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Community Development Block Grants: Legislative Proposals to Assist Communities Affected by Home Foreclosures

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Community Development Block Grants: Legislative Proposals to Assist Communities Affected by Home Foreclosures

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Summary

In response to the rising number of home mortgage foreclosures Congress passed the Housing and Economic Recovery Act of 2008, P.L. 110-289, formerly H.R. 3221 (the Act). Title III — Emergency Assistance for the Redevelopment of Abandoned and Foreclosed Homes — of the Act, which was signed by the President on July 30, 2008, will provide additional federal financial assistance to state and local governments with high concentrations of foreclosed homes, subprime mortgage loans, and delinquent home mortgages.

Many economists contend that increased numbers of foreclosures could contribute to neighborhood destabilization, trigger housing price depreciation, and result in declining state and local revenues and subsequent service cutbacks. Although Congress did include provisions in the Act that reform the mortgage financing industry, this report will focus on legislative provisions of the Act that will allocate block grant assistance to state and local governments to aid them in acquiring, rehabilitating, and reselling the growing supply of foreclosed and abandoned housing. Title III of the Act uses the framework of the Community Development Block Grant (CDBG) program to channel an additional $4 billion in assistance to state and local governments. It should be noted that Title III of the Act overcame a veto threat by the President Bush who contended that the assistance would result in the rescue of lenders and speculators. The bill also drew criticism from fiscal conservatives who argued for cuts in other programs to offset the $4 billion appropriation. This report will be updated as events warrant.

Introduction

The increasing number of mortgage foreclosures poses a financial threat to local housing markets, financial institutions, homeowners, and state and local governments. The impact of the foreclosure crisis on financial institutions and homeowners has been well documented, and has been the focus of congressional debate in the formulation of policy options. The impact on state, local governments, as well as neighborhoods, also has garnered the attention of federal policy makers.

According to a report by the U.S. Conference of Mayors, it is projected that in 2008, mortgage foreclosures:

- may displace 1.4 million households from their homes;
- could result in $1.2 trillion in lost property values; and
- could potentially result in the loss of more than $1.4 trillion in projected real estate tax revenues — important sources of financing local government operations.[1]

Given the prospect of declining revenues, falling property values, and blighted neighborhoods with significant numbers of vacant houses, some local officials have sought relief through judicial actions.[2] In addition, various state and local officials have called for federal intervention.

Congressional Action

In response, several bills, including H.R. 3221,[3] were introduced during the 110th Congress that would address specific issues, including:

- reducing the number of homeowners facing foreclosure because of their inability to keep pace with rising interest rates as their adjustable rate mortgages, many of them on subprime loans, reset;
- reclaiming the supply of vacant housing by providing assistance to states, local governments, and nonprofit entities that may use funds to acquire, resell, rehabilitate, rent, or demolish vacant properties in an effort to minimize potential blight and associated problems in neighborhoods with high concentrations of foreclosed properties; and

[1] United States Conference of Mayors. *The Mortgage Crisis: Economic and Fiscal Implications for Metro Areas.* U.S. Metro Economies. November 2007. Global Insight.

[2] For instance, the cities of Cleveland and Baltimore have filed suits against commercial and investment banks. Cleveland's suit against 21 commercial and investment banks, some of them involved in securitizing mortgage loans, contends that the banks violated state law by creating a public nuisance when providing mortgages to homeowners who could not afford them. This allegedly resulted in a significant number of foreclosures, creating blighted conditions and reducing property values and tax collections. Baltimore's suit against Wells Fargo, which was filed in U.S. District Court of Maryland, Baltimore Division, contends that the bank discriminated against black homebuyers by selling subprime, high interest loans to them at a higher rate than white homebuyers. See *City of Cleveland v. Deutsche Bank,* Court of Common Pleas, Cuyahoga County, Ohio, available at [http://www.city.cleveland.oh.us/pdf/whats_new/ForeclosureDocument1-11-08.pdf], and *Mayor and City Council of Baltimore v. Wells Fargo*, U.S. District Court of Maryland, Baltimore Division, Case No. LO8CV 062, available at [http://www.relmanlaw.com/City%20of%20Baltimore%20v.%20Wells%20Fargo%20-%2008-cv-62%20-%20Complaint.pdf].

