

## **ADDRESSING OHIO'S FORECLOSURE CRISIS: Taking the next steps**

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### **ABSTRACT**

*Facing the worst foreclosure crisis since the Great Depression, the state of Ohio has responded by focusing on helping the individuals keep their homes. While more needs to be done in that area, including leveling the playing field of the foreclosure process, the state must direct more attention and more resources to the devastating effects that foreclosures are having on entire communities, from the urban neighborhoods of Cleveland or Cincinnati to suburban and rural communities across the state.*

*This paper lays out a detailed, concrete series of steps by which the state can not only better help homeowners and tenants affected by foreclosure, but help stabilize its distressed neighborhoods and communities. These steps include legislative actions as well as changes to existing state programs. Recognizing the constraints on state resources, most of the steps recommended in this paper involve no cost to the state or local government, though some require modest outlays. Ultimately, if the state carries out these recommendations, it will not only benefit many thousands of Ohioans directly, but will preserve billions in property values and untold millions in state and local tax revenues that would otherwise be lost.*

### ***Introduction***

Ohio has already taken important steps to address the state's ongoing foreclosure crisis, yet the crisis continues, causing distress for thousands of families and individuals, and destabilizing cities, towns and neighborhoods across the state. Therefore, the state, its local governments and private stakeholders need to do still more to deal more effectively with the crisis and its impacts on the state's housing stock, cities and neighborhoods.

What is often termed the "foreclosure crisis" is actually a multi-dimensional crisis, in which the collapse of the housing bubble, the devastation caused by the lax and often irresponsible credit practices that accompanied and perpetuated that bubble, the resulting freeze on commercial and consumer credit, and the worldwide recession are interwoven, and can only with great difficulty be untangled. In Ohio, those forces are further

exacerbated by profound changes to the state's historical economic underpinnings. Ohio cannot solve the crisis by itself, but it can significantly mitigate its impact on people, neighborhoods, and towns and cities. These mitigating efforts will also help preserve the value of homes and neighborhoods in the state, and place Ohio in a stronger position to benefit from the future economic recovery.

The paper begins with a short summary of current conditions and the actions the state has already taken to address the wave of foreclosures, followed by a discussion of areas for future action. This discussion will address mitigating both the individual and community impacts of foreclosure, but will give particular emphasis to the critical issue of softening the blow of foreclosure on communities, which up to now has been less of a focus for state action.

### ***The foreclosure crisis in Ohio***

Since the beginnings of the national foreclosure crisis, Ohio has been at its forefront; indeed, foreclosures had reached crisis levels in Ohio well before the issue had become a major concern in much of the rest of the United States. Statewide foreclosure filings exceeded 50,000 in 2002 after rising steadily since the mid-1990's, and have continued to rise, reaching 79,072 in 2006 and 84,751 in 2007. Almost half or 48 percent of the 2006 filings were in six large, heavily urbanized counties, which contain only 36 percent of the state's population.<sup>2</sup> As of the middle of 2008, the Mortgage Bankers Association reported that 7.17 percent of Ohio mortgage holders were delinquent in their payments, and 3.97 percent, or 1 out of every 25 mortgages, were in foreclosure. By this measure, Ohio has the 3<sup>rd</sup> highest foreclosure rate in the United States. According to RealtyTrac, 113,570 properties statewide were in some form of foreclosure in 2008.

The situation is not likely to improve in the next few years. As the recession deepens and housing prices continue to drop, the number of foreclosures is likely to grow rather than decline, at least for the next one to two years. While the first wave of foreclosures was disproportionately made up of subprime loans, the next wave is likely to include large numbers of so-called Alt-A and no-doc loans, many of which will reset during 2009 and 2010. A recent report by Credit Suisse projects a total of 8.1 million foreclosures nationwide by the end of 2012.

Ohio is unlikely to be an exception to this grim picture. The statewide unemployment rate has been running roughly 8 to 10 percent above the national rate. Thousands of Ohioans have already lost their homes through foreclosure, and thousands more are likely to before the crisis has run its course. Cleveland and other hard-hit cities may even see a second wave of foreclosures, as buyers of foreclosed and other distressed properties lose them in turn in subsequent foreclosure proceedings.

As foreclosures increase, a series of effects, sometimes referred to as the *secondary effects* of foreclosure, become visible:

- Foreclosures lead to deterioration and loss of value of the property being foreclosed.
- Foreclosures lead to diminution of the value of surrounding properties; the more foreclosures in the immediate vicinity, the greater the loss of value.
- Foreclosures destabilize neighborhood economic and social conditions.
- Foreclosures destabilize the fiscal condition of state and local governments, by imposing additional cost burdens while reducing the revenues they have available.

As properties go through foreclosure, they lose value. By the time of the sheriff’s sale, they have often been vacant for months, and undergone significant property damage. Meanwhile, they devalue the properties around them, destabilizing the neighborhoods where they are located. Property values plummet, as recent data from a number of Cuyahoga County municipalities shows (Table 1).As recently as 2005, median house prices in both Cleveland and East Cleveland were in the vicinity of \$100,000.

Along with foreclosures and the loss of property value, the social and economic fabric of neighborhoods is destabilized. Once-healthy blocks become shadows of their former selves, as maintenance declines and those who can afford to leave get out. Municipalities and counties lose revenues as property tax collections decline, and home owners

**TABLE 1. House Price Trends in Selected Cuyahoga County Municipalities**

| Municipality         | Median sales price<br>—first half of 2007 | Median sales price<br>—first half of 2008 | One year percent<br>change |
|----------------------|---|---|----------------------------|
| Maple Heights        | \$97,620                                  | \$32,000                                  | - 67.2                     |
| Warrensville Heights | \$82,000                                  | \$25,000                                  | - 69.5                     |
| Cleveland            | \$62,000                                  | \$15,500                                  | - 75.0                     |
| East Cleveland       | \$25,000                                  | \$ 4,575                                  | - 81.7                     |

