube.aspx](http://www.brookings.edu/opinions/2009/0209_stimulus_berube.aspx) (suggesting that NSP funds needed to be enlarged to provide significant assistance to local governments and communities).

106. Whelan, *Baltimore to Spend \$4.1M in Federal Money to Fight Foreclosures*, *supra* note 104.

107. U.S. DEPT. OF HOUSING AND URBAN DEVELOPMENT, *supra* note 79.

108. Whelan, *Baltimore to Spend \$4.1M in Federal Money to Fight Foreclosures*, *supra* note 104. Baltimore will have \$46,500 in NSP funds per property. *Id.*

109. *Id.*

110. Whelan, *Lull in Baltimore-Towson Metropolitan Area Foreclosures May be Temporary*, *supra* note 100; U.S. DEPT. OF HOUSING AND URBAN DEVELOPMENT, *supra* note 79.

other large cities,<sup>111</sup> \$4.1 million is still insufficient to accomplish the city's goals with respect to its foreclosure problem.<sup>112</sup> A New York real estate attorney remarked that the funding "is a drop in the bucket . . . [n]ationwide, the numbers are so astronomical that there's no way to stabilize any area with the amount of funds that are being offered."<sup>113</sup>

NSP's success may also be somewhat hindered because HUD, which oversees the program, is overburdened in its administrative capacity.<sup>114</sup> HUD oversees both NSP 1 and NSP 2 in addition to the standard Community Development Block Grant program and disaster recovery grants.<sup>115</sup> Furthermore, HUD may only use \$10 million, or one percent of NSP 2 funds, to supervise the program.<sup>116</sup>

Finally, the required distribution and use schedules for NSP funds, as prescribed by the Housing and Economic Recovery Act of 2008,<sup>117</sup> have been criticized as overly ambitious and "hasty."<sup>118</sup> For example, all NSP allocations had to be distributed by the first quarter of 2009.<sup>119</sup> Once distributed, the recipients have only eighteen months to make use of the funds.<sup>120</sup> Thus, some experts are doubtful that many local governments will have enough time to draft economical and efficient community stabilization plans.<sup>121</sup>

#### IV. CONCLUSION

Litigation aimed at recovering maintenance costs and lost tax revenue is an indirect and inefficient way to address foreclosure blight. The NSP provided communities with a

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111. Whelan, *Baltimore to Spend \$4.1M in Federal Money to Fight Foreclosures*, *supra* note 104 (quoting Baltimore Housing Commissioner Paul T. Graziano).

112. *Id.*

113. *Id.* Edward Mermelstein works with lenders on foreclosure matters. *Id.*

114. Boyd & Gonzales, *supra* note 98, at 11.

115. *Id.*

116. *Id.* at 8.

117. Housing and Economic Recovery Act of 2008, Pub. L. No. 111-005, 123 Stat. 217 (2009). *See also* Johnson & Waldrep, *supra* note 11, at 208-12 (explaining background on Housing and Economic Recovery Act of 2008).

118. KINGSLEY ET AL., *supra* note 2, at 36.

119. *Id.*

120. *Id.*

121. *See generally id.* ("[G]iven the haste with which funds must be spent, there are doubts that many jurisdictions will be able to spend them wisely.").

comprehensive and more efficient alternative to litigation. Nevertheless, because it is too soon to speculate about the overall success of NSP plans, and given the shortcomings of the existing government program, it may be premature to advocate for further funding of the NSP in its current form. Neighborhood stabilization should be a long term goal, and, therefore, hasty short-term capital injections are insufficient to address the problem. Congress should authorize recurring funding to the NSP but only after amending the requirements for awarding and using funds.

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