

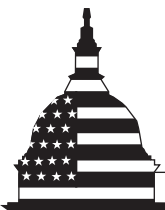
GAO

Report to the Chairman, Subcommittee  
on Economic Policy, Committee on  
Banking, Housing, and Urban Affairs,  
U.S. Senate

November 2010

# MORTGAGE FORECLOSURES

## Additional Mortgage Servicer Actions Could Help Reduce the Frequency and Impact of Abandoned Foreclosures



GAO

Accountability \* Integrity \* Reliability

Highlights of [GAO-11-93](#), a report to the Chairman, Subcommittee on Economic Policy, Committee on Banking, Housing, and Urban Affairs, U.S. Senate

## Why GAO Did This Study

Entities responsible for managing home mortgage loans—called servicers—may initiate foreclosure proceedings on certain delinquent loans but then decide to not complete the process. Many of these properties are vacant. These abandoned foreclosure—or “bank walkaway”—properties can exacerbate neighborhood decline and complicate federal stabilization efforts. GAO was asked to assess (1) the nature and prevalence of abandoned foreclosures, (2) their impact on communities, (3) practices that may lead servicers to initiate but not complete foreclosures and regulatory oversight of foreclosure practices, and (4) actions some communities have taken to reduce abandoned foreclosures and their impacts. GAO analyzed servicer loan data from January 2008 through March 2010 and conducted case studies in 12 cities. GAO also interviewed representatives of federal agencies, state and local officials, nonprofit organizations, and six servicers, among others, and reviewed federal banking regulations and exam guidance.

## What GAO Recommends

Among other things, GAO recommends that the Federal Reserve and Office of the Comptroller of the Currency (OCC) require servicers they oversee to notify borrowers and communities when foreclosures are halted and to obtain updated valuations for selected properties before initiating foreclosure. The Federal Reserve neither agreed nor disagreed with these recommendations. OCC did not comment on the recommendations.

View [GAO-11-93](#) or key components. For more information, contact contact A.Nicole Clowers at (202) 512-8678 or [clowersa@gao.gov](mailto:clowersa@gao.gov).

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### What GAO Found

Using data from large and subprime servicers and government-sponsored mortgage entities representing nearly 80 percent of mortgages, GAO estimated that abandoned foreclosures are rare—representing less than 1 percent of vacant homes between January 2008 and March 2010. GAO also found that, while abandoned foreclosures have occurred across the country, they tend to be concentrated in economically distressed areas. Twenty areas account for 61 percent of the estimated cases, with certain cities in Michigan, Ohio, and Florida experiencing the most. GAO also found that abandoned foreclosures most frequently involved loans to borrowers with lower quality credit—nonprime loans—and low-value properties in economically distressed areas.

Although abandoned foreclosures occur infrequently, the areas in which they were concentrated are significantly affected. Vacant homes associated with abandoned foreclosures can contribute to increased crime and decreased neighborhood property values. Abandoned foreclosures also increase costs for local governments that must maintain or demolish vacant properties. Because servicers are not required to notify borrowers and communities when they decide to abandon a foreclosure, homeowners are sometimes unaware that they still own the home and are responsible for paying the debt and taxes and maintaining the property. Communities are also delayed in taking action to mitigate the effects of a vacant property.

Servicers typically abandon a foreclosure when they determine that the cost to complete the foreclosure exceeds the anticipated proceeds from the property’s sale. However, GAO found that most of the servicers interviewed were not always obtaining updated property valuations before initiating foreclosure. Fewer abandoned foreclosures would likely occur if servicers were required to obtain updated valuations for lower-value properties or those in areas that were more likely to experience large declines in value. Because they generally focus on the areas with greatest risk to the institutions they supervise, federal banking regulators had not generally examined servicers’ foreclosure practices, such as whether foreclosures are completed; however, given the ongoing mortgage crisis, they have recently placed greater emphasis on these areas.

GAO identified various actions that local governments or others are taking to reduce the likelihood or mitigate the impacts of abandoned foreclosures. For example, community groups indicated increased counseling could prevent some borrowers from vacating their homes too early. Some communities are requiring servicers to list properties that become vacant properties on a centralized registry as a way to identify properties that could require increased attention. In addition, by creating entities called land banks that can acquire properties from servicers that they otherwise cannot sell, some communities have provided increased incentives for services to complete instead of abandon foreclosures. However, these actions can require additional funding, have unintended consequences, such as potentially encouraging servicers to walk away from properties before initiating foreclosure, and may not be appropriate for all communities.

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## Abbreviations

ARM	adjustable-rate mortgages
AVM	automated valuation models
BPO	broker's price opinion
FDIC	Federal Deposit Insurance Corporation
FHFA	Federal Housing Finance Agency
FTC	Federal Trade Commission
GSE	government-sponsored enterprise
HAMP	Home Affordable Modification Program
HERA	Housing and Economic Recovery Act
HFA	housing finance agencies
HUD	U.S. Department of Housing and Urban Development
MBS	mortgage-backed securities
MERS	Mortgage Electronic Registration System
MSA	Metropolitan Statistical Area
NSP	Neighborhood Stabilization Program
OCC	Office of the Comptroller of the Currency
OTS	Office of Thrift Supervision
PSA	pooling and servicing agreement
RESPA	Real Estate Settlement Procedures Act of 1974
SEC	Securities and Exchange Commission
TILA	Truth in Lending Act
USPS	U.S. Postal Service
VA	U.S. Department of Veterans Affairs

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G A O

Accountability \* Integrity \* Reliability

United States Government Accountability Office  
Washington, DC 20548

November 15, 2010

The Honorable Sherrod Brown  
Chairman  
Subcommittee on Economic Policy  
Committee on Banking, Housing, and Urban Affairs  
United States Senate

Dear Mr. Chairman:

With record numbers of borrowers defaulting on loans and facing the loss of their properties through foreclosure sale, the ongoing foreclosure crisis has resulted in a large inventory of vacant properties in neighborhoods across the country. As of June 2010, an estimated 4.6 percent of the over 52 million first lien mortgages outstanding nationwide were in some stage of foreclosure—an increase of almost 370 percent since the first quarter of 2006, when just 1 percent of mortgages were in foreclosure.<sup>1</sup> Foreclosure actions can result in vacant and unattended properties that attract crime, cause blight, and threaten neighborhood stability. In response to the effects of foreclosures and vacant properties on neighborhoods, the federal government has implemented a number of programs intended to prevent foreclosures by, for example, encouraging financial institutions to modify borrowers' loans or providing funding to assist communities and local groups with purchasing, rehabilitating, or demolishing properties affected by foreclosures.

Homeowners generally make their mortgage payments to an entity known as a mortgage servicer, which accepts payments from borrowers and manages mortgage loans on behalf of banks and other mortgage owners. If the borrower becomes delinquent on a loan, the servicer generally may initiate a foreclosure action on behalf of the mortgage owner through a court or administratively to have the property sold at auction to a third party. If no third party purchases the property at the foreclosure sale, the mortgage owner (such as a bank) generally takes title to the home, maintains it in marketable condition, and tries to resell it. However, in

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<sup>1</sup>A home mortgage is an instrument by which the borrower (mortgagor) gives the lender (mortgagee) a lien on residential property as security for the repayment of a loan. A first lien mortgage creates a primary lien against real property and has priority over subsequent mortgages, which are generally known as junior mortgages. First liens are the first to be paid when the property is sold.

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some cases, the mortgage servicer initiates the foreclosure process but then does not complete it, in effect walking away from the property. If homeowners have already left the property with the belief that they have lost the home through foreclosure or for other reasons, servicers abandoning the foreclosure process can result in vacant, unmaintained properties that can become problems for neighborhoods, local governments, and homeowners.<sup>2</sup>

With another wave of additional foreclosures potentially ahead, increased numbers of abandoned foreclosures could further negatively affect communities already harmed by the current crisis.<sup>3</sup> In response to your request, this report focuses on the prevalence, causes, and effects of abandoned foreclosures, which, for the purposes of this report, we define as properties (a) for which the servicer initiates foreclosure but subsequently opts not to complete the foreclosure and (b) that are vacant. Specifically, this report addresses (1) the nature and prevalence of abandoned foreclosures, including how they occur; (2) the impact of abandoned foreclosures on communities and state and federal efforts to mitigate the effects of foreclosure; (3) certain practices that may contribute to why mortgage servicers initiate but not complete foreclosures and the extent of federal regulatory oversight of mortgage foreclosure practices; and (4) the various actions some communities are taking to reduce abandoned foreclosures and their impacts.<sup>4</sup>

To address these objectives, we analyzed data reported to us by selected mortgage servicers and two government-sponsored enterprises (GSE) that purchase home loans, as well as information collected from literature, regulatory guidance, and interviews. We obtained data on loans covering

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<sup>2</sup>In some cases borrowers voluntarily stop paying on their mortgages even though they are still able to, so-called “strategic defaults.” These borrowers may also walk away from properties even before lenders initiate formal foreclosure actions; however, this report does not address this phenomenon.

<sup>3</sup>Kelly D. Edmiston, *Characteristics of High-Foreclosure Neighborhoods in the Tenth District*, Federal Reserve Bank of Kansas City Economic Review, 51-75 (Kansas City, Mo.: Second Quarter 2009). As a result of declining property values and economic turmoil, this paper notes that foreclosures on other types of loans are also expected to increase. For example, some loans with variable interest rates that allowed borrowers the option to pay a minimum monthly amount for the first 5 years of the mortgage have recently begun to reset to higher interest rates and will continue to reach considerably higher rates through 2012.

<sup>4</sup>This report does not examine the recent concerns over the processing of foreclosure documents. We have recently begun work on this topic and anticipate reporting our findings next year.

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the period January 2008 through March 2010 from six servicers—including some of the largest firms and those that specialized in subprime loans and from Fannie Mae and Freddie Mac, the two primary GSEs that purchase loans from originators. In total, our data represents roughly 80 percent of all mortgages outstanding.<sup>5</sup> Using this data and information on property vacancies from the U.S. Postal Service (USPS), we conducted analysis to estimate a potential range of the extent to which abandoned foreclosures were occurring and the characteristics of these properties.

To supplement this data analysis and assess the impacts of abandoned foreclosures and potential actions to address them, we conducted case studies in 12 locations that we selected to provide a range of states from different geographical regions, with varying local economic conditions. These locations were also in states that had different requirements for foreclosure, with some requiring actions to be approved by courts (judicial states) and some using other processes (statutory states). These locations were Atlanta, Georgia; Baltimore, Maryland; Buffalo, New York; Chula Vista, California; Chicago, Illinois; Cleveland, Ohio; Detroit, Michigan; Lowell, Massachusetts; and Cape Coral, Fort Myers, Manatee County, and Hillsborough County, Florida. Although we selected the case study locations to provide broad representation of conditions geographically and by type of foreclosure process, the number of locations may not necessarily be representative of all the localities. As a result, we could not generalize the results of our analysis to all the states and localities. We conducted interviews with city and county officials, government stabilization program grantees, community development organizations, academic researchers, foreclosure assistance providers, state banking supervisors, and representatives of the regulators of banks and other mortgage market participants, including the Board of Governors of the Federal Reserve System (Federal Reserve), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), Department of Housing and Urban Development (HUD), Department of Veterans Affairs (VA), Federal Housing Finance Agency (FHFA), and Securities and Exchange Commission (SEC). In addition, we contacted the housing finance agencies (HFA) in the 10 states that the Department of the Treasury had

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<sup>5</sup>We conducted a number of tests on this data and found a number of concerns with some elements of the database and some sources of the data. However, we believe we have taken steps to render the data sufficiently reliable for our limited purposes and to characterize our results in a manner that minimizes the reliability concerns. For additional information on this study's scope and methodology, see appendix I.



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identified as hardest hit by the foreclosure crisis.<sup>6</sup> We also reviewed literature related to the impacts of vacant properties and foreclosures and analyzed servicer foreclosure policies and procedures from Fannie Mae and Freddie Mac and compared them to other guidance that servicers follow. We reviewed federal regulatory guidance that covers the examination process for reviewing bank foreclosure and loss reserve processes. Appendix I contains more information about our scope and methodology.

We conducted this performance audit from December 2009 through November 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Background

Over the last few decades, the number of participants and the complexity of the market for home mortgage loans in the United States has increased. In the past, a borrower seeking credit for a home purchase would typically obtain financing from a local financial institution, such as a bank, a savings association, or a credit union. This institution would normally hold the loan as an interest-earning asset in its portfolio. All activities associated with servicing the loan including accepting payments, initiating collection actions for delinquent payments, and conducting foreclosure if necessary would have been performed by the originating institution.

Over the last few decades, however, the market for mortgages has changed. Now, institutions that originate home loans generally do not hold such loans as assets on their balance sheets but instead sell them to others. Among the largest purchasers of home mortgage loans are Fannie Mae and Freddie Mac, but prior to the surge in mortgage foreclosures that began in late 2006 and continues today, private financial institutions also

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<sup>6</sup>As of March 2010, the states in the Department of Treasury's HFA Hardest-Hit Fund program were Arizona, California, Florida, Michigan, Nevada, North Carolina, Ohio, Oregon, Rhode Island, and South Carolina.

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were active buyers from 2003 to 2006.<sup>7</sup> Under a process known as securitization, the GSEs and private firms then typically package these loans into pools and issue securities known as mortgage-backed securities (MBS) that pay interest and principal to their investors, which included other financial institutions, pension funds, or other institutional investors.<sup>8</sup> As shown in figure 1, as of June 30, 2010, banks and other depository institutions that originate and hold mortgages accounted for about 28 percent of all U.S. mortgage debt outstanding. Over 50 percent of the mortgage debt was owned or in MBS issued by one of the housing GSEs or covered by a Ginnie Mae guarantee.<sup>9</sup> About 13 percent were in MBS issued by non-GSEs—known as private-label securities, with the remaining 5 percent being held by other entities, including life insurance companies.

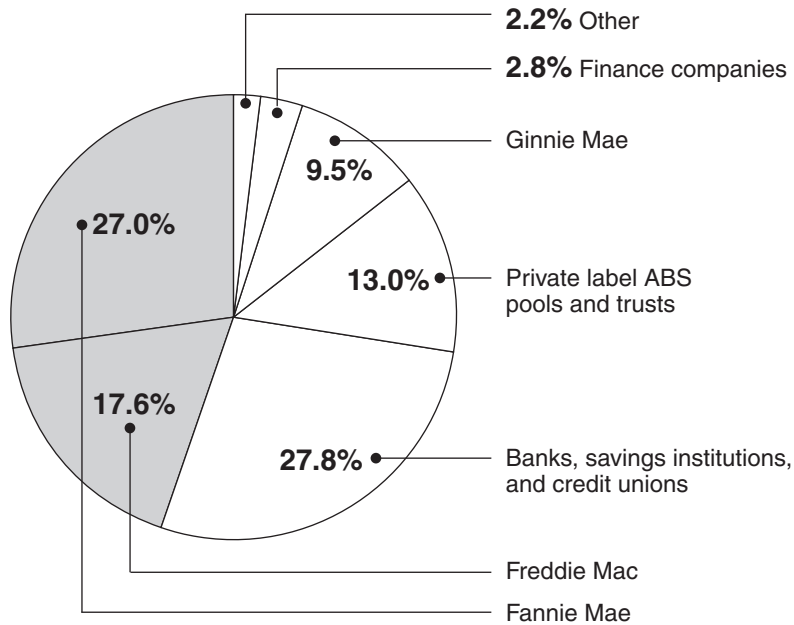
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<sup>7</sup>Investment banks have played an increased role in recent years of purchasing loans and selling them to investors. As the volume of subprime lending grew dramatically from around 2003 through 2006, investment firms took over a substantial share of the mortgage securitization market. See GAO, *Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System*, [GAO-09-216](#) (Washington, D.C.: Jan. 8, 2009).

<sup>8</sup>Fannie Mae and Freddie Mac share a primary mission that has been to stabilize and assist the U.S. secondary mortgage market and facilitate the flow of mortgage credit. To accomplish this goal, the enterprises issue debt and stock and use the proceeds to purchase conventional mortgages that meet their underwriting standards, known as conforming mortgages, from primary mortgage lenders such as banks or thrifts. The enterprises held some of the mortgages that they purchased in their portfolios. However, most of the mortgages were packaged into MBS, which were sold to investors in the secondary mortgage market.

<sup>9</sup>The Government National Mortgage Association (Ginnie Mae) is a wholly owned government corporation that guarantees the timely payment of principal and interest on securities issued by private institutions and backed by pools of federally insured or guaranteed mortgage loans. Securities guaranteed by Ginnie Mae finance the vast majority of loans backed by the Federal Housing Administration and Department of Veterans Affairs, among other federal agencies.

**Figure 1: Share of Total Residential Mortgage Debt Outstanding by Type of Participant as of June 30, 2010**



Source: GAO analysis of Federal Reserve data.

### As a Result of Securitization, Various Entities Participate in Mortgage Markets

With the increased use of securitization for mortgages, multiple entities now perform specific roles regarding the loans, including the mortgage servicer, a trustee for the securitized pool, and the investors of the MBS that were issued based on the pooled loans. After a mortgage originator sells its loans to another investor or to an institution that will securitize them, another financial institution or other entity is usually appointed as the servicer to manage payment collections and other activities associated with these loans. Mortgage servicers, which can be large mortgage finance companies or commercial banks, earn a fee for acting as the servicing agent on behalf of the owner of a loan. In some cases, the servicer is the same institution that originated the loan and, in other cases, it may be a different institution. The duties of servicers for loans securitized into MBS are specified in a contract with investors called a pooling and servicing agreement (PSA) and are generally performed in accordance with certain industry-accepted servicing practices—such as those specified in the servicing guidelines issued by the GSEs. Servicing duties can involve sending borrowers monthly account statements, answering customer service inquiries, collecting monthly mortgage payments, maintaining escrow accounts for property taxes and hazard insurance, and forwarding

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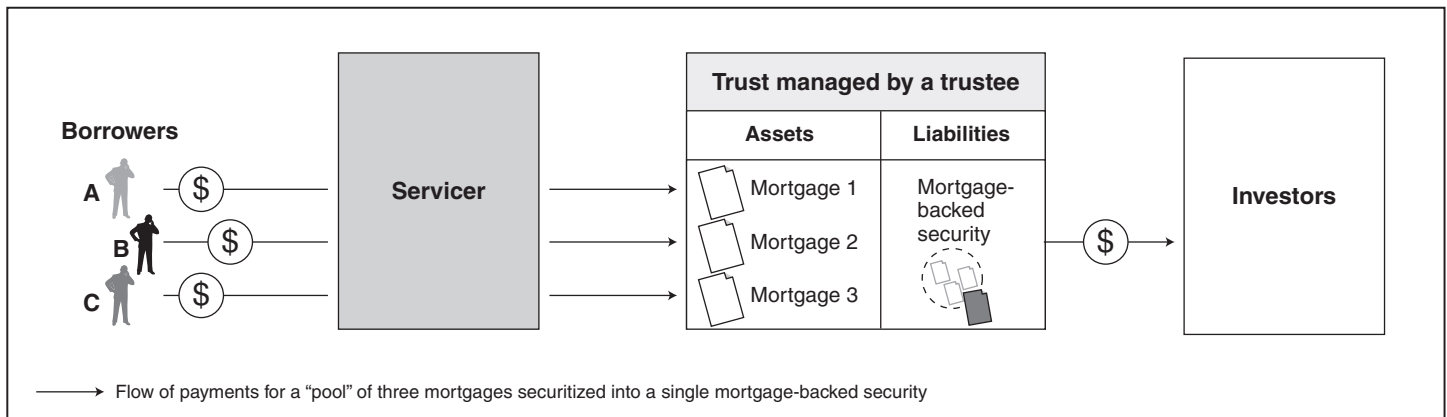
proper payments to the mortgage owners. In exchange for providing these services, the servicer collects a servicing fee, usually based on a percentage of at least 0.25 percent, of the loans' unpaid principal balance annually.<sup>10</sup> In the event that a borrower becomes delinquent on loan payments, servicers also initiate and conduct foreclosures in order to obtain the proceeds from the sale of the property on behalf of the owners of the loans, but servicers typically do not receive a servicing fee on delinquent loans.