*Source: Cleveland Plain-Dealer, July 8, 2008*

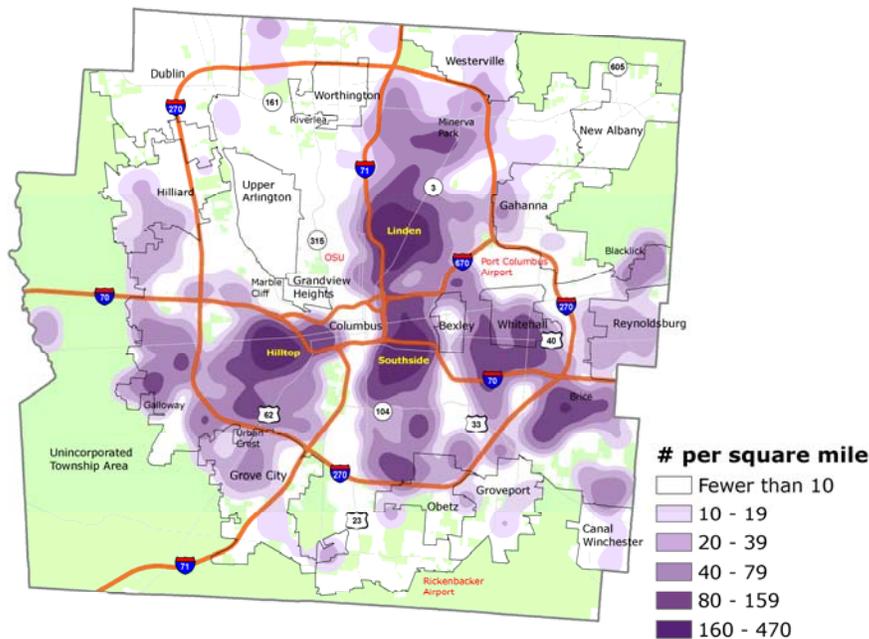
increasingly contest their now-inflated property assessments. As revenues decline, the costs to the municipalities go up, as the increase in vacant, boarded buildings demands more expenditures for policing and firefighting, increased code enforcement efforts, and more nuisance properties in need of demolition.

These effects do not come from foreclosure as such, in the sense of a legal procedure, but from the close relationship between foreclosure, disinvestment, abandonment and vacancy in properties subject to foreclosure, a process that—except in areas of high property values—regularly leads to the properties being abandoned. This nexus may not be inevitable, but it is pervasive, particularly in Ohio’s older cities, smaller villages and inner-ring suburbs.

And, as the map below shows, foreclosures, and therefore their secondary effects, are not evenly distributed within the cities and villages where they tend to be most widely found.

As the map of sheriff's sales in Columbus indicates, they cluster—often in neighborhoods largely populated by people of color—which three and four years ago saw concentrations of subprime lending. These are today most often the areas which have already been severely destabilized, or are at greatest risk of future destabilization.

## Sheriff's Sales in Columbus, Ohio Jan. 2005–Mar. 2008



Ohio must pay particular attention to the secondary effects of the foreclosure crisis. The state must see this crisis in its full dimensions—not only a disaster to the struggling families that are losing their homes, but as a force that is undermining the social and economic vitality of the state and its communities, from which it may take decades to recover. To the extent that the state can take steps in the next year or two to counteract that force, and mitigate its effects, those efforts will recoup great benefit to the state and its citizens both immediately and in the long-term.

### *Ohio's response to the foreclosure crisis*

Ohio has been one of the nation's leaders in its efforts to address the foreclosure crisis and reach out to those at risk of losing their homes, with every branch of state government making an effort to address the problem. At the same time, the state's resources may be inadequate to help all those in need.

In May 2006, the Ohio Legislature passed SB 185, one of the first pieces of state legislation to deal with some of the predatory and sub-prime lending practices that had fueled the crisis. SB 185 also gave the state Attorney General greater power to enforce the laws dealing with mortgage lending, including the Ohio Mortgage Broker Act.<sup>3</sup>

Since taking office at the beginning of 2007, the Strickland administration has:

- Created the “Save the Dream” initiative, designed to alert borrowers at risk, and increase their access to information and counseling assistance
- Negotiated a “Compact to Help Ohioans Preserve Homeownership” with nine major mortgage companies to provide (1) substantial modification efforts for ARMs and sub-prime mortgages; (2) good-faith efforts to contact at-risk or defaulting borrowers; and (3) regular progress reporting.
- Convened a foreclosure prevention task force, which submitted its report to the governor in September 2007
- Created the Opportunity Loan Refinance Program in the Ohio Housing Finance Agency (OHFA)<sup>4</sup>

Finally, in February 2008, the Ohio Supreme Court announced the creation of a Foreclosure Mediation Program Model designed to provide all common pleas courts with best practices and support for local foreclosure-mediation programs. In tandem with this program, the Ohio state court system has made a major effort to enlist attorneys to represent homeowners in foreclosure proceedings, including CLE training for participating attorneys and technical support from lawyers experienced in foreclosure and consumer law.<sup>5</sup>

It is not clear what effect these initiatives have had. Targeted efforts by a coalition of community-based organizations to increase foreclosure prevention counseling appear to have made a difference for many homeowners in Cleveland—foreclosures have been stopped for 50 percent of the families that have entered the counseling network, with one member organization, Empowering and Strengthening Ohio’s People (ESOP), stopping foreclosures for 85 percent of its clients for the period between March 2007 and February 2008. Only 20 percent of the borrowers who were the subject of foreclosure filings, however, entered the foreclosure prevention system and benefited from the counseling provided.

Many of the other programs are very recent. Both the Compact and the mediation program were initiated in 2008. Programs such as the Opportunity Loan Refinance Program, although worthy, do not have the money to help more than a minute share of the households who could potentially benefit from the program. This is not a reflection of the quality of the programs, but reflects instead the fact that state governments do not have sufficient resources to make a state-funded mortgage refinancing program anything more than a token effort.

Ohio’s foreclosure efforts have largely been focused on the homeowners directly affected by foreclosure, rather than their communities. This emphasis is starting to change, as the state’s receipt of federal Neighborhood Stabilization Program (NSP) funds, along with the obligation to submit neighborhood stabilization action plans to HUD, has led the state to begin playing a more energetic role in addressing communitywide issues. In tandem

with the NSP funds, the Ohio Housing Finance Agency (OHFA) plans to use the increase in tax-exempt bond issuing volume cap that it received under the federal Housing & Economic Recovery Act enacted in the summer of 2008 to develop new financing products targeted to distressed neighborhoods. OHFA is also working with local partners in Cleveland to support the Opportunity Homes project to demolish, rehabilitate or preserve 750 homes in six targeted neighborhoods.

### ***Thinking about the state's role in the foreclosure crisis***

The efforts described above are an admirable beginning, but the state must do more. The crisis is destabilizing not only Ohio's cities but the state as a whole, with severe long-term impacts for the state's future economic recovery. If the state can tackle this issue in ways that will significantly mitigate its impacts on the state's social and economic health, and preserve its opportunities for the future, the resources it spends in this area will be well-spent.

Before offering specific recommendations, however, it is important to devote some space to a fundamental question—how should a state with limited resources facing a massive problem think about the foreclosure issue and frame its response?

