

# **Reinvestment Partners**

## **Solving the Abandoned Foreclosure Crisis: Remedies and Proposals for Reform**

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## The Nature of the Crisis

The causes of the subprime mortgage crisis and its effects are well known. The crisis hit low-income communities particularly hard, and thus many homes left vacant when their owner defaulted on their loan are concentrated in poor communities. While many of these homes have entered foreclosure and been resold, one small class of vacant properties, abandoned foreclosures, causes enormous problems for the communities in which they are located.

Abandoned foreclosures occur when a servicer or bank (individually or collectively, the “lender”) decides against completing the foreclosure process.<sup>1</sup> Often, lenders will not obtain updated property valuations until after they have initiated foreclosure, and once they learn the property is worth less than the costs of foreclosure, they abandon the proceeding. However, lenders are generally not required to notify anyone when they have ended their foreclosure efforts, and borrowers often do not realize they still own the home. Fearing foreclosure and inaccurately assuming the lender has taken control of the property, the borrower abandons the house. The home is left vacant and often becomes vandalized and dilapidated. Though only a small percentage of vacant properties are abandoned foreclosures, the unclear ownership of these properties exacerbates the problems that come with vacancy.

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<sup>1</sup> Government Accountability Office, *Mortgage Foreclosures, Additional Mortgage Servicer Actions Could Help Reduce the Frequency and Impact of Abandoned Foreclosures* (Nov. 2010), available at <http://www.gao.gov/assets/320/312243.pdf>.

Indeed, this dual abandonment by borrower and lender harms everyone involved with the property. The collateral's limited remaining value may be destroyed, removing any chance the lender had of recovering the lost loan amount. The borrower is without a home and yet, because the property remains in their name, they may accrue tens of thousands of dollars in back taxes and code violation penalties. Meanwhile, the abandoned property harms the community because it may lead to increased crime (from vandalism and by providing a location for criminal activity), becomes a fire hazard, accumulates code violations, and often must be maintained at the local taxpayer's expense. Further, because abandoned foreclosures depress local property values and the record owner is unlikely to pay the property taxes, the municipality's revenue base is eroded. Interested community members may also be unable to determine who owns the property or be able to force the property owner or mortgage holder to take responsibility for the property.

As there is no universal solution to the abandoned foreclosure crisis, community leaders must craft creative solutions using federal, state, and private law. The following discussion highlights some of the central ideas and tools available to those interested in combating community blight, vacant properties, and abandoned foreclosures.

## Federal Law

Even after the most recent financial crisis, federal lawmakers and regulators have not adequately addressed the issue of abandoned foreclosures. Though agencies such as the Consumer Financial Protection

Bureau have proposed, and in some cases enacted, regulations dealing with the process leading up to foreclosure,<sup>2</sup> no regulations have been enacted to directly regulate lenders who decide to delay or abandon foreclosure proceedings.

## State Law

Despite the increasing presence of federal law around foreclosure processes and real estate transactions, the richest body of foreclosure law remains state law. Thus, state law provides community members a wider array of potential solutions to abandoned foreclosures. Some can be pursued in court without the need for new causes of action, while others will require legislative action to create new property management regimes. A few of the most promising options are discussed below.

### 1. Judicial Solutions

#### a. Public Nuisance Actions

In some states, citizens can bring a public nuisance action against the servicer or bank for creating hazardous conditions. A private party's ability to bring a public nuisance action is controlled by local law, but there are two primary ways public nuisance law is structured. Usually, the local government must bring the action, but private individuals can file complaints to a particular government agency. However, in some jurisdictions, concerned individuals

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<sup>2</sup> See generally, Consumer Financial Protection Bureau, *2012 Real Estate Settlement Procedures Act (Regulation X) Mortgage Servicing Proposal*, 12 C.F.R. § 1026 (Sep. 17, 2012), available at <http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0034-0015>.

have been empowered to pursue civil remedies directly against the property owners causing the public nuisance. When private individuals can bring public nuisance suits, they can obtain permanent injunctions or liens against the property (perhaps even with first priority position) that will allow them to convince the borrower or lender to abate the nuisance or release their interest in the property to the local government, a land bank, or a non-profit entity. For an in-depth look at public nuisance law in the United States, see Professor Kermit Lind's article, *Can Public Nuisance Law Protect Your Neighborhood from Big Banks*.