When loans are sold, they are generally packaged together in pools and held in trusts pursuant to the terms and conditions set out in the underlying PSA. These pools of loans are the assets backing the securities that are issued and sold to investors in the secondary market. Another entity will act as trustee for the securitization trust. Trustees act as asset custodians on behalf of the trust, keeping records of the purchase and receipt of the MBS and holding the liens of the mortgages that secure the investment. Trustees are also the account custodians for the trust—pass-through entities that receive mortgage payments from servicers and disperse them among investors according to the terms of the PSA. Although trustees are the legal owners of record of the mortgage loans on behalf of the trust, they have neither an ownership stake nor a beneficial interest in the underlying loans of the securitization. However, any legal action a servicer takes on behalf of the trust, such as foreclosure, generally is brought in the name of the trustee. The beneficial owners of these loans are investors in MBS, typically large institutions such as pension funds, mutual funds, and insurance companies. Figure 2 shows how the mortgage payments of borrowers whose loans have been securitized flow to mortgage servicers and are passed to the trust for the securitized pool. The trustee then disburses the payments made to the trust to each of the investors in the security.

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<sup>10</sup>The servicing fee is usually based on the outstanding unpaid principal balance of the loan and is generally between 25 and 50 basis points, according to recent research.

**Figure 2: Flow of Payments in a Basic Securitized Transaction**



Source: GAO analysis; Art Explosion.

## Types of Mortgage Loans

The mortgage market has four major segments that are defined, in part, by the credit quality of the borrowers and the types of mortgage institutions that serve them.

- *Prime*—Serves borrowers with strong credit histories and provides the most attractive interest rates and mortgage terms. This category includes borrowers who conform to the prime loan standards of either Fannie Mae or Freddie Mac and are borrowing an amount above the GSE federally mandated upper limit, known as “jumbo loans.”
- *Nonprime*—Encompasses two categories of loans:
  - *Alt-A*—Generally serves borrowers whose credit histories are close to prime, but loans have one or more high-risk features such as limited documentation of income or assets or the option of making monthly payments that are lower than required for a fully amortizing loan.
  - *Subprime*—Generally serves borrowers with blemished credit and features low down payments and higher interest rates and fees than the prime market.
- *Government-insured or government-guaranteed*—Primarily serves borrowers who may have difficulty qualifying for prime mortgages but features interest rates competitive with prime loans in return for payment of insurance premiums or guarantee fees. The Federal Housing Administration and Department of Veterans Affairs operate the two main federal programs that insure or guarantee mortgages.

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Across all of these market segments, two types of loans are common: fixed-rate mortgages, which have interest rates that do not change over the life of the loan; and adjustable-rate mortgages (ARM), which have interest rates that can change periodically based on changes in a specified index. The nonprime market segment recently featured a number of nontraditional products.<sup>11</sup> For example, the interest rate on Hybrid ARM loans is fixed during an initial period then “resets” to an adjustable rate for the remaining term of the loan. Another type of loan, payment-option ARM loans, allowed borrowers to choose from multiple payment options each month, which may include minimum payments lower than what would be needed to cover any of the principal or all of the accrued interest. This feature is known as “negative amortization” because the outstanding loan balance may increase over time as any interest not paid is added to the loan’s unpaid principal balance.

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<sup>11</sup>For more information about some of these products, see GAO, *Alternative Mortgage Products: Impacts on Defaults Remains Unclear, but Disclosure of Risks to Borrowers Could Be Improved*, [GAO-06-1021](#) (Washington, D.C.: Sept. 16, 2006).

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## The Foreclosure Process

If a borrower defaults on a mortgage loan secured by the home, the mortgage owner is entitled to pursue foreclosure to obtain title to the property in order to sell it to repay the loan. The mortgage owner or servicer generally initiates foreclosure once the loan becomes 90 days or more delinquent. Once the borrower is in default, the servicer must decide whether to pursue a home retention workout or other foreclosure alternative or to initiate foreclosure.<sup>12</sup>

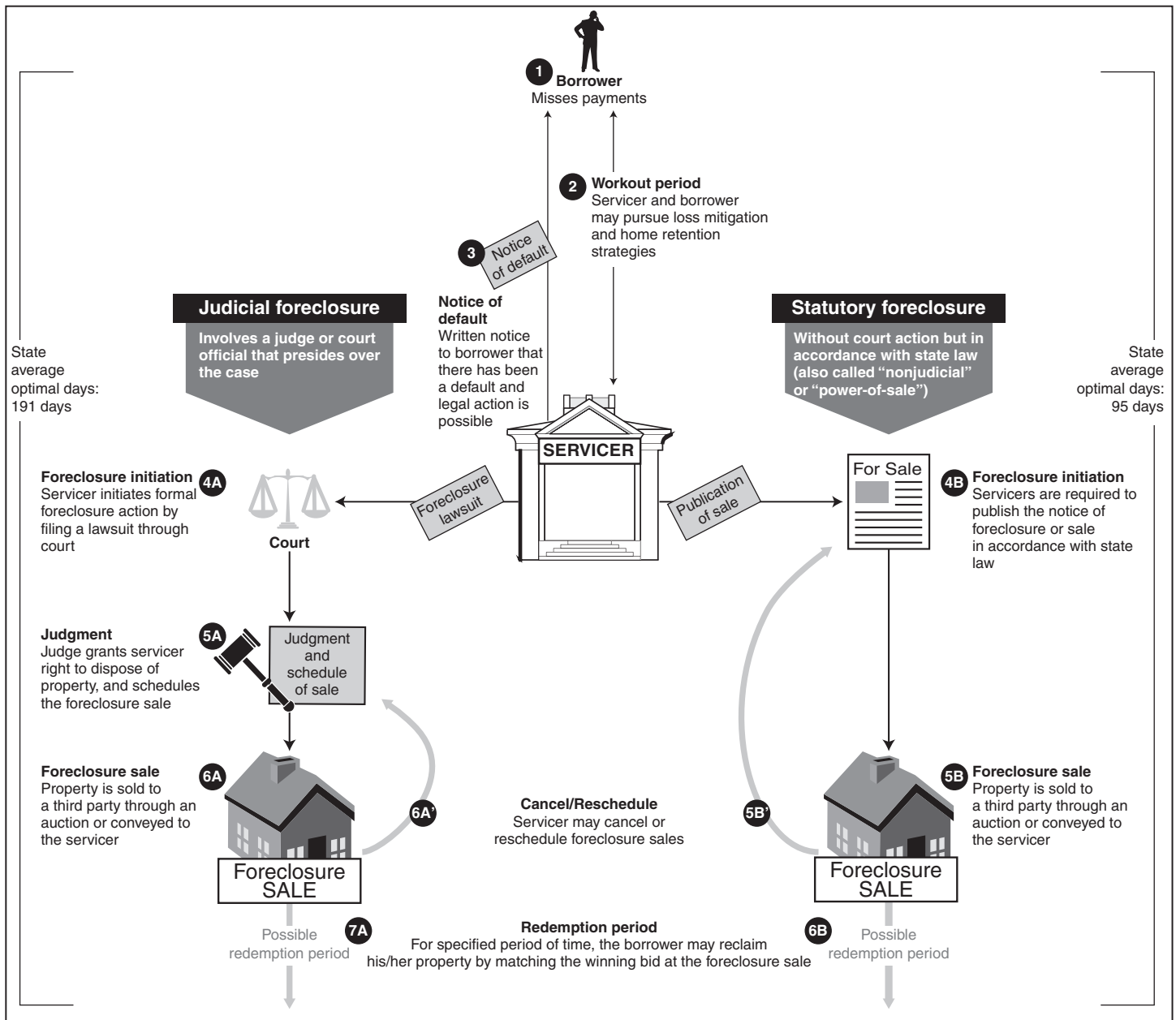
State foreclosure laws establish certain procedures that mortgage servicers must follow in conducting foreclosures and establish minimum time periods for various aspects of the foreclosure process. These laws and their associated timelines may vary widely by state. As shown in figure 3, states generally follow one of two methods for their foreclosure process: judicial, with a judge presiding over the process in a court proceeding, or statutory, with the process proceeding outside the courtroom in accordance with state law.<sup>13</sup> Because of the additional legal work, foreclosure generally takes longer and is more costly to complete in the states that primarily follow a judicial foreclosure process.

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<sup>12</sup>Home retention workouts are employed when the borrower has a desire to keep the home and the capacity to carry payments under the workout plan. These include: repayment plans—a contracted plan to make up past due amounts; forbearance—a defined period where no or only partial payments are required followed by a repayment plan to make up the arrearage; and loan modifications—a permanent altering of one or more of the loan terms. Other foreclosure alternatives include voluntary home-loss workouts that avoid foreclosure but the borrower gives up the home. These are deed-in-lieu transfers—the borrower essentially gives the investor the keys and title to terminate the debt; and short sales—the lender agrees to accept proceeds from the sale of the home to a third party even though the sales price is less than the principal and accrued interest and other expenses owed.

<sup>13</sup>According to the Department of Housing and Urban Development, as of July 2008, 25 states use a statutory process as their normal method of foreclosure, 19 states use judicial, and 6 states use both.

**Figure 3: Typical Judicial and Statutory Foreclosure Processes**



Source: GAO (analysis); Art Explosion (images); U.S. Foreclosure Network (timelines).

Notes: Loss mitigation steps could be occurring throughout these steps. Timelines reflect state average optimal days to complete foreclosure (measured from foreclosure initiation to foreclosure sale).



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## Federal Regulation of Institutions That Originate and Service Loans

Several federal agencies share responsibility for regulating the banking industry and securities markets in relation to the origination and servicing of mortgage loans. Chartering agencies oversee federally and state-chartered banks and their mortgage lending subsidiaries. At the federal level, OCC oversees federally chartered banks. OTS oversees savings associations (including mortgage operating subsidiaries).<sup>14</sup> The Federal Reserve oversees insured state-chartered member banks, while FDIC oversees insured state-chartered banks that are not members of the Federal Reserve System. Both the Federal Reserve and FDIC share oversight with the state regulatory authority that chartered the bank. The Federal Reserve also has general authority over lenders that may be owned by federally regulated holding companies but are not federally insured depository institutions. Many federally regulated bank holding companies that have insured depository subsidiaries, such as national or state-chartered banks, also may have nonbank subsidiaries, such as mortgage finance companies. Under the Bank Holding Company Act of 1956, as amended, the Federal Reserve has jurisdiction over such bank holding companies and their nonbank subsidiaries that are not regulated by another functional regulator.<sup>15</sup> Other regulators are also involved in U.S. mortgage markets. For example, Fannie Mae's and Freddie Mac's activities are overseen by the Federal Housing Finance Agency.<sup>16</sup> Staff from the Securities and Exchange Commission also review the filings made by private issuers of MBS.

Federal banking regulators have responsibility for ensuring the safety and soundness of the institutions they oversee and for promoting stability in the financial markets and enforcing compliance with applicable consumer protection laws. To achieve these goals, regulators establish capital requirements for banks, conduct on-site examinations and off-site monitoring to assess their financial condition, and monitor their compliance with applicable banking laws, regulations, and agency guidance. Among the laws that apply to residential mortgage lending and servicing are the Fair Housing and Equal Credit Opportunity Acts, which

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<sup>14</sup>12 U.S.C. § 1813(q). OCC will assume oversight responsibility of savings associations from OTS in July 2011.

<sup>15</sup>12 U.S.C. § 1844(c)(2)(A).

<sup>16</sup>On September 6, 2008, the Federal Housing Finance Agency placed Fannie Mae and Freddie Mac in conservatorship out of concern that their deteriorating financial condition and potential default on \$5.4 trillion in outstanding financial obligations threatened the stability of financial markets.

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address credit granting and ensuring non-discrimination in lending; the Truth in Lending Act (TILA), which addresses disclosure requirements for consumer credit transactions; and the Real Estate Settlement Procedures Act of 1974 (RESPA), which requires transparency in mortgage closing documents.<sup>17</sup>

Entities that service mortgage loans that are not depository institutions are called nonbank servicers. In some cases these nonbank servicers are subsidiaries of banks or other financial institutions, but some are also not affiliated with financial institutions at all. Nonbank servicers have historically been subject to little or no direct oversight by federal regulators.<sup>18</sup> We have previously reported that state banking regulators oversee independent lenders and mortgage servicers by generally requiring business licenses that mandate meeting net worth, funding, and liquidity thresholds.<sup>19</sup> The Federal Trade Commission is responsible for enforcing certain federal consumer protection laws for brokers and lenders that are not depository institutions, including state-chartered independent mortgage lenders. However, the Federal Trade Commission is not a supervisory agency; instead, it enforces various federal consumer protection laws through enforcement actions when complaints by others are made to it.

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<sup>17</sup>Fair Housing Act, 42 U.S.C. §§ 3601 – 3619; Equal Credit Opportunity Act, 15 U.S.C. §§ 1691 - 1691f; Truth in Lending Act, 15 U.S.C. §§ 1601 - 1667f; Real Estate Settlement Procedures Act of 1974 12 U.S.C. §§ 2601-2617.

<sup>18</sup>Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, title X, § 1024, 124 Stat. 1376 (2010) (Dodd-Frank Act), a new entity—the federal Bureau of Consumer Financial Protection—will oversee mortgages along with other financial products and services, including having authority over the practices of large bank and non-bank mortgage lenders, mortgage brokers, and servicers, among others.

<sup>19</sup>GAO, *Alternative Mortgage Products: Impact on Defaults Remains Unclear, but Disclosure of Risks to Borrowers Could Be Improved*, [GAO-06-1021](#) (Washington, D.C.: Sept. 19, 2006).

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## Abandoned Foreclosures Are Uncommon, but Are Concentrated in Certain Areas and Usually Involve Nonprime Loans and Low-Value Properties

Using data from large and subprime servicers and government-sponsored mortgage entities representing nearly 80 percent of mortgages, we estimated that abandoned foreclosures are rare—the total from January 2008 to March 2010 represents less than 1 percent of vacant homes. When servicers' efforts to work out repayment plans or loan modifications with borrowers who are delinquent on their loans are exhausted, staff from the six servicers we interviewed said they analyze certain loans to determine whether foreclosure will be financially beneficial. Based on our analysis of loan data provided by these six servicers covering the period of January 2008 through March 2010, servicers most often made this decision before initiating foreclosure, but in many cases did not discover that foreclosure would not be financially beneficial until after initiating the process. While we estimated that instances in which servicers initiate but then abandon a foreclosure without selling or taking ownership of a property had not occurred frequently across the United States, certain communities experienced larger numbers of such abandoned foreclosures. Specifically, we found abandoned foreclosures tended to be for properties in economically distressed communities and low-value properties and nonprime and securitized loans.

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## After Efforts to Keep Borrowers in Their Homes Fail, Servicers Analyze the Financial Benefits of Proceeding to Foreclosure on Certain Loans

When borrowers default on their loans, home mortgage loan servicers take a variety of actions in an effort to keep them in their homes, by, for example, working out repayment plans and loan modifications. The stakeholders that we interviewed—including servicers, regulators, and government and community officials—agreed that pursuing efforts to keep borrowers in their homes were preferable to foreclosure.<sup>20</sup> According to servicers' representatives, servicers engage in various efforts to reach borrowers during the delinquency period through letters, phone calls, and personal visits. For example, representatives of one servicer noted that on a typical foreclosure company representatives make over 120 phone calls and send 10 to 12 inquiries to borrowers in an effort to bring payments up to date or modify the loan. As borrower outreach continues, servicers also

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<sup>20</sup>For example, Treasury's Home Affordable Modification Program was designed to enable borrowers that meet eligibility requirements to avoid foreclosure by modifying loans to reduce their monthly payments. The program provides loan modification guidelines that participating servicers must use and includes incentives for borrowers, servicers, and investors. For information on this program, see GAO, *Troubled Asset Relief Program: Further Actions Needed to Fully and Equitably Implement Foreclosure Mitigation Programs*, GAO-10-634 (Washington, D.C.: June 24, 2010).

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send “breach” letters after borrowers have missed a certain number of payments warning borrowers of the possibility of foreclosure.<sup>21</sup>

However, if these initial efforts to bring the borrower back to a paying status are not successful, staff from the six servicers we contacted—representing about 57 percent of U.S. first-lien mortgages—told us they typically determine whether to initiate foreclosure as a routine part of their collections and loss mitigation process after a loan has been delinquent for at least 90 days. Representatives of servicers told us that they might decide to initiate foreclosure even though they were still pursuing loan workout options with a borrower. One noted that the initiation of foreclosure, in certain instances, might serve as an incentive for the borrower to begin making mortgage payments again.

According to the staff of the six servicers we interviewed, they usually conduct an analysis of certain loans in their servicing portfolio before initiating foreclosure to determine if foreclosure will be financially beneficial. These analyses—often called an equity analysis—compare the projected value the property might realize in a subsequent sale against the sum of all projected costs associated with completing the foreclosure and holding the property until it can be sold. Servicers use the results of these equity analyses to decide whether to foreclose on a loan or conduct a charge-off in lieu of a foreclosure.<sup>22</sup> In general, if the equity analysis indicates that the projected proceeds from the eventual sale of the property exceeds that of the projected costs of reaching that sale by a certain amount, the servicer will proceed with the foreclosure. However, when the costs of foreclosure exceed the expected proceeds from selling the property, servicers typically decide that foreclosure is not financially beneficial. In these cases servicers will usually cease further foreclosure-related actions, operationally charging off the loan from its servicing roles, and advising the mortgage owner—GSEs or other private securitized

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<sup>21</sup>A breach letter or demand letter is a notice to the borrower(s) requesting that the total amount of the delinquency be paid no later than a specific date, usually 45 days from the date of the letter, with failure to pay resulting in the loan being referred to an attorney to initiate foreclosure.

