STATEMENT OF ALAN MALLACH, NON-RESIDENT SENIOR FELLOW, THE BROOKINGS INSTITUTION, TO THE SUBCOMMITTEE ON HOUSING, TRANSPORTATION AND COMMUNITY DEVELOPMENT OF THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

SUBCOMMITTEE FIELD HEARING, PLAINFIELD, NEW JERSEY, FEBRUARY 10, 2012

Chairman Menendez, honorable Members of the Subcommittee:

I am pleased to have this opportunity to testify before you on the effects of foreclosures on neighborhoods in New Jersey and elsewhere in the United States, and to suggest federal and state legislative efforts that should be pursued to help mitigate the foreclosure crisis and stabilize our neighborhoods. You are hearing today from a number of individuals who are pursuing important strategies to address this problem. I will try to add a broad perspective on this issue, based on my work as researcher and advocate in New Jersey and elsewhere over the past many years.

Just as there is no one reason for the foreclosure crisis, there is no one way in which that crisis affects neighborhoods, and no one strategy that can be put in place to fix the problem. Furthermore, we should not think of mitigating the foreclosure crisis, which still rages, and stabilizing neighborhoods as separate matters: the two are totally interwoven with one another. This is particularly true in urban neighborhoods that are already hard-pressed by unemployment and other ills.

As borrowers default, and foreclosure proceedings begin, maintenance declines. Many borrowers leave their homes, or walk away from investment properties. In New Jersey, where foreclosures can take three years or more, houses and small apartment buildings can sit empty for years before title passes to the lender, deteriorating and blighting the neighborhood. As vacant and abandoned properties increase, the neighborhood's quality of life deteriorates, and its attractiveness to homebuyers declines. Meanwhile, with more REO properties coming on the market, and fewer homebuyers being able to qualify for mortgages, the market further deteriorates; abandonment grows, crime may increase, property values decline, and increasingly the only buyers are low-end and speculative investors. Breaking this vicious cycle demands action at all stages in the cycle.

We should focus on four distinct areas – not as separate actions or strategies but in an integrated, comprehensive way,. While many areas I will touch on are traditionally matters of state law, the need for consistent, overarching, national ground rules in this area is compelling and a matter of urgent public interest. As Congress showed when it enacted the Protecting Tenants at Foreclosure Act in 2009, it is capable of acting to fill the gap between inadequate state laws and what needs to be done.

- **First, reduce the flow of homes into foreclosure.**

Until we significantly reduce the number of new foreclosures, and the number of REO properties, neighborhood stabilization will remain a moving target, constantly beyond our reach. For all of the many programs and initiatives of the past few years, that goal still appears far away. I believe the federal government needs to play a stronger, more constructive role than it has in the past. Convoluted programs that prolong the agony, short-term temporary assistance programs, and similar efforts may help some people, but too few, too slowly. A more aggressive, systematic approach is needed; the White Paper just issued by the Federal Reserve Board offers a number of useful suggestions that could be pursued in developing such an approach.

This is both an administrative and a legislative responsibility. Federal regulators should use both carrots and sticks to encourage greater principal reduction in mortgage modifications, facilitate short sales and deeds in lieu, to maximize alternatives to foreclosure. The federal government should provide additional support for foreclosure counseling, and provide direction to the states to follow best practices in designing and conducting mediation and other foreclosure intervention programs. The Administration could lead the way through its control over the GSEs as well as FHA, something which has yet to happen. Congress can play a valuable role by putting constructive pressure on the Administration to treat the GSEs and FHA not as burdens or no more than bottom-line entities, but as powerful tools that can be deployed to tackle the mortgage crisis; if existing statutes are an impediment, Congress should change the ground rules the FHFA uses to regulate the GSEs .

- **Second, keep people in their homes**

If the foreclosure process itself is the first step in neighborhood destabilization, the second is the extent to which it leads to houses becoming vacant, and particularly in urban neighborhoods, abandoned, a process that often results in houses being damaged beyond repair. Congress took an important step in this respect in 2009 when it enacted the Protecting Tenants at Foreclosure Act. That act should be revisited, first, to expand tenant protection to reflect the protections afforded tenants under New Jersey law; and second, to find out whether it is indeed being followed, and if necessary – as I expect will turn out to be the case – put teeth in it to make sure.

