# TESTIMONY

OF

THE HONORABLE ANTONIO R. VILLARAIGOSA

MAYOR

CITY OF LOS ANGELES

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

UNITED STATES HOUSE OF REPRESENTATIVES

THE HONORABLE MAXINE WATERS
CHAIR

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**1. How has Los Angeles been affected by the current foreclosure crisis?**

In the City of Los Angeles, we have experienced a dramatic rise in the number of foreclosures as the fall-off of housing prices and the collapse of the sub-prime mortgage sector have progressed. Thus far, 2007 has been the worst year. In the first quarter of 2006, there were 115 foreclosures in the City of Los Angeles. By contrast, in the first quarter of 2007, foreclosures increased six-fold and 716 households lost their homes. Since then, foreclosures have risen steadily, with 850 mortgage foreclosures in the second and 1,177 in the third quarter. Statistics from specific areas of the City, indicate that this upward trend is continuing in the fourth quarter. In the San Fernando Valley, for example, foreclosures jumped by 112 from September to October to reach 414 for the month.

Significantly, the foreclosure crisis has disproportionately affected our City's most economically vulnerable neighborhoods. The ten zip codes with the highest rate of foreclosure activity--i.e., notices of default, notices of foreclosure, foreclosure sales -- were located in the Northeast San Fernando Valley and in South Los Angeles. These zip codes are: 91342, 90043, 90044, 91331, 90003, 90047, 91335, 91343, 90002, and 91344. The vast majority of sub-prime loans, which are the loans with the highest rates of foreclosure, have been made to African-American and Latino households. In other words, Los Angeles has experienced, and will continue to experience, a massive loss of equity and financial destabilization in the neighborhoods and in the communities that can least afford such circumstances.

Furthermore, there is mounting evidence that the corrosive effects of the mortgage foreclosure crisis are beginning to spread beyond individual households. One of the most pernicious consequences of widespread foreclosures is the increase in neighborhood blight caused by vacant houses. Already in Los Angeles, there is an increase in the number of abandoned building referrals to the Department of Building and Safety, as well as a rise in the number of nuisance-building cases referred to our Abandoned Building Task Force. There is also an increase in anecdotal reports of renters being evicted from apartment buildings on which the mortgages have been foreclosed.

**2. What impact, if any, has the crisis had on the City's property tax base and property tax revenues? Does the City anticipate such an impact? If so, what is the extent of this impact and how will it affect the City's ability to provide services to residents?**

Madame Chair, I want to stress the terrible human cost of the mortgage foreclosure crisis. When families lose their homes, they not only suffer a devastating economic blow, but they also lose their connection to the community and the most basic human need--a stable, secure place to live.

The financial effects of foreclosure extend well beyond the individual household. Lenders, fellow homeowners, and municipalities all face costs from mortgage foreclosures. Consequently, all have a shared interest in mitigating the financial repercussions of the current crisis. Lenders and investors face losses of between $.20 and $.60 cents on the dollar, and by one estimate, the average cost of a foreclosure to the lender is more than $58,000. Studies of the impact of foreclosures on the value of neighboring homes have found a cumulative negative impact. Each foreclosure in a neighborhood lowered the values of surrounding homes by .9%. In lower-income neighborhoods, the impact was even greater, dropping surrounding home values by 1.44% per foreclosed home.

The costs of the foreclosure crisis to the City include the direct costs associated with the foreclosure process, the loss of property tax revenues and the decrease in the Gross Metropolitan Product, that is, the value of all final good and services produced within the metropolitan area.

The study, "Collateral Damage: the Municipal Impact of Today's Mortgage Foreclosure Boom," indicates that the municipal costs of managing foreclosed properties can be staggering. Cities faced with widespread foreclosures face rising costs for increased policing, building inspections, administration of the foreclosure process, and maintenance and/or demolition of abandoned buildings. "Collateral Damage," which is a case study of Chicago, found that the city faced costs ranging from under $100 to over $30,000 per property.

Regarding the specific impact of the foreclosure crisis on property taxes, the situation is complex, and we do not yet have all of the data we need to make a precise assessment. Distress in the real estate market typically affects property tax rates several years downstream, although it is typical to see slower growth in receipts even at the beginning of a slowdown as distressed borrowers defer tax payments in order to meet their mortgage payments.

The rise in foreclosures will affect City property tax revenues in two areas: the collection rate and adjusted valuations.