<sup>22</sup>While the term charge off can denote an accounting treatment of a loan, we use the term charge off in lieu of foreclosure to mean the action servicers take when they decide to no longer pursue foreclosure on the property as a means of recovering value on the unpaid loan. They may still pursue recovery through other means, such as by selling the debt to a bill collector. In addition, the lien against the property may remain in place and must be satisfied if the borrower subsequently attempts to sell the property.

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trusts—that the loan should be acknowledged as a loss by the loan’s owner.<sup>23</sup> In determining which loans to charge off in lieu of foreclosure, some servicers maintain thresholds for property values or potential income from pursuing foreclosure. For example, some of the servicers we interviewed told us that they usually, but not always, considered charge-offs in lieu of foreclosure on properties with values roughly below \$10,000 to \$30,000. Freddie Mac servicing guidance requires a review for charge off in lieu of foreclosure when the unpaid principal balance of a loan is below \$5,000 on conventional mortgages or less than \$2,000 on government insured or guaranteed loans, such as Federal Housing Administration or Department of Veterans Affairs mortgages.

Based on our reviews of bank regulatory guidance and discussions with federal and state officials, no laws or regulations exist that require servicers to complete foreclosure once the process has been initiated. Therefore, servicers can abandon the foreclosure process at any point. Furthermore, according to staff from the servicers we interviewed, initiating foreclosure can cost as little as \$1,000, and these costs may be recovered from the proceeds of any subsequent sale of the property.

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**Majority of Loan Charge-offs in Lieu of Foreclosure Occurred Prior to Foreclosure Initiation, Although Many Occurred Afterwards Increasing the Likelihood of an Abandoned Foreclosure**

Based on our analysis of servicer data, servicers most often charged off loans in lieu of foreclosure without initiating foreclosure proceedings. However, in many cases the decisions to charge off loans in lieu of foreclosure were made after foreclosure initiation, and a significant portion of these represented abandoned foreclosures. We obtained data from six servicers including four of the largest servicers and two servicers that specialized in nonprime loans. These six servicers collectively serviced about 30 million loans, representing 57 percent of outstanding first-lien home mortgage loans as of the end of 2009. According to our analysis of the servicer-reported data, these six servicers decided to conduct charge-offs in lieu of foreclosure for approximately 46,000 loans between January 2008 and March 2010, as shown in table 1. For over

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<sup>23</sup>An operational charge off means that the servicer is expecting the amount to be collected from the loan to be zero. If the loan being serviced is in the servicer’s own asset portfolio—when a bank originates and holds the loan—then regulatory and accounting policies would require it to write down the value of its total loans by the charged-off amount. If the loan is being serviced for a third-party owner, including an MBS trust, how the owner of the loan accounts for the charged-off amount would depend on whether the owner must prepare financial statements. Servicers might also decide to conduct a charge off in lieu of foreclosure when properties have hazardous conditions, such as environmental contamination, that would be risky for servicers to remediate.

27,600 loans, or about 60 percent, the servicers made the decision to charge off in lieu of foreclosure without initiating foreclosure proceedings. Of these loans, over 19,400, or 70 percent of the properties, were occupied by the borrower or a tenant. As will be discussed later in this report, when properties remain occupied they are less likely to contribute to problems in their neighborhoods generally associated with foreclosed and vacant properties.

**Table 1: Numbers of Charge-offs in Lieu of Foreclosure by Foreclosure and Occupancy Status, January 2008 through March 2010**

	Foreclosure not initiated	Percent	Foreclosure initiated	Percent	Total	Percent
<b>Total charge-offs in lieu of foreclosure</b>	27,620	60%	18,379	40%	45,999	100%
<b>Occupancy status of properties from point of charge-off in lieu of foreclosure to June 2010:</b>						
Property occupied	19,412	70	9,603	52	29,015	63
Property vacant	8,208	30	8,776	48	16,984	37

Source: GAO analysis of data reported by six servicers.

Note: This data covers roughly 57 percent of all first liens outstanding. It does not include all loans captured in our database of GSE loans. We considered a property to be vacant if (1) either the servicers reported it as vacant at time of charge-off in lieu of foreclosure or (2) if USPS data indicated that the property became vacant between the time the charge-off in lieu of foreclosure occurred and June 2010.

However, in other cases, servicers initiated foreclosure but later decided to conduct a charge-off in lieu of foreclosure. Charge-offs in lieu of foreclosure that occurred after a foreclosure was initiated were more likely to result in a vacant property than charge-offs that occurred without a foreclosure initiation. As shown in table 1 earlier, these six servicers initiated foreclosure on over 18,300 loans between January 2008 and March 2010 that they later decided to charge off in lieu of foreclosure. For over 8,700, or 48 percent of these loans, this decision was associated with a vacancy and, therefore, an abandoned foreclosure—that is, a property for

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which foreclosure was initiated but not completed and is vacant.<sup>24</sup> We found a statistically significant association between foreclosure initiation and vacancy for the charge-offs in lieu of foreclosure in our sample. That is, we found that initiating and then suspending foreclosure was associated with a higher probability that a property will be vacant.<sup>25</sup> A potential reason that vacancies occur more frequently when servicers decide to pursue a charge-off in lieu of foreclosure after initiating foreclosure than before is confusion among borrowers about the impact of the foreclosure initiation. Specifically, local and state officials, community groups, and academics told us that borrowers may be confused about their rights to remain in their homes during foreclosure and vacate the home before the process is completed. Alternatively, servicers could be more likely to pursue a charge-off in lieu of foreclosure if a property becomes vacant before foreclosure initiation since the value of the property may deteriorate rapidly.<sup>26</sup> Nevertheless, as the data show even when servicers opt to conduct a charge-off in lieu of foreclosure before initiating

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<sup>24</sup>We asked the six servicers to provide us data on loans they had charged off in lieu of foreclosure in 2008, 2009, and the first quarter of 2010 as we have defined the term. Because some of the servicers compiled the information requested differently or were reporting information that is not a part of their normal data collection and retention apparatus, our dataset contains various degrees of inconsistency, missing data and other issues. However, we believe we have taken steps to render the data sufficiently reliable for our purposes. A limitation of our analysis is that our data did not allow us to determine when a property became vacant; therefore, we do not always know if the property became vacant before or after the foreclosure was initiated. We considered a property to be vacant if (1) either the servicers reported it as vacant at time of charge off or (2) if USPS data indicated that the property became vacant between the time the charge off occurred and June 2010. According to the data they provided to us, the servicers reported that about 19 percent of the properties were known to be vacant *at the time* the charge-off decision was made. However, for 32 percent of the properties, the servicers did not provide an occupancy status at the time of charge-off, but we were able to determine that an additional 18 percent of these were vacant using the USPS data. Although USPS vacancy data allowed us to make a determination on occupancy status more appropriate for our purposes, we discuss some limitations inherent in our matching exercise later in this report. Consequently, these vacancy estimates should be not be considered definitive.

<sup>25</sup>While the association between foreclosure initiation and vacancy was clear, we further attempted to address the potential bi-causal relationship between vacancy and foreclosure initiation using a two-stage linear probability model. However, these results should be interpreted with caution given the limitations associated with the econometric procedure and lack of important control variables.

<sup>26</sup>As result, servicers may have initiated foreclosures more quickly on properties that became vacant in an attempt to salvage value or were less likely to foreclose if the value has deteriorated significantly upon vacancy. This implies a causal link from vacancy to foreclosure initiation and complicates the ability to determine whether the foreclosure status impacts the occupancy status of a property.

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foreclosure, some borrowers may still vacate the home. Anecdotally, we heard from a variety of stakeholders that this decision could be due to financial hardship or pressure exerted by the lender in collecting delinquent mortgage payments, among other reasons.<sup>27</sup>

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**In the Absence of Overall Data on Instances of Abandoned Foreclosures, Our Estimates Indicated That It Occurs Infrequently**

Data indicating the overall number of abandoned foreclosures in the United States did not exist nor was such information being collected by the federal government agencies we contacted or by organizations in the states or local communities that we reviewed. Local governments, bank regulators, and private organizations collect information on foreclosures, vacancies, and housing market conditions, but for various reasons the phenomenon of abandoned foreclosures goes largely unrecorded. Local officials we spoke with in Baltimore, Chicago, Cleveland, Detroit, and Lowell, Massachusetts, identified similar difficulties in tracking abandoned foreclosures. For example:

- Accurately identifying the lender and borrower on a given property is often difficult due to outdated or incorrect mortgage information.
- Ascertaining which properties are abandoned foreclosures is often difficult because formal data on the foreclosure status of properties often do not exist.
- Determining whether properties are actually vacant is often difficult if a house has been used seasonally or as a rental.

Nonetheless, researchers in some cities we visited are attempting to compile data. In Cleveland, academic researchers have used court documents in an attempt to ascertain the reason a sample of foreclosure cases have stalled. In a number of cities, such as Chula Vista, California, the city governments have enacted ordinances that require lenders to register homes that become vacant. In Buffalo, a nonprofit organization has collected information on the status of foreclosure cases in Erie county, where Buffalo is located.

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<sup>27</sup> Other reasons interviewees gave us for why borrowers might leave their homes include: to find a better home and plan for the future, to secure housing before their credit is negatively impacted by foreclosure, embarrassment, servicer representatives told them to leave, they may owe more on the house than it is worth, they may not want a foreclosure action hanging over their head, or the fear that they will end up homeless if they wait too long to secure new housing. In addition, some properties may be investor-owned that were not occupied by a tenant.



Although subject to uncertainty, we estimated that the number of abandoned foreclosures that occurred in the United States between January 2008 and March 2010 was between approximately 14,500 and 34,600.<sup>28</sup> As will be discussed, although the potential number of abandoned foreclosures creates significant problems for certain communities, they represent less than 1 percent of vacant properties and an even smaller percentage of the total housing stock. Table 2 shows abandoned foreclosures as a percent of various housing market metrics.<sup>29</sup>

**Table 2: Estimated Abandoned Foreclosures as a Percent of Various Nationwide Housing Measures, January 2008 through March 2010**

	<b>Low</b>	<b>High</b>
<b>Total estimated abandoned foreclosures</b>	<b>14,500</b>	<b>34,600</b>
As a percentage of:		
Vacant properties not being actively marketed for sale or rental	0.20%	0.49%
Vacant properties not being actively marketed for sale or rental excluding those known to be used as seasonal or occasional use properties	0.40%	0.95%
Total home loans outstanding	0.03%	0.07%
Total housing stock	0.01%	0.03%

Source: Estimates based on GAO analysis and modeling of data reported by six servicers, Fannie Mae, and Freddie Mac. Housing measures based on GAO estimates using U.S. Census and Mortgage Bankers Association data.

<sup>28</sup>The relative width of this range—despite the fact that we obtained data from entities representing about 80 percent of the U.S. first lien mortgages—stems from the inherent uncertainty and imprecision of using a large but nonrandom sample to project the number of abandoned foreclosures likely among the loans being serviced by entities from whom we did not collect data, and from adjusting for potential errors in determining the occupancy status of the properties in our dataset, or in potential inaccuracies in the data reported to us by the servicers.

<sup>29</sup>Although not included in table 2, even when we factored in a significant error rate in determining vacancy, excluded the servicer with the lowest abandoned foreclosure rate, and made extreme assumptions about the remaining servicers that our database did not cover, we produced estimates that were just 2.6 percent of unmarketed vacancies excluding seasonal and occasional use properties. We assumed in many simulations that in matching the addresses in our loan database to the USPS vacancy data that we understated the vacancy rate by 10 percent. However, in this extreme simulation we also dropped the servicer with the lowest abandoned foreclosure rate and assumed that it and the other servicers not covered in the database had rates of abandoned foreclosure that approximated those of subprime lenders. Therefore, even if we assumed a similar scale of activity in 2007 and for the rest of 2010, abandoned foreclosures would still be considered a rare phenomenon. For example, based on more limited data for 2007, we were able to produce very rough estimates of 1,000 to 3,200 additional properties.

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To determine the prevalence of abandoned foreclosures in the entire U.S. market, we estimated the number of properties (1) were charged off in lieu of foreclosure after a foreclosure was initiated and (2) that are vacant. In developing our estimate, we used the data from the six mortgage servicers and data from Fannie Mae and Freddie Mac—which together represent roughly 80 percent of outstanding U.S. mortgages—and augmented this information with vacancy data from USPS. Using this information, we estimated the total number of abandoned foreclosures nationwide under varying assumptions about the remaining 20 percent of the mortgages outstanding.<sup>30</sup>

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### Abandoned Foreclosures Exist Throughout the Country, but Are Likely to Be Clustered in a Few Communities

According to the data reported to us, abandoned foreclosures represent a small portion of overall vacancies in the United States, but are highly concentrated in a small number of communities. Based on our analysis of servicer data from January 2008 to March 2010, we found abandoned foreclosures in 2,452 of the approximately 43,000 postal zip codes throughout the country, but only 167 of those zip codes have 10 or more of these properties. From January 2008 through March 2010, several zip codes in Chicago, Cleveland, Detroit, Indianapolis, and other large cities had 35 or more abandoned foreclosures. We found several zip codes in Detroit that had over 100 abandoned foreclosures. In addition, several smaller areas contain zip codes with high concentrations of the properties, such as those including Toledo, Akron, and Youngstown, Ohio; Flint, Michigan; Fort Myers, Florida; and Gary and Fort Wayne, Indiana.

Analyzing abandoned foreclosures at the U.S. Census-designated Metropolitan Statistical Area (MSA) level also suggests that such cases are likely to be concentrated in a limited number of communities. According to our analysis, 80 percent of the total abandoned foreclosures that we identified in our servicer data were in 50 of the roughly 400 MSAs; 20 MSAs account for 61 percent of the properties; and 30 MSAs account for 72 percent. Table 3 shows the MSAs with the most abandoned foreclosures. Because the data we used to produce these estimates may

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<sup>30</sup>The GSE dataset and the servicer dataset represent residential mortgage loans covering 58 percent and 57 percent of all mortgages respectively. In total, eliminating double coverage, the dataset compiled represents data covering roughly 80 percent of mortgages nationwide. The remaining 20 percent of the mortgage market were estimated via extrapolation and varying the assumptions about the characteristics of the remaining mortgages. We also considered a 10 percent error rate associated with our matching of the data to USPS vacancy data. The data did not allow us to determine whether a second lien was involved or whether the property was investor-owned.

not be generalizeable, the location of the remaining abandoned foreclosures could differ from that suggested in table 3. For example, the Flint, Michigan; Orlando-Kissimmee, Florida; South Bend-Mishawaka, Indiana; and Canton-Massillon, Ohio, MSAs are notable examples just outside the top 20. Although not having a large number of abandoned foreclosures, some small MSAs throughout the Midwest are likely to be similarly challenged by the existence of such properties given their size.

**Table 3: MSAs with the Most Abandoned Foreclosures, January 2008 through March 2010**

MSA	Vacant Properties		Total housing stock
	Charged off after foreclosure initiation (abandoned foreclosures)	Charged off without foreclosure initiation	
Detroit-Warren-Livonia, MI	1,500	1,957	1,561,961
Chicago-Naperville-Joliet, IL-IN-WI	499	361	2,797,890
Cleveland-Elyria-Mentor, OH	497	382	769,283
Indianapolis-Carmel, IN	396	303	606,834
Memphis, TN-AR-MS	232	287	438,545
Atlanta-Sandy Springs-Marietta, GA	206	137	1,659,052
Akron, OH	184	156	257,560
Columbus, OH	182	118	627,580
Miami-Fort Lauderdale-Pompano Beach, FL	180	64	1,427,458
St. Louis, MO-IL	175	317	1,022,950
Tampa-St. Petersburg-Clearwater, FL	164	64	896,181
Kansas City, MO-KS	155	197	726,356
Dayton, OH	139	106	323,097
Fort Wayne, IN	135	125	146,102
Jacksonville, FL	134	84	431,125
Youngstown-Warren-Boardman, OH-PA	133	79	225,395
Cape Coral-Fort Myers, FL	126	67	244,349
Cincinnati-Middletown, OH-KY-IN	121	96	722,182
Toledo, OH	117	72	241,293
Pittsburgh, PA	114	122	925,347

Source: GAO analysis of servicer, GSE, and USPS data; Global Insight.

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Note: Although the sample we used to identify these properties was large, covering about 60 percent of all loans serviced, it is likely nonrandom, and therefore it should not be used in making inferences about abandoned foreclosure activity for the entire United States at the MSA level. In addition, our abandoned foreclosure estimates should not be viewed as definitive or precise given that the matching exercise used to determine these figures is subject to error. Other MSAs may actually rank higher or lower, depending on the geographical profile of the loans serviced by the remaining servicers not covered in our dataset and the extent to which vacancies may have been understated in particular areas due to a higher matching error rate.

As shown above in table 3, these 20 MSAs had roughly 5,090 properties that were charged off in lieu of foreclosure by the servicer without initiating foreclosure but were also vacant in our sample. Because these also are properties on which the servicer will no longer be conducting any maintenance or attempting to sell to a new owner, the properties can create similar problems for their communities as those resulting from abandoned foreclosures.

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### Concentrations of Abandoned Foreclosures Are Associated with Various Community, Property, and Loan Characteristics

Certain community, property, and loan characteristics may help to explain some of the concentrations of abandoned foreclosures. In particular, based on our sample, abandoned foreclosures occurred most frequently in economically struggling areas and distressed urban areas of particular cities. We also found these properties in areas that experienced significant recent booms and declines in housing. In general abandoned foreclosures are also more likely to involve low-value properties and nonprime and securitized loans.

- **Economically struggling cities appear to experience the greatest number of charge-offs in lieu of foreclosure and therefore, abandoned foreclosures.** As shown in figure 4, most of the abandoned foreclosures have occurred in Midwestern industrial MSAs. In particular, our analysis of servicer data indicates that over 50 percent of all the abandoned foreclosures we identified were in Michigan, Indiana, and Ohio. Seven of the 20 MSAs with the most abandoned foreclosures are located in Ohio. Recent research also supports that this type of phenomenon is occurring largely in industrial Midwestern states.<sup>31</sup> Although the deterioration of economic conditions in 2008 and 2009 has impacted the entire nation, these Midwestern areas have been especially hard hit with population declines, high unemployment, and decreases in housing values. For example, Detroit lost about 28 percent of its population from 1980 to 2006 and the unemployment rate in Michigan was

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<sup>31</sup>Standard & Poor's, *Severe Loss Severities: Which States Suffer Most From the Housing Bust?* (New York, N.Y.: Aug. 17, 2009).