With the recession taking a toll on state revenues, over the next few years the state government will have a hard time maintaining essential services and programs. The money is just not there at the state level to undertake mortgage refinancing or property acquisition programs at a scale that would have a significant impact on the problem. To the extent that significant resources may be directed to those areas in the future, they will have to come from the federal government.

Moreover, helping homeowners and helping to stabilize neighborhoods are not either-or propositions, but rather are part and parcel of the same strategy. Foreclosures and their impacts are a constantly moving target. If a city or CDC manages, with great expenditure of time and money, to rehabilitate 50 houses in a neighborhood, during which time another 100 on the same blocks are foreclosed and abandoned, the effort may well be for naught. Neighborhood stabilization efforts can only succeed if Ohio can also stem the tide of foreclosures.

As a result of the state's constrained resources and the inextricable relationship between individual foreclosures and their neighborhood effects, Ohio policy-makers must develop a new way of thinking about the foreclosure problem and press forward on two kinds of strategies that are often overlooked:

- Revising legal systems and procedures to change the dynamics in the foreclosure process that today lead so inexorably to loss of homes, vacancy, abandonment and neighborhood destabilization
- Providing stronger tools to those in state and local government, and the public and private sectors seeking to address the crisis on the ground.

Some small steps along these lines have already taken place, such as enactment of HB 138, which requires foreclosing entities to immediately record their deed after sheriff's sale, or the severely watered-down land banking bill enacted at the end of 2008. More legislative changes are needed, however, and if Ohio is to mount a serious attack on the foreclosure crisis and tackle the destabilization of its communities, an ongoing partnership must be forged between the Strickland administration and the Legislature.

### ***Action steps for Ohio state government***

The state's actions should be driven by the seven distinct objectives listed below. Ohio has already taken important steps in some areas, limited steps in some of the others, and none yet in still others:

1. Get borrowers better information about their options, and greater access to counseling, emergency assistance and loan modification opportunities before it is too late for them to exercise those options.
2. Create a fair foreclosure process, with ample protection for borrowers and opportunity to negotiate with creditors.
3. Prevent predatory and fraudulent mortgage and foreclosure "rescue" practices
4. Break the nexus between foreclosure, disinvestment, vacancy and abandonment.
5. Enhance the ability of responsible parties in the public and private sector to gain control of properties for productive reuse or land banking.
6. Support effective, targeted local strategies for neighborhood stabilization and market recovery.
7. Take complementary state actions to support effective foreclosure prevention and neighborhood stabilization activities.

The first three categories address the needs of homeowners in foreclosure, or at risk of foreclosure, while the last three specifically focus on the secondary effects of foreclosure. The fourth area, breaking the nexus between foreclosure, vacancy, and abandonment, is particularly important, as it addresses both primary and secondary effects. Each objective

will be discussed below, with specific policy recommendations which can be accomplished either through legislation or administrative action. For convenience and economy, each recommendation is only given once, even though many have at least some bearing on more than one of the above categories.

A number of the action steps specifically call for imposing further burdens on lenders, servicers and others initiating the foreclosure process, which may have financial or liability implications for those entities.<sup>6</sup> While the legal authority of the state to enact these measures is not in serious doubt, the financial industry is almost certain to object to some of these measures, arguing that they will have a “chilling effect” on mortgage lending in Ohio.

This argument needs to be challenged head-on. First, simple fairness dictates that where a lender (or anyone else) takes actions that impose significant social and economic costs on innocent third parties, be they neighboring homeowners or local governments, they should not get a free ride at cost to the public—they should bear the burden of those costs, which are known as externalities. This is why for many decades now environmental laws have been in place that bar companies from polluting the air and water, and require them to bear the cost of cleaning them up where they do so.

Second, making commercial entities absorb the external costs of their business behavior is not only fair, but it is a good way to encourage those entities to behave in ways that do not impose such costs on society. If debt collection by foreclosure becomes more expensive—and if the parties initiating the foreclosure actions become aware of the full costs associated with their actions—alternatives to foreclosure that, in the final analysis are likely to be in the interest of both lender and borrower, will become more attractive.

Third, where the practices that triggered the cost are clearly not in the public interest, as is the case with respect to much subprime lending activity, then there is nothing wrong with public action that will, directly or indirectly, discourage them. No one complains that traffic signals have a “chilling effect” on drivers. By failing to penalize bad practices, states inadvertently create a competitive environment that drives out good practices, as was amply demonstrated in the “race to the bottom” that characterized subprime lending practices in the mid-2000s.

Fourth, it has become painfully apparent that many of the entities initiating foreclosures are not objectively assessing their own costs and benefits. Data has shown that the loss of property value resulting from a foreclosure carried through to its conclusion is massive, and in most cases is likely to exceed the loss that would be incurred by reducing the loan principal in order to enable the borrower to refinance. Similarly, despite abundant research that has shown that vacant properties consistently sell for less than occupied ones (not to mention that the new owner benefits from continued cash flow from tenants), lenders continue to insist that vacating properties after sheriff’s sale is somehow in their interest.

Evidence from many economic sectors has shown that if lenders can continue to make money in Ohio by conducting sound, responsible lending practices, they will continue to operate in Ohio. It is government's responsibility to ensure that the burdens are fairly distributed, and not unduly burdensome to any responsible party, to ensure that they can continue to make a reasonable return from responsible activity.

***OBJECTIVE 1: Get borrowers better information about their options, and greater access to counseling, emergency assistance and loan modification opportunities.***

The state of Ohio has already made substantial strides in this area. Through the "Save the Dream" program, and the support that the state has given counseling activities, large numbers of borrowers at risk have become aware of alternatives to foreclosure, and in many cases, have been able to keep their homes.

That said, more resources are needed both to ensure that any household in need has ready access to qualified counseling and mediation services, and that adequate emergency assistance funds are available through the Home Rescue Fund or other programs for all those for whose problems can likely be solved by short-term assistance.

**Recommendation 1: Impose a \$1,000 fee on all foreclosure filings (or certain categories of foreclosure filings, such as subprime loans), with the proceeds to be used principally to fund foreclosure prevention counseling programs and emergency assistance through the Home Rescue Fund.**

Such a fee is reasonable, because it is being used to cover the cost of services directly necessitated by the action taken by the entities filing foreclosure, and it is modest relative to either the amount of the average mortgage, or the average loss of value as a result of foreclosure.<sup>7</sup> It also creates an incentive for creditors to take earlier and better measures to avoid foreclosures. The state should evaluate whether the fee should be imposed on all foreclosures, or only on foreclosures associated with subprime loans or loans containing interest rate resets and/or pre-payment penalties. Limiting the fee to loan categories that are disproportionately likely to trigger foreclosures acts as a disincentive to making such loans in the future, while having no effect on more responsible lenders.

