

Neighborhoods:

Foreclosure's Silent Victims

A property I will call 5 Wendell Way is a two-family house on a dead-end street in a diverse middle-class neighborhood of Boston. The lender foreclosed on it in 2006.

For several years, I watched from my house across the street as the property sat empty and fell into disrepair. After it was vacated, youths from the neighborhood started partying in the house. In response, city officials came around and nailed up large plywood covers on the first-floor windows.

The action was part of an initiative meant to stop vacant properties from becoming crime sites. Unfortunately, it was easy to take the boards off with a screwdriver, and people did. Additionally, an elderly drunk took up residence under the porch of the house, coming and going over the summer months. Break-ins increased all along the block. The grass grew long. The snow on neighborhood streets was left to pile up. And people from other parts of the city saw the area as a good place to let their dogs run loose.

The house sat empty and dark every night for five years. It needed increasing amounts of maintenance, new shingles, roof work. But no one took responsibility for the building's condition or the impact on the neighborhood.

Legal Limbo

It turns out that the house had entered legal limbo. That happens when the foreclosure process is not completed because the process itself is defective or because lenders don't have the documents they need to lawfully foreclose. In such situations, the borrower, who has usually vacated the property long since, still holds the title. But neither the lender nor the borrower takes responsibility for the property. Properties can sit in legal limbo for months or even years. The damaging effect on neighborhoods is not often adequately recognized.

A mortgage servicer I'll call Allstar Funding Corporation foreclosed on 5 Wendell Way and bought the property at the foreclosure auction. However, according to the real estate agent who listed the property for

Allstar, the foreclosure was invalidated in 2008 because of defects in the process. As a result, Allstar never took title and thus had no responsibility for the property.

In April 2010, Allstar finally completed the foreclosure of 5 Wendell Way and purchased the home at the foreclosure auction. By late summer 2010, an investor had bought the property from Allstar, rehabbed it, and put it up for sale. The owner advertised it as two condos in an "up and coming market." By May 2011, both condos were under purchase-and-sale agreements. As of June 2011, almost five years after the property initially went into foreclosure, new residents were moving in.

"Shadow inventory" properties, a murky term referring to those properties in the foreclosure process that have not yet reached the market, number somewhere in the tens of thousands in Massachusetts alone.¹ In January 2011, there were \$450 billion worth of properties in Boston's shadow inventory.² An additional unknown number of properties are lurking in legal limbo waiting to enter the shadow inventory. In Boston, recent city estimates suggest 238 (15 percent) of 2009 and 2010 foreclosure petitions were legal-limbo properties that finally made it into the shadow inventory.³

Legal limbo is often created when distressed homeowners or the banks themselves make perfectly valid challenges to the foreclosure process. In Massachusetts, a court's decision on *U.S. Bank v. Ibanez* increased the number of Massachusetts properties that were in legal limbo and waiting to enter the shadow inventory.

The *Ibanez* ruling involved two cases where, in the flurry of activity to securitize the original mortgages, the banks in question had not appropriately transferred title of the mortgage. The mistake meant that when the new bank attempted to foreclose on the property, it found that it did not actually have legal right to do so.⁴ As a result, the court ruled that the foreclosures were invalid.

The decision in *Ibanez*, threw into question thousands of foreclosures across the state, often forcing banks to initiate new foreclosure proceedings on properties they thought they had already foreclosed on.

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Moreover, in response to the *Ibanez* ruling, banks slowed down their foreclosures, and some stopped foreclosing altogether because of concerns that they did not have the documentation establishing their right to foreclose.

For families in foreclosure and their advocates, *Ibanez* was an important ruling that forced banks to exercise greater care when foreclosing on homes. But the decision has also played out in unanticipated ways. For some neighborhoods in Boston, the bottleneck created by *Ibanez* has had negative outcomes. Units of housing, both rental and owner-occupied, were thrown into limbo, no longer a part of Boston's housing inventory. Often tenants and owners of these properties had already been evicted by mortgage servicers, leaving the buildings vacant. Properties in legal limbo couldn't move into new ownership. Some sites saw increased criminal activity. Properties fell further into disrepair. No one was taking responsibility for looking after the property and doing basic maintenance.

What About the Neighborhood?

The end result has been that attempts to slow the foreclosure process down and challenge illegal foreclosure actions have damaged properties and their neighborhoods. Lawsuits focus on individual cases and individual remedies to those cases without examining the implications more generally for neighborhoods. For example, *Ibanez* put thousands of properties into legal limbo across the state. Such homes are often vacant because servicers offer cash for families to leave the foreclosed house or because homeowners think they have really lost their homes to foreclosure and just leave without compensation. Whatever the reason, once borrowers or tenants move out, they no longer take responsibility for maintaining the property. At the same time, without a completed and lawful foreclosure and sale, no one else has any obligation to keep up the homes.

Neighborhoods and property neighbors are interested parties in foreclosure actions, but they nevertheless have no rights. The parties responsible for incomplete foreclosures (servicers, lenders, and law firms) are never required to pay for the damage they have caused to neighborhoods. They do not pay compensation to the city for managing the costs associated with vacancy and increased



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crime. Likewise, neighbors whose property has depreciated—and who may work alone or with neighborhood associations to reverse the blight—are never reimbursed for the cost that wrongful foreclosures impose on them.

Cleveland is one city that attempted to recover the costs of the lending cycle that led to so many foreclosures and devastated neighborhoods. The city filed a public nuisance case in 2008 against 21 lenders. But in March 2011, the Supreme Court dismissed the case.⁵ If the Cleveland case had developed further, it might have documented the monetary value of damage inflicted on neighborhoods and cities as a result of predatory mortgage lending and foreclosures. As it

stands, the question remains unanswered by the courts or by federal and state legislatures.

To fairly address the negative consequences of poorly executed foreclosures and to protect both homeowners and neighborhoods, the courts, attorneys general, and prosecuting lawyers need to figure out how to include neighborhoods as secondary victims of improper foreclosures. The Ibanez case provides some concrete evidence of the unanticipated impact on neighborhoods and cities when servicers and lenders are not accountable for the full panoply of harm their actions have caused. Legal redress for neighborhoods as well as homeowners is an avenue worth exploring.

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Endnotes

- ¹ Tim Davis, *Foreclosure Monitor: How Second Wave May Impact Economic Recovery* (Boston: Massachusetts Housing Partnership, 2010).
- ² "Boston Housing Market Has 5-Year Shadow Inventory," *Boston Business Journal*, January 7, 2011, <http://www.bizjournals.com/boston/news/2011/01/07/boston-housing-market-has-5-year.html>.
- ³ *Foreclosure Trends Report 2010* (Boston: Department of Neighborhood Development, 2011) and *Foreclosure Trends Report 2009* (Boston: Department of Neighborhood Development, 2010).
- ⁴ Tom Egan, "Banks Fail to Sway SJC in 'Ibanez' Case," *Massachusetts Lawyers Weekly*, January 7, 2011, <http://masslawyersweekly.com/2011/01/07/sjc-rules-against-banks-on-mortgage-assignments>.
- ⁵ City of Cleveland, Ohio, *Petitioner v. Ameriquest Mortgage Securities Inc., et al.* no. 10-915. Supreme Court of the United States; Kathleen Engel, "Do Cities Have Standing? Redressing the Externalities of Predatory Lending," *Connecticut Law Review* 38 (2006): 355-392.

