

MEMORANDUM

Abandoned and Vacant Properties

James Smith, Reporter

May 17, 2012

Dwelling units that have gone through foreclosure or are threatened by foreclosure are much more likely to be abandoned than other residential properties. The recent high foreclosure rates exacerbate the problem. In other words, the correlation between foreclosure and vacant homes is positive but not linear. As foreclosure rates increase, so does that probability that affected units are vacant. There are two reasons for this. First, due to the flood of foreclosure proceedings, especially in states that require judicial foreclosure, the average foreclosure takes much longer than before. For many properties, this results in a longer period of vacancy between the departure of the mortgagor and the next occupant. Second, since the housing bubble began to collapse in 2007, the market for residential sales has remained weak. This means that even when lenders are able to complete foreclosure expeditiously, in many markets there is little opportunity for lenders to sell the foreclosed properties to buyers who will take occupancy or who will readily lease the properties to tenants. This market reality has resulted in lenders choosing to slow down the foreclosure process in some markets.¹ This results in a feedback loop; lenders who are able to foreclose and gain title to residential units due to mortgagor default elect to hold off, believing that taking ownership of properties they cannot sell is not in their best interest.

Mortgage delinquency and foreclosure proceedings trigger abandonment not only for owner-occupied properties, but also for rental properties. Tenants in most jurisdictions do not receive prompt notice of foreclosure proceedings commenced against their landlord, but sooner later the situation becomes apparent to tenants, sometimes due to problems such as utility cutoffs associated with the landlord's financial distress. When they learn of pending foreclosure, many tenants abandon their dwelling units in the belief that if the foreclosing lender does not evict them, the quality of the housing will be impaired.²

Foreclosed properties that remain vacant have negative impacts on neighborhoods and the surrounding communities. Neighboring property values are reduced by 0.9% to 1.1% by each foreclosure, the reduction being partially attributable to empty properties. Neighborhood crime increases by 6 to 7%. Vacancies and the associated problems of lack of repair and maintenance create public health risks, including infestations by

¹ Renae Merle, *Foreclosure Wave Threatens Stability of Housing Market*, Washington Post, Mar. 12, 2010 (“Some of the positive housing data may not be signaling a true turning point, as many servicers are holding back on foreclosures and the related houses are not yet being offered for sale”).

² Dora Galactos et al., *Giving Tenants Their Due: Housing Court and Post-Foreclosure Procedure*, N.Y.L.J., Mar. 9, 2011; Aleatra P. Williams, *Real Estate Market Meltdown, Foreclosure and Tenants' Rights*, Symposium, 43 Ind. L. Rev. 1185, 1207 (2010).

vermin, mosquitoes, and other insects.³ There are fiscal impacts on local governments, who find property taxes on vacant properties often become delinquent; yet the governments are faced with added expenses to provide essential services to blighted neighborhoods, such as police and fire protection.

I. State and Local Government Responses

Many states and local governments have responded to the avalanche of vacant residential properties by imposing duties upon owners and foreclosing lenders to maintain such properties. The next sections review legal development in two states, New York and California, and in one city, Chicago. Although there is appreciable diversity in the approaches taken in other jurisdictions, these three examples are sufficient to illustrate a number of the relevant considerations and choices.

A. New York

In December 2009 New York responded to its foreclosure crisis by enacting section 1307 of the Real Property Actions and Proceedings Law.⁴ Section 1307 obligates lenders to maintain foreclosed properties after obtaining a judgment of foreclosure. The statute provides:

A plaintiff in a mortgage foreclosure action who obtains a judgment of foreclosure and sale . . . involving residential real property . . . that is vacant, or becomes vacant after the issuance of such judgment, or is abandoned by the mortgagor but occupied by a tenant . . . shall maintain such property until such time as ownership has been transferred through the closing of title in foreclosure, or other disposition, and the deed for such property has been duly recorded⁵

The statute grants to the lender or its agents “the right to peaceably enter upon such property . . . for the limited purpose of inspections, repairs and maintenance as required by this section.”⁶

If the mortgagor commences a bankruptcy proceeding prior to the completion of the foreclosure auction sale, the lender’s statutory duties are suspended until the bankruptcy proceeding terminates or the bankruptcy court removes the automatic stay of the foreclosure sale.⁷

The statute defines the lender’s duty to “maintain” by reference to the standards set forth within various sections of the New York property maintenance code. In

³ Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 Hous. Pol’y Debate 57, 59 (2006).