#### b. Quiet Title Actions

Further, community groups can advocate for borrowers to use quiet title actions to combat foreclosures. A quiet title action is a "proceeding to establish a plaintiff's title to land by compelling the adverse claimant to establish a claim or be forever estopped from asserting it."<sup>3</sup> The borrower would thus have to bring the claim, but it is perhaps possible for the borrower to force the lender to release their lien interest in the property by relying on equitable claims based on principles similar to those that underlie defenses such as laches.

Laches is an equitable defense that can be raised against a party who has delayed asserting their claim.<sup>4</sup> In North Carolina,

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<sup>3</sup> Action, BLACK'S LAW DICTIONARY (9<sup>th</sup> ed. 2009).

<sup>4</sup> See RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 70 (2011).

laches applies where: “a delay of time has resulted in some change in the condition of the property or in the relations of the parties.” The mere passage of time is not enough to constitute laches, but instead the delay must have injured party seeking to invoke laches, and the claimant must have known of the existence of the grounds for the claim.<sup>5</sup> Because the borrower’s home ends up in a dilapidated state and they are left with enormous unpaid tax and code penalties, the borrower may be able to show that the delayed foreclosure harmed their interests, and that this would justify a court in deciding against the lender in a quiet title action.

## 1. Legislative solutions

### a. Land Banks

When there are a large number of vacant properties and the properties are accumulating code violations or have title problems, land banks can be an important solution to community blight. Land banks are public or private entities “created to efficiently acquire hold, manage, and develop tax-foreclosed property.”<sup>6</sup> Land banks can take numerous forms, from city-run operations to non-profit organizations created to serve a community’s needs. The specific powers of a land bank will depend

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<sup>5</sup> MMR Holdings, LLC v. City of Charlotte, 148 N.C.App. 208, 209–10, 558 S.E.2d 197, 198 (2001).

<sup>6</sup> Frank S. Alexander, *Land Banks and Land Banking*, CENTER FOR COMMUNITY PROGRESS (June 2011), available at [http://www.communityprogress.net/filebin/pdf/new\\_resrcs/LB\\_Book\\_2011\\_F.pdf](http://www.communityprogress.net/filebin/pdf/new_resrcs/LB_Book_2011_F.pdf).

on the legal structure chosen or the nature of any state enabling legislation, but land banks can be empowered to:

- 1) Have bidding priority at tax sales such as “credit bids” and “trump bids,”
- 2) Extinguish delinquent taxes,
- 3) Hold property tax-free,
- 4) Conduct property inspections and maintenance,
- 5) Expedite the tax foreclosure process,
- 6) Create insurable and marketable title for vacant properties,
- 7) Deconstruct abandoned property and sell the salvaged material,
- 8) Assemble small, contiguous lots into developable property, and
- 9) Hold deeds in escrow after sale to a developer to ensure the property is used to improve the community.

For land banks to be the most effective, it will be important to ensure the land bank has a consistent internal source of funding. Relying on donations or on year-to-year appropriations from a local government will prevent land banks from effective long-term planning. Considering many properties are held over a three to five year time frame, land banks need to be able to predict their future income streams. By working with state or local officials to enact or amend land banking legislation, consistent funding streams can be provided through:

- 1) Accumulated penalties and interest on a property's delinquent taxes and assessments paid upon final foreclosure,
- 2) Recapturing property tax revenues for several years after a property is transferred to a private party,
- 3) Charging fees for helping developers maintain and clear title on properties, and
- 4) Resale of acquired properties and building materials to qualified rehabbers and developers.

Many land banks also supplement these sources of funding with donations, grants from local governments, and federal funding through programs such as the Neighborhood Stabilization Program.<sup>7</sup>

#### b. Vacant Property Registration Ordinances

If permitted under the applicable state law, municipalities can also enact vacant property registration ordinances (VPROs). VPROs require property owners to register a property once it becomes vacant or enters foreclosure, pay a periodic fee, and carry insurance on the property. VPROs allow a local government to accumulate data on the number of vacant properties in their

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<sup>7</sup> To be clear, in most states legislation will not be required to form a land bank, particularly if organized as a private, nonprofit corporation, but it may be required to give the land bank the broadest range of authority and/or a steady funding stream.

jurisdiction, keep current contact information for the property's owner, and help ensure that the property is secure and maintained.