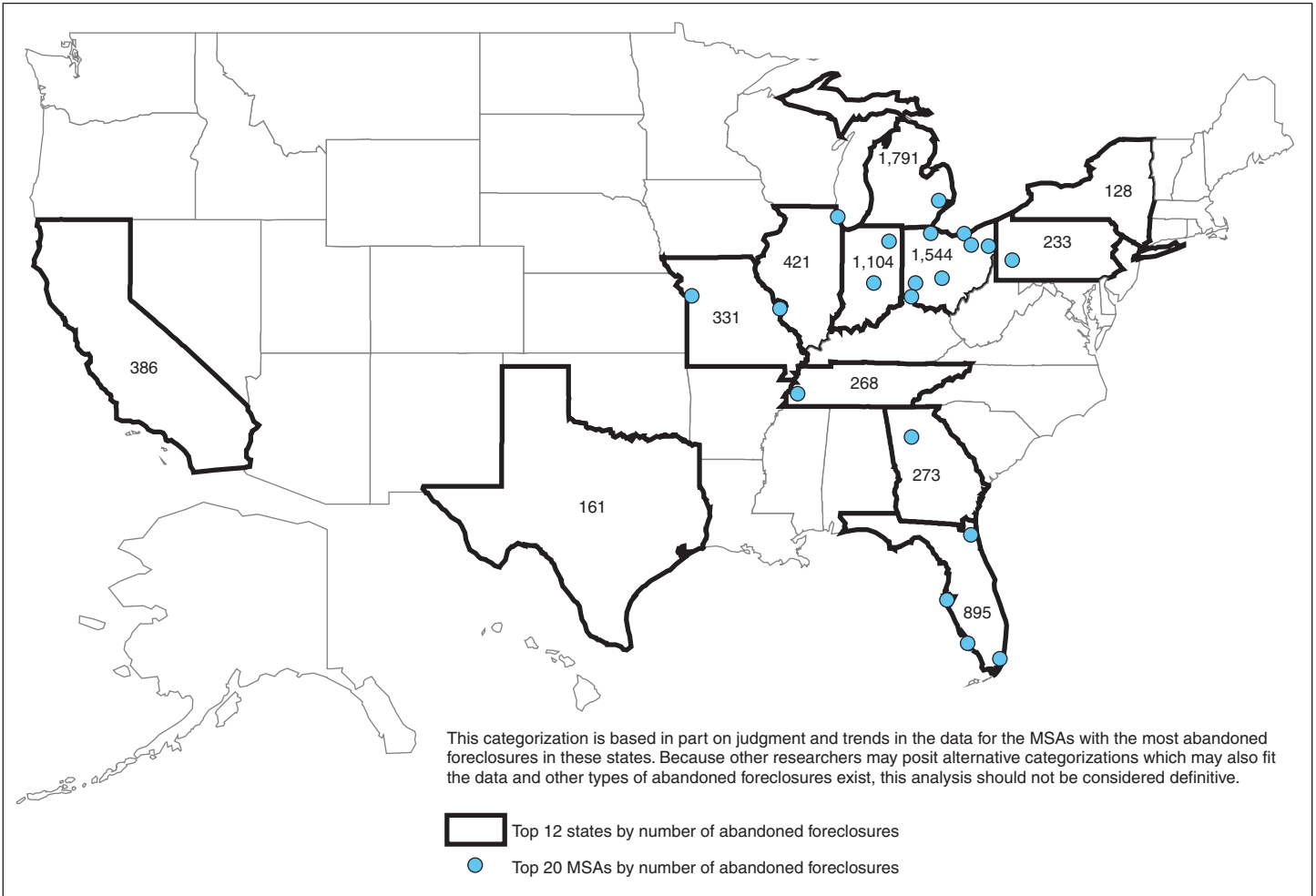
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13.0 percent versus 9.6 percent nationally as of September 2010. According to a recent report, although Michigan did not seem to experience a dramatic appreciation in housing prices before the surge in mortgage foreclosures that began in late 2006, it did witness a significant decline in housing prices after 2006, largely because the automobile manufacturing industry was severely hit by the current crisis.<sup>32</sup> Like many areas in the United States, several of the MSAs in table 3 experienced significant increases in unemployment rates. For example, the unemployment rate in the Detroit-Warren-Livonia MSA increased from 4.2 percent in December 2000 to 16.1 percent in December 2009. Similarly, in the Flint, Michigan, MSA, the unemployment rate increased by more than 10 percentage points between 2000 and 2009. High unemployment may have exacerbated the negative consequences of nonprime lending activity. For example, community development officials in Detroit explained that many people who did not have mortgages on their homes were enticed to obtain a home equity loan to make repairs, then lost their homes to foreclosure because they lost their jobs or the payments were not sustainable. However, many of the economic problems facing areas such as Cleveland, Detroit, and other Midwest cities where we identified large numbers of abandoned foreclosures predate the economic turmoil that started around 2008. For example, in 2007, the poverty rate in Flint, Michigan, was 16.8 percent, the poverty rate in Memphis, Tennessee, was 18.8 percent, and the poverty rates in both Toledo and Youngstown, Ohio, were 14.8 percent. Consequences of these challenges include weak real estate markets and other characteristics that are associated with abandoned foreclosures.

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<sup>32</sup>Yanan Zhang, Lu Ji, and Fei Liu, "Local Housing Market Cycle and Loss Given Default: Evidence from Sub-Prime Residential Mortgages," International Monetary Fund Working Paper 10/167(Washington, D.C.: July 2010).

**Figure 4: Areas Where Abandoned Foreclosures Are Concentrated, January 2008 through March 2010**



Source: GAO analysis; map (MapInfo).

For the electronic version of this graphic, move cursor over the map to view additional information. For printed version see Appendix V for more information.

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- **Abandoned foreclosures are also likely concentrated in distressed urban areas.** Our analysis shows that distressed urban areas within MSAs had significant numbers of abandoned foreclosures. In cities with high property values like Chicago, we found that abandoned foreclosures were largely driven by activity in a few zip codes. Our analysis also shows that, on average, the zip codes with the most abandoned foreclosures had larger declines in home prices (37 percent) compared to the national average of 32 percent following peak levels in 2005. Some distressed zip codes in Detroit, Michigan, had an over 60 percent drop in home prices from the peak levels between 2004 and 2006. Stakeholders also told us that abandoned foreclosures were most often associated with urban areas with largely minority populations, high foreclosure rates, blight, crime, and vandalism. For example, one academic speculated that there may be pockets of distressed housing in the inner parts of cities whose housing markets as a whole may not be so bad; these areas likely have low value houses that may end up as abandoned foreclosures. In addition, one servicer representative said that abandoned foreclosures could be found in the urban core of any large city.
  - **Concentrations of abandoned foreclosures have also occurred in areas that experienced significant house price increases followed by declines.** States such as California, Florida, Nevada, and Arizona experienced the largest increase in property values prior to 2006 also have experienced the largest decreases in property values in the last few years. For example, according to a recent report, property values in these states spanned 47 percent from peak to trough.<sup>33</sup> As a result, these states have many underwater borrowers—that is, borrowers who owe more on their mortgages than their properties are worth (negative equity). Significant overdevelopment and overspeculation prior to the economic crisis also may have caused investors to abandon their properties after housing prices declined. For example, representatives of a community group in Atlanta told us that starting in 2000 in a neighborhood close to downtown Atlanta investors increasingly constructed new housing on speculation. Representatives said that some of this new construction was never occupied, and after house prices began to decline in early 2007, much of it was vandalized. Without a market for these properties servicers may have subsequently abandoned foreclosures on many of these properties because they would not earn enough at foreclosure sale to cover losses associated with foreclosure and disposition of these properties. Among the 20 MSAs in table 3, Jacksonville, Cape Coral-Fort Myers, Tampa-St.

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<sup>33</sup>Standard & Poor's, *Severe Loss Severities: Which States Suffer Most from the Housing Bust?* (New York, N.Y.: Aug. 17, 2009).

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Petersburg-Clearwater, Miami-Fort Lauderdale-Pompano Beach, and, to a lesser extent, Atlanta, appear to fit into the category of housing boom-related abandoned foreclosures. For example, according to Global Insight estimates, average home prices in the Miami-Fort Lauderdale-Pompano Beach increased 144 percent from the end of 2000 to the second quarter of 2007 before declining by 40 percent from 2007 to the third quarter of 2010.

- **Regardless of the city or neighborhood, most abandoned foreclosures occur on low-value properties.** Data from servicers, Fannie Mae, and Freddie Mac indicate that foreclosures are most often not completed on properties with low values. Evidence from the econometric model that we applied to GSE loan-level data also suggests that lower property values increased the likelihood that a loan would be charged off in lieu of foreclosure rather than being subject to alternative foreclosure actions such as a deed-in-lieu of foreclosure or short sale.<sup>34</sup> For example, the median value of the properties Freddie Mac decided to charge off in lieu of foreclosure was \$10,000 compared to \$130,000 for deeds in lieu of foreclosure, \$158,000 for modifications and \$160,000 for short sales. Similarly, the median value of loans for which the six servicers decided to charge off in lieu of foreclosure in Michigan and Ohio was \$25,000.<sup>35</sup> In addition, servicer representatives told us properties with low values—such as those valued under \$30,000—were the most likely candidates for decisions to not pursue foreclosure.<sup>36</sup> Some properties may even have negative values because of the liabilities attached to them. For example, a property in Cleveland valued at \$5,000 may have an \$8,000 demolition lien levied against it; therefore, it may actually cost more to pay off the demolition lien than the property is worth.
- **Abandoned foreclosures also occurred most frequently on nonprime loans.** Our analysis shows that about 67 percent of all

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<sup>34</sup>In a deed-in-lieu of foreclosure, the borrower agrees to transfer title to the property to loan owner instead of going through the foreclosure process and a foreclosure sale. In a short sale, the servicer agrees to allow another buyer to purchase the property for less than the amount owed by the borrower.

<sup>35</sup>According to Global Insight, the average home price in Cleveland in 2010 was \$146,800, and the average in the Detroit MSA was \$124,800.

<sup>36</sup>Our servicer data show that foreclosures were not completed and loans were charged off in lieu of foreclosure on some very high-value properties, including some worth \$500,000 or more. Servicer representatives told us they had charged off loans and not pursued foreclosure on such properties because the property might not sell owing to environmental and safety hazards, such as lead paint, significant property damage from vandals or fire, or a low unpaid principal balance.



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abandoned foreclosures that we identified were associated with nonprime loans.<sup>37</sup> Adjustable rates were also a prominent feature of these loans. Anecdotally, stakeholders also told us that abandoned foreclosures most likely occurred on properties where borrowers had nonprime loans and unstable financing. For instance an official for a community development corporation in greater Cleveland told us he had seen about 12 instances of abandoned foreclosures in the past year, and many of the borrowers in these cases had two mortgages or subprime loans originated in 2003 or later.

- **The vast majority of abandoned foreclosures were loans that involved third-party investors including those that were securitized into private label MBS.** GSE-purchased loans account for a very small portion of our estimated number of abandoned foreclosures. Although the GSE loans made up roughly 63 percent of the data we collected from servicers, they accounted for less than 8 percent of the total abandoned foreclosures during 2008 through the first quarter of 2010. Similarly, we found that only about 0.3 percent of abandoned foreclosures were associated with FHA, VA, and Ginnie Mae insured loans. The potential for abandoned foreclosures to occur on loans associated with Fannie Mae also appears to have been reduced as Fannie Mae representatives told us that as of April 2010 they have instructed servicers to complete all foreclosures pending Fannie Mae's revision of its charge-off in lieu of foreclosure procedures to make sound economic decisions as well as stabilize neighborhoods. About 66 percent of the total abandoned foreclosures were associated with non-GSE third-party investors. We estimate that a significant portion of these loans were securitized into residential MBS, although data issues precluded us from distinguishing between private label MBS and whole loans held by third parties in some cases.<sup>38</sup>

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<sup>37</sup>We excluded data from two servicers that specialize in nonprime loans from this analysis. Including data from the nonprime specialist servicers increases the proportion to nearly 78 percent.

<sup>38</sup>To derive these percentages, we dropped one servicer that only provided information on loans held in its own portfolio. Including these loans did not change the results materially. When we also dropped the two subprime servicers, the results still suggested that the majority (53 percent) of the abandoned foreclosures were associated with non-GSE third-party investors.

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**Like Other Vacant Properties, Abandoned Foreclosures Contribute to Various Negative Effects on Neighborhoods, Local Governments, and Homeowners**

Abandoned foreclosures, similar to other vacant properties, further contribute to various negative impacts for the neighborhoods in which they occur, for the local governments, and for the homeowners. In addition, because local governments are not aware of servicers' decisions to no longer pursue foreclosure on these properties, they cannot take expedited actions to return the properties to productive use.

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**Without Notification of Servicers' Decisions to Abandon Foreclosures, Local Governments Cannot Act Quickly to Address the Negative Effects of These Properties**

Properties for which the mortgage servicers have abandoned the foreclosure proceedings are often left without any party conducting routine care and maintenance, which often results in properties with poor appearance and sometimes unsafe conditions. As a result, abandoned foreclosures can create unsightly and dangerous properties that contribute to neighborhood decline. Academics, housing and community groups representatives, local government officials, and others in the 12 locations we collected information from generally told us that, like other vacant and abandoned properties, abandoned foreclosures often deteriorated quickly. They explained what types of damage can result, including structural damage, mold, broken windows, and trash, among other things. Representatives of a national community reinvestment organization described the impact of vacant homes nationwide, from swimming pools filled with dirty, discolored water in Florida to homes in the Midwest that have sustained damage from falling trees that no one removes. A Cleveland official said that, in a 2-year period, about 20 vacant homes in one ward had caught fire and that people used vacant properties to dump trash and asphalt.

While touring abandoned foreclosures in some of the neighborhoods in the communities we visited, we observed several vacant and abandoned properties that showed various signs of property deterioration, including overgrown grass, accumulated trash or other debris, and broken windows. Because abandoned foreclosures, by definition, are vacant properties, they create similar problems as other vacant properties do for communities. Figure 5 presents pictures of abandoned foreclosures and other vacant properties in several of the communities we visited.

**Figure 5: Examples of Abandoned Foreclosures and Vacant Properties in Various Parts of the Country**



Vacant property in Manatee County, Florida. According to a county official, two juveniles were arrested in 2010 for vandalism that damaged doors, windows, and the interior; and neighbors reported that the dwelling had been vacant for 2 years. Foreclosure was initiated in July 2009 and was still active as of May 2010.

Manatee County, Florida



Vacant and abandoned property in Baltimore, Maryland. This picture shows trash piled up in the back yard and the rear balcony door open. According to data provided to us by a servicer, this property was charged off in October 2009, and was vacant at that time. As of May 2010, there has not been a foreclosure initiated on this property.

Baltimore, Maryland



Abandoned foreclosure in Manatee County, Florida. According to a county official, there was an arson fire on this property in July 2010. Foreclosure was initiated in December 2008 and dismissed in February 2010. Since the servicer never completed foreclosure, the liability for the fire remains with the owner of record.

Manatee County, Florida



Baltimore, Maryland

Abandoned foreclosure in Baltimore, Maryland. This structure has sustained fire damage and has broken windows in the front, as well as a broken window in the rear. According to data we received from a servicer, foreclosure was initiated in May 2007, at which time the property was vacant, and the loan was charged-off in September 2009.



Vacant and abandoned property in Detroit, Michigan. This property has sustained structural damage to the roof.

Detroit, Michigan

Source: Manatee County, Florida, Nuisance Abatement Division (middle left photo); GAO (all other photos).

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Abandoned foreclosures also create problems in communities because homes in foreclosure proceedings that become vacant in certain neighborhoods are often quickly stripped of valuable materials, further depressing their value. Housing and community group representatives, and local government officials, told us that looters strip vacant houses of copper piping, wiring, appliances, cabinets, aluminum siding, and other valuables, usually within a few weeks of the time at which the property became vacant, but sometimes within 24 hours. An official from a foreclosure response organization in one Midwestern city told us that a thriving industry of home salvage thieves exists in the city and an official from a non-profit housing organization in another Midwestern city told us that junkyards in the area accept things they should not, such as aluminum siding and refrigerators—and this provides an incentive for criminals to strip houses of any materials of potential salvage value. Representatives from a national property maintenance company that operates across the country told us a house can be secured, including having its windows and doors boarded up and entrances locked, only to be broken into and stripped of any valuable parts. Similarly, a local official told us that many houses in Chicago are secured with steel grates, but vandals will bypass these and cut a hole in the roof or brick to gain access—and, once inside, they will rip the house apart by sawing into the walls and cutting out the wiring and piping. A local official in another city reported that several gas explosions have occurred at vacant properties there recently due to vandals stealing pipes while the gas was still flowing to the home. Staff from a national property maintenance company told us that mortgage servicers contract with them to inspect the properties of homeowners whose loans become delinquent and that in certain locations, they often have to re-secure properties at every monthly inspection because such properties are constantly being broken into and damaged. In addition, a code enforcement official told us that vandalism had become such an issue for the city that a sign left on a property's door indicating that it had a code violation would serve as a flag to thieves to strip the house. Finally, representatives from two national community revitalization organizations told us that, as a result of vandalism, exposure, and neglect, vacant properties can become worthless.

Similar to other vacant and uncared for properties, abandoned foreclosures also can create public safety concerns. Staff from an entity that advises local governments on community development explained that abandoned foreclosures that remain vacant for extended periods pose significant public health, safety, and welfare issues at the local level. Although unable to identify which properties were abandoned foreclosures, local government officials in Detroit said that safety issues

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associated with vacant properties were the primary reason they had identified 3,000 vacant properties that were to be demolished in 2010. Of these, they said that 2,100 had been deemed dangerous and that 400 were considered so hazardous that they were considered emergency situations, noting that a firefighter had recently been killed when he entered a vacant property and a floor caved in. Likewise in Fort Myers, Florida, officials told us that 1,200 to 1,300 of the city's 1,600 vacant and abandoned properties were considered unsafe. A Cleveland official told us that, when housing inspectors discovered a vacant property with a code violation, the city was compelled to act to address the potential danger, or it may be liable for any subsequent injuries. Officials from this same office further noted that the public money that is used to fund the land bank—which may take in unsafe and abandoned properties—may have otherwise been used for civic uses, such as teacher salaries.