[3] Other measures include S. 2455, S. 2636, and H.R. 5818. H.R. 3221 incorporated much of the language of S. 2636.

- addressing declining tax revenues, particularly property taxes and the subsequent cutbacks or curtailment in the delivery of public services.

Foreclosure Prevention Act, H.R. 3221, Title III (P.L. 110-289). The Senate version[4] of the bill, which was introduced by Senator Dodd in the nature of a substitute, initially passed the Senate on April 10, 2008. Subsequently, in an effort to expedite consideration and passage of the measure, the House and Senate engaged in an amendment exchange, rather than establishing a conference committee. Despite initial objections raised by the White House, including the threat of a presidential veto, the measure passed the House on July 23, 2008. Subsequently, the Senate approved the measure on July 26, 2008. Despite his objections to the provisions of Title III and his strong support for other provisions of the Act, the President signed H.R. 3221 into law as P.L. 110-289 on July 30, 2008.

Title III — Emergency Assistance for the Redevelopment of Abandoned and Foreclosed Homes — of the Act as signed by the President, appropriates $4 billion in supplemental assistance to states and local governments, as defined under the CDBG program, based on a separate formula to be developed by HUD. The Act directs HUD to establish an allocation formula that distributes funds to states and local governments with the greatest need as measured by:

- the number and percentage of foreclosed homes in each state or locality;
- the number and percentage of subprime mortgages in each state or locality; and
- the number and percentage of homes in default or delinquency in each state or locality.

The measure gives HUD 60 days after enactment to establish a formula for allocating funds to eligible states and local governments, and an additional 30 days to distribute funds to states and local governments.

Formula or Allocation Elements. Each state and local government that receives funds will be required to allocate funds within 18 months of receipt and to give priority consideration to areas and metropolitan cities with:

- the greatest percentage of home foreclosures;
- the highest percentage of subprime loans; and
- the greatest likelihood of facing a significant rise in the number of home foreclosures.

Although the legislation identifies specific factors to be used by HUD to develop a formula, it does not specify an actual formula other than requiring a minimum allocation for each state of 0.5%. If for illustrative purposes it is assumed that HUD assigned equal weights to the three factors, then a formula to allocate funds under the Act would resemble the following.

$$[(SF/FN) + (SSL/SLN) + (SD/DN)] \div 3 \times \$4{,}000{,}000{,}000 = \text{state allocation}$$

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[4] The House version of H.R. 3221 does not include CDBG funds to buy foreclosed property.

- SF = number of foreclosures in a state.
- FN = number of foreclosures nationwide .
- SSL = number of subprime loans in a state.
- SLN = number of subprime loans nationwide.
- SD = number of delinquencies in a state.
- DN = number of delinquencies nationwide.

Under this scenario foreclosures, subprime loans and delinquencies in a state as a share of the nationwide total would be weighed by one third and multiplied by the $4 billion available in funding.

Eligible Activities. State and local governments could use funds to:

- create financing instruments that would enable them to finance the purchase and redevelopment of foreclosed homes and residential properties;
- purchase and rehabilitate foreclosed homes and residential properties for sale, rent, or redevelopment;
- establish land banks for foreclosed homes; and
- demolish blighted structures.

Restrictions, Limitations, and Prohibitions. The Act limits the purchase price of a home or residential property acquired by a state or local government to an amount less than the home's current appraised market value. The discounted value should be significant enough to ensure that when the home is sold by the state or local government the purchaser (homebuyer) will pay below market value for the home or property. Further, when a foreclosed home or property is to be purchased as a primary residence by an eligible homebuyer, the act would limit the price for which a state and local government may resell such property to no more than the cost the state or local government paid to acquire and redevelop or rehabilitate the property.

