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"ADDRESSING THE ISSUE OF ABANDONED RESIDENTIAL PROPERTY"

by

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I. BACKGROUND.

Apart from the State's significant and continuing fiscal issues relating to the budget and pension and Medicaid reform, the topic of foreclosure remained an overarching focus of the General Assembly during its 2012 spring session. Foreclosure is a politically sensitive issue because borrowers (constituents) live in the collateral. The collateral frequently is the embodiment of their life long goal of owing a home – a goal actively fostered by the federal government through the pre-recession lending programs of its government-sponsored enterprises. When a loan default occurs, and with the financial crisis, housing bust and recession of 2008, loan defaults have occurred in extraordinary numbers, the dream of home ownership is shattered. The harsh consequence of eviction motivates every legislator to do something to address the issue, and so bill after bill is introduced. That motivation has been further exacerbated by the robo-signing debacle involving large servicers. Unfortunately, most of the initiatives are punitive in orientation with fees, fines and restrictions, and none of them are introduced from the perspective of taking an integrated and comprehensive approach to the issue.

Through their respective associations, credit unions and other lenders have worked in a positive way with sponsors since the foreclosure crisis began in 2008. They have said "yes" to at least 16 measures amending the Illinois foreclosure process that have been enacted into law in the past four years. Those measures take a balanced approach in providing additional information, guidance and options to borrowers, without burdening lenders with even more time and expense in prosecuting their foreclosure complaints.

In their effort to affirmatively and reasonably address the issue of foreclosure, lenders have reminded legislators that lenders are under intense regulatory agency pressure to control loss loan writedowns attributable to residential mortgage loan defaults. In debunking the perception that lenders can't wait to throw borrowers out of their homes, lenders have explained to members of the General Assembly that they experience the horns of a dilemma for two significant reasons when it comes to foreclosure.

First, State legislative efforts strive to keep borrowers, tenants and other lawful occupants in their homes for as long as possible following default and attack lenders with new foreclosure restrictions and fees in support of those efforts. At the same time and as a matter of regulatory supervision, the State mandates that the lenders it supervises aggressively pursue collection efforts and control their loan losses to avoid safety and soundness issues. It does this because high delinquencies and charge-offs affect the capital strength of financial institutions and can leave them impaired, which harms the consumers they serve. Also, to make credit available at a reasonable cost, lenders must recover balances to the greatest extent possible from their borrowers that have defaulted on their loan obligations. Keeping consumers in their homes and keeping consumers safe from insolvent financial institutions present the State and, in turn, lenders with conflicting policy dynamics that come head to head in the arena of foreclosure. The State wants it both ways and finds it difficult to identify and promulgate a consistent legislative policy to accomplish both objectives.

Second, the barrage of hostile foreclosure initiatives, if all passed into law, would make the "back-end" mortgage loan default collection effort all but impossible. Yet, the State is quick to turn around and criticize lenders for tightening up their "front-end" loan origination and underwriting standards. Legislators do not seem to understand that credit availability cannot increase when loan defaults are uncollectible. Again, the State wants it both ways.

II. **<u>ISSUE</u>**.

In both the 2011 and 2012 sessions of the General Assembly, the specific and particularly challenging foreclosure issue of abandoned residential property emerged. A mortgage loan default generates a legal issue between lender and borrower. However, when the borrower vacates his or her home and no longer cares for the property, the impact of the default becomes a social issue affecting the immediate neighborhood and community as a whole.

The issue may be framed as follows: Failing the owner's assumption of responsibility, should the cost of maintaining and securing abandoned residential property be borne by the municipalities in which the property is located or the lenders that hold a mortgage lien on the property?

III. LEGISLATIVE RESPONSE.

A. The Chicago Lender Liability Ordinance and S.B. 16.

Last year, four major servicing banks (Bank of America, J.P. Morgan Chase, Wells Fargo and PNC), broke ranks with the financial institution industry coalition[1] and worked with the City of Chicago to draft an ordinance requiring lenders to maintain and secure abandoned residential property within the City, upon the owner's failure to do so. Liability under the ordinance was unlimited, as was exposure to per diem fines. Notwithstanding a lawsuit filed against the City last fall by the Federal Housing Finance Agency (conservator of Fannie Mae and Freddie Mac), alleging the ordinance was vague and subjective and pre-empted by federal law, the City and the four large banks crafted Senate Bill 16 House Amendment 6 to "export" to the entire State the authorization for municipalities to adopt "Chicago style" ordinances. If passed into law, S.B. 16 would amend the Illinois Municipal Code to delegate authority to each of the 1,300 municipalities in Illinois to adopt an ordinance in substantial compliance with the S.B. 16 standards. However, the measure did not establish a uniform statewide standard for municipalities to hold lenders liable for maintaining and securing costs. Some standards, such as monthly determinations of vacancy beginning 45 days after default, are entirely permissive (and apply to property that is not abandoned).

