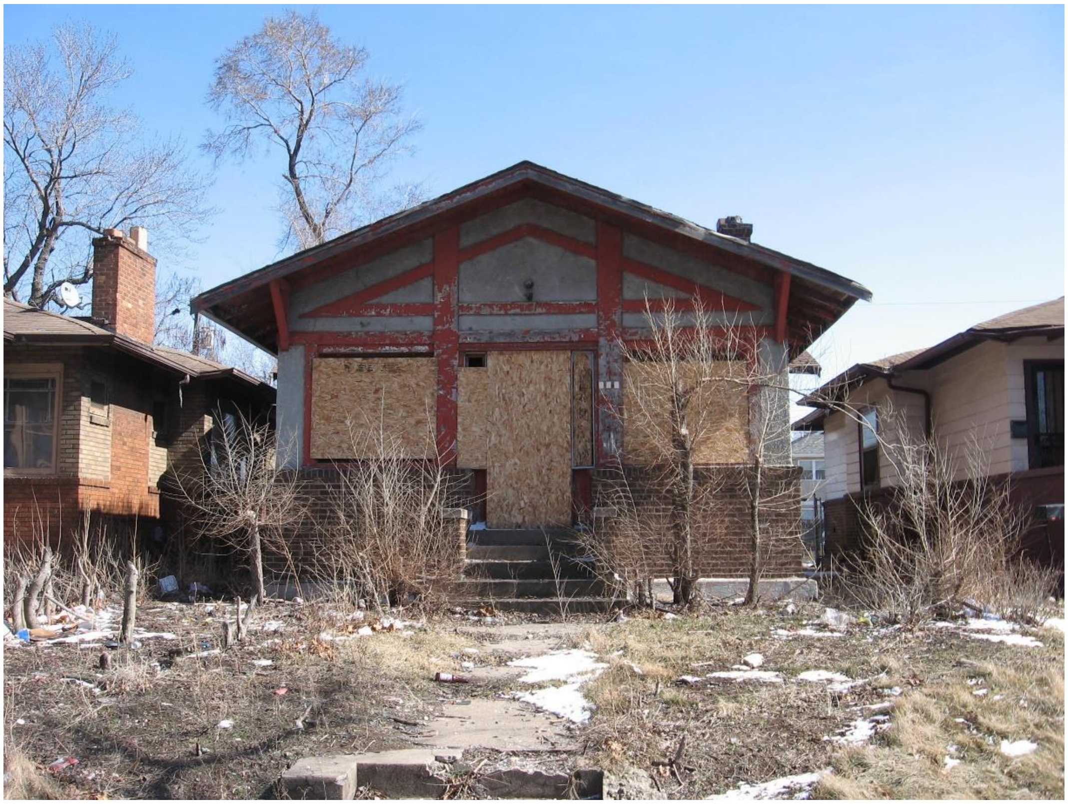
September 2021

HOT TOPIC ALERT

Foreclosure Property Maintenance



Beginning in 2006, the United States experienced a foreclosure crisis of a magnitude that the country had not experienced since the Great Depression. While the immediate victims of the crisis were the millions of homeowners and tenants who were losing their homes, the crisis continues to affect the real estate market today, nearly 15 years later. The proliferation of vacant and foreclosed properties has destabilized America's neighborhoods and communities. One common theme that is a focal point of this crisis is property maintenance—how to ensure that properties, as they move through the foreclosure process, are well maintained and do not become a nuisance, devaluing neighborhood properties and straining their community's resources.

How Big is the Problem?

At the peak of the foreclosure crisis, foreclosure property maintenance was a big topic, frequently covered by media outlets throughout the country, on the internet, and on national and local news programs. Over 1.2 million residential properties went into foreclosure in 2008, and over five million American families lost their homes to foreclosure between 2007 and the end of 2014. In 2020, there were 214,323 active foreclosure cases nationwide. The brighter news was that 2020 also experienced the lowest number of foreclosures in 16 years. There were 214,323 foreclosures in 2020; 57% fewer compared to 2019 and over ten times fewer than the peak of nearly 2.9 million in 2010.