The state should prepare an analysis of the amount such a fee is likely to yield and the cost of adequate counseling and emergency assistance programs. Based on that, the legislation should provide that the first X million dollars collected should go to fund counseling programs, and the next Y million to emergency assistance. Any additional funds should go to the Ohio Housing Trust Fund to be used in conjunction with local neighborhood stabilization efforts.

**Recommendation 2: Expand the Home Rescue Fund to increase both the overall fund availability and the level of assistance offered.**

Given the high levels of economic distress in Ohio, a more robust emergency assistance program—both with respect to the total amount available and the amount that any one household can receive—can be an important element in helping homeowners keep their homes. The foreclosing filing fee proposed above would enable Ohio to significantly expand the Home Rescue Fund.

***OBJECTIVE 2: Create a fair foreclosure process, with ample protection for borrowers and opportunity to negotiate with creditors.***

The foreclosure process is an extreme example of what is known as an “asymmetrical” relationship, where the distribution of both available resources and potential costs are highly uneven. Creditors have far more resources to pursue foreclosure than most debtors have to defend against it, while the consequences of failure to the debtor—loss of her home, her assets, her credit rating, and often her health and family stability—vastly exceed the consequences of failure to foreclose that may be borne by the creditor. In such an asymmetrical setting, fairness demands explicit measures to ensure that the process is transparent and that the rights of the borrower are thoroughly protected at all stages in the process, beyond seeming procedural equity.

The process should also recognize the substantial public interest in fostering alternatives to foreclosure, and in preserving the value of the properties at risk of foreclosure. The mediation program initiated by the Ohio Supreme Court is a good example of a step that reflects the public interest in fostering alternatives to foreclosure, and increases fairness by creating a forum in which borrower and creditor can meet on roughly equal terms.<sup>8</sup>

**Recommendation 3: All foreclosure filings should provide clear and complete documentation of the plaintiff’s ownership of the note and mortgage, including an affidavit by plaintiff’s attorney that he or she represents and is authorized to negotiate on behalf of a responsible owner. With respect to securitized mortgages the documentation should include identification of the mortgage-backed security and not only the trustee.<sup>9</sup>**

This information is needed to ensure that the foreclosure is indeed a bona fide one that should be allowed to proceed. Knowing the identity of the security can make it possible in turn to know the contractual terms under which the servicer is operating, and the extent to which those terms permit flexibility in loan modification.

**Recommendation 4: Require plaintiff to complete a mortgage origination fraud “screen”; that is, a series of questions about the origination of the mortgage being foreclosed, at the commencement of foreclosure proceedings, in order to enable the**

**court to evaluate the possibility that fraud or misrepresentation occurred in the course of originating the mortgage.**

In the event that the information provided by the plaintiff establishes such a possibility, the defendant in the proceedings would be entitled to an evidentiary hearing to establish whether fraud was indeed present, and to what extent.<sup>10</sup> Where the court found that fraud was material to the mortgage origination, it would be empowered to set aside the foreclosure, modify the mortgage, and in extreme cases declare the mortgage void.

**Recommendation 5: Offer borrowers of mortgages in foreclosure the opportunity for a six month forbearance period, during which time the foreclosure proceedings are frozen, in order to create a meaningful opportunity for mediation or other negotiations leading to loan modifications or refinancing.**

In thinking about a forbearance period, state policymakers may want to consider limiting it to those mortgages that are particularly problematic, such as 2-28 or 3-27 ARMs with upcoming resets, or mortgages with prepayment penalties. Any language creating such a forbearance period should include language that provides that if the borrower vacates the premises during the period forbearance immediately ends and the foreclosure is fast-tracked from that point onward (see Recommendation 12).

**Recommendation 6: Require that plaintiffs file a statement of property condition, occupancy and asset value at the commencement of all mortgage proceedings.**

This information would put on record the condition of the property, the extent to which the property was occupied (by a homeowner and/or tenants) and the value of the property at the point the foreclosure was initiated. This would not only ensure that existing possessory property interests are not illegally terminated, but establish the condition of the property for purposes of code enforcement and other proceedings. It would also help the creditor make a rational assessment of whether it is in its financial interest to pursue foreclosure, or seek alternative forms of resolution. If recommendations dealing with property maintenance (Recommendation 8) or tenants' or owners' possessory rights (Recommendations 9 and 10) are enacted, this information becomes critically necessary to effective enforcement of these provisions.

**Recommendation 7: Establish a linked deposit program for state and municipal cash balances based on the quality of banks and other lenders' loan mitigation and refinancing activities.**

Where the state is in a position to do so without direct cost to the taxpayers, it should actively encourage responsible and responsive behavior by lenders by giving first preference for state and municipal deposits to those institutions that are ready to make meaningful loan modifications, provide refinancing on reasonable terms to borrowers at

risk, and take other steps designed to reduce foreclosures or mitigate the secondary impacts of those foreclosures that take place.

***OBJECTIVE 3: Prevent predatory and fraudulent mortgage lending and foreclosure “rescue” practices***

One well-known and unpleasant by-product of the foreclosure crisis is the emergence of firms and individuals preying on at-risk borrowers by offering to “rescue” them from foreclosure. Common practices include charging fees for bogus foreclosure prevention counseling, inducing owners to relinquish their titles in return for bogus commitments to sell owners their own home back clear of mortgage debt, and other scams. At the same time, while the number of improper or irresponsible mortgage origination practices has declined significantly from the go-go days of 2005 and 2006, they still happen. Although some practices were banned or restricted by SB 185, and still others by the recent amendments by the Federal Reserve to Regulation Z dealing with subprime lending, safeguards to prevent improper practices from recurring if and when the market improves and capital is more readily available are still incomplete.

**Recommendation 8: Enact state legislation to regulate foreclosure rescue practices, and setting civil and criminal penalties for violations of the law.**

The law should contain the following provisions:

- Clear definitions of what practices are or are not permitted
- Requirements that a formal contract be executed to cover any foreclosure rescue activities
- Providing for rescission of such contracts as necessary, including a cooling-off period for the homeowner
- Licensing and imposing requirements on private foreclosure consultants
- Providing stiff civil and criminal penalties for violations of the law

**Recommendation 9: Bar or limit inappropriate or abusive lending practices not already barred by SB 185 or Federal Reserve Regulation Z.**

The combined effects of SB 185 and the amendments to Regulation Z adopted by the Federal Reserve System in July 2008 have either barred or limited most of the clearly inappropriate or abusive lending practices that have been identified as materially contributing to the foreclosure crisis, as shown in Table 2. There remain a number of actions that should be taken by the state that would benefit the state’s consumers, and reduce the risk of future similar problems, including:

- Imposing a fiduciary standard on mortgage brokers in their dealing with their clients.
- Establishing a suitability or ‘best available product’ standard, to ensure that brokers offer their clients the best product available to meet their needs in light of their financial condition.
- Provide a clear standard for application of the tangible net benefit standard in SB 185<sup>11</sup>
- Provide restrictions on option ARMs, including minimum income requirements and/or counseling requirements, and a mandatory “cooling-off” period before the commitment becomes final.
- Ban yield spread premiums, or commissions to mortgage brokers that incentivize higher interest rates or ‘exotic’ loan products.