Though VPROs are designed to deal with vacant property, they cannot address the abandoned foreclosure crisis unless a municipality recognizes an expansive definition of property ownership. If banks or servicers cannot be considered the property owner for the purposes of the registry, VPRO compliance and fees are likely to be ignored by the borrower just as they often ignore housing code compliance and the obligation to pay property taxes after they have left their home.<sup>8</sup>

#### c. Code Enforcement Liens

Similarly, if permitted under the applicable state law, code enforcement and repair liens can also provide leverage for community groups or land bank institutions. Under these circumstances municipalities can make code violation penalties a part of the tax code and collectible by the tax assessor.<sup>9</sup> By doing so, the code penalties

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<sup>8</sup> For example, Cleveland's definition of owner includes not only the borrower whose name is on the title, but also *any* "person, firm, or corporation directly in control of the premises or having a legal or equitable interest in the property." C.C.O. §3101.05(j). Using such an expansive definition of ownership can help ensure that the lender who initiates the foreclosure action will be required to comply with a VPRO.

<sup>9</sup> North Carolina has authorized municipalities to impose code enforcement liens. N.C.G.S. § 160A-216. These liens are inferior to state, local, and federal taxes, but have priority over all other liens. N.C.G.S. § 160A-233. Raleigh has enacted

gain a form of “super priority” that will hold the first lien position which can even displace the lender’s interest in the property. Considering most abandoned homes are low-value properties, the back taxes and code penalties may consume much of the property’s value. If so, the lender may be willing to release their lien interest and donate the property as they know foreclosure will never become cost effective.

### **Private Law**

There are two sources of private law that individuals may be able to utilize to address abandoned foreclosures. First, the community blight provisions of the National Mortgage Settlement (the “AG Settlement”) have the potential to be a powerful force for addressing community blight and perhaps abandoned foreclosures. Second, Reinvestment Partners has had success compelling foreclosure under a deed of trust.

#### 1. The National Mortgage Settlement

The AG Settlement is a joint state-federal settlement between 49 state attorneys general (Oklahoma did not sign onto the settlement) and the country’s five largest mortgage servicers (the “Big Five”): Ally/GMAC, Bank of America, Citi, JP Morgan Chase, and Wells Fargo. The settlement absolved the Big Five of potential liability arising out of allegedly

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ordinances allowing the city to impose civil penalties and code enforcement liens against properties that are public nuisances or for the costs of nuisance abatement. Raleigh Code of Ordinances §§ 12-6002–05, 10-6123.

defective mortgage practices in exchange for \$25 billion dollars in mortgage relief to borrowers whose loans are owned by the Big Five.

The AG Settlement lays out what it calls “Measures to Deter Community Blight,” and mandates that Servicers “shall develop and implement policies and procedures to ensure that REO properties<sup>10</sup> do not become blighted,” along with policies that “enhance participation and coordination with state and local land bank programs, neighborhood stabilization programs, nonprofit redevelopment programs, and other anti-blight programs.” Currently, servicers are not required to make these plans publicly available.

Potentially the most important provision of the settlement related to abandoned foreclosures can be located at Exhibit A. Section 8, Paragraph 4, which states that when the “Servicer makes a determination not to pursue foreclosure action on a property with respect to a first lien mortgage loan, the Servicer shall:

- a. Notify the borrower of Servicer’s decision to release the lien and not pursue foreclosure, and inform the borrower about his or her right to occupy the property until a sale or other title transfer action occurs, and

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<sup>10</sup> An REO property is a property fully owned by the lender after an unsuccessful foreclosure sale. While abandoned foreclosures are not REO properties since ownership is in a state of limbo, REO properties are often themselves sources of community blight.

b. Notify local authorities, such as tax authorities, courts, or code enforcement departments, when Servicer decides to release the lien and not pursue foreclosure."

In essence, this provision commands servicers who do not pursue foreclosure on a property to release the lien. The obvious problem with this mandate is that it does not define *when* or through what *procedures* a lender "makes a determination not to pursue foreclosure action." If a servicer delivers a formal notice required by state foreclosure law but does not complete the actual foreclosure sale, has the servicer made a "determination not to pursue foreclosure action"? If the servicer begins formal foreclosure proceedings but places the action on indefinite hiatus have they likewise made such a determination? Neither the AG Settlement nor any other authority offers guidance on the matter.