⁴ The law became effective on April 14, 2010.

⁵ N.Y. Real Prop. Acts. § 1307(1).

⁶ N.Y. Real Prop. Acts. § 1307(2). If tenants occupy the property, the lender must give notice to the tenants before entering the property to make repairs.

⁷ N.Y. Real Prop. Acts. § 1307(4).

addition, tenant-occupied property must be “maintained in a safe and habitable condition.”⁸

The New York statute does not override local laws that prescribe property maintenance obligations, or the local government’s ability to enforce its laws.⁹

The statute makes significant changes to prior law. It abrogates the traditional common-law principle that a mortgagee not in possession or control of real property is not liable for the condition of the property. The statute appears to override a provision of the Multiple Dwelling Law that requires an “owner” to keep the dwelling “in good repair,” but defines the “owner” to include a lender only when that person is a “mortgagee in possession.”¹⁰

Section 1307 imposes a maintenance obligation upon a lender “who obtains a judgment of foreclosure and sale.” Precisely when this takes place is not clear. Possibly “obtaining a judgment” occurs when the trial court enters a written judgment of foreclosure; possibly service on the parties is required; possibly the obligation does not arise if the litigation is not concluded because a party has moved the court for reconsideration.

Many vacant properties are in the process of foreclosure, but are not subject to the statutory maintenance obligation because foreclosure is still in the pre-judgment stage. Judicial foreclosures in New York are not quickly completed, especially since the upsurge in loan delinquencies and mortgage foreclosure filings that began in 2007. Many factors delay the issuance of foreclosure judgments, including the unavailability of personnel to conduct foreclosure sales, problems with publication, bidder defaults, title issues that require resolution, and judicial claims asserted by mortgagors and third parties.

The lender’s maintenance obligation, once it begins, lasts under Section 1307 until “such time as ownership has been transferred through the closing of title in foreclosure, or other disposition.” The statute provides no additional clues as to the ending point. It seems plain that the obligation can last no longer than the time of recordation of a deed of conveyance to a third-person purchaser. It is not clear what should happen if there is a significant gap in time between delivery of the deed and recording, and what constitutes an “other disposition.”

The legislature may have expected that the maintenance obligation it imposed on lenders was a relatively short duration. Although in principle there could be very little time between the foreclosure judgment and the sale of the property to a third person, in most cases the sale is not immediately completed. Thus, in most cases there will be a substantial time period during which the lender is obligated.

⁸ N.Y. Real Prop. Acts. § 1307(5).

⁹ N.Y. Real Prop. Acts. § 1307(8).

¹⁰ N.Y. Mult. Dwell. §§ 4(44), 78. See Bruce J. Bergman, *New Law Will Create Delay. Additional Costs for Lenders*, N.Y.L.J., Jan. 13, 2010 (citing cases).

The statutory maintenance obligation suffers from indeterminacy because there is no attempt to define “vacant” property or property “abandoned by the mortgagor but occupied by a tenant.” The latter term (“abandoned”) apparently envisions that the mortgagor as landlord has breached its obligations with respect to the leased premises.

The statute does not address lender liability for vacant properties apart from the New York property maintenance code, but it may have further impacts. Lenders may become subject to the risk of tort liability to third parties under the principles that generally govern premises liability. This would follow from a conclusion that the lender’s statutory duty to maintain and repair the premises puts them in a position of care, custody, and control over the property just like other property owners.¹¹

Lenders who attempt to meet their statutory repair obligations probably will do so by hiring independent contractors. Such lenders apparently will have the normal obligation of an owner to exercise care in the selection of repairers and in ensuring that their work meets the standards of the maintenance code.

