

TESTIMONY
OF
ALAN MALLACH
“NEIGHBORHOODS the BLAMELESS VICTIMS
of the SUBPRIME MORTGAGE CRISIS”

DOMESTIC POLICY SUBCOMMITTEE
OVERSIGHT AND GOVERNMENT REFORM COMMITTEE
WEDNESDAY, MAY 21, 2008
2154 RAYBURN HOB
2:00 P.M.

Chairman Kucinich, Ranking Member Issa, and Members of the Subcommittee.

My name is Alan Mallach. I am a Visiting Scholar at the Federal Reserve Bank of Philadelphia, and will be joining the Metropolitan Policy Program of The Brookings Institution as a Visiting Nonresident Fellow as of July 1 of this year. I have been working on the issues affecting urban neighborhoods in general, and on vacant and abandoned properties in particular, for much of my adult life, as a public official, advocate and scholar. I am the author of *Bringing Buildings Back: From Abandoned Properties to Community Assets*, published in 2006, which is the most comprehensive, systematic examination of this issue available.

I am pleased to have the opportunity to testify before you with respect to how best to address the neighborhood effects of vacant and abandoned properties, particularly in light of the dramatic increase in the number of such properties that is taking place as a result of mortgage defaults and foreclosures.

The devastating impact of vacant properties on neighborhoods, particularly urban neighborhoods with weak housing market conditions, has been well-documented. Vacant properties undermine property values, discourage investment, increase the risk of crime and fires, and create health hazards. The foreclosure crisis that is sweeping the United States has rendered thousands of properties in America’s cities vacant, devastating many once-stable neighborhoods, or areas such as Cleveland’s Slavic Village or Mt. Pleasant neighborhoods, which over recent years have fought back against decay, and gained a measure of vitality. Hundreds of other neighborhoods are at risk.

Successfully tackling this issue will require action in two separate arenas. Strategies are needed to enable capable local governments and non-profit entities to gain control of abandoned properties, so that they can be reused in ways that benefit the community and its residents. At the same time, actions must be taken to minimize the harm that these properties do to their surroundings during the period – which can be a long one – before they are reused, while they remain vacant. I would like to address both of these areas.

Minimizing harm from vacant properties

A community's ability to minimize the harm from privately-owned vacant properties is a function of its ability to enforce its codes and abate nuisance conditions. If a city can effectively make property owners clean, secure, and maintain their properties – and step in to do the work if the owner fails to do so – they can dramatically reduce the harm those properties do, while taking the long-term steps needed to put them back to use. This is typically the responsibility of each city or county, which is given the authority to enforce codes and abate nuisances by state law.

There are a number of reasons, however, why this system is not working well in many cities in the current crisis:

- ***Many cities lack the resources to provide effective code enforcement.*** With too few inspectors, prosecutors and support staff, they have been overwhelmed by the volume of vacant properties created by the foreclosure crisis.
- ***Many cities' code enforcement programs are poorly organized and ineffective.*** Inspectors may be poorly trained or supervised; technology, which could dramatically increase productivity, is not used, or used poorly; courts have backlogs, or give code matters low priority.
- ***Cities are unwilling to use their powers to abate nuisance conditions,*** either because of lack of capacity or the difficulty of recovering their costs.

A fourth problem has arisen more recently as a result of the foreclosure crisis. In many states, foreclosure is a slow process, taking anything from nine months to over two years. Many homeowners facing foreclosure do not wait for what they consider to be inevitable, and abandon the property long before the sheriff's sale. The owner disappears, but the foreclosing lender or servicer is unwilling to take responsibility for the property. The property falls into limbo – a state that can last for years.

A small but growing number of states and cities, including Buffalo, Boston and some California cities, are holding the foreclosing lenders responsible for these properties, but most state laws do not permit this. *We need clear law that establishes that once a lender has asserted its control over a property by initiating foreclosure, it also takes the responsibility that goes along with that control, if the owner is no longer in the picture.* Cities should be able to hold lenders responsible for repairs, and if the lender fails to do so, correct the violations itself and go after the lender for the cost.

Cities need help, though, in building their capacity to enforce the codes and abate nuisances. A small amount of federal money could make a huge difference. One or two million dollars won't acquire or demolish that many properties. Used to hire inspectors or prosecutors, or enable cities to set up systems to use their existing resources efficiently, it could help preserve hundreds of properties.

Taking control of vacant properties

It is now widely recognized that preserving urban neighborhoods requires that qualified, capable local entities gain control of the thousands of vacant properties that have been created through subprime mortgage defaults and foreclosures. Without such steps, these properties will languish, particularly in weak market cities. While banks and

mortgage companies may spend money to preserve the value of their REO assets in San Diego or Las Vegas, they are not doing so in Cleveland or Detroit. Effective measures to gain control of vacant properties, and properties at risk of abandonment will require that policymakers address three separate issues:

- Money for property acquisition
- Local capacity to acquire, manage and dispose of massive property inventories; and
- A willingness on the part of lenders and servicers to negotiate reasonable terms to transfer property to local entities.

Congress has taken important first steps with respect to providing money to local entities, with one caveat to which I will return. The other two issues, however, remain serious potential stumbling blocks.

Few cities or counties, and even fewer community development corporations and other nonprofits, have the capacity to handle thousands, or even hundreds of vacant properties. While a few, like the Land Bank in Genesee County, Michigan, can do so, other cities and counties don't even know what properties they already own, or what condition they're in. In addition to money for acquisition, assistance is needed to build the capacity – in both local government and the non-profit sector – to acquire, manage, maintain, and ultimately dispose of these properties.

Second, local governments and non-profits are still having a hard time getting lenders and servicers to come to the table, and negotiate transactions that reflect the true value of the properties or the cost of foreclosure. Whether this is from fear of legal repercussions, or more plausibly, because the industry is still in denial about the ultimate financial fallout from the unfolding crisis, is unclear. Either way, without them at the table, reuse strategies may be stillborn.

While local players can make headway here and there, a timely solution to this problem is likely to need federal action. Some combination of carrots and sticks may be needed. Much as it goes against the grain to provide *any* incentives to an industry that bears the brunt of the responsibility for a crisis that is destroying millions of lives and hundreds of communities, the fate of many of these communities hinges on how this issue can be resolved.

Finally, I would like to turn back to the question of the money that is likely to be provided for property acquisition. All foreclosures are unfortunate, but all foreclosures are not equal. What happens to vacant properties – and how much they end up costing the community – depends heavily on the regional economy. In Las Vegas, as a recent article in *Governing* magazine pointed out, local officials are counting on job growth to fill up most if not all of the vacant houses in the next year or two. Officials cannot make that assumption in Dayton, Flint or Buffalo. Properties there will have to be held longer, maintained longer, and ultimately either demolished or rehabilitated before they can be put back to productive use. I strongly suggest that any formula that is used to allocate federal money for property acquisition and related costs reflect the difference in economic and housing market conditions between the different regions of the United States.

Thank you for your attention. I look forward to your questions.