Like other vacant properties, abandoned foreclosures also contribute to neighborhood decline by providing venues for a wide variety of crimes. Local government and other officials told us that vacant and abandoned properties were subject to break-ins, drug activity, prostitution, arson, and squatting, among other things. A study of the City of Chicago noted that some vacant building fires were the result of arson by owners seeking to make insurance claims and that others were started by squatters making fires to keep warm.<sup>39</sup> Other empirical studies have found relationships between vacant or foreclosed properties and crime. For example, a national organization representing municipal governments reports that crime is moderately correlated with vacant and abandoned properties, deteriorating housing and high divestments in the neighborhood.<sup>40</sup> Another study of central city Chicago found that a 2.87 percentage point increase in the foreclosure rate would yield a 6.68 percent increase in the rate of violent crimes such as assault, robbery, rape, and murder.<sup>41</sup> The author of

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<sup>39</sup>William C. Apgar, Mark Duda, and Rochelle Nawrocki Gorey, *The Municipal Cost of Foreclosures: A Chicago Case Study*, Housing Finance Policy Research Paper 2005-1, Homeownership Preservation Foundation (Minneapolis, Minn.: 2005).  
[http://www.995hope.org/content/pdf/Apgar\\_Duda\\_Study\\_Full\\_Version.pdf](http://www.995hope.org/content/pdf/Apgar_Duda_Study_Full_Version.pdf).

<sup>40</sup>Christiana McFarland, Casey Dawkins, and C. Theodore (Ted) Koebel, "Local Housing Conditions and Contexts: A Framework for Policy Making" (Washington: National League of Cities, 2007)  
<http://www.nlc.org/ASSETS/29106477103E49EBB9BEFD49588362E5/PAR2007SoACHousingrpt.pdf>.

<sup>41</sup>Dan Immergluck and Geoff Smith, "The Impact of Single-family Mortgage Foreclosures on Neighborhood Crime," *Housing Studies* 21, no. 6 (2006): 851 - 866.  
[www.prism.gatech.edu/~di17/HousingStudies.pdf](http://www.prism.gatech.edu/~di17/HousingStudies.pdf).

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this study explains the weaker positive relationship between foreclosure and property crimes, such as theft and vandalism, may be due to an under-reporting of such crimes in lower-income areas.

Another impact of abandoned foreclosures is that, like other vacant and uncared for properties, they negatively affect the value of surrounding properties. Although property values have fallen sharply in many regions around the country as part of the recent economic recession, many of those we interviewed said that vacant properties and abandoned foreclosures compounded this problem. One local official explained that, once a few properties in a neighborhood became vacant, the negative effects tended to spiral and lead to further foreclosures and vacancies, particularly in low-income neighborhoods. In addition, empirical studies have found that vacant and abandoned properties, together with foreclosures, can cause neighboring property values to decline. For example, using data from 2006 in Columbus, Ohio, a recent study found that each vacant property within 250 feet of a nearby home could decrease its sales price by about 3.5 percent, whereas the impact from each foreclosure was less severe, but had a wider impact out into the neighborhood.<sup>42</sup> In addition, an author for a federal research organization reviewed several research papers on foreclosure's price-depressing impact on sales of nearby properties and reported that, according to the literature, this impact can range from as little as 0.9 percent to as much as 8.7 percent.<sup>43</sup>

Because local government officials are not aware that foreclosure actions are no longer being pursued, these properties remain vacant and contribute to neighborhood decline for longer periods of time. Instead of

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<sup>42</sup>Brian A. Mikelbank, "Spatial Analysis of the Impact of Vacant, Abandoned and Foreclosed Properties," study conducted for the Office of Community Affairs, Federal Reserve Bank of Cleveland, 2008.

[http://www.clevelandfed.org/Community\\_Development/publications/Spatial\\_Analysis\\_Impact\\_Vacant\\_Abandoned\\_Foreclosed\\_Properties.pdf](http://www.clevelandfed.org/Community_Development/publications/Spatial_Analysis_Impact_Vacant_Abandoned_Foreclosed_Properties.pdf). This study looked at the impact on sales price separating the effect of pre-foreclosed properties and vacant/abandoned properties using a spatial factor. Using the spatial model, the authors found that (1) each vacant/abandoned property within 250 feet could decrease the sales price of a home by 3.5 percent with rapid decreasing impact as the distance increases and (2) each foreclosure has a less severe impact on the sales price of a home close by but tends to have a robust impact on sales price even farther out into the neighborhood.

<sup>43</sup>Kai-yan Lee, "Foreclosure's Price-Depressing Spillover Effects on Local Properties: A Literature Review," Community Affairs Discussion Paper, Federal Reserve Bank of Boston, (Boston: 2008), [www.bos.frb.org/commdev/pcadp/2008/pcadp0801.pdf](http://www.bos.frb.org/commdev/pcadp/2008/pcadp0801.pdf).

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learning that servicers are charging off loans in lieu of foreclosure and will not assume responsibility for maintenance, local government staff responsible for enforcing housing codes told us they typically find out about vacant and abandoned properties through citizen complaints, vacant property registration ordinances, or on their own initiative. They noted that, by the time they become aware of a property for which a servicer is no longer taking responsibility, the property may have been vacant and deteriorating for months or years, which exacerbates the overall neighborhood decline. Several stakeholders noted that, if local governments were made aware of properties for which servicers were charging off the loans in lieu of foreclosure, they may be able to take more timely action. For example, they could take expedited actions to acquire the vacant property—such as through the use of a land bank—and return it to productive use.

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### Abandoned Foreclosures also Increase Costs for Local Governments

Abandoned foreclosures also increase costs for local governments because they must expend resources to inspect properties and mitigate their unsafe conditions. Within local communities, code enforcement departments are largely responsible for ensuring that homeowners maintain their properties in accordance with local ordinances regarding acceptable appearance and safety. In cases in which such ordinances are not being complied with, code enforcement departments can typically fine violating property owners or take actions themselves, such as making repairs or boarding up doors or windows and billing the property owner for these expended costs. However, code enforcement and other officials told us that it is often difficult to locate the owners of abandoned foreclosures because they have left their homes; they also told us that it is difficult to locate current mortgage lien holders—who generally have an interest in maintaining the properties. Officials said that one reason identifying lien holders is difficult is because they often fail to record changes in ownership with local jurisdictions. To address the challenge, the code enforcement manager of one of the cities we visited told us that he had made one of his field staff a full-time “foreclosure specialist” whose job it was to research owners and lien holders of foreclosed properties with identified code violations. The new foreclosure specialist told us that he uses several different avenues to find property owners and lien holders, including county court records, local realtors, property managers, property maintenance companies, and the Mortgage Electronic

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Registration Systems (MERS®).<sup>44</sup> In addition, another code enforcement manager told us that he had developed a team of investigators trained in skip tracing to increase the division’s ability to identify and locate violators.<sup>45</sup>

Local governments are often burdened by having to pay for the maintenance or demolition of abandoned foreclosures. In the interest of public safety, code enforcement departments will often take action when they cannot identify or contact another responsible party. Researchers tallied total costs of over \$13 million for code enforcement activities to address and maintain all vacant and abandoned properties for eight Ohio cities in 2006.<sup>46</sup> In addition, the City of Cleveland, Ohio, has budgeted over \$8 million of federal grant money for demolition and has already expended nearly \$5 million. Recent literature, as well as our interviews with local officials, further revealed the burden some local governments are experiencing due to an increase in the amount of vacant and abandoned properties:

- A 2005 report estimated the direct municipal costs of an abandoned foreclosure to be \$19,227 in the City of Chicago—and if it is a severe case with a fire, the cost can be as high as \$34,199.
- The same study reported that the cost of boarding up a single-family home one time was \$900, but noted that, because most units were boarded up multiple times, the true cost was \$1,445.<sup>47</sup>

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<sup>44</sup>MERS is an electronic system that is designed to record assignments when trading residential and commercial mortgage loans.

<sup>45</sup>Skip tracing refers to services in locating debtors who have disappeared.

<sup>46</sup>Community Research Partners and ReBuild Ohio, “\$60 Million and Counting: The cost of vacant and abandoned properties to eight Ohio cities” (Columbus: Community Research Partners, 2008).  
[http://communityresearchpartners.org/uploads/publications//FullReport\\_Nonembargoed.pdf](http://communityresearchpartners.org/uploads/publications//FullReport_Nonembargoed.pdf).

<sup>47</sup>William C. Apgar, Mark Duda, and Rochelle Nawrocki Gorey, The Municipal Cost of Foreclosures: A Chicago Case Study (Minneapolis: Homeownership Preservation Foundation, 2005)  
[http://www.995hope.org/content/pdf/Apgar\\_Duda\\_Study\\_Full\\_Version.pdf](http://www.995hope.org/content/pdf/Apgar_Duda_Study_Full_Version.pdf).



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- In a 2008 study, the City of Baltimore reported that the cost per block of police and fire services showed an annual increase of \$1,472 for each vacant and unsafe property on that block.<sup>48</sup>
  - Code enforcement officials for a city in Florida reported that they spent over \$120,000 to mow lawns of vacant properties in 2008; this was up from less than \$30,000 in 2006 and prior years.
  - Code enforcement officials for another city in Florida told us they have \$850,000 in outstanding code invoices for boarding up or mowing lawns for abandoned properties.
  - Code enforcement officials for a county in Florida reported that prior to 2007, the number of code enforcement cases against properties in foreclosure was not significant enough to warrant tracking; however, in 2008, after the department began to identify and track these properties because of the noticeable increase in citizen complaints, statistics reveal that 25 percent of all their cases involved properties in foreclosure—and as of May 2010, they had 443 active cases against properties in foreclosure.
  - A Cleveland official reported an approximately \$80,000 increase in personnel costs for code enforcement over the prior year. She said these costs were related to hiring additional staff to support existing staff with research, documentation, and court testimony.

When local governments maintain or demolish properties, they typically may place liens against the properties for the associated costs. In some jurisdictions, these liens may have the same first-priority status as tax liens and may, therefore, be relatively easily recovered, but in other jurisdictions these liens may have lower priority. In one jurisdiction, we were told that code enforcement liens were wiped out when the foreclosure was completed. A case study of Chicago estimated that between 2003 and 2004 the city recovered only about 40 cents on each dollar it spent for demolition.<sup>49</sup>

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<sup>48</sup>Winthrop, B., and R. Herr, "Determining the COST of Vacancies in Baltimore," Government Finance Review (June 2009) <http://www.proquest.com/> (accessed Oct. 7, 2010).

<sup>49</sup>William C. Apgar, Mark Duda, and Rochelle Nawrocki Gorey, "The Municipal Cost of Foreclosures."

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Abandoned foreclosures also burden local governments with reduced property tax revenues. Local jurisdictions directly lose tax revenue from vacant and abandoned properties in two ways: (1) property taxes owed by the property owner sometimes go unpaid and are not recouped, (2) a loss of tax value of a property when a structure is demolished. In addition, abandoned foreclosures contribute to falling housing values, which further erode the property tax base. For example, researchers calculated that in 2006, the City of Cleveland lost over \$6.5 million due to the tax delinquency on vacant and abandoned structures, and over \$409,000 because structures were demolished.<sup>50</sup> Moreover, one local official told us that every 1 percent decline in home values costs the City of Cleveland \$1 million in tax revenue.

Abandoned foreclosures also contribute to an increased demand for city services. As discussed, abandoned foreclosures result in an increased demand for code enforcement related services—including demolition, boarding of windows, removing trash, mowing the lawn, and a range of other activities intended to keep the unit from becoming an eyesore. Abandoned foreclosures also result in a variety of other municipal costs, including increased policing and firefighting, building inspections, legal fees, and increased demand for city social service programs.

Abandoned foreclosures also increase the difficulty of transferring the property to another owner, which can increase the potential for the property to contribute to problems within a community. If a borrower remains in the home or in contact with the servicer, title to the property can be transferred to a new owner through short sales or deed-in-lieu of foreclosure actions. If homeowners vacate their properties and cannot be reached, these alternative means of transferring title cannot occur. However, in these cases, the servicer can complete the foreclosure process where title is transferred to a new owner—either a third party buyer or the lien holder where the property is then held in its or the servicer’s real estate-owned inventory. However, when the servicer abandons the foreclosures, this transfer of title does not occur. Without this transfer, abandoned foreclosures may remain vacant for extended periods of time, with recent media and academic reports labeling such properties as being in “legal limbo” or having a “toxic title.” One academic we interviewed said abandoned foreclosures result in property titles that lack transparency and cannot be easily transferred; another academic told

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<sup>50</sup>Community Research Partners and ReBuild Ohio, “\$60 Million and Counting.”

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us that uncertainty about a property's ownership and status may make it hard for neighborhood groups or cities to determine what actions can be taken to dispose or sell such property. According to a recent report by a national rating agency, most properties associated with charged-off loans will ultimately be claimed by municipalities for back taxes, which according to stakeholders may not be an efficient process.

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### Lack of Transparency of Foreclosure Decisions May Cause Confusion among Homeowners and Increase the Number of Abandoned Foreclosures

Abandoned foreclosures can also create confusion among the borrowers over the status of their properties and their responsibilities for such properties. According to representatives of counseling agencies, community groups, and some of the homeowners we interviewed, borrowers are often surprised to learn that the servicer did not complete the foreclosure and take title to the house—and that they still own the property and are responsible for such things as maintenance, taxes, and code violations. A nonprofit law firm representative said that borrowers who thought that they had lost their homes through foreclosure were sometimes brought to housing court for code violations. For example, a court record from Buffalo City indicates that one individual appeared in court to address code violations 3 years after receiving a judgment of foreclosure. According to the record, after the judgment of foreclosure, there was no sale of the property. While in court, this individual claimed that she did not believe that she still owned the property.

Because servicers typically do not notify borrowers when they decide to charge off loans in lieu of foreclosure, borrowers may not be aware that they do not need to vacate their homes and that they are still responsible for maintaining their properties. Representatives from four servicers told us that they did not notify borrowers of this decision. Servicer and regulatory officials said that borrowers did not need to be aware when servicers decided to charge off loans in lieu of foreclosure because these were internal decisions that did not affect borrowers' obligations to pay on their mortgages. Some servicers also expressed concern that they would not want borrowers to interpret such notices to mean that they do not still owe money on the mortgage. However, recent research indicates that notifying borrowers that the servicer is charging off their loans in lieu of foreclosure could increase the likelihood that owner-occupants or tenants will remain in the properties in cases where the servicer does not intend to

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take title, and thus reduce the number of abandoned foreclosures.<sup>51</sup> In addition, several interviewees suggested that servicers should notify homeowners about decisions to charge off loans in lieu of foreclosure because homeowners often do not understand their rights to remain in their homes and responsibility to maintain the property going forward.

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### Abandoned Foreclosures Have Not Significantly Affected Federal and State Foreclosure-Related Programs

Although creating various negative impacts on neighborhoods and communities, abandoned foreclosures have not significantly affected state and federal foreclosure-related programs because most of these programs try to prevent foreclosure and some only apply to properties still occupied by homeowners. In response to the surge in mortgage foreclosures that began in late 2006 and continues today, several states created task forces to address the crisis. According to a 2008 report by a national trade association, the main objectives of almost every task force created as of March 2008 was to get practical help directly to “at risk” homeowners by, for example, creating consumer hotlines, and developing outreach and educational programs designed to encourage homeowners to get counseling.<sup>52</sup> In addition, we spoke with a legislative analyst for a national organization who told us that over the past 3 years state legislatures have enacted many laws focusing on such topics as payment assistance and loan programs, regulating foreclosure scam artists, ensuring homeowners and tenants receive proper foreclosure notice, shortening or lengthening the foreclosure process, and implementing mediation or counseling programs. The federal government has also implemented several foreclosure-related programs, most of which focus on foreclosure prevention and require that borrowers live in their homes.<sup>53</sup> For example, the federal Home Affordable Modification Program (HAMP) is a program designed to help borrowers avoid foreclosure and stay in their homes by providing incentives for servicers to perform loan modifications; however,

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<sup>51</sup>Stergios Theologides, *Servicing REO Properties: The Servicer’s Role and Incentives*, REO & Vacant Properties, Strategies for Neighborhood Stabilization, a joint publication of the Federal Reserve Banks of Boston and Cleveland and the Federal Reserve Board (Sept. 1, 2010).

<sup>52</sup>American Financial Services Association, Mortgage Task Force Report (March 2008). [http://www.afsaonline.org/other\\_information/search.cfm?cx=000027011606866024496%3A\\_2nm6bkqhwg&cof=FORID%3A11&ie=UTF-8&q=task+force+report#1023](http://www.afsaonline.org/other_information/search.cfm?cx=000027011606866024496%3A_2nm6bkqhwg&cof=FORID%3A11&ie=UTF-8&q=task+force+report#1023). This organization has a matrix of state executive foreclosure task forces updated as of September 2010, which indicates similar trends.

<sup>53</sup>See appendix IV for a list of federal programs.

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HAMP requires as a pre-condition that borrowers currently live in their homes.

Abandoned foreclosures have also not significantly impacted the federal Neighborhood Stabilization Program (NSP) according to those grantees we interviewed and surveyed. The NSP program, unlike most other federal programs we reviewed, does not focus on keeping borrowers in their homes; rather, it focuses on stabilizing communities that have suffered from foreclosures and abandonment.<sup>54</sup> Congress has appropriated NSP monies in two rounds thus far (NSP 1 and NSP 2) to help states and local governments purchase and redevelop foreclosed and vacant properties; and in September 2010, the U.S. Department of Housing and Urban Development (HUD) allocated a third round of NSP grants.<sup>55</sup> Prior to April 2010, the NSP program limited grantees' ability to intervene when a servicer initiated but did not complete foreclosure; therefore, abandoned foreclosures may have limited the pool of available properties for acquisition prior to this time. However, in April 2010, HUD announced it had modified the NSP program, expanding the definition for "foreclosure," to allow grantees to more easily acquire properties after foreclosure has been initiated and before it has been completed. HUD also expanded the definition of "abandoned" to allow access to more properties under NSP.<sup>56</sup>

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<sup>54</sup>NSP money may also be used to create land banks and to demolish blighted structures, among other things; however, NSP money may not currently be used to directly support local code enforcement efforts.

<sup>55</sup>NSP 1, a term that references the NSP funds authorized under Division B, Title III of the Housing and Economic Recovery Act (HERA) of 2008, provides grants to all states and selected local governments on a formula basis. Pub. L. No. 110-289, 122 Stat. 2654 (2008), codified at 42 U.S.C. § 5301 note. NSP 2, a term that references the NSP funds authorized under the American Recovery and Reinvestment Act (the Recovery Act) of 2009, provides grants to states, local governments, and nonprofits on a competitive basis. Pub. L. No. 111-5, 123 Stat. 115 (2009). NSP 3 funding is provided under the Dodd-Frank Wall Street Reform and Consumer Protection Act, and, like NSP 1, will provide grants to states and local governments on a formula basis. Effective October 1, 2010, section 1497 of the Dodd-Frank Act made available to HUD \$1,000,000,000 for the Neighborhood Stabilization Program; specifically for HUD to use the funds for assistance to states and local government for the redevelopment of abandoned and foreclosed homes.

