

Testimony of

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**Before the Subcommittee on Domestic Policy of the
House Committee on Oversight and Government Reform**

**Hearing on Targeting Federal Aid to Neighborhoods Distressed by the
Subprime Mortgage Crisis**

Thursday, May 22, 2008

Chairman Kucinich, Representative Issa, Members of the Subcommittee, it is my pleasure and honor to be invited to meet with you this afternoon to discuss the best strategies for providing assistance to local governments as they confront the consequences of the dramatic rise in residential mortgages over the past eighteen months. In the hearing held yesterday afternoon you heard testimony from some of the foremost experts in the country who are dealing with the adverse consequences of vacant and abandoned properties. Drawn from a broad range of public leadership, not-for-profit organizations, and private sector developers, these key individuals spoke succinctly and forcefully in one voice. Their message was clear: once foreclosures have occurred the costs of vacant houses are borne by the adjoining property owners, the neighbors down the street, the surrounding community, the schools and the local governments. As Alan Mallach observed, “vacant property is not a victimless crime”.

The focus of today’s hearing, and the related pending legislation, is not on the causes of the recent “crisis” in residential mortgage foreclosures, or on the important steps that need to be undertaken to avoid the recurrence of such problems in the future. Similarly, today’s hearing does not focus on the plight of those individuals and families who are facing an impending foreclosure and the loss of their homes. These are each incredibly vital issues that deserve and require a strong federal response, and I am pleased that Congress is working hard to fashion appropriate legislation.¹

Instead, these two days of hearings before the Domestic Policy Subcommittee focus on the key strategic decision to recognize the tremendous costs borne by neighborhoods, communities and cities as a result of large volumes of foreclosed homes becoming vacant and abandoned, and the methods of directing appropriate financial

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¹ American Housing Rescue and Foreclosure Prevention Act of 2008, H.R. 3221, as passed the House of Representatives May 8, 2008.

resources to mitigate these costs. The precise focus is the legislation passed by the House of Representatives two weeks ago, the Neighborhood Stabilization Act of 2008.² Because much work remains to be done by both the Senate and the House of Representatives before these bills become law, it is indeed appropriate to make sure that federal financial assistance is targeted in the most effective manner.

The Challenge of Vacant and Abandoned Properties

Not all foreclosed homes become vacant, and not all vacant properties become abandoned. In the presence of weak housing markets and depressed economic conditions, however, the rate at which homes sit vacant for many months post-foreclosure increases, and the higher the prevalence of vacancy the greater the incidence of abandonment. When real estate foreclosures are coupled with mortgage fraud, bankruptcy, and extended litigation, the time period for vacancy is only extended further. Crucial to the current crises is the fact that while a neighborhood may be able to remain relatively unaffected by a single residential foreclosure or a limited number of homes remaining on the “For Sale” market for several months, when the number of such home reaches a certain “tipping point” there is a rapid de-escalation in real estate values. The declining market creates a downward spiral as fewer investors can purchase or are willing to purchase in neighborhoods perceived as weak, existing homeowners can no longer refinance as their equity positions evaporate, and vacant properties not only lack all routine maintenance but become easy targets of vandalism and crime.

Vacant and abandoned properties quickly become liabilities to the surrounding community. When owners chose to ignore their responsibilities, the costs of these properties are imposed on everyone else. The external costs of vacant and abandoned properties occur across a number of categories:³

- Declining property values of adjacent properties
- Declining property tax revenues from nonpayment of taxes
- Declining property tax revenues from declining property values of adjacent properties
- Increased costs of police and public safety surveillance and responses
- Increased incidence of arson and fire prevention
- Increased costs of local government code enforcement activities
- Increased costs of judicial actions

² Neighborhood Stabilization Act of 2008, H.R. 5818, as passed the House of Representatives on May 8, 2008.