Ten years after the recession, the grim foreclosure rates were finally looking up. The foreclosure rate was at an all-time low… and then a global pandemic struck. The COVID-19 pandemic caused unemployment to soar due to stay-at-home orders and business closures, which led to high unemployment and a sharp increase in foreclosures. Fortunately, despite millions of delinquent mortgages, the foreclosure rates are still low, and the numbers are actually improving.

The number of U.S. properties in foreclosure has dropped by 90% compared to the pre-recession average. That number does not tell the complete story, however. Pandemic-triggered foreclosure moratoria have kept the number of foreclosures lower than it might otherwise be. The distressing factor is the high number of mortgages that are in serious stages of delinquency. That number is actually five times higher than it was in 2020. Still encouraging though, is that mortgage delinquency is in decline, and prepayment activity is improving as well. Although it is likely 2021 will have an increase in foreclosures by year-end, a full collapse of the housing market is not expected.

Geographically, the distribution of foreclosure rates varies throughout the U.S. Foreclosure statistics for Nevada, Delaware, and New Jersey show rates that are much higher than the national average. Families in these states are at a much greater risk of foreclosure. Vermont is the state with the lowest number of residential foreclosures, with only one foreclosure filing for every 83,750 housing units, and the second lowest is South Dakota, with one filing per 77,714 housing units. Nevada has the highest residential foreclosure rate, with one foreclosure per 3,626 housing units. With Delaware and New Jersey next at one foreclosure per 4,206 and 4,809 housing units, respectively. The challenge continues, however. With foreclosures, come zombie properties.

What are Zombie Foreclosures and What are their Market Impacts?

A zombie foreclosure occurs when a homeowner vacates their property after receiving a mortgage default notice. The homeowner assumes they will probably lose the home in the pending foreclosure, and will take no further steps towards preserving or maintaining their home. Unbeknownst to the homeowner, however, the foreclosure may be canceled or delayed for many reasons or never be completed. This means the home title will remain with the homeowner, who may not even know they still own the home and are financially responsible for it. These homes are called “zombies” because the house is essentially “dead,” growing decayed and decrepit. Even its mere presence can continue to cause harm to its former owners and the community where it is located.

In encouraging news, improving housing market conditions should translate into fewer zombie foreclosures. Looking back to the foreclosure crisis, which peaked in 2010, there were thousands of properties left as zombie foreclosures. At one point, RealtyTrac reported at least 300,000 zombie properties in the United States. Amazingly, by the second quarter of 2021, according to ATTOM Data Solutions, zombie properties had fallen to just 8,078. Sadly, some states and particular zip codes still have an excessive number of zombie homes. States with rising numbers of zombie properties include Maryland, Iowa, North Carolina, South Carolina, and Ohio. New York has the highest actual number of zombie properties, followed by Ohio, Florida, Illinois, and Pennsylvania.

What is the effect of Zombie or other Unmaintained Foreclosed Property?

Zombie properties can have serious detrimental effects on neighborhoods. Abandoned homes can fall into disrepair and affect the value of the surrounding properties. These homes are unsightly and can attract vermin as well. Zombie property or vacant homes often becomes shelters for vagrants and squatters, illicit drug activity, and attract vandalism or other crimes. These frustrating conditions can drive away potential new residents and cause current ones to reconsider whether their neighborhood is still safe to live in.

These Zombie homes also feed into the "Broken Windows" effect on a neighborhood. The "Broken Windows" theory holds that "any visible signs of crime and civil disorder, such as broken windows (hence, the name of the theory) vandalism, loitering, public drinking, jaywalking, and transportation fare evasion, create an urban environment that promotes even more crime and disorder." While the broken windows theory has its critics and doubters in the field of criminology, it has more validity in the realm of real estate. Zombie homes decay and become damaged and vandalized, and the appearance of these Zombie homes will affect the values of other homes in the immediate neighborhood. . In terms of market impact, "broken windows" can be an indicator of low real estate value, thus deterring investors.

The Federal Government and Zombie Foreclosures

Although early in the housing crash, the Federal government instituted programs to stem the looming foreclosure crisis, the zombie property explosion was a direct after effect. In 2008, the Neighborhood Stabilization Program (NSP), administered by the US Department of Housing and Urban Development (HUD), was established to provide emergency assistance to stabilize communities with high rates of abandoned and foreclosed homes. The program yielded three rounds of $7 billion in total funding through 2010. The funds allotted to state and local governments to "establish financing mechanisms for purchase and redevelopment of foreclosed homes and residential properties, purchase and rehabilitate homes and residential properties abandoned or foreclosed, establish land banks for foreclosed homes, demolish blighted structures and redevelop demolished or vacant properties."