Thus, currently no law or provision of the AG Settlement explicitly requires a servicer to decide whether or not it intends to pursue foreclosure and, thus, lenders can avoid complying with the AG Settlement's blight provisions. But because allowing properties to remain in ownership limbo contributes to community blight, avoiding the decision to foreclose violates the spirit of the AG Settlement's blight provisions. There may, therefore, be an opportunity to convince the Monitor of the Mortgage Settlement or federal banking regulators that the time has come to make the letter of the law better match its spirit.

Three proposals in particular can help improve the efficacy of the AG Settlement. The first two relate specifically to

strengthening servicer obligations under Exhibit A. Section 8, Paragraph 4 of the AG Settlement. First, the monitor of the AG Settlement (the "Monitor") could require servicers to decide whether they intended to foreclose within a set time after the borrower's default. Second, the Monitor or federal regulation could establish a rebuttable presumption that a servicer or other lending institution has decided not to foreclose on a property if a defined time period of time has elapsed since the lender or service delivered a notice of foreclosure to the borrower, for example, if the foreclosure hasn't been completed after one year.

The third proposal takes a slightly different approach. Instead of focusing specifically on the obligation of a servicer with respect to any particular property, the Monitor could require servicers to make public the community blight plans they have been required to formulate. This would create access to information about the servicer's strategy regarding these issues at a more comprehensive scale, and thus should provide an opportunity for community groups and lenders to work together to remedy blighted conditions.

In the meantime, community groups can attempt to show that servicers have in fact decided whether or not to pursue foreclosure on a given property, thereby triggering the AG Settlement's blight provisions. Though not required by law, the servicer's records may show why no foreclosure action has been completed. The key, then, is to determine a way to compel the servicer to disclose their foreclosure records on the property in question.

One possible method may be to rely on any timelines existing in the state foreclosure statutes. In some states, such as North Carolina, an Order of Sale is only valid for 90 days after the original date of sale. After that time, the foreclosure trustee must return to court to obtain a new order.<sup>11</sup> It may be possible to persuade a court that a servicer must have determined whether or not it will foreclose within this 90 day window, given the consequence of delaying. If so, a community group may be able to gain discovery into the servicer's files on the property and perhaps even force the servicer to finish the foreclosure action or release their lien interest in the property.

## 2. The Deed of Trust

Those fighting against abandoned foreclosures in their communities should also examine their state foreclosure laws to determine if non-judicial foreclosure under a deed of trust is allowed. If so, they may be able to pursue a third-party suit to compel foreclosure against the lender under the deed of trust. Compelling foreclosure removes the property from ownership limbo and allows a private owner or community organizations to take title to the property.

Many deeds of trust include mandatory language requiring foreclosure once the power of sale is invoked. Indeed, the Freddie Mac form deed of trust includes such mandatory language.<sup>12</sup> If the lender

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<sup>11</sup> N.C.G.S. § 45-21.21(d).

<sup>12</sup> Freddie Mac, *North Carolina Deed of Trust Uniform Instrument*,

has invoked the power of sale provision of the mortgage deed of trust after notifying the borrower and after a hearing with the clerk of court, a third party with standing<sup>13</sup> may be able to require the trustee to complete the foreclosure sale.

Reinvestment Partners has successfully brought a third-party suit against Bank of America under a deed of trust before the Durham Clerk of Court, and Reinvestment Partners has drafted form motions that may assist others pursue this method of compelling foreclosure.

## Conclusion

Abandoned foreclosures can cause enormous harm to their surrounding community, yet there is no easy solution to the abandoned foreclosure crisis. However, with creative thinking and by using innovative approaches such as those outlined here, community groups can begin to reclaim their communities. Because no one solution can completely solve the abandoned foreclosure crisis or address every vacant property, Reinvestment Partners recommends using a multi-pronged approach. Combining the tools described above will allow community

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<http://www.freddiemac.com/uniform/pdf/3034.pdf>

<sup>13</sup> A party's right to make a legal claim or seek judicial enforcement of a duty or right. Standing, BLACK'S LAW DICTIONARY (9<sup>th</sup> ed. 2009). To demonstrate standing to bring an action under the deed of trust, a third party needs to be able to show that the abandoned property has tangibly harmed them or their property interests (through increased crime or blight).

groups to address the problem from all

angles.

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