

Testimony of

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Joint Hearing on

“Targeting Federal Aid to Neighborhoods Distressed by the Subprime Mortgage Crisis”

House Oversight and Government Reform Committee,  
Domestic Policy Subcommittee and

House Financial Services Committee Housing,  
Community Opportunity Subcommittee

May 22, 2008



Chairman Kucinich, members of the subcommittee, thank you for the opportunity to present my views on this subject of pressing national importance. (Before I begin, I would like to acknowledge the expert assistance of my colleague, Francisca Winston, in carrying out the analysis I report on here.)

For nearly 30 years, the Local Initiatives Support Corporation, of which I am Director of Research and Assessment, has invested in America's low-and-moderate income neighborhoods to make them better places to work, raise families, and pursue life's opportunities. Last year alone, we channeled more than \$1 Billion into affordable housing and other community revitalization projects, and into the community-based non-profit organizations that carry them out.

We have seen many of these same communities hit hard by a wave of foreclosures tied to subprime lending. Staff accounts from the 30 cities where we maintain offices, as well as reports from revitalization partners and local journalists, point toward a sharp upswing in the number of properties that remain vacant as foreclosed properties wend their way through the legal process. In turn, these vacancies trigger other vacancies, as the housing market responds to the deterioration in neighborhood quality these empty units produce. The net result is concentrations of vacant properties that undermine property values, harbor crime, and cause further deterioration.

Over the last six months, we at LISC have been exploring the patterns of subprime mortgage origination and loan performance across the United States to identify neighborhoods where concentrated foreclosures have occurred, and help our staff develop appropriate responses. For example, we ranked all US metropolitan area counties based on the numbers of neighborhoods that are most at risk of concentrated foreclosures due to subprime lending. We supplied maps of these neighborhoods to each of our offices, and we continue to track the numbers of foreclosures in these places using data available from proprietary sources.

At the invitation of committee staff, we turned our attention to the uses these and other data could be put to help the Congress target vacant property funding to areas that are most in need. These are areas with the largest increases in vacant properties resulting from mortgage foreclosures. Although our work is still in its early stages, we conclude that currently available data show considerable promise as a means to make reasonably accurate identifications of areas where increased vacancies have resulted from mortgage defaults and foreclosures. That said, a considerable amount of work remains to be done to realize that promise.

One of our tasks was to establish the strength of statistical relationships between home mortgage loan performance and residential vacancies. We had the following sources available to us:

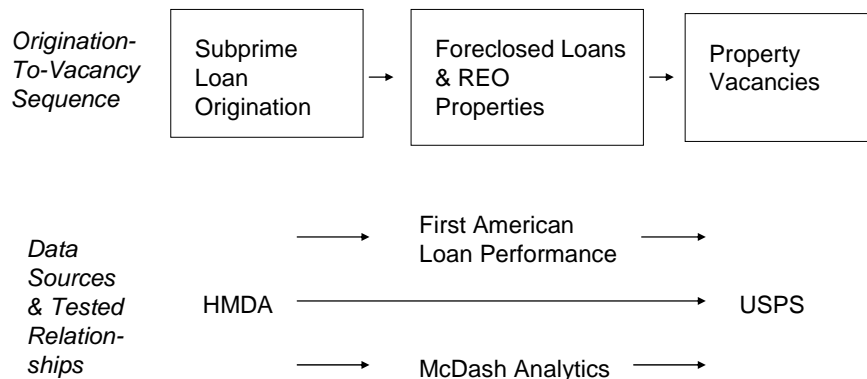
- United States Postal Service (USPS) data on occupied and vacant addresses, and addresses that are in the process of either being withdrawn or being entered into active use. HUD makes these data available quarterly, for free, at the census tract level, but we analyzed them at the zipcode level to match the geographies available for other data. Our analysis covers changes in vacancies between April 2007 and March 2008.
- First American Loan Performance data on numbers of subprime loan originations, delinquencies, foreclosures, and real-estate-owned properties, as well as other information on loan terms for approximately 50 percent of the subprime lending market. These data were made available in late 2007 by the Federal Reserve at the zipcode level, and present a snapshot of the inventory as of October 2007. We understand that these data are no longer available in downloadable form, nor are they available for purchase to those outside the financial services industry.
- McDash Analytics data on the principal dollar volume of subprime loan originations, delinquencies, and foreclosed loans, including those that are real estate owned. These data are available monthly at the zipcode level on a subscription basis, and cover about the same portion of the subprime market. Our analysis uses the most recent available data, which presents a snapshot of the inventory as of March 2008.
- Home Mortgage Disclosure Act (HMDA) data on origination of “high-cost” loans, which include those that are subprime. These data are available at no cost at the census tract level from the Federal Financial Institutions Examination Council. Our analysis uses data from 2005 and 2006, the most recent years for which data are available.

