Testimony before the House Financial Services Committee Subcommittee on Housing and Community Opportunity regarding

"The Impact of the Foreclosure Crisis on Public and Affordable Housing in the Twin Cities"

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Madame Chairwoman and Members of the Subcommittee, the Housing Preservation Project thanks you for inviting us to testify today regarding the impact of the foreclosure crisis on public and affordable housing in the Twin Cities, specifically, how the foreclosure crisis is adversely affecting the affordable rental market. The Housing Preservation Project is a non-profit, public interest law firm. Our primary mission is to employ legal and advocacy strategies to preserve and expand affordable housing for low income individuals and families.

In 2007, it was clear that foreclosures and the growing economic crisis were destabilizing neighborhoods. It was also having a disproportionate impact on persons of color, displacing both homeowners and renters. With a grant from the Family Housing Fund, we started a program specifically focused on foreclosures---the Foreclosure Relief Law Project. Over the past three years we have brought innovative lawsuits on behalf of individuals and neighborhoods negatively impacted by predatory lending and foreclosures. In 2008, the Foreclosure Relief Law Project worked with the Family Housing Fund, HOME Line and other non-profit legal service providers to bolster legal assistance for renters and strengthen laws protecting renters living in foreclosed properties. The Housing Preservation Project is also active in leveraging affordable housing opportunities along planned transit corridors, and works throughout the country to retain affordable housing and ensure that it is safe and habitable.

Because we are one of the few legal organizations that are active in both foreclosure prevention and in protecting affordable rental housing, we have a unique perspective on these issues. This testimony will share some of our own research and findings related to the nature of the problem, and then make suggestions for useful reforms.

The bottom-line is this---our recovery efforts should not simply be a band-aid, our recovery efforts need to strengthen communities and make our communities less susceptible to future economic exploitation. People are out there right now trying to figure out new ways to drain money from vulnerable people and vulnerable communities. But, we have an unprecedented opportunity to break a cycle of this ever-evolving exploitation. We can use our recovery efforts to expand long-term, quality, affordable housing and integrate communities. By bringing new properties into federal housing programs, we ensure that there are standards and oversight.

THE FORECLOSURE CRISIS AND RENTERS

Although significant media coverage did not begin until 2007, the foreclosure crisis had been going on for years.[1] In certain neighborhoods of Minneapolis and Saint Paul, the number of foreclosures began to exceed normal rates in 2003. By 2006, the foreclosure rate had spiked even higher. For example, in 2006, the foreclosure rate in north Minneapolis was six times higher than the foreclosure rate for Hennepin County, and the Hennepin County foreclosure rate was three times higher than what it was in 2003.[2]

The initial programs designed to stop foreclosures and mitigate the effects of foreclosure were targeted at homeowners. Nobody wanted to reward real estate speculators or lenders that enabled and profited from this speculation.[3] This policy decision, however, had the unintended consequence of creating a significant gap in foreclosure relief efforts. Renters, arguably the most innocent party impacted by a foreclosure, had few legal rights and there was little, if any, funding to help defray unanticipated moving costs, deal with utility shut-offs, or recover lost security deposits. Because many renters were personally served with the foreclosure papers, many renters also misunderstood their rights. It was common for a renter to immediately move, even though they had the right to remain in the property during the six month redemption period. Other renters believed that they could stop paying rent, which created the potential for an eviction.

A study recently released by the University of Minnesota found that non-homesteaded (rental) property comprised 61% of all foreclosures that occurred in North Minneapolis in 2006-2007.[4] A similar proportion of foreclosures in Saint Paul, during this time period, were also non-homesteaded (rental) property. The University of Minnesota study also found that a very high percentage of these properties had children that were attending Minneapolis public schools.[5]

An even harder situation to quantify and analyze are the rental properties that were part of a larger mortgage fraud scheme. When a property is part of a mortgage fraud scheme, the adverse affect on the renters and the risk that the property itself will deteriorate becomes even greater. For example, in Minneapolis, a Hennepin County District Court identified 141 rental properties that were part of an alleged mortgage fraud ring perpetrated by TJ Waconia.[6] Some of these

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[1] For example, in 2006 there were just 57 articles in the *New York Times* that included the word "foreclosure." In 2007, there were 274, and in 2008, there were 665 articles that included the word "foreclosure."