During the first five years following its enactment, the Act requires a community or state to reinvest all profits in additional sales, rentals, redevelopment, and rehabilitation of foreclosed homes and properties. After the five-year period, all profits may be deposited in the U.S. Treasury unless HUD approves a request to allow a community or state to continue to use funds to finance activities eligible for assistance under the Act. Other provisions of the bill would subject funds and revenues generated by activities under this Act to the same requirements as funds appropriated under the regular CDBG program. However, for the sole purpose of expediting the use of funds under the Act, HUD may issue alternative requirements to those governing the regular CDBG appropriations, except for requirements related to fair housing, nondiscrimination, labor standards, and environmental review. In addition, the legislation:

- prohibits funds from being used in economic development projects involving the use of eminent domain;
- limits the income of individuals and families who may benefit from assistance provided by the act to those whose incomes do not exceed 120% of the area's median income;
- requires a state and local government to certify that at least 25% of the amount allocated by the bill will be used to purchase and redevelop

housing for individuals and families whose incomes do not exceed 50% of the area's median income; and

- requires that each state receives a minimum allocation of 0.5% of the amount appropriated.

Analysis

Weighing Foreclosures, Subprime Loans and Delinquencies. Although P.L. 110-289 directs HUD to take into account high concentrations of foreclosed homes, subprime loans, and mortgage delinquencies/defaults when developing an allocation formula, it provides HUD broad discretion over how these factors are to be weighted. Different weighting would result in differing allocation patterns.

Table 1 presents data from the Mortgage Bankers Association (MBA) showing the distribution of foreclosures, subprime loans, and defaults, differs among the states. In some cases — for example Georgia and Indiana — states have the same number of foreclosures: 31,000. However, Georgia has nearly twice as many subprime loans (209,000) than Indiana (124,000). In addition, Georgia has almost one-third as many homes in default (67,128) than Indiana (49,069).

Therefore, if absolute numbers of foreclosures, subprime loans, and defaults were used to rank states, then Georgia and Indiana would receive the same amount of funding for foreclosures, but different amounts for subprime loans and mortgage defaults. On the other hand, if states are ranked based on the percent of the total, both Indiana and Georgia represent 3.3% of total foreclosures in the nation. However, Georgia represents 3.6% of subprime loans and 4.0% of homes in default while Indiana represents 2.1% of subprime loans and 2.9% of mortgage defaults.

Table 1. Ranking of States by Relative Share of Foreclosures, Subprime Loans, and Mortgage Defaults as of 12/31/2007

	Foreclosures			Subprime Loans			Defaults		
State	Number	Share of total	Rank	Number	Share of total	Rank	Number	Share of total	Rank
California	132,830	14.2%	1	768,629	13.1%	1	228,133	13.7%	1
Florida	115,457	12.3%	2	573,562	9.8%	2	186,093	11.2%	2
Ohio	60,070	6.4%	3	221,457	3.8%	5	91,188	5.5%	4
Michigan	51,914	5.5%	4	212,296	3.6%	7	91,081	5.5%	5
Illinois	43,499	4.6%	5	215,477	3.7%	6	69,251	4.2%	6
Texas	42,821	4.6%	6	408,399	7.0%	3	99,495	6.0%	3
New York	39,403	4.2%	7	280,767	4.8%	4	61,978	3.7%	8
Georgia	31,111	3.3%	8	209,008	3.6%	8	67,126	4.0%	7
Indiana	31,098	3.3%	9	124,399	2.1%	15	49,069	2.9%	10
Pennsylvania	27,749	3.0%	10	206,662	3.5%	9	52,069	3.1%	9
New Jersey	24,432	2.6%	11	137,337	2.3%	13	40,074	2.4%	11
Arizona	22,060	2.4%	12	187,029	3.2%	10	38,048	2.3%	12
Minnesota	20,536	2.2%	13	90,171	1.5%	21	31,359	1.9%	15

