

Testimony to Committee on Financial Services  
United States House of Representatives  
H.R. 3068, TARP for Main Street Act of 2009  
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## **To Chairman Frank and Members of the Committee:**

Thank you for the invitation to testify on H.R. 3068, the TARP for Main Street Act of 2009. I work for Cleveland Mayor Frank Jackson as his Chief of Regional Development. In that capacity I oversee the work of six city departments, including the departments of Community Development, Planning, and Economic Development.

Mr. Chairman, I will cover three points:

1. How the sub-prime mortgage crisis has wrecked havoc in Cleveland and its inner ring suburbs.
2. How our community is responding to the crisis, including our use of Neighborhood Stabilization Program funding made available through the Housing and Emergency Recovery Act of 2008 and our proposal to use Neighborhood Stabilization Program funding made available on a competitive basis through the American Recovery and Reinvestment Act of 2009.
3. Finally, a ringing endorsement, with a few qualifying suggestions, for the idea set forth H.R. 3068, namely that in addition to the bailouts of banks, TARP resources should also help responsible homeowners avoid foreclosure and help communities reclaim devastated neighborhoods and properties.

### **Foreclosure Crisis in Cleveland**

Mr. Chairman, it is not hyperbole to say the sub-prime mortgage crisis has hit Cleveland with a force akin to a horrific natural disaster. I call it Hurricane Greed. The devastation is manifest:

- 24,000 residential foreclosures since 2005, at least 70% attributable to subprime lending. (see map)
- An overwhelming concentration of foreclosure activity in inner city neighborhoods with predominantly African American and Hispanic populations.

- 2,000 sheriff sales a year due to tax delinquencies.
- Over 10,000 vacant and seriously damaged residential structures; a threefold increase since 2004.
- \$35 million of public funds spent since 2006 on the eradication of life-threatening public nuisances created by the irresponsible maintenance of vacant properties. Unfortunately, local government is the payer-of-last-resort for demolition or boarding of condemned structures, cutting of high weeds, removal of debris at properties controlled by some of the largest financial institutions in the world.
- Sharp increases in the demand for shelter services due to foreclosures, especially from families with children and the elderly.
- The undermining of redevelopment progress in many Cleveland neighborhoods.
- A City housing code enforcement department pushed to the breaking point as inspectors and prosecutors contend with an enormous spike in unsafe condemned properties.

And, the devastation in our region does not stop at the city limits. Double the foreclosure, abandonment, and public service numbers I just cited and you will have a fair idea of the impacts in Cuyahoga County.

While Cleveland is hardly alone, market dynamics and the nature of Cleveland's housing stock made Cleveland neighborhoods especially vulnerable to sub-prime predatory lending. Cleveland contains a large quantity of low value (less than \$50,000) small wood frame one and two family homes. These properties attracted two kinds of buyers susceptible to purchases financed by sub-prime deals: 1. Cash-strapped, low wealth, and credit deficient households lured by the dream of ownership and enticed by low upfront costs; and, 2. Undercapitalized investor-owners attracted by the prospect of making a quick buck through the accumulation of over-appraised one and two family rentals.

As we have all now learned the predatory practices of unregulated mortgage brokers was made possible by the liquidity provided by the largest financial institutions in this country and the world. Most of those titans have either gone under or have received billions in TARP investments to stay afloat. The most active participants in the sub-prime fiasco in Cleveland are among the highest beneficiaries of TARP. Six mammoth financial institutions have initiated nearly 40% of the mortgage foreclosure sheriff sales in Cleveland since 2005. All of these institutions except Deutsche Bank have received TARP investments. The total TARP price tag? A staggering \$96.6 Billion!