[2] Mark Ireland, *Bending Toward Justice: An Empirical Study of Foreclosures in One Neighborhood Three Years after Impact and a Proposed Framework for a Better Community* (October 22, 2009). Available at SSRN: http://ssrn.com/abstract=1492777

[3] *See e.g.* House Committee of Financial Services, *House Passes American Housing Rescue and Foreclosure Prevention Act*, Press Release (May 8, 2008) ("Only primary residences are eligible: NO speculators, investment properties, second or third homes will be refinanced."); United States Dept. of the Treasury, *Relief for Responsible Homeowners One Step Closer Under New Treasury Guidelines: Updated Fact Sheet*, Press Release (March 4, 2009) ("[W]hile attempting to prevent the destructive impact of the housing crisis on families and communities. It will not provide money to speculators, and it will target support to the working homeowners…")
")http://treas.gov/press/releases/reports/housing_fact_sheet.pdf

[4] *Id.*

[5] *Id.*

[6] Steve Brandt, *Minneapolis Takes Charge of T.J. Waconia homes in fraud case*, Star Tribune April 16, 2008.

properties were occupied, but not being maintained, while others were vacant, unsecured, and creating neighborhood blight and attracting illegal activity.[7]

AFTER THE FORECLOSURE SHERIFF'S SALE

After the foreclosure sheriff's sale, there continues to be an adverse affect on renters and the surrounding neighborhood. The Housing Preservation Project studied a sample of one hundred foreclosed properties in Minneapolis, which were foreclosed upon in 2006. We found that there was a significant delay from the date of the foreclosure Sheriff's Sale to the date that the property was transferred from the lender to a new owner.[8] The median time was 484 days.[9] Even when the redemption period is taken into account, it still took ten months for a property to be sold. During this time, the property is presumably sitting vacant, unused, and often becomes a magnet for crime. We found that 83% of the foreclosed properties in our sample had 911 calls post-Sheriff's Sale.[10] The average number of 911 calls was eight, while the median was five calls per property.[11]

The standard, traditional practice of lenders is to evict the renters of foreclosed properties as soon as possible. Most lenders say that they are not in the "business of managing rental property." They do not have the procedures and staff available to maintain rental property nor do they have the procedures to collect rent. Lenders also state that it is more difficult and expensive to sell occupied property. And so, rather than create and maintain a stream of revenue, lenders force the renters to move and eventually sell the properties at a discount. Based upon our sample, the difference between the amount that a lender purchased a property for at the Sheriff's Sale auction (typically the amount owed on the mortgage loan) and the later sale price was usually a loss of $65,039 (average) or $77,424 (median).[12] As a percentage, the lender sold the properties for a median loss of 49%.[13]

REAL ESTATE SPECULATORS AND RENTERS

Of course there is nothing inherently bad about people who invest in real estate and responsibly rent these properties. Being a responsible landlord, however, requires knowledge of federal, state and local laws; capital to maintain the property and ensure that it is in code compliance; and time to respond to both tenant and community questions or concerns. The problems arise when people invest in real estate to turn a quick and easy profit. That profit always comes at the expense of the renters and the neighborhood.

For example, some cities have experienced out-of-state real estate speculators purchase foreclosed properties for small amounts of money, and then sell them to other real estate

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[7] *Id.*
[8] Mark Ireland, *Bending Toward Justice: An Empirical Study of Foreclosures in One Neighborhood Three Years after Impact and a Proposed Framework for a Better Community* (October 22, 2009). Available at SSRN: http://ssrn.com/abstract=1492777
[9] *Id.*
[10] *Id.*
[11] *Id.*
[12] *Id.*
[13] *Id.*

speculators for a small profit.[14] None of the buyers are interested in fixing the property, selling it, or renting it. Thus, the speculators are not only allowing a property to deteriorate, the speculators are also keeping an affordable rental property off the market.