We have anticipated a declining tax collection rate and have made our budget calculations based on this anticipated decline. However, we will not have the first property tax installment data until December. At that time, we may be able to discern if our projections are correct or if the rate is at risk of falling below the reduced budget level.

For the upcoming budget year (FY 2008-09), it is likely the collection rate will fall and if the real estate downturn is prolonged, the collection rate could fall for several years as it did in the early 1990s. This would reduce budgeted revenue until the distressed properties are redeemed.

Declines in property values caused by widespread foreclosures will contribute to downward tax reassessments. Assessed valuations of property are revised downwards when an appeal of the valuation is successful. The successful appeal process requires a refund of the excess taxes already paid by the property owner and distributed to the City and a lower assessment in future years until the property value returns to its former level. Should the price level fall, property owners who are not foreclosed upon may seek a downward assessment. And in a prolonged downturn, if property changes hands at a price lower than the current assessment, the new price would be the basis for the valuation.

In general, it is still too early to put a precise dollar amount of the current foreclosure crisis and housing downturn on property tax receipts. However, if past slumps are an indication, we expect a significant impact on city finances in the future.

Further, "The Mortgage Crisis: Economic and Fiscal Implications for Metro Areas," which was recently prepared for the United States Conference of Mayors, has examined the effects of foreclosures and falling home prices on the Gross Metropolitan Product in the countries major metropolitan areas, including the Los Angeles-Long Beach-Santa Ana metro area. The report forecasts that the declines in home prices, the accompanying decline in consumer spending, and other elements of economic weakening associated with the foreclosure crisis will significantly impact Los Angeles' gross metropolitan product. The Los Angeles area's GMP is forecast to grow by only 1.7%. This is a full percentage point lower than would be the case without the current housing market woes and represents an $8.3 billion loss of nominal GMP.

The negative fiscal impact of the foreclosure crisis exacerbates the City's budgetary challenges. One of my goals as Mayor has been to improve the City's fiscal discipline while, simultaneously, improving the kind and quality of City services. While the first two years of my administration-have been extremely successful, this fiscal year, we face a much more challenging budget situation. The growth of general fund revenues is forecast to be only a modest 1.3%. Moreover, there is uncertainty regarding the Telephone Users Tax, the loss of which would equal an estimated $270 million. The negative fiscal impact of the foreclosure crisis will only serve to sharpen the City's budgetary challenges.

**3. In your opinion, what has contributed to the city's foreclosure rank (ranked 26$^{th}$ nationally)? In what ways do you anticipate the current crisis to worsen for Los Angeles homeowners?**

The vast majority of foreclosures are taking place in the sub-prime mortgage sector of the market relative to loans that were originated between July 2005 and September 2006. Sub-prime loans default at a much higher rate than prime loans. In the second quarter of 2007, sub-prime loans represented only 15% of the outstanding mortgages in California, but nevertheless accounted for 68% of the state's foreclosure starts. We are also seeing an increase in the rate of delinquency among sub-prime loans. From February to July of this year, the rate of delinquency rose from 11.1% to 19.4%. Los Angeles, like the rest of the state, has a significant number of sub-prime loans.

The significant number of sub-prime loans made to City residents, combined with the high rate of foreclosure in the sub-prime sector, helps to explain the high number of foreclosures in the city.

Unfortunately, we expect that the problem will only worsen. Many sub-prime adjustable-rate mortgage loans are about to reset. The pace of the resets will increase through July 2008. Because these mortgage loans go into foreclosure at a higher rate than prime mortgage loans, we can expect a continued increase in defaults and foreclosures well into then end of 2008.

These are very sobering numbers, but I would caution against focusing too much on statistics and losing our view of the bigger picture.

Many sub-prime adjustable-rate mortgage loans were designed to fail and were not made in the best interest of the borrower. These lenders have now gone out of business and are nowhere to be found. As such, the need for reform of national and state lending laws, including increased consumer protections against predatory lending, is urgent and immediate!

The need is critical for meaningful financial education and for building healthy relationships between low-income residents and responsible banking and lending institutions. In our low-to-moderate income neighborhoods, 30% of residents lack a relationship with a bank. In neighborhoods with more extreme poverty, the percentage is even higher. This situation, combined with the lack of financial education, leaves our most economically vulnerable residents exposed to the predations of irresponsible financial agents.