To stem the foreclosure tide and stabilize the housing market, then-President Obama also announced a $275 billion housing plan in early 2009, dubbed the "Homeowner Affordability and Stability Plan," which is also known as "Making Homes Affordable." This national program attempted to keep homeowners in their homes. The program provided lenders and servicers with incentives to modify outstanding mortgages. This solution focused on the mortgages themselves, rather than addressing the problems posed by the maintenance of vacant properties resulting from foreclosures. Several enhancements to the program expanded the pool of borrowers eligible for assistance and continued to help distressed homeowners until the program ended in December

2016.

To the dismay of many communities, however, the blighted properties continued to exist for many years. In a joint program between the Federal Housing Finance Agency (FHFA), Fannie Mae, and Freddie Mac, a strategy was developed for the disposal of the foreclosed properties owned and held by Fannie Mae and Freddie Mac. This program, the Neighborhood Stabilization Initiative (NSI), stabilized neighborhoods hardest hit by the housing downturn. NSI was started as a pilot in the city of Detroit, Michigan in May 2014, and was then expanded to Cook County, Illinois, in April 2015. Following the initial pilot program, from 2015 to 2017, NSI was further expanded to 28 different metropolitan areas with high volumes of low-value owned inventory. The program was implemented by the National Community Stabilization Trust (NCST), a national non-profit organization experienced in stabilization efforts for distressed communities. Working together, both organizations leveraged their ties to "boots on the ground" community groups and local non-profits, to work closely with local governments to make timely and informed decisions about the best treatment of individual properties.

In March of 2021, the Neighborhood Homes Investment Act (NHIA) was introduced in Congress to provide a federal tax credit for new construction or substantial rehabilitation of affordable, owner-occupied housing in distressed urban, suburban, and rural neighborhoods. The NHIA is oriented to assist these communities where "single-family homes comprise most of the housing stock" and where "many of these homes need substantial rehabilitation or replacement. In these areas, "[d]ilapidated homes have been abandoned, undermining neighborhood stability and the local tax base." The challenge "is that these neighborhoods cannot keep or attract working families without quality homes, but property values there are too low to support the cost of building or substantially rehabilitating quality homes." The program "can address the needs of older, existing housing in need of substantial rehab; vacant lots where in-fill homes can be built; or housing so far gone it needs to be torn down and rebuilt."

What have State and Local Governments done to Address Zombie Properties?

All states in the U.S. have laws that address property maintenance. These laws usually allow enforcement of housing and health codes, and allow public officials to enter onto a property in order to abate certain nuisance conditions. Some of these abatement efforts range from mowing lawns to demolishing or repairing hazardous structures. The challenge with these laws is that while these laws can often apply to vacant properties, most states do not have laws that provide explicitly for the maintenance of vacant properties. The state laws that exist have gaps and limitations. The laws usually impose obligations only on "owners" of the subject property, which term is sometimes defined narrowly, excluding the lenders that do not actually hold title. The existence of these laws does not adequately resolve the problem, since an evicted property owner or owner who walks away from his or her mortgage is unlikely to comply with property maintenance requirements. To address some of these gaps, states have mandated additional required procedures during the foreclosure process.

One remedial action some states have implemented is the appointment of a receiver who is to ensure that foreclosed property is maintained and preserved (*e.g.*, Arkansas, Illinois, Indiana, and

Minnesota). California instituted a creative solution to the zombie property dilemma. Codified in 1988 under California Health and Safety ("H&S")Code §§ 17980.6 and 17980.7, the legislature created these so-called health and safety "H&S" receiverships. These receiverships are an enhancement of the typical receivership statutes found in California Code of Civil Procedure. In a typical zombie property foreclosure, there usually is a back and forth between the property owner and the bank about the status of the property, which leaves the local government stuck with an abandoned, vacant property. The H&S receivership was specifically designed to address this problem.