On Tuesday, about fifty properties were posted on ebay. The properties were primarily located in hard-hit urban areas like Detroit, Michigan and Cleveland, Ohio. One property, a three bedroom and one bath house in Cleveland, had eight bids on Tuesday. The "current bid" was $560. Luckily, we are unaware of any foreclosed properties in the Twin Cities that have been sold on ebay in this manner. But, we have found a significant increase in the number of unlicensed rental properties as well as rental properties that are not in compliance with local housing codes and safety requirements.

THE NEED FOR FEDERAL HELP

Public safety, health, and welfare have traditionally been state and local issues. We just provided information that may initially appear to be beyond the scope of the federal government. For example, code compliance, policing nuisance properties, and regulating landlords are traditionally local matters. The foreclosure crisis and broader economic crisis, however, is national in scope. The federal government can help mitigate the local, negative impacts of the foreclosure crisis both directly and indirectly.

With regard to renters and providing opportunities for quality, affordable housing, now is the time to expand tax credits, public voucher programs, and create a funding mechanism to provide financing to non-profit community development corporations. There are five reasons to act now. First, it is smart financial investment. We have an opportunity to acquire properties at historically low prices and add them to a permanent affordable housing supply. Both single family homes and multifamily properties should be targeted for acquisition by nonprofit or public agencies. This opportunity will be missed, if we wait and the economy fully recovers and values rise. Right now we can maximize our investment.

Second, expanding federal rental programs and financing responsible buyers will improve the quality of life for renters and ensure that they are living in safe, quality housing. Providing a pathway to homeownership is important, of course, but owning a home is not right for everybody. There is also not significant demand for homes in highly impacted areas. This means that, if foreclosed properties in high impact areas are occupied, they are likely going to be occupied by renters. The only question will be whether the owners are committed to providing quality rental housing or are simply speculators. Getting as many of these properties as possible into the hands of publicly minded responsible owners, such as through the NSP program, is critical. Federal programs have quality and safety requirements that will provide another layer of oversight. Federal requirements help ensure the quality of the housing as well as its availability.

Third, we have the opportunity to address racial segregation and economic isolation. When expanding federal housing programs, we can target our investments. We now have an opportunity to create affordable housing in areas that are near good schools and jobs. We also

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[14] *See* John Kroll, *ebay auctions become flippers' tools*, Cleveland Plain Dealer (September 5, 2008) http://blog.cleveland.com/metro/2008/09/ebay_auctions_become_house_fli.html

have an opportunity to purchase properties near planned mass transit corridors. We have access to these properties now, but it will likely be financially infeasible in the future when the housing market recovers.

Fourth, we need the federal government to help finance or subsidize scattered site rental programs. There is wariness about taking on the challenge of scattered site rental. A number of local non-profit organizations have had past experience in managing scattered site programs, and found them to be logistically challenging and expensive to manage. They need support to ensure the program is sustainable and properly run.

The federal government can also encourage our local public housing authorities to use their experience. Many larger public housing authorities have operated scattered site public housing rental programs successfully for years; locally that is the case with both the Minneapolis Public Housing Authority and the St. Paul Public Housing Agency. In some cases, these PHAs have disposed of public housing units in the past, but remain eligible to access ongoing operating subsidies from those lost units, if new public housing units could be created.

Acquiring “bargain” properties in foreclosure could be a way to create new public housing units, access that stream of unused federal subsidies, and stabilize neighborhoods through quality ownership and management. A PHA could create public housing units in this way, and then combine them into a “mixed income” scattered site program in which the non-public housing units are rented at rent levels sufficient to cover operating expenses without further subsidy. To make this work, there needs to be some recognition that management of scattered sites are more costly, and that PHAs may need additional flexibility to make this approach feasible.

Finally, Congress should allow more flexibility in using Neighborhood Stabilization Program funds. Although there are common challenges facing every city that has been hard hit by foreclosures, needs often vary. As described above, there are many opportunities to expand affordable housing and help the quality of life for renters. Some experts have suggested that the financial woes plaguing the single family home ownership market may move in the future to also adversely affect commercial real estate, including many multifamily properties. If that’s the case, we can expect to see more apartment properties experience financial distress and move toward foreclosure. This is an opportunity for public-minded purchasers---similar to what we have seen with single family homes. Systems need to be created so that affordable housing providers can track such opportunities and take advantage of the chance to acquire these properties inexpensively and then operate them as permanent long term affordable housing.