Before turning to our findings, it’s worth noting that none of these data are perfect, and researchers are only beginning to become expert in their advantages and limitations. The USPS data are unusually fresh and on-point for analysis of neighborhood vacancies. But they were designed to help postal workers deliver mail, not carry out neighborhood analysis, so further diagnostic and data treatment efforts are needed. Each of the First American and McDash data covers only part of the subprime mortgage market, and it is not yet clear how these sources overlap. The HMDA data are very well understood by

now, and they have been used in a number of high-quality statistical analyses of neighborhood conditions. But even these data must be used with some care.

Our research task was to determine whether changes in property vacancies could be linked in some way to the performance of loans in the subprime market. Exhibit 1 diagrams the commonly encountered relationships between loan origination, eventual foreclosures and real-estate-owned (REO) properties, and property vacancies. To each of these steps in the sequence corresponds a source or sources of data available to measure these elements at the zip code level.

Exhibit 1  
Research Model and Tested Relationships

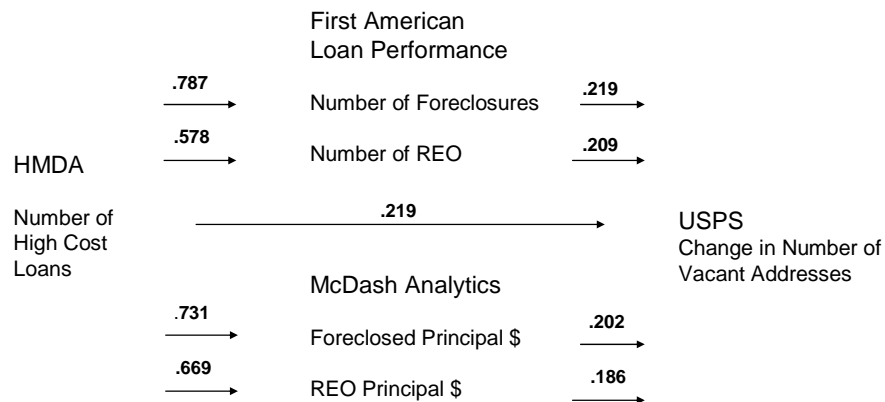


In our statistical tests, we examined the relationships between the numbers of subprime loans originated in a zip code – from HMDA – and the numbers and unpaid principal balances of foreclosed loans and real-estate-owned properties -- from First American Loan Performance and McDash Analytics. (Because of the work required to prepare data for use, we carried out these tests only for the 20 largest states.) We then examined relationships between these loan performance indicators and the *increase* in numbers of vacant properties as indicated in the USPS data. (Although all vacancies affect neighborhood quality, we wanted to capture only those vacancies likely to be the result of foreclosed loans.) Because HMDA data are more readily available to analysts than either of the proprietary sources of data, and have a broader coverage of the market, we also tested the direct relationship between the volume of loan originations on the one hand and property vacancies on the other.

Exhibit 2 shows the results of our analysis for all zip codes in the 20-state sample. The numbers above the arrows depicting each relationship correspond to the simple statistical correlations between each pair of variables. This “correlation coefficient” ranges from 0 to 100, with 0 meaning “no relationship” and 100 signifying a perfect relationship.

As the exhibit shows, high cost loans tend to be closely tied to the number (.787) and dollar volume of the unpaid principal balance (.731) of foreclosures, as well as to the dollar volume of unpaid principal for loans on REO properties (.669) and the number of REO properties (.578). In other words, knowing only the number of high-cost loans, an analyst can make a very good prediction about the number of subsequent subprime foreclosures, and to a lesser extent, the number of real-estate-owned properties.

Exhibit 2  
Statistical Relationships Among Originations, Loan Performance  
and Vacancies



Note: Numbers are Simple Correlations

Statistical relationships between the number and unpaid principal balances of foreclosed loans, and those in REO status and the change in number of vacant addresses, are not as strong. In fact, we don't expect these correspondences to be extremely high, insofar as other factors in addition to subprime loan performance are likely to create or remove vacancies. Put another way, not all subprime loans create vacancies, and not all vacancies are the result of subprime loans.