**TABLE 2. Summary of Ohio lending practice regulations**

| PROVISION  | Addressed in SB 185   | Addressed in Regulation Z   |
|--|---|---|
| Fiduciary responsibility of mortgage brokers     | Establishes more limited “good faith” standard                      | No  |
| Suitability or ‘best available product’ standard | No  | No  |
| ‘Ability to repay’ standard                      | Establishes limited “no reasonable probability of payment” standard | Establishes “ability to repay” standard                               |
| Tangible net benefit standard for refinancing    | Yes   | No  |
| Loans without adequate documentation             | No  | Requires documentation of income and assets                           |
| Excessive or unreasonable pre-payment penalties  | Bars penalties in mortgages <\$75K, limits in others                | Bars in mortgages with resets in first 4 years, limits in some others |
| Excessive fees                                   | Bars some fees. Other fees regulated by Mortgage Broker Act         | No  |
| Mandatory arbitration clauses                    | Bars “unconscionable” arbitration clauses                           | No  |
| Restrictions on option ARMs                      | No  | No  |
| Escrow of property taxes and insurance           | Requires statement whether taxes will be escrowed                   | Requires escrow   |
| Banning yield spread premiums                    | No  | No  |

**Recommendation 10: Strengthen the surety bond provisions of the Ohio Mortgage Brokers Law to provide greater protection for mortgage brokers’ clients.**

The Ohio Mortgage Broker Act is one of the strongest and most comprehensive mortgage broker regulatory schemes of any state in the United States (Table 3). Despite its strengths, the act’s surety bond requirement is far too modest in light of the potential

financial liability that can arise from inappropriate, incompetent or illegal behavior by brokers. The requirement should be changed as follows:

- The amount should be increased. The base bond amount should be \$250,000 at a minimum.
- The actual bond amount should be determined by a formula which adjusts the amount annually on the basis of the volume of the broker’s activity during the preceding year.

The Act could benefit from other changes, but they are minor and not matters of urgency

**TABLE 3. Summary of Ohio mortgage brokerage regulations**

| Model Provision   | Addressed in Ohio Mortgage Broker Law  |
|---|--|
| License mortgage originators as well as brokers                           | Yes  |
| Establish minimum education and experience requirements                   | Experience requirements only   |
| Require continuing education for license renewal                          | Yes  |
| Require comprehensive review of qualifications for annual license renewal | Yes  |
| Require qualifying examination for brokers and originators                | Yes  |
| Require fitness standard (criminal check and credit history)              | Criminal records check (including financial matters)                               |
| Require office with regular hours within licensing jurisdiction           | Requires office in jurisdiction. Does not specify regular hours                    |
| Set minimum net worth standard  | No   |
| Require that brokers post surety bond proportionate to broker volume      | Requires \$50K surety bond + \$10K for each office location after initial location |
| Establish record-keeping and reporting obligations                        | Yes  |
| Provide credible penalties for violation of brokerage laws                | Yes  |
| Provide for effective enforcement of violations                           | Yes  |

***OBJECTIVE 4: Eliminate the nexus between foreclosure, disinvestment, vacancy and abandonment.***

This may be the single most important area for state policy-makers. As noted earlier, it is not the foreclosure as such that creates many of the most damaging outcomes for Ohio’s neighborhoods and cities, but the relationship or nexus between foreclosure, vacancy and ultimate abandonment. If policymakers can break that connection, they can dramatically reduce the effects foreclosure has on the properties being foreclosed, nearby homes, and the neighborhoods, cities and villages in which they are located. This nexus arises as a result of a number of separate but inter-related factors:

- Foreclosure is a slow process, and the longer it takes, the more opportunities are created for loss of property value and neighborhood destabilization
- During the course of foreclosure, particularly in areas with low property values, neither the creditor nor the borrower are often motivated to maintain the property
- Large numbers of borrowers vacate their property even before title passes from them at sheriff's sale
- If the property is still occupied at the time of sheriff's sale, it is all but automatic for the entities taking title to the property to move immediately to vacate the properties
- Once the property is vacant, it not only loses value, but devalues neighboring properties, destabilizing the community at large

There are a series of straightforward changes in state laws that can break the vicious cycle now taking place. These are probably the most valuable things—in terms of their effect on the problem—that the state can do without requiring any expenditure of public funds.

**Recommendation 11: Require that the entity initiating a foreclosure on a residential property be legally responsible for maintenance of the property in the event that the title-holder vacates the premises at any point after the initial foreclosure filing.**

Foreclosure is a slow procedure, and if the owner vacates the property—as often takes place—before the end of the process, the property falls into a legal limbo, and the municipality cannot hold anyone accountable for upkeep. By initiating the foreclosure, the creditor has asserted the control over the property that is given it by the mortgage and note, and should thus be deemed responsible for code violations or nuisance conditions that may occur if the owner is no longer available to take responsibility.<sup>12</sup> This should apply both to properties that have been vacated and those that may still contain tenants but where the owner is no longer available. Thus, *someone* is always responsible for the property, and can be served with violation notices.<sup>13</sup> Costs incurred by the lender to maintain the property can be added to the amount due at sheriff's sale.<sup>14</sup>

**Recommendation 12: With respect to code enforcement, nuisance abatement and receivership costs incurred by municipalities on properties in foreclosure (1) provide that these liens have priority and can be foreclosed upon directly by the municipality or added to the tax duplicate; (2) require that any unpaid lien amounts must be paid by buyer at sheriff's sale; and (3) allow municipalities recourse against other assets of the owner and/or entity initiating the foreclosure.**

The responsible entities—whether title holder or mortgagee—do not always comply with orders to correct violations and abate nuisances. Cities often incur public costs to address violations and abate nuisances. Cities' exercise of their police power to preserve public health and safety gives rise to a lien that supersedes liens to protect economic interests.