<b>Institution</b>	<b>Sheriff Sale Actions</b>	<b>TARP Award</b>
Wells Fargo	2624	\$25,000,000,000
Bank of America (incl. Countrywide)	668	\$15,000,000,000
J.P. Morgan Chase	1274	\$25,000,000,000
CitiGroup	826	\$25,000,000,000
US Bankcorp	1091	\$6,600,000,000
Deutsche Bank	3010	\$0
<b>Totals</b>	<b>9493</b>	<b>\$96,600,000,000</b>

### **Cleveland's Response**

Cleveland's response to this unnatural disaster is predicated on three basic strategies:

#### **1. Collaboration**

We have organized a countywide coalition bringing under one umbrella the City of Cleveland, suburbs, Cuyahoga County, the county Treasurer's Office, our Municipal Housing Court, our countywide public housing authority, dozens of community based development corporations, housing counseling agencies, universities, local and national philanthropic foundations, banks, and a newly created countywide land bank to fashion a common strategy and mutual commitments of resources and energy. Our \$74 million application for NSP II funds, in fact, will be submitted to HUD next week by a consortium comprised of four governmental agencies plus dozens of civic partners.

#### **2. Gaining Control of Abandoned Property**

Earlier this year the Ohio General Assembly responded to a proposal set forth by Cuyahoga County Treasurer Jim Rokakis and a chorus of Cleveland supporters by passing legislation enabling the creation of the Cuyahoga County Land Bank. This unique entity (modeled on a similar program in Genesee County, Michigan) has the statutory powers and resources (an estimated \$9 million per year funded through penalties and interest charged on delinquent tax collections) to acquire, responsibly maintain, and position for redevelopment thousands of mortgage foreclosed and tax foreclosed properties located throughout the county, including Cleveland.

#### **3. Intense Targeting of Resources**

In 2008, the City of Cleveland and its partners launched the Opportunity Homes initiative in six Cleveland neighborhoods. The effort calls for the acquisition and rehabilitation of 150 homes, the demolition of 100 homes, the productive reuse of 200 vacant lots, and pre-foreclosure counseling and debt restructuring for 150 at-risk homeowners. In

addition, large scale catalytic real estate developments, including affordable multifamily projects, are being undertaken in each area. Finally, within each neighborhood the City has started an aggressive street-by-street housing code enforcement program in an effort to derail the wholesale dumping of distressed REO properties to irresponsible bulk buyers. Funds made possible through a \$25 million NSP I grant and hopefully a successful NSP II application will allow an expansion of this approach to an additional 14 target neighborhoods, including five within inner-rings suburbs.

### **Comments on H.R. 3068**

Mr. Chairman, passage of the TARP for Main Street Act of 2009 will unequivocally advance our efforts to recover in Cleveland and in Cuyahoga County. The Housing Trust Fund and Multi-Family Stabilization provisions will undergird our efforts to reclaim troubled properties and produce safe affordable housing. The Emergency Mortgage Relief Fund will help thousands of borrowers stay in their homes and avoid the blight and costs of abandonment. And, support for a third round of Neighborhood Stabilization Program will advance Cleveland and Cuyahoga County's sensible homegrown recovery program.

On behalf of Cleveland Mayor Frank Jackson, I congratulate Chairman Frank and other sponsors for bringing forward this landmark legislation.

The following are suggestions and recommendations for enhancing the bill:

1. We support a set of technical recommendations submitted to HUD by the National Foreclosure Prevention and Neighborhood Stabilization Task Force (attached for reference). These recommendations identify regulatory changes that would make the Neighborhood Stabilization Program more effective.
2. NSP guidelines should permit the draw down of sufficient NSP funds to facilitate the use of loan loss reserve pools. NSP funded reserves would allow our County Land Bank to maximize the net proceeds produced by bonding recurring revenue streams. All loans generated from the capitalized reserve pools would remain subject to NSP rules.
3. HUD strictly interprets the NSP statute as limiting the use of the 25% low-income set aside to foreclosed properties or properties acquired by Deed in Lieu of Foreclosure. HUD should amend its NSP notices to explicitly allow vacant residential and non-residential properties to qualify for the 25% low-income set aside.
4. TARP recipients should be held to strict standards with respect to the disposition of foreclosed properties. Two troubling practices have emerged in Cleveland and elsewhere in recent months.
  - o Financial institutions are unloading unsalvageable REO properties in bulk sales to faceless out-of-town investors at give away prices. As a

consequence, the City is put in the position of proceeding with a publically funded demolition with little chance of recovering its costs from the new owner. Financial institutions, especially TARP recipients, should bear the cost of demolition of such properties.