When a H&S receivership is sought, it will alert a party with an interest in the property that they could lose control of the property. This alert is in the form of a statutory Notice, delineating the violations at issue. The Notice will provide a period of time, usually seven to thirty days, for the owner to rectify the issues or be subject to a petition for receivership in court. This, in turn, will usually force them to oppose the receivership. If they file opposition, the city will have the bank, owner, or other party responsible for the property in a court of law to confirm and commit to abate the zombie property issues and violations. If not, alternatively, a judge can appoint a receiver over the property to abate the conditions complained of. In 2008, the California Supreme Court empowered receivers and authorized receivers to demolish buildings, too. Another benefit to receiverships is that cities usually recover attorney's fees and enforcement costs for bringing receivership actions.

Another solution has been the implementation of "foreclosure registration," ordinances and regulations. These ordinances require lenders or loan servicers to register a property with the local municipality after a foreclosure procedure has been begun, or to post a bond or a fee with a municipality. The city of Cleveland Heights, Ohio, established a vacant building registration that requires "the Owner of any building or dwelling that is vacant must register with the housing inspections department within 60 days after the structure becomes vacant and annually thereafter, so long as the building remains vacant." Registration is typically a means toward the ultimate goal of establishing who handles property maintenance, getting revenue, and reoccupying vacant property. Research conducted on these programs has concluded that "[g]iven that [vacant property registration ordinances (VPROs)] had relatively little enforcement cost, . . . they seem a relatively efficacious way to directly address the foreclosure externalities arising from any future downturn in housing markets. Certainly compared to other interventions like the Home Affordable Modification Program (HAMP) that attempted to forestall bank initiated foreclosures (and their spillovers) via costly inducements to banks, VPROs appear to be highly cost effective."

There are numerous similar laws enacted at local levels throughout the U.S. Fees, fines, liens, civil proceedings, and criminal penalties are commonly used to enforce these mandates. Many registration ordinances also impose fees to cover the cost of monitoring, inspecting, and re-inspecting vacant properties. Only through these inspections can a local municipality, lender, or property owner find out if a property has been vacated and whether it is being properly maintained. Saint Louis, Missouri, for example, organized the "Problem Property Unit" which is a "partnership between Law Enforcement and Code Enforcement" that "tackle and solve especially persistent Problem Properties—the poorly maintained addresses." The unit offers a host of services to address problem properties, including:

- Physical investigation and in-depth records research
- Counseling of problem landlords
- On-site warnings to problem tenants
- Finding absent landlords
- Removal of trash and debris
- Prosecution at the local and state levels
- Demolition of condemned buildings
- Coordination of social services and public and private sector resources
- Orders to Vacate

Another zombie property tool for municipalities to use is the property lien. Almost all states allow cities and counties to impose liens on properties when municipal money has been used to repair code violations or ease nuisance conditions. The consequences of these liens differ from one state to the next, especially when foreclosure is involved. Municipal tax liens (for failing to pay property taxes) are a type of lien that has priority over mortgages and judgements in the United States. The City of Cincinnati, for example, modified their city code to provide that the city "shall promptly place a priority lien on the property for the total cost of abating the violations." Municipalities in Illinois have the option of recovering the expenses of specified work they perform on abandoned residential property under Illinois law. The law applies to any sort of permanent housing unit that has been vacant for at least 90 days and for which the municipality has attempted but failed to contact the owner(s) or the owner's agent(s). It includes clearing the property of trees, weeds, debris, grass, waste, or graffiti, as well as securing or fencing it. Liens obtained under this statute are superior to all other liens except for tax liens.

Liens for nuisance abatement, on the other hand, are governed by state law. Some states do not give such liens precedence. As a result, the liens follow behind previously executed mortgages and can quickly become worthless if the property's value falls below the amount owing. Even though certain liens have precedence, the question of who can really collect on them may arise. Because of the delays and problems in recouping the money, many municipalities are hesitant to invest money on nuisance abatement, even if they may get a lien on the property.

Because a foreclosure sale is a debt collection action rather than a traditional transfer of ownership, nuisance abatement liens are often not required to be paid. As a result, the liens survive the sale and become the obligation of the first buyer of the property. The occurrence of a lien may have a negative influence on the sale, depending on the amount and circumstances of the lien. In the end, the authority to impose liens is a more controversial instrument for municipal governments than it looks at first glance.