³ William C. Apgar & Mark Duda, COLLATERAL DAMAGE: THE MUNICIPAL IMPACT OF TODAY’S MORTGAGE FORECLOSURE BOOM (Homeownership Preservation Foundation, May 11, 2005).

In addition to these objective and empirical costs, vacant and abandoned properties result in a broad range of intangible costs to the community:

- Decline in neighborhood confidence and social cohesion
- Instability in school age populations and weakening of public school resources
- Loss of incentives to invest and maintain existing occupied properties
- Fear of social engagement

Over the past decade the National Vacant Properties Campaign of Smart Growth America⁴ has focused on a broad range of strategies to address these external costs imposed on the larger community by the present of vacant and abandoned properties. With technical assistance of the Campaign, new local ordinances have been adopted in Indianapolis, Little Rock, Flint, Baltimore, Atlanta, Buffalo, Columbus, Cleveland, New Orleans and a host of other cities. These strategies include reform of property tax foreclosure laws,⁵ creation of vacant properties registration ordinances, and enhanced procedures for code enforcement and receivership actions. All of these strategies share a common conviction that vacant and abandoned properties are liabilities which could and should become productive assets for the community at large.⁶

One of the strategic options which has been most successful in addressing large concentrated volumes of vacant and abandoned properties is the creation of land bank authorities.⁷ Land banking is a recent concept in historical terms. First proposed as a new form of urban land planning in the 1960s, it began to take root in the experience of a handful of metropolitan communities in the last twenty years. As with most new approaches to land use and land planning, some of these recent efforts have been more successful than others, but they all share a common characteristic: the possibility of a new approach for federal, state and local policies in addressing market inefficiencies and building inclusive and sustainable communities for the future.

Land banks as originally proposed were intended to be public entities that would engage in early and significant land acquisition in anticipation of urban growth and urban and suburban sprawl. Conceived of as a flexible tool to mitigate the static nature of exclusionary zoning and to provide for an inventory of land to meet future strategic public needs, the early proposals for a federal state partnership did not move forward.

⁴ www.vacantproperties.org.

⁵ See, e.g., Ga. Code Ann. § 48-4-75 et. seq.; Mich. Con. L. Ann. 211.78 et. seq. (1999 Public Act 123).

⁶ Frank S. Alexander, RENEWING PUBLIC ASSETS FOR COMMUNITY DEVELOPMENT (Local Initiatives Support Corporation, 2000).

⁷ Frank S. Alexander, LAND BANK AUTHORITIES: A GUIDE FOR THE CREATION AND OPERATION OF LOCAL LAND BANK (2005). Frank S. Alexander, *Land Bank Strategies for Renewing Urban Land*, 14 J. Aff. Housing 140 (2005).

Instead, during the last quarter of the twentieth century five metropolitan areas – St. Louis, Cleveland, Louisville, Atlanta and Flint – moved forward with the creation of their own land banks. These five land banks (and now another dozen smaller and newer land banks) share a common dominant focus on the acquisition and conversion of abandoned tax delinquent properties into new productive use. Each of these five land banks has also been able to learn from, and build upon, the experiences of its predecessors with the result that each land bank has become successively broader, stronger, and more productive.⁸

As land banks continue to evolve as flexible intergovernmental public authorities they are today the best potential models for addressing the sudden increase in the number of vacant and abandoned properties resulting from the mortgage foreclosure crisis. Land banks can reclaim the original vision as tools of urban planning; they can become managers of market distortions which create sudden excess supply of properties; they can serve as true “banks” in moderating real estate liquidity and capitalization.