But simply empowering the municipality to place a lien on the property may be not enough, particularly in cases of low value properties. Municipalities should be given the strongest reasonable tools to ensure, to the extent possible, that their costs are reimbursed, by foreclosure, from proceeds at sheriff's sale, or by recourse against other assets of the responsible party, and that the public is not forced to bear both the risk of harm and the costs made necessary by private action or inaction.<sup>15</sup>

**Recommendation 13: Eliminate foreclosure as legal grounds for eviction of a sitting tenant who is otherwise in compliance with her legal obligations as a tenant.**

Under current practice and law in Ohio, when a tenant-occupied residential property is foreclosed, eviction of the former owner's tenant is automatic and all but immediate. Where the tenant is a responsible one, this makes no sense. A rent-paying tenant, who is in no manner responsible for the owner's default, loses her home. An occupied property is rendered vacant, and in most cases, immediately begins to lose value and devalue neighboring properties. The lender, who is now the new owner, suffers from the loss of the property's value, and loses the opportunity to gain at least some cash flow from the property while seeking a new buyer.<sup>16</sup> Tenants should be allowed to remain in their home at least until expiration of their lease (or, in the absence of a lease, some minimum period no less than twelve months from sheriff's sale).<sup>17</sup> They should only be required to leave earlier if the buyer of the property seeks to occupy it personally.

**Recommendation 14: Allow former owners who are still occupying the premises at the time of sheriff's sale, and have adequately maintained the property, to remain as tenants, paying the new owner a fair market rent.**

The same basic principles apply to allowing owners to remain in properties. Although one could argue that the owner may not be "innocent" in the same sense that a tenant may be, the economic and social arguments for allowing the owner to remain in her property are otherwise the same, with the added feature that if the owner knows that she will be able to remain in her property as a tenant—subject to her responsible behavior—that is likely to motivate her to maintain and not purposely damage the property during the foreclosure process. The legislation should also provide that the ex-owner/tenant must vacate if a buyer wants to occupy the property personally, and provide for a fair means of establishing the fair market rent for the property.

**Recommendation 15: Establish a fast-track procedure to expedite foreclosure of properties that have become vacant subsequent to the initiation of foreclosure proceedings.**

The longer the property is vacant—both before and after the sheriff's sale—the more value it typically loses, and the more it devalues surrounding properties. Ohio has a judicial foreclosure statute that can require as much as nine months from initial filing to sheriff's sale. This period is longer in those cases where owners are unknown heirs or

defunct business entities, where owners file bankruptcy staying the foreclosure or where service on interested parties requires extensive efforts or publication. While this lengthy process protects borrowers in possession, it serves no purpose if the borrower has vacated the property, and the vacant property is at risk of deterioration. A small but simple step to reduce the value loss is to provide that if the plaintiff or municipality brings evidence to the court that a property in foreclosure has become vacant, it triggers an expedited process that leads to an immediate default hearing and sheriff's sale and passing of title to a new owner.<sup>18</sup>

***OBJECTIVE 5: Enhance the ability of responsible parties in the public and private sector to gain control of properties for productive reuse or land banking.***

The recommendations in the preceding section are designed, above all, to prevent harm—to the occupants, to the community, and to the financial interests of the lender. While they are critically important, neighborhood stabilization and market recovery require going beyond harm prevention to affirmative steps to foster change. Despite the best efforts to mitigate harm, many properties will become vacant, particularly in cities like Cleveland, Dayton or Youngstown where the supply of housing significantly exceeds the demand. If Ohio's cities are to be able to mount effective strategies to rebuild their neighborhoods, the state must give them greater ability to gain control of the properties that are vacant or inadequately maintained, and devaluing their neighborhoods. A number of bills that would give local governments tools to assert greater control over their physical environments are pending in the Ohio legislature.

**Recommendation 16: Enact new legislation to expand and enhance Ohio's recently-enacted land banking legislation to authorize long-term, financially-sound land bank entities at the option of any county meeting appropriate criteria.**

In counties with significant vacancy problems, whether triggered or exacerbated by foreclosures, a land bank entity can play a major role in assembling and maintaining properties and arranging for their productive re-use. Although a land banking bill passed during the last legislative session, it was significantly watered-down from its sponsors' initial intent. Instead of a bill that could have had a major impact on the state's foreclosure crisis, the bill that passed only allowed a land bank entity to be created in Cuyahoga County, giving it only a narrow two-year window for acquisition of properties. HB 602/SB 353 sought to expand the authority to create land bank entities to all qualified counties, permitting them to establish such entities in a financially-responsible fashion. A bill to achieve that end should be a priority in the coming legislative session.

**Recommendation 17: Enact HB 531 to amend the Ohio receivership statute**

Ohio has a strong statute providing for residential nuisance abatement by receivership, which has been used effectively by local governments and non-profit entities to gain control of problem properties and restore them to productive use. At the same time, the existing law has elements that limit its reach and effectiveness. HB 531 would amend the statute to ensure that a judicial sale of the property to redeem a receiver's lien at the end of the receivership provides the buyer with marketable title, correcting a major flaw in the existing law, and would expand its scope to vacant non-residential properties with nuisance conditions.

**Recommendation 18: Permit local government to “step into the shoes” of lenders who fail to initiate foreclosure after an extended period of default or who initiate foreclosure but abandon it after initial filing.**

In many cases, lenders may choose not to exercise their right to foreclose; where the property is vacant, they may not see it as worth the expense. In other cases, lenders may initiate the foreclosure, but then fail to pursue the process to final resolution. In either case, the effect may be to put ownership and control of the property into limbo, while it continues to lose value and destroy the value of surrounding properties. Local governments should be given the power in such situations to provide notice to lenders to use their contractual rights to take control and prevent waste or lose the lien on the property. If the lender fails to respond or to pursue the foreclosure after notice the county or municipality would be able to get a court order transferring those rights to the local government.

***OBJECTIVE 6: Provide increased state support for effective, targeted local strategies designed to foster neighborhood stabilization and market recovery.***

The state of Ohio can play an important role in supporting the many cities—and some villages and townships—attempting to stabilize their neighborhoods that have been destabilized through foreclosure, through a wide variety of activities including financial and technical assistance. Since state resources are severely limited, the state should avoid spreading its money too thinly. In each case, it should make sure that state resources are targeted not only to need, but to areas with realistic revitalization potential and local governments with the capacity to both plan and execute effective initiatives. This is particularly important because the Obama administration's economic stimulus package contains an additional \$2 billion in Neighborhood Stabilization Program funds, which will be allocated on a competitive, rather than a formula basis.