Section 1307 grants a right to municipalities, homeowner associations, condominium boards, and tenants in possession the right to enforce the statutory maintenance obligations in any court of competent jurisdiction. The entity must give the lender seven days notice, unless emergency repair is required. Such an entity may recover its costs in maintaining property from the lender.¹²

In the first case interpreting Section 1307, *Town of Huntington v. Lagone*,¹³ the town brought an action against the non-occupying homeowners (the Lagones) and the foreclosing lender to compel repairs to an abandoned, partially constructed residence that was deteriorating and infested with vermin. The lender succeeded in obtaining a dismissal because it had not yet obtained a judgment of foreclosure against the Lagones. The Town argued that the bank had not made “good faith” efforts to conclude the foreclosure sale, but the court reasoned that this was “a policy consideration for the legislature,”¹⁴ evidently concluding that Section 1307 was clear on the lack of lender liability. *Lagone* establishes that Section 1307 is to be interpreted literally with respect to the condition that lenders must obtain a judgment of foreclosure before their statutory duties to maintain take effect. In *Lagone*, the court ordered the defendant homeowners (the Lagones) to make the necessary repairs. The statutory language, as interpreted by *Lagone*, creates a disincentive for lenders to prosecute foreclosure proceedings in a diligent manner when the property already has code violations.

It is worth noting that Section 1307 obligates lenders to make repairs that were made necessary by the malfeasance of other persons, usually their borrowers. Vacant

¹¹ See Bruce J. Bergman, *New Law Will Create Delay. Additional Costs for Lenders*, N.Y.L.J., Jan. 13, 2010.

¹² N.Y. Real Prop. Acts. § 1307(3).

¹³ *Town of Huntington v. Lagone*, 908 N.Y.S.2d 320 (Dist. Ct. 2010).

¹⁴ *Id.* at 322.

properties that are in the worst shape are often heavily vandalized and stripped of fixtures and other components, including appliances, plumbing, and wiring. Section 1307 does not expressly give the lender a remedy for waste committed by the borrower to recoup its maintenance costs. Such an action arises independently, based either on an express covenant in the mortgage or an implied duty, but to assert such a waste action the lender must obtain permission of the court.¹⁵

The extensive New York statutory obligations on lenders can be expected to affect lender behavior. First, in pending transactions lenders are likely to avoid moving forward to obtaining foreclosure judgments; and when they do so, they are likely to accelerate their efforts to sell foreclosed property quickly to minimize the time period their obligations remain in effect. This may induce lenders to accept lower prices in foreclosure than would otherwise be the case. Second, lenders are likely to consider the risk of statutory maintenance obligations in making new loans; they may impose higher underwriting standards to exclude borrowers who are more likely to default or under-repair the properties, and they may demand additional fees or interest to compensate for the additional risk.

B. California

In 2008 California enacted the Perata Mortgage Relief Bill to reform its foreclosure statutes. One component of the reform measure was a requirement that foreclosure purchasers maintain vacant residential properties. The key provision of California Civil Code section 2929.3 states:

A legal owner shall maintain vacant residential property purchased by that owner at a foreclosure sale, or acquired by that owner through foreclosure under a mortgage or deed of trust.¹⁶

The term “legal owner” includes both lenders who purchase at foreclosure sales and third-party foreclosure purchasers. The statute goes on to define “failure to maintain” as

failure to care for the exterior of the property, including, but not limited to, permitting excessive foliage growth that diminishes the value of surrounding properties, failing to take action to prevent trespassers or squatters from remaining on the property, or failing to take action to prevent mosquito larvae from growing in standing water or other conditions that create a public nuisance.¹⁷

The statute allows a governmental entity to impose a civil fine of up to \$1,000 per day for an owner’s violation of the maintenance obligation. The government may impose the fine only after giving notice of the violation to the owner and a period of not less than

¹⁵ N.Y. Real Prop. Acts. § 1301(3) (“While the action is pending or after final judgment for the plaintiff therein, no other action shall be commenced or maintained to recover any part of the mortgage debt, without leave of the which the former action is brought.”).

¹⁶ Cal. Civ. § 2929.3(a)(1).

¹⁷ Cal. Civ. § 2929.3(b).

14 days for the owner to commence correction of the violation and not less than 30 days for completion of its correction.¹⁸ The fine is stated to be a maximum, with the entity instructed to determine “the amount of the fine [by taking] into consideration any timely and good faith efforts by the legal owner to remedy the violation.”¹⁹ The local government must direct all collected fines “to local nuisance abatement programs.”²⁰

A prior California statute, enacted in 1987, authorizes lenders to repair property acquired through foreclosure under a mortgage or deed of trust.²¹ The 1987 statute does not require repairs. The new 2008 statute did not amend the 1987 statute.