I am proud to say that the City of Los Angeles has a successful model for encouraging long-term, financial secure homeownership among low- and moderate- income households. The Los Angeles Housing Department administers three programs that serve first-time home buyers earning between 80% and 150% of AMI. Two key components of these programs stand out, especially in light of the current crisis: 1) program participants much complete extensive financial education and, 2) they must secure traditional, fixed-rate mortgages. As we move forward from mitigating the negative effects of the current crisis, to creating programs to serve low-income residents, I would strongly encourage increased funding for such homeownership programs with a mandatory counseling component. Such programs foster healthy, livable, sustainable neighborhoods and are proven vehicles for family wealth creation.

**4. In your opinion, what is preventing servicers from working with homeowners to prevent foreclosures? How can these obstacles or problems be surmounted?**

Servicers have signaled their desire to work with borrowers, and we believe that many are. However, we also believe that much more can and should be done.

Our goal, at the municipal level, is to foster local lender accountability. As the crisis grows, the need for a streamlined, transparent process for loss mitigation will grow ever more urgent. We need lenders to publicize their loss mitigation programs and the criteria they use to decide how they can help distressed borrowers.

We also need lenders to provide periodic reports of how many borrowers they have helped and where those borrowers live.

We need lenders to identify foreclosure prevention liaisons to work with my office, the City Council, and the relevant city departments.

We need to begin a meaningful discussion with lenders about creating a process to offer foreclosed properties to the City and/or non-profit organizations, so that these properties can be converted into affordable housing. The current foreclosure crisis cannot become an opportunity for speculators to buy up vast numbers of homes and further destabilize neighborhoods with absentee landlords.

The fact of the matter is, however, that municipalities lack the regulatory power to force these types of changes. We only have the bully pulpit and our collective power as advocates to affect these policy and procedural changes.

For this reason, I would like to use this opportunity to ask my fellow California Mayors to join with me to advocate for the necessary state and federal regulatory changes that will streamline the loan workout process. We need objective loan workout criteria that will enable lenders to process loan modifications more quickly and to ensure that borrowers are being treated equitably.

It is my opinion that the recent proposal by FDIC Chairwoman Sheila Bair is a very good starting point for creating such a transparent, streamlined process. Chairwoman Bair has proposed freezing adjustable rate mortgages at the starter rate. This would apply only to ARMs that have not reset and only for borrowers who occupy their homes and are not delinquent on their loans. Speculators who do not live in their homes would expressly be forbidden from taking advantage of this program. We understand that Chairwoman Bair's proposal was the basis for Governer Schwarzenegger's recent agreement with four major loan servicers in California to streamline the loan modification process. We must work to expand such agreements and also to monitor servicer compliance.

**5. What tools or resources will the City of Los Angeles need in order to be able to assist families either in or at risk of foreclosure? What other solutions are needed to prevent foreclosures?**

Currently, one of the greatest needs in the city is support to build the capacity of foreclosure counseling and legal aid agencies to help homebuyers at risk of foreclosure. Both types of organizations have seen a dramatic increase in the demand for these indispensable services. The City of Los Angeles has committed $100,000 for foreclosure counseling, but much more money is needed to expand these services and help forestall as many mortgage foreclosures as possible. Despite the size of its housing market, and its share of foreclosures, California receives very limited funding to support counseling assistance. Incredibly, these funds were cut to $2 million for the current fiscal year. Moreover, most of the available funds are now being directed at pre-purchase assistance for first-time homebuyers. I believe that our paramount goal, at this point, is to keep as many people in their homes as possible. Responsible foreclosure counseling is one of the most cost-effective means to keep families in their homes. An infusion of federal funds specifically designated for foreclosure counseling and legal assistance would not only help avert future predatory mortgages, but also help avert foreclosure of mortgages that are currently at risk.

Interestingly, we have also begun to receive reports of an increase in so-called foreclosure consultants who prey on the economic distress of borrowers currently facing foreclosures. Consequently, the City is examining ways to increase the resources dedicated to combating such fraud, and an infusion of federal resources would support our ability to mitigate such fraud at the local level.

Finally, we, at the local level, need an aggressive set of state and federal regulations designed to prevent such a crisis from ever happening again. We support the "Mortgage Reform and Anti-Predatory Lending Act of 2007" and would urge immediate Senate passage of your bill.