What are the Maintenance and Upkeep Requirements of Zombie Properties?

As discussed, the maintenance of vacant properties fell into a vacuum because, often, laws placed property maintenance obligations on property owners who were absent. States began amending or enacting laws that expanded the legal responsibility for property maintenance to include foreclosing lenders, or even to provide specifically for creditor responsibility once foreclosure proceedings begin. New York RPAL § 1308New York Real Property Actions & Proceedings Law (RPAPL) § 1308, for example, imposes a duty to inspect, secure and maintain vacant and abandoned properties on mortgagees or their servicing agents. If the servicer or their agent determine that the property is abandoned under the criteria set forth in RPAPL § 1309, the servicer must secure and maintain the property until the earliest of certain events occur. In New York, the servicer or agent must address the following regarding the property at issue:

- where the property contains two or more points of ingress or egress, replace only one door lock to provide subsequent access to the property;
- secure, replace or board up broken doors and windows;
- secure any part of the property that may be deemed an attractive nuisance;
- take reasonable measures to ensure that pipes, ducts, conductors, fans and blowers do not discharge harmful gases, steam, vapor, hot air, grease, smoke, odors or other gaseous or particulate waste directly upon abutting or adjacent public or private property or that of another tenant;
- where appropriate, winterize the applicable plumbing and heating systems;
- provide basic utilities including, but not limited to, water, electricity, natural gas, propane and sewer service, as appropriate and, when allowed by the local utility provider, that are needed for the operation of a sump pump or dehumidifier, or when there are jointly owned or shared utilities with adjoining properties or units, except for turning off water service to prevent flooding or water leaks in the property, or when other utility service could reasonably create a hazard to the property or an unauthorized occupant or person entering the property;
- remove and remediate any significant health and safety issues, including outstanding code violations; and
- take reasonable measures to prevent the growth of harmful mold.

Should the servicer or agent fail to comply with RPAPL § 1308, a hearing officer or a judge can address the matter. The servicer or agent may be subject to a civil penalty in the amount of up to $500 per day, per property for each day the violation persists. In addition, the municipality where the property is located, shall have the right to, upon notice, enter and maintain the property and shall have a cause of action against the applicable mortgagee or servicer to recover any costs incurred.

At a local level, such as a county or other municipal government, similar laws, ordinances and rules have been established. Although these categories overlap and there are many distinct local variations, many municipal initiatives can be broadly classified as imposing registration, maintenance, or inspection requirements. To promote local aims, most local ordinances include components of two or all three of these needs. Flat Rock City, Michigan, for example, passed an ordinance that requires all mortgage/financial institutions to register all of their abandoned and foreclosed properties located within the city limits. The ordinance requires registration, a city property inspection following registration, as well as follow-up property maintenance requirements. The city and/or a contractor may maintain and secure the property if it is not properly kept or secured, and charge the bank, lender, or note holder who has an interest in the foreclosed property.

Most local municipalities seek fees, fines or liens (as discussed above) as enforcement penalties. Vacant or foreclosed property registration fees can range from $35 to $500, or even more. These fees help defray the costs of maintaining foreclosed properties, as well as the additional costs of securing and policing them; municipal officials say that taxpayers should not be responsible for mowing lawns, draining pools, and boarding up windows, or for extra enforcement. The threat of fines also encourages property maintenance. While fees may be considered a cost of doing business, fines can quickly add up.

On the more extreme end of the spectrum, some cities impose criminal liability to encourage cooperation and compliance. For example, in 2018, the City of Long Beach, New York, enacted a local ordinance establishing a "Mortgage in Default Registry," along with associated maintenance requirements. Besides potential fines, violators may also be subject to "a term of imprisonment for a period not to exceed 15 days." Some of the maintenance required to be conducted under the City of Long Beach ordinance includes: being "kept free of weeds, overgrown brush, dead vegetation, trash, junk, debris, building and construction materials left idle for an unreasonable period of time, any accumulation of newspapers, circulars, flyers, notices, except those required by federal, state, or local law, discarded personal items, including, but not limited to, furniture, clothing, large and small appliances, printed material or any other items that give the appearance that the property is abandoned or not being properly maintained." Also, the property must be "maintained free of graffiti or similar markings by removal or painting over with an exterior grade paint that substantially matches the color of the exterior structure, or by replacement with substantially similar materials in substantially similar colors and/or designs." The yards around the property "shall be landscaped and maintained." Any "[p]ools and spas shall be kept in working order so that pool and spa water remains free and clear of algae, pollutants and debris. Pools and spas shall comply with the enclosure requirements" as well. Under this ordinance, violators face the potential prospect of jail.