B. The Lenders' "Fast Track" Counter Proposal – S.B. 2534.

The approach taken by the City of Chicago and the four large servicing banks that splintered away from the financial institution working group was punitive in nature, burdening lenders with significant and unlimited registration fees, assessments, penalties and fines. The approach treated the lender the same as the owner of the property and the nexus for that liability was the lender's mortgage lien of record. It was the only link by which the proposed Municipal Code obligations were activated (in fact, the bill recognized if the lien was released, the obligations would immediately terminate).

Lenders argued that this was an insufficient link to mandate that lenders enter and maintain property they didn't own. Mechanics lien claimants have as much interest in the property they improve with their labor and materials and they are not mandated to maintain and secure the property if it becomes abandoned. It was further argued that municipalities could not constitutionally treat the lender the same as the owner of the

[1]The coalition or "working group" has consisted of the Illinois Credit Union League ("ICUL"), Community Bankers Association of Illinois ("CBAI"), Illinois League of Financial Institutions ("ILFI") and Illinois Bankers Association ("IBA"). The coalition has worked collaboratively on foreclosure measures since the financial crisis and housing bust began in 2008.

property until the lender actually became the owner of the property (by purchasing it at the foreclosure judicial sale and having the court enter an order confirming the sale and issuing a judicial deed transferring title).

Lenders acknowledge that upon acquiring title to the property in a foreclosure proceeding, they legally become responsible for the maintenance of the property under applicable local ordinances. They will then renovate it (if economically practical), so that it can be liquidated and the proceeds applied against the loan balance to reduce the loss loan write-down they must bear.

The key to acquiring that responsibility and accomplishing that goal is to expedite the foreclosure process for mortgaged property that is abandoned. Hence, the financial institution working coalition advanced a "fast track" foreclosure counterproposal embodied in S.B. 2534. The expedited procedure for judgment and sale set forth in the bill would enable lenders to compress the foreclosure process from two years or longer to a period as short as 90 days. That, in turn, would accelerate and facilitate the maintenance and securing functions that municipalities are desperately seeking in connection with abandoned residential property within their borders. Stated differently, maintenance and securing costs currently borne by cities and villages would be dramatically reduced, if title to the abandoned residential property within their boundaries was transferred to lenders in 100 days rather than 600 or more days.

The expedited process for the foreclosure of abandoned residential property included the following important elements that had been negotiated with several housing advocate and consumer groups in a series of five meetings chaired by Senate President Cullerton during the month of May:

1) Integrated "fast track" approach for clarity of reference by bench and bar, using a precise statutory definition of "abandoned residential property"; and

2) Substantial due process to protect the borrower and all lawful occupants, and their personal property, as follows:

    - The lender must perform a physical inspection of the property to confirm it is not occupied.

    - The lender must sign a <u>verified</u> affidavit (which, under Section 1-109 of the Code of Civil Procedure, exposes the affiant to a Class 3 felony for any material false statements). The affidavit must set forth facts sufficient for the court to find that the property is abandoned (and there are express exclusions from what may be considered "abandoned").

- The expedited process may be stopped and the case converted back to the regular procedure, in any one of the following ways:

    - The borrower, an unknown owner or a lawful occupant may appear in the action in any manner before or at the hearing on the motion for an expedited judgment and object to a finding of abandonment; or

    - The borrower or a lawful occupant may appear in the action prior to issuance of the order confirming the judicial sale and establish to the satisfaction of the court that the property is not abandoned. In that instance, the court shall vacate the judgment of foreclosure.

- A statutory notice to tenants and lawful occupants of the request for an expedited judgment and sale must be posted at the borrower's property and there is a first class mailing obligation to the borrower of the notice of the motion.

- A statutory notice to tenants and lawful occupants of the hearing to confirm the judicial sale must be posted at the borrower's property and there is a first class mailing obligation to the borrower of the notice of the motion.

- After a finding of abandonment, the court must conduct the trial of foreclosure before judgment is entered.

- The borrower may redeem his or her residence pursuant to the existing statutory time frame.

- Safeguards are established to protect against the disposition of any lawful occupant's personal property.

- Safeguards are established to protect lenders from liability in connection with entering the abandoned property to maintain and secure it.

C. <u>End of Session Funding Proposals</u>.

1. <u>2010 Funding Provision (S.B. 3739).</u>

By way of background, in 2010 and against the backdrop of several burdensome and costly measures that had been filed addressing foreclosure relief, the financial institution working coalition drafted and submitted to the Speaker the following "foreclosure prevention program" and "abandoned residential property municipality relief program" counterproposal (referred to as the "Save Our

Neighborhoods Act of 2010"), which was accepted by the Speaker, passed by each House and became law as P.A. 96-1419 on October 1, 2010:

(1) **<u>"Front end" filing fee</u>** (to be paid by the lender upon filing the foreclosure complaint): $50.00

The funds are distributed by IHDA in the form of grants to approved housing counseling agencies and approved community based organizations for counseling and foreclosure prevention outreach programs (50% to Chicago and 50% to the rest of the state). No portion of the program grants can be used to fund civil litigation services (where the debtor obtains legal representation or advice to defend against the foreclosure complaint), or court-sponsored mediation services.