The Current Federal Legislative Initiative – H.R. 5818

The primary thrust of the proposed legislation, the Neighborhood Stabilization Act of 2008, is directed precisely towards the problems imposed on our communities by vacant and abandoned properties. This bill specifically identifies its purpose as to “preserve the equity and ensure the safety of the neighbors of homes made vacant by the predatory lending and foreclosure crises, [and] to prevent and reduce the incidence of such vacancies through various means, including purchasing and rehabilitating owner-vacated, foreclosed homes with the goal of stabilizing and occupying them as soon as possible.”⁹

The Allocation Formula -- Eligible Recipients and Funding

This legislation would authorize \$7.5 billion in federal grants, and \$7.5 billion in loans to achieve the goals of the legislation.¹⁰ The funds would be made available to “qualified” states and local governments that submit a plan that is approved by the Secretary of Housing & Urban Development.¹¹ Cities that can qualify for mandatory allocations are those jurisdictions that among the nation’s 100 largest cities or have a population of at least 50,000 and have a foreclosure rate in excess of 125 percent of the

⁸ Nigel G. Griswold, *The Impacts of Tax-Foreclosed Properties and Land Bank Programs on Residential Housing Values in Flint, Michigan* (Masters Thesis, Michigan State University, 2006).
http://www.aec.msu.edu/theses/fulltext/griswold_ms.pdf.

⁹ Sec. 2(1), H.R. 5818 (EH).

¹⁰ Sec. 14, H.R. 5818 (EH).

¹¹ Sec. 4, H.R. 5818 (EH).

national average.¹² Counties that are eligible for mandatory allocations are limited to the fifty most populous urban counties (exclusive of qualified cities).¹³ The grant amounts may be utilized by the state or local government recipients, by any unit of local government or local government entity, or by a nonprofit organization.¹⁴

The legislation provides that the aggregate appropriation is to be divided among the states based upon their respective percentage of (i) the national foreclosures (during the prior four calendar quarters) of mortgages on single family housing and (ii) of subprime mortgages on single family housing that are over 90 days delinquent.¹⁵ The state allocations are adjusted to reflect variations from the median price of single family housing.¹⁶ The primary effect of this allocation is to provide greatest funding to those states with higher than average residential foreclosures during the past two years. Pass-through allocations must be made by the states to qualified cities and urban counties based upon their respective percentages of the state's foreclosures, also adjusted for variations in median home sale prices.¹⁷

The loans are to be made by a governmental entity with a three year term for homeownership transfers, and five years for rental housing.¹⁸ All loans are interest free, non-amortizing, and non-recourse loans. The loan authority is subject to a 4 year sunset provision from the date of enactment.¹⁹

A feature of the pending legislation that is not found in any other federal legislation is a provision that requires that any transferee of qualified foreclosed housing must agree to repay to the federal government twenty percent of the increase in value of the property upon resale.²⁰

The Allocation Formula – Priority of Uses

The dominant use of the loan funds authorized by the legislation is likely to be the acquisition of “Qualified Foreclosed Housing”. Qualified Foreclosed Housing consists of single family or multifamily housing that is not presently occupied by an owner, that is

¹² Section 13(8)(A), H.R. 5818 (EH). Presumably the reference to an “improved plan” on line 3, page 36 of this bill is a typographical error, and the text should read “approved plan”.

¹³ Sec. 13(10), H.R. 5818 (EH).

¹⁴ Sec. 7, H.R. 5818 (EH).

¹⁵ Sec. 5(d), H.R. 5818 (EH).

¹⁶ Sec. 5(c), H.R. 5818 (EH).

¹⁷ Sections 5(f), 5(g), H.R. 5818 (EH).

¹⁸ Sec. 6(d), H.R. 5818 (EH).

¹⁹ Sec. 6(g), H.R. 5818 (EH).