<sup>56</sup>The term "abandoned" was originally defined as a property that had been foreclosed upon and was vacant for at least 90 days. HUD expanded the definition to include properties where (a) mortgage, tribal leasehold, or tax payments are at least 90 days delinquent, or (b) a code enforcement inspection has determined that the property is not habitable and the owner has taken no corrective actions within 90 days of notification of the deficiencies, or (c) the property is subject to a court-ordered receivership or nuisance abatement related to abandonment pursuant to state, local, or tribal law or otherwise meets a state definition of an abandoned home or residential property.

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Therefore, there is no longer a programmatic barrier preventing NSP grantees from acquiring abandoned foreclosures.

NSP grantees we received information from reported that abandoned foreclosures have not significantly impacted their acquisition efforts, although HUD's NSP programmatic change—enabling grantees to more easily acquire properties prior to foreclosure sale—has helped some grantees acquire multifamily properties. We received responses from 25 NSP 1 and NSP 2 grantees (including subrecipients) regarding the extent to which abandoned foreclosures were impacting their programs.<sup>57</sup> Of the 25 grantees, 23 indicated that abandoned foreclosures had not impacted their programs—and of the two remaining grantees, neither one reported that abandoned foreclosures had a significant impact. We also spoke with an additional 12 NSP 1 grantees to assess the extent to which HUD's programmatic change—expanding the definitions of “foreclosed” and “abandoned” to enable grantees to more easily acquire properties prior to foreclosure sale—impacted their acquisitions.<sup>58</sup> Some grantees with whom we spoke said the change announced in April 2010 would not have a significant impact on their acquisition efforts because they had a large inventory of fully foreclosed homes available, or they had already made many acquisitions prior to the programmatic change. However, several grantees that we spoke with said that the programmatic change assisted them in acquiring multifamily properties. HUD officials also reported that they had heard from grantees that the programmatic change assisted in their efforts to acquire multifamily homes; however HUD officials had not heard from grantees that they had applied the expanded definitions to address any single family properties for which foreclosure had not been completed. The expanded definitions may have more of an impact for the more recent rounds of funding of NSP, (NSP 2 and NSP 3), because they are in earlier stages of planning and implementation.

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<sup>57</sup>On behalf of GAO, a national nonprofit organization e-mailed structured questions to 25 NSP grantees, including NSP 1 and NSP 2 grantees, and their subrecipients.

<sup>58</sup>In conjunction with a separate GAO review of the first phase of the Neighborhood Stabilization Program (NSP 1) (report forthcoming), we obtained information from 12 NSP 1 grantees on the impact of HUD's modification to certain NSP definitions. The grantees were: Orange Country, Lee County, and City of Tampa (Florida); State of Nevada, Clark County, City of Las Vegas, City of North Las Vegas, and City of Henderson (Nevada); State of Indiana, City of Indianapolis, and City of Fort Wayne (Indiana); and City of Dayton (Ohio).

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## Some Servicer Practices Increase Likelihood of Abandoned Foreclosures and Regulatory Oversight Has Been Limited

Various servicer practices may be contributing to the number of abandoned foreclosures. These practices include initiating foreclosure without obtaining updated property valuations and obtaining valuations that did not always accurately reflect property or neighborhood conditions or other costs, such as delinquent taxes or code violation fines.

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## Without Updated Property Valuations That Consider Property and Neighborhood Conditions, Servicers May Abandon Foreclosures on Certain Properties

By not always obtaining updated property valuations at foreclosure initiation, servicers appeared to increase the potential for abandoned foreclosures to occur. As described earlier, after a certain period of loan delinquency—usually around 90 days—has passed, officials from the six servicers that we interviewed representing about 60 percent of the nation’s home mortgages told us that they make a determination about whether to initiate foreclosure. Representatives of servicers told us they take into account various information about the property when deciding whether to initiate foreclosure and some servicers conduct an equity analysis on certain loans to determine if the expected proceeds from a sale will cover foreclosure costs. However, the valuations used in these analyses might be outdated at the time of foreclosure initiation and staff from four of the six servicers told us that they did not always obtain updated information on the value of the property at the time they conducted this analysis and initiated foreclosure. The representatives from one servicer told us that the company performs an equity analysis on loans in its own portfolio before foreclosure initiation. However, for loans serviced for Fannie Mae, Freddie Mac, or third-party investors, this servicer follows the applicable servicing agreement or guidance, which may not require such analyses or updated property valuations. Instead, the company initiates foreclosure automatically when one of these loans reaches a certain delinquency status. Only two of the six servicers we interviewed reported updating property valuations on all loans before initiating foreclosure.

Even when servicers obtain updated property valuations, this information does not always reflect actual property or neighborhood conditions, which can also increase the likelihood of servicers commencing foreclosure but then abandoning it. Representatives of the six servicers we interviewed said that property inspections begin in the early stages of delinquency and continue on a regular basis, but that information collected during inspections—information relevant to the resale value of a property, such

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as vacancy status and property damage—is not used in developing property valuations. Most of the servicers we interviewed reported using automated valuation models (AVM) to estimate property values, not necessarily taking into consideration property-specific conditions. Furthermore, servicers we interviewed said they do not incorporate information on property and neighborhood conditions obtained from property inspections in their valuations. Simply using a BPO or AVM without consideration of up-to-date property or neighborhood conditions may result in abandoned foreclosures because the actual resale value and accurate expected proceeds from foreclosure sale may not be reflected in the valuation.

Another servicer practice that appeared to increase the potential for an abandoned foreclosure was that servicers generally were not considering local conditions that can affect property values prior to initiating foreclosure. Our interviews with the six servicers indicated that they did not always adjust property valuations to take into consideration potential steep declines in value due to factors specific to neighborhoods or city blocks. Staff from most of the servicers we interviewed reported that in some areas a property that was occupied and well-maintained when foreclosure was initiated could become vacant and be vandalized and decline in value. Similarly, local government officials said that homes with resale value could be stripped of raw building materials during the foreclosure process, leaving them practically worthless. As previously discussed, representatives of community groups and local governments told us that properties are sometimes vandalized within 24 hours of becoming vacant. In Detroit, for example, according to officials, property values can be seriously impacted by vacancy due to vandalism and rapid decay of vacant properties. Data from one property maintenance company contracted to inspect and secure homes undergoing foreclosure indicated that 29 percent of the properties it oversaw nationwide had some property damage in the 6 months from January to June 2010. In Detroit, about 54 percent of its properties had incurred damage.

In addition, not considering other costs, such as local taxes and potential for code violation fines, associated with a property before initiating foreclosure can increase the likelihood that a foreclosure would be abandoned. For example, local taxes owed or code violations and fines can add significant costs to the foreclosure process. Servicers told us that they may abandon foreclosures because of the amount of tax owed on the property. Tax liens are commonly placed on delinquent properties when borrowers are unable to pay property taxes. Unattended properties or those with damage can often accumulate local municipality code violation



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finances that can also decrease the net proceeds that the servicer will gain from completing a foreclosure. These fines vary widely, but in some cities fines may accrue while a property is in delinquency and foreclosure, and over time the assessed fines can exceed a property's value. The unpaid taxes and code violation fees that may accumulate during foreclosure can encourage servicers to abandon the foreclosure because they serve to reduce the net proceeds that the servicer would realize in completing the foreclosure.

In some cases, the circumstances that lead to servicers initiating but then abandoning a foreclosure appeared to be those that could not have been anticipated at the time the decision to initiate foreclosure was being made. For example, property inspections and valuations usually include only information about external conditions of properties, potentially leaving internal damage or conditions such as lead paint or contaminated drywall undetected. Addressing these internal problems could be costly. Unexpected fires or other natural disasters can also leave properties with very low values. If such damages are discovered or occur after foreclosure was initiated, servicers may decide that completing the foreclosure is not warranted.

When servicers do not have updated or complete information about property and neighborhood values and conditions before initiating foreclosure, the likelihood that they will commence then abandon foreclosures increases. Representatives of servicers said that they did not always obtain updated valuations before initiating foreclosure because they did not think it was necessary or because they were not required to do so. Instead, they generally obtained more current information only after foreclosure initiation, such as when preparing for the foreclosure sale. In cases where this valuation indicates that the value of the property was insufficient to justify completing the foreclosure process, the servicers generally stop the foreclosure and charge off the loan in lieu of foreclosure. However, by that time the property may already be vacant and negatively impacting the neighborhood. As previously discussed, our servicer data indicates that charge-offs in lieu of foreclosure that occurred after foreclosure was initiated were associated with a higher rate of vacancy than when the charge-off occurred prior to foreclosure initiation.

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## Views on Whether Servicers Have Financial Incentives to Initiate but then Abandon Foreclosures Were Mixed

Academics, local government officials, community groups, servicers, and others expressed mixed views on whether mortgage servicers have financial incentives to initiate foreclosure even in cases in which they were unlikely to complete the process. For example, accounting requirements for mortgage loans do not appear to provide incentives for servicers to initiate foreclosures but then not complete them. First, most mortgage loans that servicers are managing are being serviced on behalf of other owners. As a result, any accounting requirements applying to such loans do not financially affect the servicer's financial statements because these loans are not their assets. However, servicers that service loans for other owners do carry the expected value of the servicing income they earn on such loans on their own financial statements as an asset. The reported value of this servicing rights asset would be reduced if a serviced loan is charged off and no more servicing income is expected from it. However, this reduction would occur regardless of whether foreclosure has been initiated or not.

If the servicer of a mortgage loan is also the holder (owner) of the loan, accounting requirements also do not appear to provide incentive to initiate foreclosure. For the six servicers from whom we obtained data, 7 percent of the loans were owned by the servicing institution, meaning accounting decisions made by the servicer directly affect the institution financially. For these loans, bank regulatory rules require servicers to mark the value of delinquent loans down to their collateral value (or charge off the loan) after the loan is 180 days past due, regardless of whether foreclosure has been initiated or not. As a result, servicers then cannot avoid recognizing the loss by, for example, abandoning the foreclosure, because the loan's loss of value is already reflected in their accounting statements. Furthermore, financial institutions holding loans in their own portfolio must develop reserve accounts for expected losses on their books. Thus, they have to anticipate any declines in property values for loans in their portfolio and start setting aside funds to cover any losses at specific points in the delinquency cycle. Whether the property is carried to foreclosure sale or charged off, the loss has already been reflected in their loan value accounts.

For private label securitized loans that are being sold to private investors and serviced in pools, servicers do not appear to have incentives to delay or abandon foreclosure due to investors' potential motivation to postpone accounting for losses on those securities. According to OCC officials, a single charge-off for a loan held in a pool would not necessarily lead to a devaluation or write-down of the value of the overall pool of loans. In addition, they said that whether the value of a security is written down

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depends on several factors, including overall losses to the pool, liquidity, and interest rate changes. Thus, investors have some discretion under accounting guidance in deciding when to write down securitized assets. Further, public accounting standards require investors holding mortgage-backed securities to either set aside loss reserves and write down the value of impaired assets. Therefore, abandoning or postponing foreclosure completion would be unlikely to have an advantage to the security.

Some academics or local government officials we interviewed were concerned that servicers may have an incentive to initiate foreclosures even though they might later abandon the process in order to continue profiting from servicing mortgages. However, in servicers' and experts' descriptions of servicing practices, such incentives were called into question. Servicers can derive part of their revenue from imposing fees to borrowers who are past due with payments, and do not need to forward this revenue on to investors. Therefore, some stakeholders suggested servicers might initiate foreclosure in an effort to accrue late fees and other charges associated with servicing the loan during the foreclosure process. In addition, some stakeholders suggested that servicers might continue earning income from other financial interests they might own on the property, such as a second lien mortgage. However, five of the six servicers we interviewed reported that they stopped charging fees once a loan enters foreclosure as assessed fees are unlikely to be fully collected on loans in foreclosure. In addition, servicers might not continue yielding profits on second-lien mortgages because second-lien mortgages were much less prevalent on subprime first lien mortgages, which were often found in areas with very low housing values, such as Detroit and Cleveland, compared to high-price areas, such as California, according to a 2005 study.<sup>59, 60</sup> Finally, servicers and other experts told us that servicers do not have to initiate foreclosure in order to stop advancing payments on loans.

While servicers might begin pursuing foreclosure in order to receive mortgage insurance claims, we found that such insurance likely reduces the number of foreclosures that are abandoned because servicers must complete the process to be reimbursed. To collect on insurance claims,

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<sup>59</sup>Sean Dobson, Laurie Goodman, *Mortgage Modifications: Where Do We Go From Here*, Amherst Securities Group LP (July 2010).

<sup>60</sup>Charles A. Calhoun, *The Hidden Risks of Piggyback Lending* (Annandale, Va.: June 2005).

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government and private mortgage insurance and guarantees require that foreclosure be completed before claims are paid. For example, FHA mortgage insurance and VA guarantees, which cover a portion of potential losses from loan defaults, require a claimable event, such as a foreclosure sale, short sale, or deed-in-lieu of foreclosure before servicers can collect on a claim. Representatives of mortgage insurers also said that they could not pay an insurance claim on an abandoned foreclosure because the bank did not hold the title.<sup>61</sup> Similarly, the GSEs may provide servicers incentives to complete foreclosures in order to receive reimbursements. Fannie Mae requires servicers to submit final requests for reimbursement of advances after the foreclosure sale and after any claims have been filed with other insurers or guarantors.<sup>62</sup>

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### Past Oversight of Servicer Foreclosure Practices Had Generally Been Limited, Although Bank Regulatory Agencies Have Recently Conducted Additional Reviews Addressing Practices

Mortgage servicers' foreclosure activities were not always a major focus of bank regulatory oversight, although federal banking regulators have recently increased their attention to this area, including the extent to which servicers were abandoning foreclosures. Various organizations have regulatory responsibility for most of the institutions that conduct mortgage servicing, but some of these institutions do not have a primary federal or state regulator. According to industry data, OCC—which oversees national banks—is the primary regulator for banks that service almost two-thirds of loans serviced by the top 50 servicers.<sup>63</sup> The Federal Reserve oversees entities that were affiliated with bank holding companies or other state member banks that represented about 7 percent of these loans. Entities that are not chartered as or owned by a bank or bank holding company accounted for about 4 percent of the top 50 servicers' volume. Some states require mortgage servicers (including state-chartered

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<sup>61</sup>Private mortgage insurance protects a lender or investor against loss if a borrower stops making mortgage payments. Lenders and investors generally require mortgage insurance for loans with down payments of less than 20 percent.

<sup>62</sup>As of April 2010 Fannie Mae has instructed servicers to complete all foreclosures pending Fannie Mae's revision of its charge-off in lieu of foreclosure procedures to make sound economic decisions as well as stabilize neighborhoods.

<sup>63</sup>We identified institutions' share of mortgage servicing market as reported in an industry publication, *Inside Mortgage Finance*. Based on our analysis, the top 50 institutions that service home mortgages accounted for about 80 percent of all loans. OCC oversees servicers that have 63 percent of the market share. The Federal Reserve oversees servicers with 7.1 percent of the market. The Office of Thrift Supervision, whose functions are scheduled to be transferred to OCC on July 21, 2011, oversees servicers accounting for 5.5 percent of the volume of the top 50. The Federal Deposit Insurance Corporation acts as the primary regulator for servicers that represent 1.2 percent of the market.

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banks) to register with the state banking department, according to state banking supervisors we interviewed. These supervisors also told us that most banks that were chartered in their states did not service mortgage loans. According to our analysis, only a few of the top 50 servicers were state-chartered banks that were not members of the Federal Reserve System.

According to our interviews with federal banking regulators, mortgage servicers' practices, including whether they were abandoning foreclosures, have not been a major focus covered in their supervisory guidance in the past. The primary focus in these regulators' guidance is on activities undertaken by the institutions they oversee that create the significant risk of financial loss for the institutions. Because a mortgage servicer is generally managing loans that are actually owned or held by other entities, the servicer is not exposed to losses if the loans become delinquent or if no foreclosure is completed. As a result, the extent to which servicers' management of the foreclosure process is addressed in regulatory guidance and consumer protection laws has been limited and uneven. For example, guidance in the mortgage banking examination handbook that OCC examiners follow when conducting examinations of banks' servicing activities notes that examiners should review the banks' handling of investor-owned loans in foreclosure, including whether servicers have a sound rationale for not completing foreclosures in time or meeting investor guidelines.<sup>64</sup> In contrast, the guidance included in the manual Federal Reserve examiners use to oversee bank holding companies only contained a few pages related to mortgage servicing activities, including directing examiners to review the income earned from the servicing fee for such operations, but did not otherwise address in detail foreclosure practices.

In addition, until recently, the extent to which these regulators included mortgage servicing activities in their examinations of institutions was also limited. According to OCC and Federal Reserve staff, they conduct risk-based examinations that focus on areas of greatest risk to their institutions' financial positions as well as some other areas of potential concern, such as consumer complaints. Because the risks from mortgage servicing generally did not indicate the need to conduct more detailed reviews of these operations, federal banking regulators had not regularly examined servicers' foreclosure practices on a loan-level basis, including

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<sup>64</sup>OCC, *Mortgage Banking: Comptroller's Handbook* (Washington, D.C.: 1998).

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whether foreclosures are completed. For example, OCC officials told us their examinations of servicing activities were generally limited to reviews of income that banks earn from servicing loans for others and did not generally include reviewing foreclosure practices. Staff from the federal banking regulators noted that no federal or state laws or regulations require that banks complete the foreclosure process; therefore, banks are not prohibited from abandoning foreclosures. In addition, many of the federal laws related to mortgage banking, such as the TILA, are focused on protecting borrowers at mortgage origination, and Federal Reserve officials reported that none of the federal consumer protection laws specifically addressed the process for foreclosure.<sup>65</sup> As a result, the Federal Reserve staff who conduct consumer compliance exams also have not focused on how servicers interact with borrowers during the default and foreclosure process. Further, OCC officials said that, even if examiners observed banks they supervised abandoning the foreclosure process, the practice would not negatively impact the bank's overall rating for safety and soundness. These officials said that a bank's need to protect its financial interest might override concerns about walking away from a home in foreclosure.