The new statute has a sunset provision, which provides for expiration on January 1, 2013, unless extended by the legislature.²²

The statute is cumulative of rights and remedies provided by other laws; and the statute does not preempt local ordinances, but a governmental entity may not impose fines on a legal owner both under the statute and under a local ordinance.²³

C. City of Chicago

In November 2011, the City of Chicago amended its “Vacant Buildings Ordinance” to impose registration and maintenance requirements upon lenders holding mortgagees on vacant residential real estate. Previously the City’s ordinance, like those adopted in many cities, imposed obligations only upon the owners of vacant properties. The City expanded the scope of its ordinance to require lenders to register and maintain properties when owners fail to do so. If payment of a residential mortgage loan is more than 45 days delinquent, the lender is required to inspect the home to ascertain the property has been abandoned. If it is abandoned, the lender has to register the property with the City and secure the property. Subsequently Cook County passed a similar ordinance to impose obligations upon lenders for properties in unincorporated areas of the county and any municipality that chooses to participate.

The City’s ordinance requires owners, including lenders, to pay a one-time \$500 registration fee for vacant properties and requires monthly inspections of mortgaged properties to determine if they are vacant. The ordinance sets forth detailed maintenance requirements and authorizes the City to impose fines of up to \$1,000 per day for an owner’s noncompliance.

The City claims that the amended ordinance is achieving its purposes. The City’s Department of Buildings reports that there presently are 5,787 homes on its official vacant property registry, more than half of which were added after the new rules went

¹⁸ Cal. Civ. § 2929.3(a)(1),(2). Shorter notice is allowed if the government “determines that a specific condition of the property threatens public health or safety. *Id.* § 2929.3(c).

¹⁹ Cal. Civ. § 2929.3(a)(2).

²⁰ Cal. Civ. § 2929.3(d).

²¹ Cal. Civ. § 2932.6.

²² Cal. Civ. § 2929.3(i).

²³ Cal. Civ. § 2929.3(e), (f), (h).

into effect last November. A City attorney reports that it uses the registry quickly to solve complaints about vacant properties: “When a building is registered and we get a complaint through 311 that the building’s vacant and open, we go right to the registry, we find out which bank it is, we have their contact, we email them, and by that night the building is boarded. Otherwise the city would have had to do that.”²⁴ During the first quarter of 2012, the City collected \$619,000 in fines from financial institutions.²⁵

In December 2011 the Federal Housing Finance Agency (FHFA), the entity that regulates Fannie Mae and Freddie Mac, filed an action against the City of Chicago to enjoin enforcement of the ordinance with respect to Fannie Mae and Freddie Mac-owned mortgages.²⁶ The two federally regulated entities own more than 250,000 mortgages on properties within Chicago, and have guaranteed approximately 750,000 additional Chicago mortgage loans.²⁷ The plaintiff’s theory is that the ordinance impermissibly interferes with its role as sole regulator and conservator of Fannie Mae and Freddie Mac; that the registration fees function as a tax, which the City may not impose; and that the costs of complying with the ordinance increase the costs to federal taxpayers associated with the bailout of Fannie Mae and Freddie Mac.

While the case is pending, Fannie Mae and Freddie Mac have instructed the banks and servicers they work with to pay registration fees to the City “under protest” to preserve the right to obtain refunds if the FHFA prevails. The case is highly significant. If the City prevails, many other states and cities throughout the United States will consider enacting similar ordinances. If the FHFA prevails, a federal exemption for Fannie Mae and Freddie Mac-related mortgage loans will almost certainly result in the demise of Chicago’s ordinance, given the market share of residential mortgages controlled by the federal entities.

II. Issues to Consider with Respect to Vacant and Abandoned Properties

A review of the New York and California vacant property statutes and the City of Chicago ordinance suggests the following issues to consider with respect to the preparation of a statute.

1. A statute should attempt to define “vacant” and “abandoned” property. In contrast to the New York and California statutes, which provide no guidance, an Indiana statute that became effective in March 2012 has a multi-part definition:

²⁴Odette Yousef, *Federal mortgage giants lay ground for restitution*, available at <http://www.wbez.org/news/federal-mortgage-giants-lay-ground-restitution-98694>

²⁵ May 03, 2012|By Mary Ellen Podmolik, *Vacant building ordinance nets \$619,000 in fines so far*, Chicago Tribuen, May 3, 2012 (city said it fined more than 150 mortgage servicers during first quarter for not abiding by its vacant building ordinance).