These results point the way toward two further analysis tasks that must be carried out successfully before the data are suitable for use in targeting aid to areas of high vacancy due to foreclosure. The results from early testing argue strongly for continued work to strengthen the relationships discussed here.

The first task is to verify that the strong relationships already identified at the national level between HMDA loan originations and subsequent loan performance hold true at State levels, as well. (The appropriated funds are slated to be allocated by States.) If they do, then HMDA data can be used as a proxy for a more direct, but less available, measure of loan performance. Based on our analysis of the 20 States in our sample, we have verified the generally close tie between numbers of high-cost originations and numbers of subprime loan foreclosures.

That said, correlations in six States fell below .875, roughly corresponding to an inability to explain more than 75 percent of the variation in foreclosure volume across zip codes (a high bar by social science standards). In these States, other unaccounted for factors must influence the relationship between originations and foreclosures. The most obvious of these factors, and one easily accounted for in future analysis, is house price trends: differences in market strength across metropolitan areas within a state, for example, are very likely to influence demand for properties that have entered foreclosure and the resulting likelihood of their remaining vacant for long periods.

Second is the generally low correspondence between loan originations, foreclosures, and REO properties on the one hand and increases in vacant addresses on the other. As noted, we don't expect this relationship to be a perfect one, but it would be wise to explore patterns in the data to validate construction of indicators using this source. For example, we examined relationships state-by-state, and found the highest positive correlation between HMDA 2006 loan originations and change in vacant addresses in Michigan (.470), and the highest negative correlation (an unexpected result) in Pennsylvania (-.246). We don't yet know why this difference occurred.

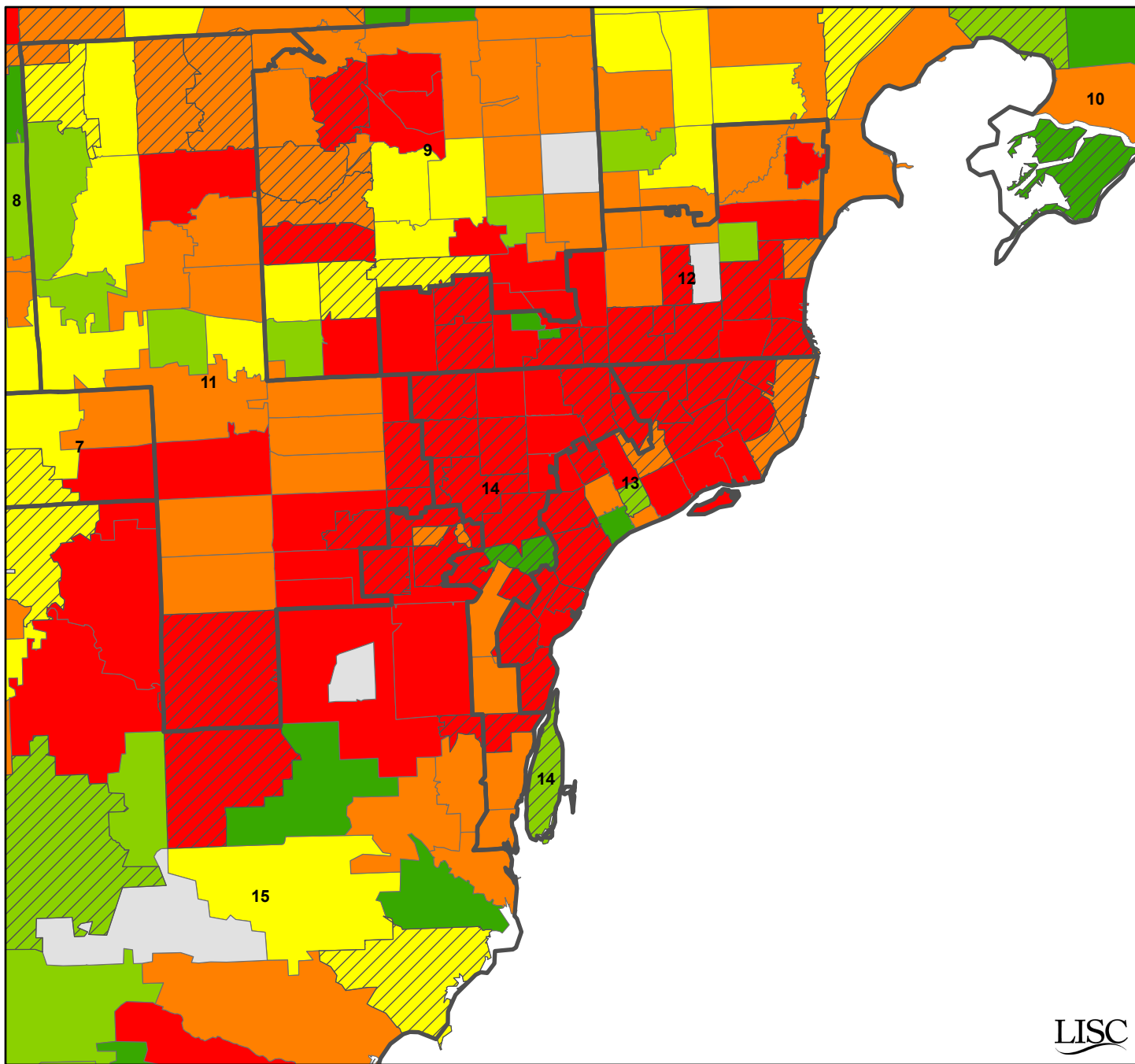
To further explore these data, we drew distinctions between metropolitan and non-metropolitan areas, included loans originated in both 2005 and 2006, distinguished between loans made to owner-occupants and investors, and considered a measure of the change in occupied residential addresses in addition to change in vacant addresses. We believe that more work on the relationship between investors and owner-occupants and changes in occupied addresses and vacancies, by metropolitan area status, offers a promising avenue to development of workable targeting criteria.