However, in recognition of the ongoing mortgage crisis in the United States, staff from OCC and the Federal Reserve told us that their examiners have been focusing on reviewing servicers' loan modification programs, including those servicers participating in the federal mortgage modification program, HAMP. As potential problems with foreclosure-related processes and documentation at major servicers emerged, these two regulators have also increased examination of servicer foreclosure practices. OCC staff responsible for examinations at one of the large national banks that conducts significant mortgage servicing activities told us that they had obtained data on loans that were charged-off and foreclosure was not pursued and found that the practice was very rare and typically involved loans on low-value properties. OCC examiners acknowledged that abandoned foreclosures—due to their association with neighborhood crime and blight—could pose a reputation and litigation risk

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<sup>65</sup>Federal Reserve consumer affairs officials said that the only federal oversight of the foreclosure process they had identified was the Protecting Tenants at Foreclosure Act of 2009, 12 U.S.C. §§ 5201 note, 5220 note, which protects tenants from immediate eviction by new owners throughout the foreclosure process. The law expires December 31, 2014. Section 1418 of the recently passed Dodd-Frank Act amends TILA to require servicers to notify borrowers of impending interest rate changes on adjustable rate mortgages and section 1420 amends TILA to require certain disclosures in monthly statements to borrowers.

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to the bank. For example, we found that some servicers and lenders have been sued by various municipalities over their servicing or lending activities.<sup>66</sup>

The Federal Reserve has also recently increased its attention to mortgage servicing among the institutions over which it has oversight responsibility. In the past, the Federal Reserve has not generally included nonbank subsidiaries of bank holding companies that conduct mortgage servicing in their examination activity because the activities of these entities were not considered material risks to the bank holding company. However, in 2007, the Federal Reserve announced a targeted review of consumer compliance supervision at selected nonbank subsidiaries that service loans. Additionally, in October 2009, the Federal Reserve began a loan modification initiative, including on-site reviews, to assess whether certain servicers under its supervisory authority—including state member banks and nonbank subsidiaries of bank holding companies—were executing loan modification programs in compliance with relevant federal consumer protection laws and regulations, individual institution policies, and government program requirements.<sup>67</sup> In addition, as part of its ongoing consumer compliance examination program, the Federal Reserve incorporated loan modification reviews into regularly scheduled examinations of state member banks, as appropriate. Federal Reserve officials noted that as of October 2010 these reviews and examinations were still in progress; however, initial work identified two institutions that were engaging in abandoned foreclosure practices. Federal Reserve officials reported that, in general, no federal regulation or law explicitly requires that servicers notify borrowers when they decide to stop pursuing a foreclosure after the foreclosure process had been initiated.<sup>68</sup>

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<sup>66</sup>See for example, *City of Buffalo v. ABN AMRO Mortgage Group, Inc.*, Case Index No. 002200/2008 (N.Y. Sup. Ct. Erie County: 2010).

<sup>67</sup>Recognizing the critical need to conduct on-site reviews of the credit practices of nonbank lenders, in July 2007 the Federal Reserve initiated a multi-agency partnership to conduct targeted consumer compliance reviews of selected nonbank lenders that had significant subprime mortgage operations. See <http://www.federalreserve.gov/newsevents/press/bcreg/20070717a.htm>. As a result of this pilot, in 2009 the Federal Reserve introduced a framework for routine consumer compliance supervision of non-bank subsidiaries of the largest bank holding companies. See <http://www.federalreserve.gov/boarddocs/caletters/2009/0908/caltr0908.htm>.

<sup>68</sup>Federal Reserve officials, however, noted that in certain circumstances, a servicer's failure to notify borrowers that it stopped pursuing a foreclosure could potentially raise concerns related to fair lending or unfair and deceptive practices.

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Nevertheless, Federal Reserve staff instructed the servicers to do so as a prudent banking practice. According to Federal Reserve officials, the institutions agreed to do so. Because abandoned foreclosures do not necessarily violate any federal banking laws, supervisors did not take any actions against the institutions.

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### Other Regulators and Entities That Review Servicers' Activities also Do Not Oversee Servicers' Foreclosure Practices

Other federal and state regulators that review servicers' activities also reported having little insight into servicers' foreclosure practices and decisions to abandon foreclosures, particularly those with non-GSE loans, which account for the greatest numbers of abandoned foreclosures. Officials from the Securities and Exchange Commission, which receives reports on publicly traded residential mortgage-backed securities, told us that they did not examine servicers' policies or activities for these securitized assets. Furthermore, SEC's accounting review of publicly traded companies engaged in mortgage servicing included aggregate trends in foreclosure activity but not incomplete foreclosures on individual loans. While the Federal Housing Finance Agency Federal Property Manager's Report includes data on charge-offs in lieu of foreclosure, FHFA also does not routinely examine whether Fannie Mae and Freddie Mac are abandoning foreclosures. Like the banking regulators, they also said they had focused most of their oversight on the institutions' loan modification and pre-foreclosure efforts. In addition, the Federal Trade Commission (FTC) may also pursue enforcement actions against nonbank institutions that violate the FTC Act or consumer protection laws. However, FTC staff told us they did not think that either the unfair and deceptive acts and practices provision of the FTC Act or the Fair Debt Collections Practices Act would apply to an institution that walked away from a home in foreclosure, as a general matter. State banking regulators that we interviewed said that they conduct little oversight of servicers' foreclosure practices given the limited number of state-chartered banks that conduct mortgage servicing activities. However, several examiners and industry association officials we interviewed acknowledged the need to obtain further information about the foreclosure process and improve their examination process for nonbank mortgage servicers.

Other entities that review servicers' activities also do not review servicers' foreclosure practices or decisions to abandon foreclosures.

Representatives from private rating agencies that evaluate mortgage servicers' told us that although they review servicers' handling of loans in default and the overall average length of time servicers take to complete foreclosure, they do not track specific loans to see if foreclosure was



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completed because it would not be a specific trigger for downgrading that security's rating. In addition, representatives of institutions that serve as trustees for large numbers of pooled assets in an MBS pool told us that they sought to ensure that servicers forwarded payments to investors and noted that trustees did not provide management oversight of servicers' decisions on how to handle loans.

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## Various Actions Are Being Taken by Some Communities to Prevent or Mitigate the Effects of Abandoned Foreclosures, but Each Presents Tradeoffs

We identified various actions that some communities are taking to reduce the likelihood of abandoned foreclosures occurring or reduce the burden such properties create for local governments and communities. Communities dealing with abandoned foreclosures may benefit from implementing similar actions, but they may need to weigh the appropriateness of the various actions for their local circumstances as these actions can require additional funding, have unintended consequences, and may not be appropriate for all communities. In addition, these actions generally were designed to address vacant properties overall; therefore, they may not fully address the unique impacts of abandoned foreclosures.

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## Some Communities Are Taking Steps to Increase Borrowers' Awareness of Available Counseling

Officials from local governments, community groups, and academics told us that borrowers often leave their homes before the foreclosure sale even though they are entitled to stay in their homes at least until the sale. Although borrowers may leave for a variety of reasons, we consistently heard that many borrowers leave because they believe that servicers' initial notices of delinquency and foreclosure initiation mean that they must immediately leave the property. For example, a representative of a counseling group in Chicago told us that many people, especially the elderly and non-native English speakers, do not understand notices that they receive from servicers and think that they are being told to leave their homes.

Some jurisdictions are taking steps to increase borrowers' awareness of their rights during foreclosure through counseling. A variety of counseling and mediation resources are already available to borrowers. For example, HUD sponsors housing counseling agencies throughout the country to provide free foreclosure prevention assistance and provides references to

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foreclosure avoidance counselors.<sup>69</sup> In addition, according to a national research group, at least 25 foreclosure mediation programs were in operation in 14 states across the country as of mid-2009 to encourage borrowers and servicers to work together to keep people in their homes and avoid foreclosure.<sup>70</sup> Officials from local governments and community groups, servicers, and an academic noted that increasing the use, visibility, and resources of counseling efforts could provide avenues to educate borrowers about their rights to remain in their homes during the foreclosure process and prevent vacancies. To increase the visibility and use of counseling resources, the state of Ohio implemented a hotline phone number to help refer borrowers to counselors and a Web site to provide information about foreclosure.<sup>71</sup> In addition, local officials have credited a recent law in Michigan with helping to educate borrowers about their rights during the foreclosure process. The Michigan law allows borrowers a 90-day delay in the initiation of foreclosure proceedings if they request a meeting with a housing counselor and a servicer representative to try to arrange for a loan modification.<sup>72</sup>

Representatives of community groups, local governments, and servicers were generally supportive of efforts to educate borrowers about their rights during foreclosure, and a recent study has demonstrated the effectiveness of such counseling on keeping people in their homes. In our interviews, representatives of a servicer and local government and a researcher noted that counseling could be more effective at educating borrowers about their rights than servicers' efforts because borrowers might be more willing to talk to a counselor than to a bank representative.

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<sup>69</sup>The National Foreclosure Mitigation Counseling Program was created by the Consolidated Appropriations Act, 2008 (Pub. L. No. 110-161, 121 Stat. 1844, 2441 (2007)) in December 2007 to address the nonprime foreclosure crisis. The legislation named NeighborWorks America administrator of the \$180 million program. On July 30, 2008, section 2305 of the Housing and Economic Recovery Act of 2008 (Pub. L. No. 110-289, 122 Stat. 2654, 2854 (2008)) appropriated an additional \$180 million to the NFMC Program, including \$30 million for legal assistance. An additional \$50 million was appropriated to the program on March 11, 2009, through the Omnibus Appropriations Act, 2009 (Pub. L. No. 111-8, 123 Stat. 524 (2009)), and an additional \$65 million was appropriated to the program on December 16, 2009, through the Consolidated Appropriations Act, 2010 (Pub. L. No. 111-117, 123 Stat. 3034 (2009)).

<sup>70</sup>National Consumer Law Center, "State and Local Foreclosure Mediation Programs, Can They Save Homes?" (Boston, Mass.: September 2009).

<sup>71</sup>The Web site is: [www.savethedream.ohio.gov](http://www.savethedream.ohio.gov).

<sup>72</sup>Mich. Comp. Laws Ann. § 600.3205a(e), which became effective on July 5, 2009.

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Representatives of a law firm also noted that local staff might reach more borrowers and achieve better results than bank representatives because the local individuals have a better understanding of local conditions and homeowners could work with the same individual rather than with bank representatives who change with each contact. Community group and servicer representatives also noted that counseling is most effective at keeping people in their homes if it is offered soon after a borrower first becomes delinquent because they are more likely to leave their homes later in the foreclosure process. In addition, a November 2009 study found that homeowners who received counseling were about 1.6 times more likely to get out of foreclosure and avoid a foreclosure sale—possibly allowing them to remain in their homes—with counseling than without.<sup>73</sup>

Local community representatives noted that increased counseling may not completely prevent abandoned foreclosures for several reasons. First, counselors cannot reach every borrower needing assistance. For example, officials from a community group and counseling agencies said that some borrowers might not be aware that counseling is available or might be too embarrassed about their situation to seek assistance. Second, the quality of counseling may limit its effectiveness. Researchers noted that the quality of counseling can be uneven and organizations that are not HUD-approved or foreclosure rescue scams could mislead borrowers about their rights.<sup>74</sup> Third, representatives of research and advocacy groups we interviewed also noted that increased funding for counseling efforts would allow counseling agencies to expand and help more homeowners.

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## Many Jurisdictions Have Implemented Vacant Property Registration Systems

Another action that some local governments are taking to address the problems of vacant properties, including abandoned foreclosures, is to require servicers to register vacant properties. As previously discussed, one of the major challenges confronting code enforcement officials is identifying those responsible for maintaining vacant properties. Vacant property registration systems can attempt to address this problem by

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<sup>73</sup>The Urban Institute, *National Foreclosure Mitigation Counseling Program Evaluation, Preliminary Analysis of Program Effects* (Washington, D.C.: Nov. 2, 2009). The study considers as positive program outcomes, cases where homeowners were able to remain in their homes by becoming current on their loan, possibly through a loan modification or refinancing, as well as cases where homeowners lost their homes through a property sale, including a short sale. For our purposes, the latter case likely also resulted in an occupied property and, therefore, could be considered a positive outcome for the community.

<sup>74</sup>See also [GAO-10-787](#).

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requiring servicers to provide the city with specific contact information for each vacant property they service. According to a national firm that contracts with servicers to maintain properties, nearly 288 jurisdictions have enacted vacant property registration ordinances as of February 2010. Although the structures of these ordinances vary, researchers generally classify them into two types. The first type of systems tracks all vacant and abandoned properties and their owners. For example, among the cities we studied, Baltimore, Maryland has implemented this type of registration system. The second type of systems attempts to hold the lender and servicer responsible for maintenance of vacant properties during the foreclosure process. According to the Fannie Mae and Freddie Mac uniform mortgage documents, although these mortgage contracts typically give servicers the right to secure abandoned properties and make repairs to protect property values, they do not necessarily obligate them to do so. The cities of Chula Vista, California, Cape Coral and Fort Myers, Florida, and Chicago, Illinois, for example, have implemented this second type of ordinance. New York state also enacted a similar law statewide.<sup>75</sup>

According to some local officials and researchers, the contact information in vacant property registration systems makes it easier for local code enforcement officials to identify the parties responsible for abandoned foreclosures and that holding mortgage owners accountable for vacant properties can reduce the negative impact of these properties on the community. For example, local officials we interviewed in some cities with vacant property registries said that most owners complied with their city's registry requirements and noted that the registries had been effective at providing contacts for officials to call to resolve code violations on vacant properties. Several stakeholders, including local officials, researchers, and representatives of a community group also recommended the type of vacant property ordinance that holds servicers accountable for maintaining vacant properties during foreclosure. They noted that these types of ordinances could provide servicers with needed incentives to

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<sup>75</sup>Section 6 of the Foreclosure Prevention, Tenant Protection and Property Maintenance Act of 2009 (N.Y. Real Prop. § 1307) was signed into law on December 15, 2009. Among other things, this law requires that lenders maintain abandoned properties. Effective April 14, 2010, a plaintiff who obtains a judgment of foreclosure and sale involving residential real property that is vacant, or becomes vacant post-judgment, or is abandoned by the mortgagor but occupied by a tenant, must maintain the property until ownership is transferred (either through the closing of the title in foreclosure, or otherwise) and the deed is recorded.

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keep up vacant properties to avoid incurring additional costs and help them in determining whether to initiate foreclosure.<sup>76</sup>

Local officials and industry representatives told us that, while vacant property registration systems can help local governments identify some owners, they might not capture all owners, and some servicers found certain requirements overly onerous and outside of their legal authority to perform. Local officials in a couple of cities and one servicer representative told us that these systems might not capture all owners because those who did not want the responsibility of maintaining certain properties would choose not to register. Further, systems that do not require that properties be registered until after the foreclosure sale would not help officials identify those responsible for maintaining abandoned foreclosures. In addition, servicers' representatives told us that complying with these ordinances can be burdensome. For example, servicers consider ordinances that require them to secure doors and windows with steel, install security systems, and perform capital improvements to vacant properties as onerous, according to an industry association. Servicers also reported having difficulty tracking and complying with multiple systems and said that they would prefer a uniform system with consistent requirements. Further, servicers and other industry representatives we spoke to believe servicers' authority to perform work on properties they did not yet own as limited. Holding a mortgage on a property does not give the servicer right of possession or control over the property. Therefore, servicers argue that they cannot be held liable for conducting work on properties because they are not the titleholders until after a foreclosure sale. For example, representatives of one servicer told us that the company would take steps to prevent a property from deteriorating but was cautious about going onto a property it did not own. In addition, community groups, researchers, and other industry analysts have expressed concerns that such laws could have the unintended consequence of encouraging servicers to walk away from properties before initiating foreclosure to avoid the potential maintenance and

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<sup>76</sup>As an alternative to state or local ordinances, an industry trade association has suggested that MERS, which tracks the ownership and servicing of loans that are registered on its system, could serve as a vacant property registry. MERS was created by the mortgage banking industry to streamline the mortgage process by using electronic commerce to eliminate paper. MERS acts as nominee in the county land records for the lender and servicer. Lenders or servicers generally do not record transfers of loans registered on the system.

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related costs, which could have the same negative effects on neighborhoods and communities as abandoned foreclosures do now.<sup>77</sup>

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### Some Areas Are Reducing the Time Required for Foreclosing on Vacant Properties or Requiring Foreclosures to Be Completed Once Initiated

State or local actions to streamline the foreclosure process for vacant properties could also reduce the number of abandoned foreclosures by decreasing servicers' foreclosure costs and preserving the value of vacant properties. As we have seen, the length of the foreclosure process affects servicers' foreclosure costs as well as the condition and value of a property.<sup>78</sup> Some areas are implementing streamlining efforts. For example, a law was recently enacted in Colorado allowing servicers to choose a shortened statutory foreclosure process for vacant properties that provides for a foreclosure sale to be scheduled in half the time of the typical process, according to a state press release on the new law.<sup>79</sup> In addition, some courts in Florida have created expedited foreclosure court dockets for uncontested cases in order to move a higher number of cases forward in the process. Shortening the time it takes to complete foreclosure could result in less decrepit properties that servicers could resell more easily and at a higher price than they might have been able to otherwise—thereby encouraging servicers to abandon fewer foreclosures.

However, some stakeholders raised concerns about streamlined actions. First, servicers and other industry analysts note that determining whether properties were actually vacant could be difficult. Second, shortening foreclosure times is contrary to the trend among state and local governments across the country to enact laws such as foreclosure moratoriums that extend foreclosure timelines. Therefore, some raised concerns about ensuring that homeowners had appropriate opportunities to work out a solution within a shortened time frame. Third, another potential unintended consequence is that in judicial states, shortening the time frame for foreclosing on vacant properties by moving these cases to

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<sup>77</sup>Stergios Theologides, *Servicing REO Properties: The Servicer's Role and Incentives*, REO & Vacant Properties, Strategies for Neighborhood Stabilization, a joint publication of the Federal Reserve Banks of Boston and Cleveland and the Federal Reserve Board (Sept. 1, 2010).

<sup>78</sup>According to research from Standard and Poor's, foreclosure moratoriums and other state or local measures that lengthen the time a servicer has to wait before initiating foreclosure in an effort to reduce the rate of foreclosures seem to be delaying foreclosure sales and increasing servicing costs and losses. Standard & Poor's, *Severe Loss Severities: Which States Suffer Most From the Housing Bust?* (New York, N.Y.: Aug. 17, 2009).

<sup>79</sup>Colorado House Bill No. 1249 was signed into law by the Governor on April 29, 2010.

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the head of the queue could lengthen the time frames for other cases, increasing servicers' carrying costs on those properties.

Other jurisdictions have attempted to require servicers to complete foreclosures once they have initiated them. For example, staff in one court we visited told us the judge requires a foreclosure sale to be scheduled within 30 days after the court enters a foreclosure judgment. If servicers do not comply, they can be held in contempt of court, fined, and perhaps serve jail time. Many local officials and researchers we interviewed suggested that foreclosure cases should be dismissed, that servicers should face fines, or that servicers should lose their right to foreclose or take other actions on a property if they do not take action on foreclosure proceedings or schedule a sale within a certain amount of time. These actions could reduce abandoned foreclosures because servicers would more thoroughly consider the benefits and costs of foreclosure before initiating the process, and once initiated, foreclosures would be completed in a timely manner. Others also said that these actions would quickly move properties out of the foreclosure process and into the custody of a servicer that local officials could then hold responsible for the property's upkeep.