Other Efforts on Zombie Properties and Related Issues

Recognizing that the government alone cannot address the challenges zombie properties present to communities, other non-profit organizations have contributed ideas, programs, and resources to help tackle the problem. NeighborWorks America, a congressionally chartered and funded nonpartisan, nonprofit, supports organizations that provide communities with affordable housing, financial counseling and coaching, training, and resident engagement and collaboration in the areas of health, employment and education. The group helps approximately 250 organizations around the U.S. achieve the group's goals.

NeighborWorks America has invested over $9.3 billion into the U.S. communities. Among other accomplishments, they have helped repair 76,169 homes and helped preserve 9,056 homeowners. Their successful grant program is a testament to their commitment to communities. In FY 2019, NeighborWorks awarded nearly $100 million in core grant funding to network organizations. In 2019, NeighborWorks was able to secure $64 of investment from other sources for every $1 provided by Congress to their organization. This funding has helped them establish many successful programs. Following the late-2000s foreclosure crisis, Congress tasked NeighborWorks with designing and implementing the now-closed National Foreclosure Mitigation Counseling Program, which serviced over 2.1 million borrowers. Also, NeighborWorks has managed several down payment assistance programs for low- and moderate-income homebuyers. Customers whose properties require repairs can take advantage of a variety of services provided through NeighborWorks organizations. Loan professionals from the NeighborWorks organization assist with finance (typically through NeighborWorks CDFIs or local revolving loan funds), while construction specialists assist people in finding suitable contractors, writing work requirements, and overseeing property.

Another organization addressing zombie property issues is the National Community Stabilization Trust (NCST). The NCST is a non-profit organization dedicated to repurposing unused and abandoned structures and preventing blight in communities. Their programs make it easier to restore unoccupied but structurally sound homes, allow for safe, targeted demolition when necessary, and encourage imaginative and productive land reuse. Other key activities by NCST include their First Look REO acquisition program. As part of a neighborhood redevelopment strategy, First Look REO gives community-based buyers the option to buy unused, abandoned, or distressed properties before they are sold to the public. Through its ReClaim Project, NCST now owns and administers troubled mortgages. The group manages a portfolio of significantly distressed mortgages in partnership with the Housing Partnership Network (HPN) to address delinquencies, aid homeowners, and prepare unoccupied properties for beneficial disposition. The NCST also works in collaboration with NeighborWorks America on what is called the Middle Neighborhoods Initiative. The Middle Neighborhoods Initiative raises awareness of neighborhoods around the country that have long been stable communities for middle and working-class families, but are now at risk of gentrification-related decline or displacement.

NAR Efforts on Zombie Properties

NAR has always been at the forefront of the zombie foreclosure issue, whether through supporting legislation at Federal, State and local levels or through training and supporting state and local associations. More recently, because of the continuing global pandemic, NAR along with the NCST and the National Fair Housing Alliance have advocated for the preservation and improvement of distressed properties. NAR has supported prioritizing homeownership and neighborhood stabilization in distressed and REO sales. We also support properly maintaining REO properties in all neighborhoods, as well as preventing zombie foreclosures and actively addressing continuing vacancy issues. NAR has also partnered with regional and local associations to provide training to address their blighted property issues. In the City of Spokane, for example, a NAR sponsored training program provided guidance to a local zombie homes coalition on issues dealing with zombie properties. This training provided the group key insight into the various ways to address the issues.

Although zombie properties have declined in many communities, they still exist as a detriment to the real estate market and community stability. Federal, state, and local governments have successfully implemented laws and ordinances to better manage and address zombie properties. In addition, both public and private funding to many successful nonprofits has also helped stabilize and, most times, improve blighted areas. The major shift in placing property maintenance obligations on lenders has also been a successful tactic. Continuing support at all levels of government and within the private sector should help to stem any further major zombie foreclosure outbreak.

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