For example, in Michigan, the higher the number of high-cost loans to investors, the higher the number of vacancies from 2007 – 2008 (.552) and the lower the number of occupied addresses (-372); the corresponding correlations for owner-occupants were .425 and -.224, respectively. Correlations of this magnitude, used to guide appropriate groupings of data, may allow us to construct measures that reliably identify areas of foreclosure-related vacancy.

Continuing the Michigan example, Map 1 displays zip codes in the Detroit metropolitan area, classified according to the number of high-cost loans made to investors in 2006. The map also identifies areas where vacant addresses increased and occupied addresses declined between 2007 and 2008. As the map shows, there appears to be a reasonably strong correspondence between investor loan volume and areas of increased vacancy and declining occupancy, although there remain areas of occupancy and vacancy change that remain unassociated with large numbers of investor loans. As another example, Map 2 shows the same information for Northeastern Ohio, where there appears to be an even stronger correspondence between loans to investors and vacancy and occupancy changes.

More of these kinds of State- and metropolitan- areas analyses will have to be done to validate use of the USPS data in conjunction with HMDA and other sources for the purpose of targeted funds to areas of need. Based on the work we have done to date, we have considerable confidence that this can be done in the not-too-distant future.

**Map 1**  
**Relationship Between High Cost Mortgage Loans Made to Investors in 2006 &**  
**Change in Vacant and Occupied Addresses 2007-08**  
**Detroit Metro, MI**



Data Sources: Home Mortgage Disclosure Act, 2006;  
 USPS Administrative Data On Address Vacancies March 2007 & 2008

0 2 4 8 Miles

**Quintile of Investor High Cost Loans by Zip Code**

- 0 - 2
- 3 - 5
- 6 - 10
- 11 - 25
- 26 or more
- Increasing Vacant & Decreasing Occupied Addresses 2007-08
- No Loan Data
- Congressional Districts