**Recommendation 19: Create a state program to provide qualified local governments with money to create nuisance abatement revolving funds for cities or court-appointed receivers.**

Enacting Recommendations 8 and 9 above will dramatically increase the ability of local governments to carry out administrative or court-ordered nuisance abatement, and recapture the funds used for those activities. This will make those programs significantly more powerful as tools for mitigating foreclosure impacts and preserving neighborhoods. Even with those changes, local governments will remain constrained by their inability to pay for these activities. By providing cities and counties with small amounts of ‘seed money’, the state can trigger a dramatic increase in the use of these key preservation tools.

State funds would be provided as revolving funds that cities could reuse, but would return to the state after 15 years, or sooner, if the state found that the funds were not being effectively utilized. Before providing any city or county with seed money, the state would be required to make a determination that the city or county had a code enforcement program in place with the necessary technical capacity and management systems to use the funds effectively.

**Recommendation 20: Initiate a state program to build local capacity to plan and execute effective neighborhood stabilization efforts**

Another major constraint on local government’s ability to address foreclosure impacts and carry out effective neighborhood stabilization programs is their limited technical, managerial and organizational capacity. The state should work with organizations such as Greater Ohio, the Ohio Municipal League, the Ohio CDC Association, and others to provide training, technical assistance, and ongoing peer-to-peer support for local officials and their non-governmental partners pursuing neighborhood stabilization efforts. A major focus of this effort should be on providing the skills to carry out effective and data-driven strategic planning and targeting, to ensure that limited resources are used to maximum effect.

**Recommendation 21: Have the Ohio Housing Finance Agency (OHFA) work with lenders to develop mortgage products that will leverage local Neighborhood Stabilization Program efforts**

Under the federal Neighborhood Stabilization Program, the state of Ohio along with many of its cities and counties will spend large amounts over the coming year to acquire and rehabilitate foreclosed and vacant properties or demolish those properties and redevelop those sites. Unless adequate sources of mortgage money on reasonable terms are available for prospective home buyers, there is a serious risk that many newly constructed or rehabilitated dwellings will not be able to be sold, or will have to be sold at prices that compromise the community’s market recovery efforts. Creating mortgage products that moderate and middle-income families can afford in order to buy these houses is critically important. OHFA should take a leading role in developing these products, using its resources to leverage private lending capital.

**Recommendation 22: Enact a state income tax credit as an incentive for homebuyers to buy and rehabilitate houses for owner-occupancy in designated target areas;**

As many Ohio neighborhoods have been destabilized through foreclosure and abandonment, their attractiveness to potential homebuyers has declined. Even though desirable homes may be available, prospective buyers may be reluctant to buy them or put money into their rehabilitation, either because the cost of acquisition and rehab may exceed their market value, or because the buyers perceive that their investment may depreciate rather than appreciate. One approach that is likely to be effective is a credit against state and local income taxes for families who buy and improve homes for their own occupancy in targeted neighborhoods. The credit would be taken over a number of years as long as the household remained the owner-occupants of the home (if they moved, they would lose the remaining credit, but would not be subject to recapture for prior years), and should be transferable so that it would be attractive as well to families with only modest tax liabilities.<sup>19</sup>

**Recommendation 23: Study the feasibility of creating a homeowner equity insurance program to protect homeowners against loss in their home's value.**

Another approach, which has been used elsewhere although only to a limited extent, is to offer homebuyers insurance against potential loss of their home's value, if property values in the neighborhood or city decline.<sup>20</sup> This is considerably more complicated, and the state should conduct a study of how such a program might work, and what resources would be needed to implement it.

**Recommendation 24: Design, adopt and implement a comprehensive state strategy for revitalization of the state's older distressed neighborhoods.**

In the final analysis, it is impossible to separate efforts to revitalize neighborhoods destabilized by foreclosure from those destabilized by adverse economic conditions and neglect. The state, therefore, should look at the issue of neighborhood stabilization in a broader framework, asking how state resources and energy can be marshaled to strengthen the state's older communities and their neighborhoods, as critical building blocks for restoring prosperity to the state. This, in turn, demands that the state develop a comprehensive strategy to direct its resources toward older neighborhoods in ways that maximize and leverage limited public resources, and result in the greatest impact not only on the neighborhoods themselves, but on the cities and the state as a whole. Engaging different departments of state government as well as local government leaders in framing such a strategy should be a priority for Ohio state government.

***.OBJECTIVE 7: Take other state actions to support and enhance the effectiveness of Ohio's strategy for foreclosure prevention and neighborhood stabilization***

**Recommendation 25: Create a uniform statewide mortgage and foreclosure data and reporting system, and provide the data in a publically-accessible, user-friendly web-based format.**

Efforts by policy-makers, planners and practitioners to grapple with the foreclosure crisis, and develop effective approaches to dealing both with its direct effect on homeowners and tenants, and its indirect effect on properties and neighborhoods, have consistently been hindered by the lack of solid, reliable information. Some information is provided at the county level, while other information is not available at all. At the same time, the nature of the mortgage system—which requires regular reporting and recording of information—lends itself readily to the establishment of a comprehensive and accessible data base. Such a data base will significantly increase the effectiveness of all those engaged with addressing the foreclosure crisis, from housing counselors to city planners.

What is needed is first, a uniform system of reporting information about mortgages, foreclosure filings, loan modifications, and actual foreclosures; and second, a system for compiling this information and disseminating it through a user-friendly web-based format, which can provide data not only by city and county, but for small areas such as census tracts.<sup>21</sup> NEO CANDO, a data system based at Case Western Reserve University in Cleveland, has already developed much of such a system for Cleveland and Cuyahoga County. The state should begin by establishing a working group, in partnership with NEO CANDO and others, to develop a statewide system; and to adopt regulations requiring the level of reporting needed to make such a system effective.

**Recommendation 26: Create an information system to track the activity under each of the major state programs, such as the compact, the state mediation program, and the Home Rescue Fund, to enable the state to regularly evaluate their effectiveness, and change them as necessary.**

Ohio is already devoting substantial public resources to addressing the foreclosure crisis, and is likely to expand its commitment in the future. Many of the activities on which the state will expend resources are relatively untried, and uncertain in their outcomes. In that light, it is important that the state carefully monitor these activities in order to determine whether they are effective and producing results commensurate with the resources being devoted to them. If not, they should be modified or closed down. A monitoring team, either based in state government or within a qualified university-based entity, should be formally established with the mission of tracking programs, and regularly disseminating their findings not only to state and local officials, but to the general public as well.