²⁶ *Federal Housing Finance Agency v. City of Chicago*, (Dec. 12, 2011, E.D. Ill.), available at http://www.fhfa.gov/webfiles/22831/COMPLAINT_FILE%20STAMPED.pdf

²⁷ Mary Ellen Podmolik, *Feds look to dispose of vacant property ordinance quickly*, Chicago Tribuen, Jan. 18, 2012.

[F]or purposes of an abandonment determination under this chapter, one (1) or more of the following constitute prima facie evidence that mortgaged property is abandoned:

- (1) The enforcement authority that has jurisdiction in the location of the mortgaged property has issued an order under IC 36-7-36-9 with respect to the property.
- (2) Windows or entrances to the mortgaged property are boarded up or closed off.
- (3) Multiple window panes on the mortgaged property are broken and unrepaired.
- (4) One (1) or more doors to the mortgaged property are smashed through, broken off, unhinged, or continuously unlocked.
- (5) Gas service, electric service, water service, or other utility service to the mortgaged property has been terminated.
- (6) Rubbish, trash, or debris has accumulated on the mortgaged property.
- (7) The mortgaged property is deteriorating and is either below or in imminent danger of falling below minimum community standards for public safety and sanitation.
- (8) The creditor has changed the locks on the mortgaged property and for at least fifteen (15) days after the changing of the locks the owner has not requested entrance to the mortgaged property.
- (9) There exist one (1) or more written statements, including documents of conveyance, that have been executed by the debtor, or by the debtor's personal representatives or assigns, and that indicate a clear intent to abandon the mortgaged property.
- (10) There exists other evidence indicating a clear intent to abandon the mortgaged property.²⁸

2. A statute should consider what problems associated with vacant and abandoned properties it seeks to address. The New York statute, by referring to a comprehensive maintenance code, seeks to make sure that the dwelling unit remains in compliance with building and safety codes, and is in good shape suitable for habitation. The California statute is less ambitious, focusing principally on the outward appearance of the properties, which may contribute to neighborhood blight.

²⁸ Ind. Code § 32-30-10.6-5(a). Other states have similar statutes. *E.g.*, Colo. Rev. Stat. § 38-38-903; Minn. Stat. § 582.032.

3. What persons are responsible for maintaining vacant and abandoned properties? The New York and California statutes and the Chicago ordinance all reflect the trend of expanding liability beyond the homeowner to reach mortgage lenders. When that step is taken, it is critically important to consider not only the scope of a lender's obligation, but timing issues. The statutes impose a liability only after the completion of foreclosure. The Chicago ordinance imposes liability once the mortgage loan becomes seriously delinquent. Obviously, a number of intermediate positions are also possible.

4. What parties have the right to enforce statutory obligations with respect to vacant and abandoned properties; and what are the remedies? The California statute and the Chicago ordinance authorize local governments to impose civil fines. The New York statute grants enforcement rights to local governments, and in addition to homeowners associations, condominium associations, and tenants, but with no civil penalties.

5. If lenders have liability for vacant and abandoned properties, what recourse should they have with respect to mortgagors who are sometimes primarily responsible both for the poor physical condition of the property and the fact of vacancy and abandonment? Neither the New York nor the California statutes adequately address the question of recourse. In California, recourse issues are further complicated by the California anti-deficiency judgment statutes.

6. Should the statute provide special foreclosure procedures when the property is vacant or abandoned? Some states have foreclosure statutes with special provisions for such properties. For example, New Jersey allows the lender to use an "optional mortgage foreclosure procedure without sale" when the owner has abandoned the property. This is a statutory form of strict foreclosure. Entry of judgment transfers title to the lender and extinguishes the mortgage debt, precluding from the lender from obtaining a deficiency judgment. N.J. Stat. § 2A:50-63. Washington provides the purchaser at a foreclosure sale takes from of the owner's redemption rights when the owner "has abandoned said property for six months or more." Wash. Rev. Code § 61.12.093.

7. Owner-occupied and rental properties both can present substantial problems associated with abandonment and vacancy. Query whether the context and issues are sufficiently similar to be handled by the same statutory provisions. The New York statute's attempt to do this is, at best, highly awkward.