**Notes**

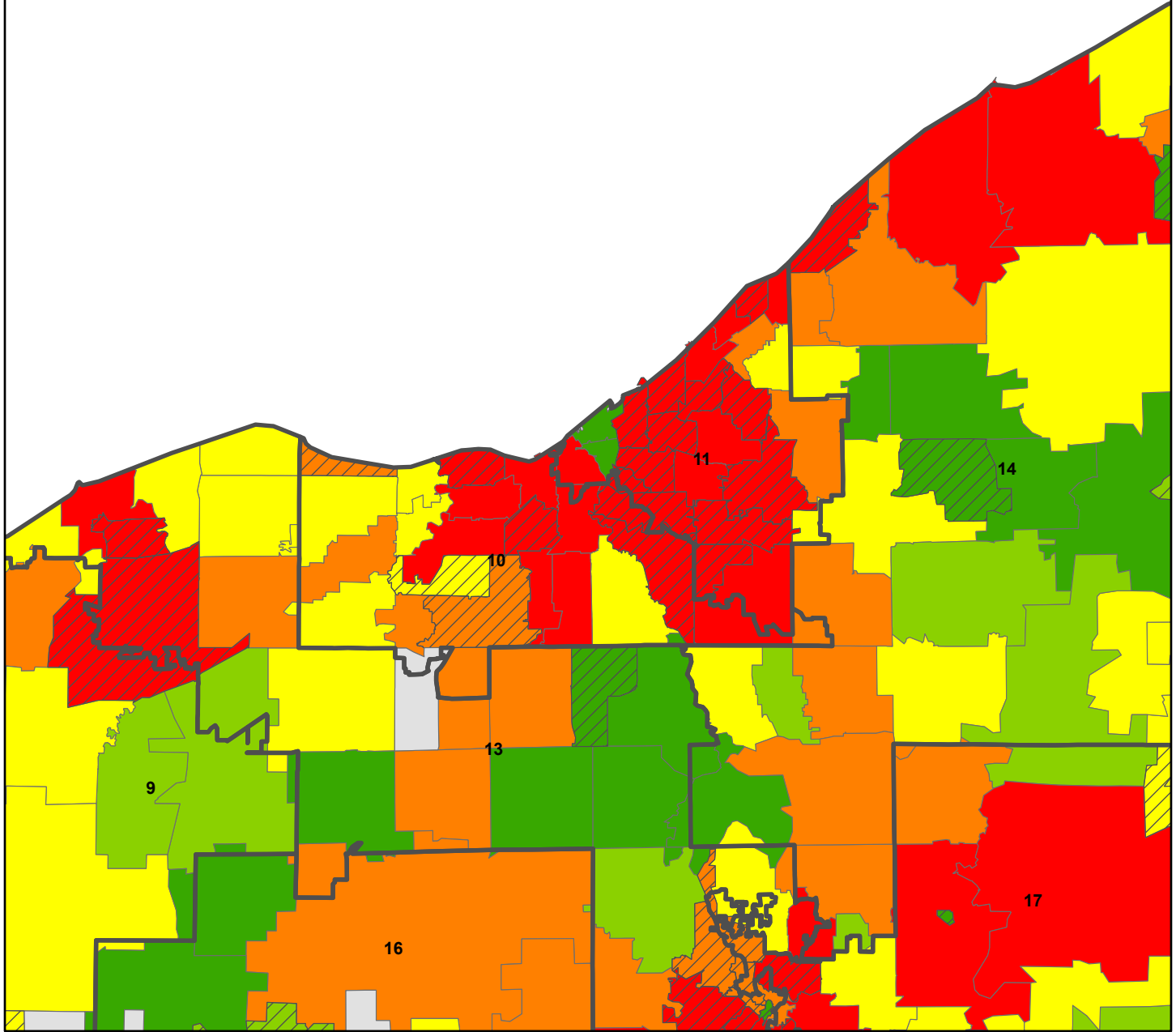
Includes single-family home purchase and home refinance loans originated in 2006.

Quintiles are based on loans originated in all Michigan zip codes.

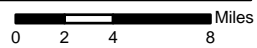
High cost loans have interest rates 3 percentage points above comparable Treasury rates for first liens and 5 percentage points above for junior liens.

**Map 2**  
**Relationship Between High Cost Mortgage Loans Made to Investors in 2006 &**  
**Change in Vacant and Occupied Addresses 2007-08**  
**Northeastern Ohio**

LISC



Data Sources: Home Mortgage Disclosure Act, 2006;  
 USPS Administrative Data On Address Vacancies March 2007 & 2008



**Quintile of Investor High Cost Loans by Zip Code**

- 0 - 2
- 3 - 4
- 5 - 10
- 11 - 30
- 31 or more
- Increasing Vacant & Decreasing Occupied Addresses 2007-08
- No Loan Data
- Congressional Districts

**Notes**

Includes single-family home purchase and home refinance loans originated in 2006.

Quintiles are based on loans originated in all Ohio zip codes.

High cost loans have interest rates 3 percentage points above comparable Treasury rates for first liens and 5 percentage points above for junior liens.