(2) **<u>"Back end" judicial sale fee</u>** (to be paid ONLY BY a third party purchaser – NOT THE LENDER acquiring the property through its credit bid): At the rate of $1.00/$1,000 or portion thereof of the amount paid by the purchaser at the sale, not to exceed $300.00

The funds are distributed by IHDA in the form of grants to municipalities to assist with the costs they incur in removing nuisance greenery (neglected weeds, grass, trees and bushes), pests, infected trees, garbage, debris and graffiti on abandoned residential property within their boundaries, as well as securing or enclosing such properties (25% to Chicago and 75% to municipalities other than Chicago.

2. <u>2012 Funding Provisions (S.B. 2534).</u>

In May, 2012, the Governor's office and many members of the General Assembly recognized that the concepts imbedded in P.A. 96-1419 could be utilized to provide a meaningful protocol for addressing the continuing and escalating problem of abandoned residential properties. However, they concluded the current fees identified in P.A. 96-1419 would require revision in order to generate adequate funding.[2] An initial proposal put forth by the Governor's office in early May contemplated:

(1) Raising the front-end fee from $50 to $600, with the fee split between the front-end purpose of foreclosure counseling and the back-end fee purpose of municipality abandoned property maintenance and securing costs.

[2] The amount that should be in the Abandoned Residential Property Municipal Relief Fund is in dispute, particularly after the financial institution working group obtained RealtyTrac foreclosure data for 2011. Notwithstanding that dispute, there was consensus that the fund balance is inadequate to properly address the issue of securing abandoned property.

(2) Deleting the back-end fee exemption so that it would apply to credit bidders; i.e. lenders acquiring their collateral to be sold as REO property; and adjusting the current variable fee structure to a flat fee of $600.

In each instance, the Governor's proposal contemplated that lenders under $10 billion in assets would be exempted from paying the fees.

In the spirit of compromise to extend the scope of their fast track counterproposal to include a funding component, lenders first responded with a proposal to delete the lender exemption from the back-end fee (S.B. 2534, Senate Amendment 3 ("SAM #3")). Based on RealtyTrac foreclosure date for Illinois (2011), that adjustment was estimated to raise approximately $8 million a year for municipality abandoned property relief.

As a result of further negotiations, lenders then responded with a proposal to add a new front-end filing fee of $250 to be used entirely for municipality abandoned property relief. That new fee was estimated to generate approximately $20 million a year (S.B. 2534, Senate Amendment 4 ("SAM #4")).

Both S.B. 2534, SAM #3 and SAM #4 passed out of committee. SAM #3 was then withdrawn and S.B. 2534, as amended by SAM #4, passed the Senate on a vote of 38-03-13 on May 25, 2012. However, over the Memorial Day weekend, it became clear the measure was dead upon arrival in the House because the fee escalation was deemed insufficient.

3. 2012 Funding Provisions (S.B. 3522).

On May 30, 2012, Rep. Karen Yarbrough filed House Amendment 2 to S.B. 3522 ("HAM #2"). The bill as amended by HAM #2 included the following provisions:

(1) It contained the financial institution working group expedited process for the foreclosure of abandoned residential property from S.B. 2534 that had been negotiated with the housing advocates and consumer groups during the Cullerton meetings:

(2) It avoided S.B. 16 "Chicago style" statewide ordinance authorization (subjecting lenders to pre-foreclosure acquisition maintenance and securing liability for abandoned residential property on which they held a lien), without adversely affecting the existing Chicago ordinance.

(3) It established the following elements of funding support:

a) Existing $50 front-end fee retained – paid by all lenders at the time of filing their foreclosure complaint – funds used for IHDA grants for counseling and foreclosure prevention outreach programs;

b) New $500 front-end fee paid by lenders over $10 billion in assets at the time of filing their foreclosure complaint – funds used for IHDA grants for counseling, outreach and municipality abandoned property relief;

c) Existing back-end fee revised:

(i) Existing variable fee of up to $300 paid only by judicial sale purchasers <u>other than</u> lenders acquiring their own collateral, replaced with $750 flat rate fee paid <u>only by</u> lenders acquiring their own collateral;

(ii) Existing fee exemption retained for lenders with assets of $10 billion or less;

(iii) Existing purpose retained – funds used for IHDA grants for municipality abandoned property relief.