²⁰ Sec. 9, H.R. 5818 (EH). The appreciation recapture amount is fifty percent in the case of for-profit owners.

owned by an entity pursuant to a foreclosure, and that has a purchase price that does not exceed the lesser of 110 percent of the average sales price or the current fair market value.²¹ Such Qualified Foreclosed Housing can be used either for homeownership transfers or the creation of rental housing.²² Both loan funds and grant funds can be utilized for housing rehabilitation.²³

The grant funds made available under this legislation are designed to cover operating and holding costs related to acquisition of qualified foreclosed properties, administration costs and planning costs.²⁴

The legislation specifies that the first priority for the use of funds shall be for rehabilitating housing, and for providing housing to members of the Armed Forces, school teachers, and emergency responders.²⁵ The legislation also establishes a mandatory minimum that not less than fifty percent of all grant funds must be utilized to provide housing for families at or below fifty percent of area median income.²⁶ More generalized priorities are for the use of funding for the purchase or occupancy of properties that will facilitate the repayment of loans made under the Act,²⁷ for activities that serve the lowest income families for the longest period, and homeowners (who meet income requirements) whose mortgages has been foreclosed.²⁸

The Allocation Formula – Priority of Target Areas

The plans that must be submitted to and approved by the Secretary must identify targeted geographic areas for use of these federal funds. Generally the highest priority geographic areas are to be low-income and moderate income neighborhoods with high concentrations of vacancies, according to census tracts, as measured by vacancy rate

²¹ Sec. 13(7), H.E. 5818 (EH).

²² Sec. 8(a). Homeownership transfers are limited to families with incomes at or below 140 percent of area media income, and rental housing must be made available to families with incomes at or below 100 percent of area median income.

²³ Sections 8(a)(3), 8(b)(5), H.R. 5818 (EH).

²⁴ Sec. 8(b), H.R. 5818 (EH).

²⁵ Sec. 4(b)(8), H.R. 5818 (EH). The grammatical structure of this section creates an ambiguity as to whether “rehabilitating housing” is a separate priority, or whether it is a single priority of rehabilitating housing for the categories of military personnel and others.

²⁶ Sec. 8(d)(1), H.R. 5818 (EH). Of this fifty percent amount, at least fifty percent (or twenty five percent of the aggregate grant funds), must be targeted to families with incomes at or below thirty percent of area median income. Sec. 8(d)(2).

²⁷ Sec. 4(b)(3), H.R. 5818 (EH).

²⁸ Sec. 4(b)(9), H.R. 5818 (EH). A key element of this allocation formula is that it is based upon mortgages on single family housing, and not multifamily housing and excludes all non residential mortgage foreclosures. Multifamily housing (consisting of 64 or few units) can, however, qualified as “qualified foreclosed housing” for acquisition using grant funds. Sec. 13(7)(A)(ii).

increases over the past two years.²⁹ Priority is also to be given to the areas with the greatest needs, defined according to the greatest percentage of home foreclosures, highest percentage of homes financed by subprime mortgages over 90 days delinquent, or identified as likely to face a significant rise in the rate of home foreclosures.³⁰

Points for Further Consideration

If this legislation is enacted by Congress and the funds appropriated, this federal action would be a significant and dramatic step towards achieving neighborhood stabilization in the face of the current mortgage foreclosure crisis. As the legislation continues to be debated and modified in the House of Representatives, or in the Senate, however, I encourage further review and consideration of some key points.

The Allocation Formula – Eligible Recipients and Funding. The federal financial assistance is distributed across the states based upon their respective percentage of national foreclosures over the past two years and 90 day delinquencies on subprime mortgages. No definition is provided (and it is not clear that discretion is left to the Secretary) with respect to what constitutes a “foreclosure”. Many of the current statistics that are available count foreclosure filings (in judicial foreclosure states), or foreclosure advertisements (in non-judicial foreclosure states), but these numbers do not bear any given correlation to the number of foreclosures that actually result in a foreclosure sale or transfer of the property. A more accurate unit of measure, if it is available, would be the aggregate number of foreclosure sale transfers and deeds in lieu of foreclosure. Similarly, the legislation does not offer a definition of “subprime” for purposes of calculating the 90 day delinquencies or a method of integrating the two variables of foreclosures and delinquencies.