With respect to homeowners, the goal should be to make sure that a house that goes through foreclosure is empty for no longer than a house that is sold in the normal course of events. Fostering more short sales and deeds in lieu is an important step in that direction, but the next major step should be to protect homeowners in foreclosure by allowing responsible homeowners who have maintained their property in good condition during the foreclosure process to remain in their homes as tenants, paying a fair market rent, until or unless a new buyer wants to move into the house. This should be a no-brainer. It preserves families, helps stabilize neighborhoods, and preserves the value of the property better than if the property is vacated after the sheriff's sale. Representatives Grijalva and Kaptur introduced legislation that would achieve that goal, but it remains bottled up. It should be given a chance to work.

- **Third, ensure that properties are properly maintained both during and after foreclosure**

In New Jersey and many other states properties can sit vacant for years before lenders gain title through sheriff's sale. In 2010, the New Jersey Legislature passed a state law making lenders legally responsible for maintaining properties that become vacant after the initial foreclosure filing but before the sheriff's sale. I believe New Jersey is unique in terms of state law, although some cities, particularly in California, have passed local ordinances along similar lines. Congress should consider legislation that would establish such legal responsibility as a national mandate and strengthen the ability of local governments to enforce that responsibility.

The extent to which lenders simply walk away from low-value properties, particularly in distressed areas like Cleveland and Detroit, has been widely recognized. In other areas, they may not walk away, but may slow down the process to ration the flow of properties into REO status. Both of these practices harm the families involved, the neighborhoods and the housing market generally. Simply stated, lenders should not be allowed to initiate foreclosures unless they are prepared to see the process through in a timely fashion and take full responsibility for the property. If they are unwilling to do so, they should release the mortgage, or convey it to an entity that has the borrower's interest at heart. While individual states could enact such legislation, the likelihood of all 50 doing so is remote; this is another area where federal legislation would be valuable.

- **Fourth, make sure that REO and other vacant properties are quickly put back to productive use**

While high-value REO properties in strong housing markets usually sell quickly, many REO properties elsewhere languish, some to be bought by low-end speculators, and others to remain vacant. Meanwhile, other properties in the same hard-hit neighborhoods are falling vacant for many other reasons. Making sure REO properties are restored to productive use not only requires that the lenders who control these properties are motivated to do so, but needs a pool of responsible, capable people ready to buy them. In some cases they could be homebuyers, in other cases responsible investors, or contractors willing to put them back into shape, and in still others, non-profit corporations and CDCs.

In addition, municipalities need stronger tools, such as the ability to create municipal land banks, to gain control of other vacant properties and put them back to use. Such legislation has been enacted in Michigan, Ohio and New York. In New Jersey, the Housing & Community Development Network has helped draft a bill that has just been introduced. The federal government should support such efforts, and ensure that federal programs are designed to work in tandem with local land bank efforts.

Coupled with legislation to motivate lenders to complete foreclosures and put REO properties on the market, we need programs to make it easier and more financially feasible for people to buy properties, either to occupy as homeowners, to rent out, or to fix up and put back on the market in move-in condition. This demands two things.

First and foremost, we need a system that provides access to capital on reasonable terms for responsible individuals and businesses ready to acquire, occupy, rent out or fix up REO and other distressed property. In the short run, this should be clearly defined as part of the mission of the GSEs and FHA. In the long run, we need to get away from the rhetoric that has come to surround the question of the nation's future mortgage finance system, and come up with a model for a mortgage system that appropriately balances risk management and public policy goals. If we are to continue to provide homeownership opportunities to hard-working Americans, government will inevitably have to play an important and ongoing role.

Second, in weak market areas, where the cost of fixing up houses exceeds their market value, we need to look at incentives such as tax credits to motivate responsible landlords, developers and contractors to invest in those areas, to help those areas get back on their feet.

Finally, I'd like to come back to a point I made earlier. Yes, there are many dimensions to this problem which demand different strategies and programs, but they have to be connected, not handled – as is too often the case today – as separate, unrelated, activities. Moreover, many programs – housing programs as well as other public efforts – that we do not associate with foreclosure prevention or neighborhood stabilization affect the future of the same neighborhoods.

The Administration and Congress should take a close look at current federal programs – in housing and elsewhere – and asking whether the way they are designed and their funds allocated works to sustain neighborhoods, or whether some programs are indifferent to, or in some cases, even inimical to the future of urban neighborhoods.

Communities need to be encouraged to develop comprehensive strategies, to get everyone involved around the table to work together, to make sure that foreclosure prevention, and keeping houses occupied and maintained, and restoring vacant houses to productive use are all part of a multifaceted effort to stabilize and reinvigorate our older neighborhoods, towns and cities. Both federal and state governments should be their partners in that effort.