(4) It addressed the issue of whether the <u>permissive</u> form of a mortgage document set forth in the Illinois Conveyances Act (765 ILCS 5/11) could be used by a trustee in bankruptcy as a basis to avoid a mortgage lien for lack of constructive notice, when a particular mortgage instrument failed to state the interest rate and/or maturity date. The Illinois Conveyances Act states that "mortgages of lands *may* be substantially in the following [statutory] form" (which includes amount of debt, maturity date and interest rate) – this is a permissive not mandatory standard. However, in the recent bankruptcy court case of <u>In Re Crane</u> (B.C., C.D. Ill. 2012), the judge ruled a mortgage that didn't include the interest rate and maturity date failed to provide the trustee with constructive notice and the lien was therefore avoided. The case is currently on appeal to the federal district court for the Central District of Illinois. The issue is obviously of critical importance to secured lenders.

HAM #2 clarified that the statutory form is permissive, not mandatory, that the failure of a recorded mortgage to be in the statutory form would not affect the validity or priority of the mortgage and that recordation was effective for notice purposes. HAM #2 also provided that the clarification was effective as to all mortgages, regardless of when they were recorded, thereby effectively extending the protection of the measure to mortgages recorded before the measure took effect (i.e., a retrospective clarification – not an ex post facto law). That is important, since most existing mortgages recorded in Illinois (including uniform Fannie Mae mortgages for Illinois) do not contain any reference to the interest rate.

(5) It clarified how copies of foreclosure notices and orders confirming the sale of property should be sent to municipalities, if they failed to post an address on their website or in their main office for receipt of the documents (per a foreclosure measure passed into law two years ago – S.B. 1894, P.A. 96-0856 eff. 03/01/10). It also provided that copies of the foreclosure notice must be sent to aldermen in Chicago and copies of the order confirming the sale must be sent to last known property insurers.

Ironically, the four large servicing banks that originally divided the financial institution working coalition with their support of the Chicago ordinance and S.B. 16 were the impetus for the IBA to oppose the proposal. That position was taken, notwithstanding the measure's beneficial impact on every IBA affiliated member (as to the substantive fast track and mortgage lien avoidance provisions) and virtually all of its affiliated members (as to the fee provisions – only about 5 Illinois chartered banks and 10 to 15 out-of-state national banks that do business in Illinois would pay the new fees).

Since the measure contained the positive substantive provisions the financial institution working group had worked so hard to negotiate and exempted financial institutions $10 billion and less from the additional fees, ICUL, CBAI and ILFI supported the amendment. In effect, the plaintiffs paying the new fees under the proposal would be the handful of large (and mostly out-of-state) lenders that generate 80% of the foreclosures in this State. It is pertinent to note that Congress has explicitly recognized the functional and operational differences between large (over $10 billion) financial institutions and smaller financial institutions, when it passed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub.L.No. 111-203, eff. July 21, 2010). A number of Dodd-Frank Act provisions include exemptions for financial institutions with less than $10 billion in assets (e.g., the debit interchange fee restraints).[3]

The bill as amended by HAM #2 was adopted by the House Judiciary Committee on May 30 and then passed the House on a vote of 67-48-2 on May 31. Over in the Senate, the motion to concur was then approved by the Senate Financial Institutions Committee on a 7-5 vote about a half hour before the midnight deadline. The measure was vigorously lobbied against by the large banks, and it was not called for a Senate floor vote (which after midnight would have required 36 rather than 30 votes).

[3] TCF National Bank was unsuccessful in its effort to obtain a preliminary injunction in its lawsuit against the Federal Reserve Board over the "small issuer" exemption in the Dodd-Frank Act. TCF Nat'l Bank v. Bernanke (2011 WL 1578535, D.S.D. Apr. 25, 2011; aff'd 643 F.3d 1158 (8th Cir. 2011)). As in the TCF case, the small institution economic classification in HAM #2 did not involve protected classes.

IV. **<u>CONCLUSION</u>.**

Chicago and the four large servicing banks that worked in concert with the City to construct a horribly negative lender liability ordinance, and then attempted to gain cover for their scheme by exporting the measure throughout the State of Illinois with S.B. 16, forced all other banks, thrifts and credit unions doing business in Illinois to counter with a creative expedited foreclosure procedure. But for the threat of unlimited lender liability embodied in S.B. 16, the financial institution working group would not have initiated S.B. 2534 and expend so much effort and resource to seek its passage. The fundamental goal was always to prevent “Chicago style” ordinance authorizations from becoming State law. Rather than merely opposing S.B. 16, the financial institution working group crafted, in consultation with and the ultimate approval of key housing activist and consumer advocacy groups, an expedited foreclosure process to address the abandoned residential property issue in a meaningful and balanced way. When the spring session adjourned in the early morning hours of June 1, credit unions successfully emerged with no statewide Chicago-style abandoned property liability scheme and no new foreclosure fees.

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