### *Closing note*

The preceding section has outlined an ambitious legislative and administrative agenda for the state of Ohio. While some may be daunted by the number of separate, specific, recommendations, it is important to remember that the crisis facing the state is not a simple, one-dimensional, problem, but a multifaceted crisis that has its origins in a complex financial system, and is manifesting its impacts on individuals, families, properties, neighborhoods, cities and counties, and the state as a whole. There is no single “magic bullet” available to address this problem. Only by taking a variety of different actions, each one focusing on a particular aspect of the crisis, can Ohio hope to have a meaningful impact on the current situation.

Even then, these actions will not solve the problem. What is going on in Ohio is the product of forces operating at a national, even global scale. The immediate problems facing the state as a result of foreclosures are exacerbated both by Ohio’s long-term economic problems, and the current recession. These actions will, however, make a major difference. They will allow thousands of Ohio families—both owners and renters—to stay longer in their homes, and allow many of them to keep those homes. They will dramatically reduce the destabilizing effect of future foreclosures, and strengthen the hands of local governments, non-profits and other community stakeholders to rebuild neighborhoods already destabilized. With luck, hard work and foresight, they will place Ohio farther along the road to regaining new, sustainable prosperity.

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<sup>1</sup> Alan Mallach is a Non-Resident Senior Fellow with the Metropolitan Policy Program at Brookings. The author would like to acknowledge the invaluable assistance of Kermit J. Lind, Esq. of Cleveland-Marshall Law School and Frank Ford, Sr., of Neighborhood Progress, Inc. in the preparation of this paper.

<sup>2</sup> These counties were Cuyahoga (13,610), Franklin (8,875), Montgomery (5,076), Summit (4,833), Lucas (3,618), and Mahoning (1,946).

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<sup>3</sup> Key provisions of SB 185 include a requirement that transactions confer a “tangible net benefit” on the borrower, good faith obligations of mortgage brokers and lenders, limitations on pre-payment penalties, and increased disclosure requirements.

<sup>4</sup> This program, however, is closed and no longer accepting applications.

<sup>5</sup> See Hon. Thomas J. Moyer, “Ohio Offers Comprehensive Response to Foreclosure Problem” in *Future Trends in State Courts, 2008*, National Center for State Courts.

<sup>6</sup> Foreclosures are initiated by a variety of different entities. For purposes of this paper, the terms lender, creditor, servicer and plaintiff are used variously to describe the entity that initiates a foreclosure.

<sup>7</sup> There have been a number of studies of the costs of foreclosure; while the details vary, they document a consistent—and substantial—pattern of losses. Chairman Bernanke of the Federal Reserve System Board of Governors has cited costs that include legal, sales, and maintenance costs equivalent to 10 percent of principal amount, and total losses to creditors exceeding 50 percent of principal amount, while a study by the Center for Responsible Lending found that 5 percent of the unpaid balance is lost in transaction costs, 10 percent to dispose of property and 22 percent in resale discount, for a total loss of over 1/3 of principal balance. Other studies have come up with lump-sum estimates of average losses in the vicinity of \$50,000 or more. Although some of these costs represent out-of-pocket costs to servicers, which may not be seen as having any neighborhood impacts, the greater part of the costs reflect a diminution of property value associated with foreclosure.

<sup>8</sup> This assumes, of course, that the Court is successful in its efforts in both recruiting enough attorneys to participate in the process, and providing them with enough training so that they can give their borrower clients meaningful representation.

<sup>9</sup> With respect to this as well as many other recommendations, the author is indebted to the suggestions and comments of Kermit J. Lind, Esq, of Cleveland-Marshall Law School.

<sup>10</sup> This provision should clearly state that if the plaintiff or its representative misrepresented facts in response to any of the questions, they would be liable for both civil and criminal penalties.

<sup>11</sup> Regulations adopted by the state of Massachusetts (209 CMR 53.01) may offer a good model for such a standard.

<sup>12</sup> Virtually all mortgages made in the United States given the lender the power to do so where the owner has abandoned the property. Where properties in foreclosure have considerable value, such as in affluent suburban communities, lenders typically take responsibility for maintaining the property even in the absence of any legal obligation to do so.

<sup>13</sup> Assignment of responsibility to entities initiating foreclosure is widely imposed by municipal ordinances, particularly in the state of California, generally modeled after that of the city of Chula Vista. A new law passed by the New Jersey Legislature, and signed by Governor Corzine on January 9, 2009 (Public Laws of 2008, Chapter 127) will impose this legal responsibility on entities initiating foreclosure in New Jersey effective April 1 of this year. In addition to establishing responsibility, the New Jersey statute requires entities initiating foreclosure to provide notice to local officials when they do so, and provide contact information for an in-state entity which can accept service on behalf of the lender.

<sup>14</sup> The record of violation notices and the extent to which violations have been cured should become part of the record in foreclosure proceedings. The state could further require that at the time of sheriff’s sale, the

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plaintiff demonstrate either that the violations have been cured, or would be required to post cash or a bond to cover the cost of curing the violations before taking title to the property.

<sup>15</sup> New Jersey, among a few other states, gives municipalities recourse against other assets of the property owner (and after April 1, 2009, where applicable, the entity filing foreclosure proceedings) for the costs of nuisance abatement; N.J.Stats.Ann.55:19-100.

<sup>16</sup> Some lenders will argue that it is inappropriate for them to be required to act as a landlord. Clearly, the burden of being a landlord (if any) is trivial by comparison to the burden currently being assumed by the tenant, the neighbors, and the municipality of their *not* assuming the responsibility. It is worth noting that in recent months, both Fannie Mae and Freddie Mac have voluntarily agreed to follow practices similar to those recommended here with respect to properties on which they are foreclosing, demonstrating clearly that the practical obstacles to taking on this role are hardly insuperable.

<sup>17</sup> As a matter of public policy, it is better to limit eviction to cause rather than to provide, as is the case in most states including Ohio, for the landlord to be able to evict a tenant without cause at the end of a lease. That is an issue, however, which goes beyond the subject of foreclosures, and is not the subject of this recommendation.

<sup>18</sup> The Cuyahoga County Court has established this option by local rule which is triggered by a report from the local government unit that the property is vacant and abandoned..

<sup>19</sup> Similar state tax credits have been used widely to encourage rehabilitation of historic properties, and have been shown to be an effective incentive.

<sup>20</sup> The state of Illinois has enacted legislation authorizing the creation of equity insurance protection districts, where the insurance fund is created through a small surcharge on property tax bills within the district. Three such districts have been created within the city of Chicago. A somewhat different program was also initiated in Syracuse, New York.

<sup>21</sup> It is actually quite simple for mortgage brokers, servicers and others to enter the census tract for a given property when filling out forms, since there are a number of websites which offer nearly instantaneous conversion of address data to census tracts.

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