More significant is the fact that completed foreclosures do not, by themselves, necessarily correlate with destabilization of existing neighborhoods as a result of being vacant and abandoned properties. An increase in foreclosure rates does not have the adverse impact on communities and lead to neighborhood destabilization when the foreclosed properties are scattered and isolated. I recommend first that the allocation formula of the basic grants and loans to the states be based not just on the relative rates for residential foreclosures but also on the degree of concentration of such foreclosures within a single geographic area. For these purposes the concentration of the increased foreclosures within each census tract, or within each postal zip code (either 5 digit or 9 digit), would be a far more accurate indicator of the likelihood of significant external costs being imposed on neighborhoods, communities and cities. The aggregate grants can still be made to the states, but the state share would be based on a combination of (i) concentrated foreclosures and (ii) subprime delinquencies.

²⁹ Sec. 4(b)(3), H.R. 5818 (EH).

³⁰ Sec. 4(b)(7), H.R. 5818 (EH).

The same concern applies to the mandatory allocation of funding to Qualified Metropolitan Cities and Qualified Urban Counties. At present their allocation is similarly based on relative foreclosure rates and subprime delinquencies.³¹ I recommend that this allocation follow the same approach I recommend for the state allocation, that it be based on the (i) concentrated foreclosures and (ii) subprime delinquencies.

I also recommend that the foreclosure rates (or alternative the target area priority) be adjusted to focus on previously occupied single-family foreclosed properties. To include within the calculations partially built single family construction – particularly when it is in large scale subdivisions or condominium structures – distorts both the purpose and the effect of the legislation.

The Allocation Formula – Priority of Uses. The dominant use of this emergency federal funding will, quite appropriately, be used to acquire Qualified Foreclosed Housing and then make it available to targeted families either for homeownership or as rental property. The definition of Qualified Foreclosed Housing, however, should be modified when referring to single family housing to be limited to housing that has been vacant for at least sixty days. Single family housing which was foreclosed upon and which was occupied prior to foreclosure or which is occupied post-foreclosure and has not been vacant for any period of time carries little justification for federal or state intervention in this context.

The permitted uses of the federal funding should also be extended to include demolition and remediation costs when rehabilitation is not economically viable. In many neighborhoods with high rates of single family residential foreclosure the structures were already – or will quickly become – a net liability to the fair market value of the underlying property. In parallel fashion, the permitted use of the funds by local governments should include the aggregate cost of code enforcement activities and public safety activities at least insofar as they are attributable to Qualified Foreclosed Housing prior to the purchase of the housing by the local governments. The dual limit of the purchase price for Qualified Foreclosed Housing is tied, in part, to current fair market value but no definition is provided. I recommend that current fair market value be defined by appraised value established by an appraisal not older than 90 days based upon comparable sales not older than 180 days, and with a projected resale period of 90 days.

The geographic targeting of the funds to those jurisdictions with both a high concentration of vacancies and a high rate of increase in vacancies, by census tracts, is quite appropriate. If the funding is allocated to states and local governments based upon the relative concentration of foreclosures and subprime delinquency, and then further correlated with increases in concentrated vacancy rates, the maximum impact can be achieved.

³¹ Sections 5(f), (g), H.R. 5818 (EH).

Conclusion

The Neighborhood Stabilization Act of 2008 could be a critical step in providing core capital funding for local governments to use to mitigate the external costs created by vacant and abandoned properties. The thrust of the legislation is appropriately to address the properties left vacant as a result of the current mortgage foreclosure crisis and move those properties as quickly as possible into safe, decent and affordable housing. Getting the residential properties occupied – whether by new owners or by tenants – is the quickest and most efficient strategy to minimizing the adverse consequences to the entire community. In those jurisdictions that have already created a land bank authority, or could create one under existing state authority, the local governments are positioned to take immediate action that is consistent with the purposes of the Act.

Thank you for the honor of appearing before the Domestic Policy Subcommittee, and for all you are doing on behalf of this country.

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