- We are seeing “walk-away” foreclosures. This practice involves a decision by creditors to forego recovery of foreclosed properties through sheriff sales because the costs of abating public nuisances are expected to exceed liquidation value. These “walk-aways” have two effects on a community, both bad. One, responsibility for the property is left in limbo. Two, the financial institutions off-load responsibility for dealing with the condition of the property. TARP recipients should be required to either pursue the sheriff sale or transfer its claim together with a check to cover the costs of abating public nuisances to a responsible party, such as a public land bank.

In closing, I appreciate the opportunity to testify this morning and welcome any inquiries you may have.

# ATTACHMENT A

## National Foreclosure Prevention and Neighborhood Stabilization Task Force

### Outstanding NSP1 and NSP2 Issues

June 23, 2009

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We are deeply committed to ensuring that the Neighborhood Stabilization Program (NSP) is as successful and impactful as possible. We know that HUD and Congress share this vision, and we are grateful for the statutory and regulatory changes made in the American Reinvestment and Recovery Act, the HUD NSP Notices of Funding Availability (NOFAs) issued in May and June of 2009, and the Bridge Notice issued last week. However, we have identified a number of outstanding regulatory changes that still need to be made. These changes are vital to the success of NSP and we ask that HUD and Congress act on them immediately.

#### *Issues Specific to NSP2:*

1. National Applicants: As currently constructed, the HUD NSP2 program NOFA makes it difficult for national and large regional organizations to submit funding applications that HUD will deem competitive. National and large regional nonprofit organizations have been working for the past year to establish efficient and scalable approaches to NSP activities that could increase NSP2's success. These important existing systems and solutions could be lost, given the NSP2 NOFA requirements, despite the fact that the NSP2 NOFA correction provided some additional flexibility and encouragement for national applicants. These problems can be overcome in either of two ways:
  - a. *Establish a set-aside*: The NOFA could be amended to explicitly enable national and large regional organizations to apply for a specific portion of the funds through a "set-aside." This competition would be based on the special assets that the applicants could deliver – e.g. financial resources designed to leverage NSP2 funds, access to foreclosed property, special expertise in the area of acquiring and assembling financing to redevelop properties and undertake direct development, and the organizations' visions as to how such an effort could be administered.
  - b. *Clarify rating factors for national and large regional applicants*: Alternatively, HUD could more clearly outline how an application would be scored under the current structure by clarifying its rating factors and their interpretation for national and large regional organizations. Organizations that will be using NSP2 funds to provide services and leveraged resources to support local programs should be given a more flexible opportunity to demonstrate that they will achieve positive results in the areas of Neighborhood Transformation, Energy Efficiency

and Soundness of Approach without having to provide quantitative, area-based information for the entire country or region at the time of application.

2. Land Bank Capacity: Land banking is a relatively new national activity, and it will be very difficult for both national and local applicants to prove prior experience with this specific use as required by the NSP2 NOFA. Applicants proposing land banking activities should be allowed to demonstrate prior experience through similar activities, such as property acquisition, holding, maintenance, and/or disposition.

