

## How to Fight Blight Caused by Residential Foreclosure

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We hear a lot about how residential foreclosures in some areas of New York State harm nearby neighborhoods. The owner of a house in foreclosure doesn't properly maintain it, or even abandons it. That invites crime. It makes the neighborhood look bad. It drives down property values. It reduces real estate tax revenues. It's an awful thing. Government should do something about it.

Recent legislation out of Albany makes some mortgage lenders responsible for maintaining these "zombie houses," if the borrower has in fact abandoned them – a factual inquiry that can create its own issues, uncertainty and delay. If a zombie house needs maintenance or security, the lender must now sometimes pay for it. The new law also has a requirement to report these houses to a central registry, so the government can track them.

It all sounds like a great plan. We don't like zombie houses. It must be the lenders' fault. So let's impose some new burdens on lenders.

The discussion misses the point. Residential foreclosures harm neighborhoods because they create uncertainty about ownership. The nominal owner, the defaulting borrower, has no incentive to maintain their property, so they let it run down and deteriorate. The value of the house has typically fallen below the amount due under the mortgage. As a practical matter the borrower's interest in the house is worthless. That's sad but true. It is one of several possible outcomes when a homeowner borrows a mortgage loan. Why would any sane borrower spend money to preserve an asset in which their interest is worthless?

Likewise, mortgage lenders face uncertainty and have little incentive to spend money to maintain houses in foreclosure. They don't know what surprises await them in the foreclosure process, or if the foreclosure might get derailed for technical reasons. In New York, they may endure a foreclosure timeline that can take two years or more, even if the borrower is in default and has no worthwhile defenses. So, except for Albany's new law, lenders have no real reason to take control of these houses and prevent blight.

What caused such a slow foreclosure process – the indirect driver of the foreclosure "blight"? Answer: the State Legislature. It has piled on a series of protections for residential borrowers. Each has had the effect of further complicating and dragging out the foreclosure process. Every time, the Legislature ignored whatever procedural protections already applied, and just added more. And the new legislation on zombie houses added even more procedural protections, creating new issues and further slowing down foreclosures.

The Legislature also thought it would be a good idea to encourage borrowers and lenders to settle their differences, presumably by making the borrower's mortgage less burdensome so that the borrower could continue to pay it. The latest legislation added frosting to that cake by saying that if a lender rejects a borrower's proposal, the lender has to explain why. (What about the proposition that the loan documents obligated the borrower to pay the loan or lose their collateral?)

Encouragement of settlements sounds like a wonderful idea. In practice, once a defaulted mortgage gets into litigation, the borrower has probably had a number of opportunities to work something out, but it hasn't happened. So the foreclosure finally starts and could take two years or more – all while a defaulting borrower continues to occupy their house without paying their mortgage or real estate taxes.

If the state truly wants to solve the problem of zombie houses, it should simplify and speed up the foreclosure process so lenders can quickly obtain certainty about who owns these houses. The borrower cannot or chooses not to pay the mortgage because it exceeds the value of the house. If we want to preserve neighborhoods and prevent blight, we should quickly move these troubled houses into the hands of new owners who can and will pay the mortgages and real estate taxes and maintain the houses. That's how to preserve neighborhoods.

To achieve that goal, though, requires a rethinking of New York's foreclosure process. Instead of adding more procedural requirements and protections for borrowers who are underwater and unable or unwilling to pay their obligations, and more burdens for lenders, we should speed up the process so houses gets revalued, and into the hands of new owners who can support them, before lack of maintenance and resulting deterioration destroy their values entirely. That could also mean joining the majority of other American states and establishing a nonjudicial foreclosure process. This would eliminate the extraordinary delays caused by the judicial system, help create quick certainty on ownership and take a huge step toward solving the problem of zombie houses.

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