State	Foreclosures Number	Foreclosures Share of total	Foreclosures Rank	Subprime Loans Number	Subprime Loans Share of total	Subprime Loans Rank	Defaults Number	Defaults Share of total	Defaults Rank
Colorado	19,349	2.1%	14	117,102	2.0%	17	32,040	1.9%	14
Nevada	17,350	1.8%	15	101,528	1.7%	20	28,783	1.7%	18
North Carolina	17,116	1.8%	16	145,611	2.5%	11	37,062	2.2%	13
Massachusetts	16,394	1.7%	17	88,813	1.5%	22	26,787	1.6%	21
Virginia	14,402	1.5%	18	137,368	2.3%	12	30,372	1.8%	17
Wisconsin	13,950	1.5%	19	61,773	1.1%	27	21,049	1.3%	24
Maryland	13,204	1.4%	20	125,653	2.1%	14	27,491	1.7%	19
Missouri	12,873	1.4%	21	107,850	1.8%	19	27,366	1.6%	20
South Carolina	12,361	1.3%	22	76,229	1.3%	23	21,797	1.3%	23
Tennessee	12,355	1.3%	23	120,406	2.1%	16	31,020	1.9%	16
Kentucky	10,362	1.1%	24	51,969	0.9%	30	17,241	1.0%	26
Louisiana	9,739	1.0%	25	65,343	1.1%	24	19,621	1.2%	25
Oklahoma	8,906	0.9%	26	51,743	0.9%	31	14,727	0.9%	28
Washington	8,727	0.9%	27	114,124	2.0%	18	16,847	1.0%	27
Connecticut	8,459	0.9%	28	62,626	1.1%	26	13,808	0.8%	29
Alabama	8,391	0.9%	29	60,273	1.0%	28	23,013	1.4%	22
Iowa	7,165	0.8%	30	28,230	0.5%	35	10,800	0.6%	31
Mississippi	5,473	0.6%	31	38,467	0.7%	32	13,502	0.8%	30
Kansas	5,182	0.6%	32	32,563	0.6%	33	9,682	0.6%	32
Oregon	4,679	0.5%	33	64,764	1.1%	25	8,578	0.5%	33
Arkansas	3,618	0.4%	34	29,172	0.5%	34	8,452	0.5%	34
Utah	3,557	0.4%	35	52,987	0.9%	29	7,025	0.4%	35
Rhode Island	3,417	0.4%	36	19,227	0.3%	40	5,530	0.3%	37
Maine	3,414	0.4%	37	18,563	0.3%	41	5,064	0.3%	40
Delaware	3,307	0.4%	38	17,628	0.3%	43	5,274	0.3%	39
Nebraska	3,154	0.3%	39	18,291	0.3%	42	5,504	0.3%	38
New Hampshire	2,892	0.3%	40	22,669	0.4%	38	6,599	0.4%	36
New Mexico	2,688	0.3%	41	24,585	0.4%	37	4,959	0.3%	41
Idaho	2,412	0.3%	42	25,035	0.4%	36	4,288	0.3%	42
Hawaii	1,944	0.2%	43	19,572	0.3%	39	3,204	0.2%	44
West Virginia	1,827	0.2%	44	16,242	0.3%	44	4,002	0.2%	43
Montana	1,038	0.1%	45	8,392	0.1%	47	2,117	0.1%	45
South Dakota	975	0.1%	46	4,800	0.1%	49	1,564	0.1%	47
District of Columbia	950	0.1%	47	8,793	0.2%	46	1,966	0.1%	46
Vermont	907	0.1%	48	4,745	0.1%	50	1,344	0.1%	48
Alaska	629	0.1%	49	10,319	0.2%	45	1,135	0.1%	49
Wyoming	588	0.1%	50	6,016	0.1%	48	964	0.1%	50
North Dakota	514	0.1%	51	2,996	0.1%	51	891	0.1%	51
Other	30,905	3.3%		251,352			58,330		
U.S.	938,152	100.0%		5,849,012			1,664,760		

Source: CRS, based on MBA data available at [http://www.hopenow.com/site_tools/data.html].