***Issues Pertinent to both NSP1 and NSP2:***

1. Loan Loss Reserves: It is important that NSP funds leverage other public, private and philanthropic funding, so the maximum beneficial impact can be achieved in distressed neighborhoods. As such, HUD NSP guidelines should permit the drawdown of sufficient NSP funds necessary to facilitate the use of loan loss reserve pools, as established in HERA, on a local, state and national basis. All loans generated from the capitalized reserve pools would remain subject to the NSP/CDBG rules. In addition, borrowers of loans backed by an NSP-funded loan loss reserve should not be considered subrecipients of NSP, and income and fees from loans backed by an NSP-funded loan loss reserve should not be considered program income.
2. Eligible Uses: HUD has determined that Eligible Uses A (financing mechanisms) and C (land banks) are only applicable to foreclosed properties, not all properties that are otherwise eligible for NSP funds. This narrow application of the original statute compromises the effectiveness of the program. HUD should broaden its interpretation of eligible properties, or the statute should be revised to clarify that financing mechanisms and land banks are to be used in support of the other eligible NSP activities.
3. Use of Funds for Non-Foreclosed Properties: HUD strictly interprets the HERA NSP statute by stating that vacant properties that have not been abandoned or foreclosed upon are not eligible to meet the 25% low-income set-aside requirement. This interpretation severely restricts the types of multi-family properties that can be acquired and rehabilitated for the lowest income group. HUD should amend its NSP1 and NSP2 Notices to explicitly allow vacant residential and non-residential properties to qualify for the 25% low-income set-aside. If HUD continues to assert that the statute prohibits such a regulatory amendment, it can revise its definition of “abandoned” in the notice such that abandonment is not tied to foreclosure proceedings.
4. Previously Acquired Properties: HUD has limited the eligibility of third-party acquisitions to those properties acquired after the date of submission of the NSP action plan (typically December 1<sup>st</sup>, 2008). The allowable date for these acquisitions should ideally be extended back to the enactment of HERA, or at least to the issuance of the NSP1 NOFA on October 6, 2008. A written agreement prior to acquisition should not be required between a grantee and a third party. Rather, a written agreement should be required only prior to the commitment of NSP funds.

5. Definition of Foreclosed: Properties should be considered foreclosed until they are rehabilitated and reoccupied.
  - a. The acquisition of properties by intermediaries using private funds, such as bulk purchasers or other third-party acquisition entities, should be permitted without negating the foreclosed status of the properties.
  - b. Environmental review requirements should adhere to the CDBG requirements that prohibit the commitment of funds or "choice-limiting action" prior to the completion of the environmental review, but which do not apply to prior acquisitions made with private financing.
  - c. Formal written clarification is required to confirm that other acquisition-related rules (e.g. purchase discount and appraisal) do not apply to projects purchased with private funds and that only receive NSP financing for rehabilitation.
  
6. Definition of Abandoned: Section 2301(c)(3)(B) of HERA allows NSP funds to be used for properties that have been "abandoned." The current HUD definition of "abandoned" is too restrictive because of its strong connection to the foreclosure process and its requirement that a property be vacant for at least 90 days. This is extremely problematic in localities where the buildings have been abandoned by the owner, but rental tenants remain. Therefore, the definition of "abandoned" should be expanded to explicitly state that abandoned properties include those that have been functionally and financially abandoned by their owners, not necessarily by rental tenants.
  
7. Continued Affordability: It is necessary to clarify that "affordable rents" for NSP are not limited to the HOME rents as referenced in 24 CFR 92.252(a) (lesser of FMR or affordability for household at or below 65%AMI). It is also necessary to clarify that lease purchase tenants do NOT *have to* buy their home in 36 months (longer lease purchase periods are OK) and that the HOME rents as referenced in 24 CFR 92.252(a) do NOT apply if the home is not transferred to a homebuyer in 42 months. In both cases, affordable rents should be defined as: A rent that does not exceed 30 percent of the adjusted income of a family whose annual income equals 120 percent of the median income for the area, as determined by HUD, with adjustments for number of bedrooms in the unit.
  
8. Continued Affordability for Tenants of Owner-Occupied Properties: HUD is requiring that rents for small owner-occupied rental properties (2-4 units) must remain affordable for the specified affordability period. As a result, in addition to the affordability requirements placed on the homeowner, the owner must also impose rent restrictions and conduct ongoing income certifications for their tenants. This process can be burdensome on both the owner-occupant and the renters. The HOME regulations allow for a presumption of continued affordability for homeowners in certain markets, but this does not appear to apply to rental units. Therefore, HUD should not require ongoing income certifications for renters in small owner-occupied rental properties in areas where market rents, based on a market study, are expected to remain affordable to 120% of AMI.