However, others noted that such a requirement could result in missed opportunities to work out solutions with the borrower and that it could be difficult to enforce. For example, representatives of servicers and others told us that borrowers often sought such alternatives at the last minute before a foreclosure sale and that requiring servicers to complete all foreclosures would limit their ability to explore alternatives late in the foreclosure process.<sup>80</sup> An academic and regulatory officials expressed concerns that servicers would incur additional expenses if they had to complete sales and take ownership of properties when doing so was not in their best interest and they would not be able to recover their costs. In addition, regulatory staff cautioned that such a requirement could cause servicers to walk away from properties before initiating foreclosure. This type of action also would be difficult to implement in a state with a statutory foreclosure process because there is not the same degree of public records tracking foreclosures in these states.

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<sup>80</sup>In the court mentioned above, however, court staff told us that the judge allows extensions for servicers that are working with borrowers on a loan modification.

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## Certain Communities Are Establishing Outlets for Servicers to Dispose of Low-Value Properties

Local actions to establish reliable outlets for servicers to easily and cheaply dispose of low-value properties could reduce the number of abandoned foreclosures by providing incentives for servicers to complete the process. As previously discussed, servicers told us that many properties that were abandoned foreclosures were those that would likely have been either too costly for servicers to take ownership of or not likely to have resulted in sufficient sale proceeds. Taking foreclosed properties into their own real estate ownership inventories can be costly to servicers as they must continue to pay for taxes and insurance, maintain a deteriorating property, and hire a broker to market the property for sale. According to a recent report, if servicers and their investors know that they will not be further burdened by costs for the property, they may be more willing to take title and transfer it to a government or nonprofit entity that will be able to begin moving the property back into productive use.<sup>81</sup>

The use of land banks is one alternative that some jurisdictions are attempting to use to address problems arising from large numbers of foreclosures and vacant properties.<sup>82</sup> Land banks are typically governmental or quasi-public entities that can acquire vacant, abandoned, and tax-delinquent properties and convert them to productive uses, hold them in reserve for long-term strategic public purposes such as creating affordable housing, parks, or green spaces, or demolish them. Land banks can reduce the incidence of abandoned foreclosures by providing servicers a way to dispose of low-value properties that they might otherwise abandon. Sales or donations to land banks could help servicers reduce their foreclosed property inventories. For example, Fannie Mae and the Cuyahoga County Land Reutilization Corporation have an agreement whereby on a periodic basis Fannie Mae sells pools of very low-value properties to the land bank for 1 dollar, plus a contribution toward the cost of demolition. This agreement allows Fannie Mae to reliably dispose of pools of properties in a recurring transaction at pre-defined terms. Land bank officials from Cuyahoga County noted that they are in

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<sup>81</sup>Stergios Theologides, *Servicing REO Properties: The Servicer's Role and Incentives*, REO & Vacant Properties, Strategies for Neighborhood Stabilization, a joint publication of the Federal Reserve Banks of Boston and Cleveland and the Federal Reserve Board (Sept. 1, 2010).

<sup>82</sup>Land banks generally may be created at the city or county level, like the Fulton County/City of Atlanta Land Bank Authority in Georgia and the Cuyahoga County Land Reutilization Corporation in Ohio. They may also be created at the state level, like the State of Michigan Land Bank Fast Track Authority.



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the process of negotiating similar agreements with several large servicers. Once it has acquired the properties, a land bank can help stabilize neighborhoods, such as by reducing excess and blighted properties through demolition or transferring salvageable properties to local nonprofits for redevelopment. According to recent research, the Genesee County Land Bank in Flint, Michigan, has been credited with acquiring thousands of abandoned properties, developing hundreds of units of affordable housing, and being the catalyst for increasing property values in the community by more than \$100 million between 2002 and 2005 through its demolition program.<sup>83</sup>

Although land banks can help reduce abandoned foreclosures or their negative effects, our interviews revealed potential challenges of implementing these banks. First, many of the local government officials we interviewed noted that land banks did not have enough resources to manage a large volume of properties. Land banks may be dependent on local governments for funding, and without a dedicated funding source it may be difficult for land banks to engage in long-term strategic planning. However, recently created land banks, such as those in Genesee and Cuyahoga counties, have developed innovative funding mechanisms that do not depend on appropriations from local governments.<sup>84</sup> Second, some mentioned that contributions from servicers—such as the agreement between Fannie Mae and the Cuyahoga County Land Reutilization Corporation—could help defray land banks’ property carrying costs.

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<sup>83</sup>Nigel G. Griswold and Patricia E. Norris, *Economic Impacts of Residential Property Abandonment and the Genesee County Land Bank in Flint, Michigan*, MSU Land Policy Institute Report #2007-05 (East Lansing, Mich.: April 2007).

<sup>84</sup>According to a recent report, land banks in Michigan are funded primarily by retaining proceeds from all properties sold out of inventory, either by recapturing a portion of the real property taxes on every property it puts back into productive use for the first 5 years, or by renting properties that are held in inventory. The report also notes, and land bank officials confirmed, that the Cuyahoga County Land Reutilization Corporation in Ohio is funded by advancing taxing districts the principal value of real property taxes when they are due, based on historic collection rates. There are multiple ways to fund this advance, for instance: borrowing from the county or issuing unpaid and delinquent tax anticipation securities. When taxes are collected, their principal value, plus some interest, goes to pay down the line of credit or security holders. The penalties on delinquent real property taxes, which are increased in counties with land banks, remain in the land bank to fund operations. This provides for a stable revenue stream for land bank operations. See Thomas J. Fitzpatrick IV, *How Modern Land Banking Can Be Used to Solve REO Acquisition Problems*, REO & Vacant Properties, Strategies for Neighborhood Stabilization, a joint publication of the Federal Reserve Banks of Boston and Cleveland and the Federal Reserve Board (Sept. 1, 2010).

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Second, land banks may be limited in their authority to acquire or dispose of properties. For example, by design land banks tend to passively acquire and convert abandoned properties with tax delinquencies into new productive use. However, land banks can also be designed to actively and strategically acquire properties from multiple sources. The Cuyahoga County Land Reutilization Corporation, for example, has the authority to strategically acquire properties from banks, GSEs, federal or state agencies, and tax foreclosures. Third, some municipalities face political challenges in establishing land banks or local officials question whether they are needed. For example, according to an advisor to local governments on establishing land banks and a representative of a community group, the Maryland state legislature authorized the creation of a land bank in Baltimore, but its implementation fell through due to political differences at the city level. Further, some local officials we interviewed in Florida did not think land banks were needed in their areas because they expected the housing market to recover so that vacancies would not be a long-term problem.

Similar to land banks, other methods for cities to acquire properties before or following foreclosure could also provide incentives to servicers to complete the foreclosure process for low-value properties rather than abandoning it.<sup>85</sup> Some cities have negotiated specialized sale transactions with Fannie Mae and HUD. For example, HUD recently announced a partnership with the National Community Stabilization Trust (NCST) and leading financial institutions that account for more than 75 percent of foreclosed property inventory to provide selected state and local governments and nonprofit organizations the first opportunity to purchase vacant properties quickly, at a discount, and before they are offered on the open market.<sup>86</sup> In addition, some cities have worked with Fannie Mae to purchase foreclosed and low-value properties. According to Fannie Mae, the City of St. Paul, Minnesota, has purchased 45 properties from the

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<sup>85</sup>Banking regulators announced a proposed rule on June 24, 2010, that, in combination with these local actions, could provide further incentive for servicers to complete foreclosures and donate properties. The rule aligns Community Reinvestment Act requirements with Neighborhood Stabilization Program activities. As a result, under this proposal an institution could receive favorable CRA consideration for donating foreclosed properties to nonprofit housing organizations in eligible areas. 12 U.S.C. §§ 2901 – 2908; 75 Fed. Reg. 36016 (June 24, 2010).

<sup>86</sup>The National First Look Program was announced on September 1, 2010. See HUD press release at: [http://portal.hud.gov/portal/page/portal/HUD/press/press\\_releases\\_media\\_advisories/2010/HUDNo.10-187](http://portal.hud.gov/portal/page/portal/HUD/press/press_releases_media_advisories/2010/HUDNo.10-187).

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entity and has access to review Fannie Mae's available properties to be able to submit an offer for a pool of properties before they are marketed. And, according to a representative of a national community development organization, with the broadened definitions of abandoned and foreclosed properties under the NSP program, local governments and other grantees will be able to work with servicers earlier in the foreclosure process to acquire such properties through short-sales, for example, which could discourage abandoned foreclosures. For example, one organization in Oregon is pursuing purchasing notes prior to foreclosure using some of the state's Hardest Hit Fund money, which would save the servicer the costs of initiating and completing foreclosure. However, the ability of these types of programs to fully address the issue of abandoned foreclosures may be limited. For example, local officials and researchers said cities' capacity to receive donations or acquire properties was limited because they did not have enough resources to manage properties. According to recent research, capacity constraints prevent most community development organizations from redeveloping enough vacant homes to reverse the decline of neighborhood home values.<sup>87</sup> In addition, according to industry observers, and HUD and local government officials, local governments have not pursued many pre-foreclosure acquisitions, such as short sales and note sales, because they can be time-consuming and technically difficult to complete.<sup>88</sup>

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## Conclusions

The overall estimated number of abandoned foreclosures nationwide is very small. However, the communities in which they are concentrated often experience significant negative impacts, including producing vacant homes that can be vandalized, reduce surrounding neighborhood property values, and burden local government with the costs associated with maintenance, rehabilitation, or demolition. Given the large number of homeowners experiencing problems in paying their mortgages and the negative impacts on communities when properties become vacant, avoiding additional abandoned foreclosures would help reduce any further potential problems that another vacant and uncared for property can

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<sup>87</sup>Daniel Fleischman, *Nonprofit Strategies for Returning REO Properties to Effective Use, REO & Vacant Properties, Strategies for Neighborhood Stabilization*, a joint publication of the Federal Reserve Banks of Boston and Cleveland and the Federal Reserve Board (Sept. 1, 2010).

<sup>88</sup>Further, HUD officials told us that note sales were not an allowable use of NSP funds.

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create for communities already struggling with the impacts of the current mortgage crisis.

Various servicer practices appear to be contributing to the potential for additional abandoned foreclosures. First, no requirement currently exists for mortgage servicers to notify borrowers facing foreclosure of their right to continue to occupy their properties during this process or of their responsibilities to pay taxes and maintain their properties until any sale or other title transfer activity occurs, and regulatory officials told us that they were not sure they had the authority to require servicers to do so. The lack of awareness among borrowers about their rights and responsibilities contributes to the problems associated with abandoned foreclosures. With such information, more borrowers might not abandon their homes, reducing the problems that vacancies create for neighborhoods, their surrounding communities, and the local government of the community in which the property exists. Second, no requirement exists for servicers to notify the affected local government if they abandon a foreclosure. Without such notices, local government officials often are unaware of properties that are now at greater risk of damage and create potential problems for the surrounding neighborhood. With such information, local governments could move more quickly to identify actions that could ensure that such properties are moved to more productive uses.

Third, servicers are not always obtaining updated property value information that consider local conditions that can affect property values when initiating foreclosure. As a result, the likelihood that servicers may initiate foreclosure only to later abandon it after learning that the likely proceeds from the sale of the property would not cover their costs is increased. If servicers had more complete and accurate information on lower-value properties that were more at risk for such declines in value, they may determine that foreclosure is not warranted prior to initiating the process for some properties. Having servicers improve the information they use before initiating a foreclosure could result in fewer vacant properties that cause problems for communities.

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## Recommendations for Executive Action

To help homeowners, neighborhoods, and communities address the negative effects of abandoned foreclosures, we recommend that the Comptroller of the Currency and the Chairman of the Board of Governors of the Federal Reserve System take the following four actions:

- require that the mortgage servicers they oversee notify borrowers when they decide to charge off loans in lieu of foreclosure and inform borrowers

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about their rights to occupy their properties until a sale or other title transfer action occurs, responsibilities to maintain their properties, and their continuing obligation to pay their debt and taxes owed;

- require that the mortgage servicers they oversee notify local authorities, such as tax authorities, courts, or code enforcement departments, when they decide to charge off a loan in lieu of foreclosure; and
- require that the mortgage servicers they oversee obtain updated property valuations in advance of initiating foreclosure in areas associated with high concentrations of abandoned foreclosures.
- As part of taking these actions, the Comptroller of the Currency and the Chairman of the Board of Governors of the Federal Reserve System should determine whether any additional authority is necessary and, if so, work with Congress to ensure they have the authority needed to carry out these actions.

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## Agency Comments and Our Evaluation

We requested comments on a draft of this report from the Board of Governors of the Federal Reserve System, Department of Housing and Urban Development, Department of the Treasury, Department of Veterans Affairs, Fannie Mae, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, Freddie Mac, Federal Trade Commission, Office of Comptroller of Currency, Office of Thrift Supervision, and Securities and Exchange Commission. We received technical comments from Federal Reserve, FDIC, FHFA, FTC, OCC, and OTS, which we incorporated where appropriate.<sup>89</sup> The Comptroller of the Currency did not comment on the recommendations addressed to him.

We also received written comments from Treasury and the Federal Reserve that are presented in appendices II and III. The Acting Assistant Secretary for Financial Stability at the Department of the Treasury noted that, although the number is small, abandoned foreclosures are a serious problem that underscores the importance of holding servicers accountable. The Director of the Division of Consumer and Community Affairs at the Board of Governors of the Federal Reserve System agreed with our findings but neither agreed nor disagreed with our

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<sup>89</sup>HUD, VA, and SEC responded that they did not have any comments on the report. Technical comments from Fannie Mae and Freddie Mac were combined with those from FHFA.

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recommendations. Instead, the Director's letter described ongoing actions the Federal Reserve is taking to address these issues and noted that the agency is concerned about the effects abandoned foreclosures may have in communities where they are concentrated. In response to our recommendation that the agency require the servicers the Federal Reserve oversees to notify borrowers that their loans are being charged off in lieu of foreclosure, the Director's letter states they agreed that such notification represents a responsible and prudent business practice and will advise institutions they supervise to notify affected borrowers in the event of abandoned foreclosures. While this would ensure that borrowers are notified in cases where examiners identify instances of abandoned foreclosures, we believe that a more affirmative action by the Federal Reserve to communicate this expectation to all servicers it supervises would be more effective at reducing the impact of abandoned foreclosures on homeowners.

Regarding our recommendation that the Federal Reserve require mortgage servicers to notify local authorities when loans are being charged off in lieu of foreclosure, the Consumer and Community Affairs Division Director stated that the Federal Reserve expects servicers to comply with any local laws requiring registration of vacant properties. While this would ensure that local authorities are notified in those communities, we reiterate that the Federal Reserve should take steps to ensure that the servicers it oversees are notifying local authorities that would likely be in a position to take action to mitigate the impact of an abandoned property, such as tax authorities or code enforcement departments, in all areas—not just those with existing vacant property registration systems—to ensure that all communities have such information that could help them better address the potential negative effects of abandoned foreclosures. We also encourage the Federal Reserve, along with other banking regulators with responsibilities to oversee mortgage servicers, to work with Congress to seek any additional authority needed to implement such a requirement.

In response to our recommendation that the Federal Reserve require servicers to obtain updated property valuations in advance of initiating foreclosure in certain areas, the Consumer and Community Affairs Division Director letter notes they agree with the importance of servicers having the most up-to-date information before taking such actions, but noted that servicers' ability to obtain optimal information could be limited. Even without the ability to conduct interior inspections of properties, having servicers take additional steps to improve the accuracy of their valuations prior to initiating foreclosure would still be possible. We acknowledge that updating property valuations can be challenging, which

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is why our recommendation encourages a risk-based approach to identifying properties where an updated evaluation could assist servicers in making a more well-informed decision about initiating foreclosure. The Director's letter also cites existing Federal Reserve guidance outlining expectations for obtaining property valuations, which, according to Federal Reserve staff, applies to actions that institutions should take before and after they have acquired properties through foreclosure. According to this guidance, an individual who has appropriate real estate expertise and market knowledge should determine whether an existing property valuation is valid or whether a new valuation should be obtained because of local or property-specific factors including the volatility of the local market, lack of maintenance on the property, or the passage of time, among others. Having the Federal Reserve take further steps to ensure that servicers understand and implement this guidance and evaluate properties in advance of initiating foreclosure would likely help to reduce the prevalence of abandoned foreclosures as well.

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We are sending copies of this report to interested congressional committees, the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, Office of Controller of Currency, Office of Thrift Supervision, Department of Housing and Urban Development, Department of the Treasury, Department of Veterans Affairs, and Securities and Exchange Commission, and other interested parties. The report is also available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-8678 or [clowersa@gao.gov](mailto:clowersa@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix VI.

Sincerely yours,



A. Nicole Clowers  
Acting Director, Financial Markets  
and Community Investment

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# Appendix I: Objectives, Scope, and Methodology

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This report focuses on the prevalence, causes, and effects of abandoned foreclosures. Specifically, this report addresses (1) the nature and prevalence of abandoned foreclosures, including how they occur; (2) the impact of abandoned foreclosures on communities and state and federal efforts to mitigate the effects of foreclosure; (3) certain practices that may contribute to why mortgage servicers initiate but not complete foreclosures and the extent of federal regulatory oversight of mortgage foreclosure practices; and (4) the various actions some communities are taking to reduce abandoned foreclosures and their impacts.

To determine the nature and prevalence of abandoned foreclosures—where servicers initiated but decided not to complete foreclosure and the property is vacant—we analyzed mortgage loan data from January 2008 to March 2010 reported to us from selected servicers and two government-sponsored enterprises (GSE). We obtained aggregated and loan-level data from six servicers—including large servicers and those that specialize in servicing nonprime loans—Fannie Mae, and Freddie Mac on loans that were categorized as charge-offs in lieu of foreclosure (loans that were fully charged off instead of initiating or completing a foreclosure). After eliminating overlapping loans, the institutions contributing data to our sample collectively account for nearly 80 percent of all first-lien mortgages outstanding.<sup>1</sup> The database we have assembled is unique and, therefore, difficult to cross-check with other known sources to check its reliability. Because we were able to cross-check the loan level information provided by the GSEs with official reports submitted by Federal Housing Finance Agency (FHFA) to Congress we believe that these data are sufficiently reliable for our reporting purposes.<sup>2</sup> However, because some of the servicers compiled the information requested differently or were reporting information that is not a part of their normal data collection and retention apparatus, our dataset contains various degrees of inconsistency, missing data and other issues. In reviewing these data we found a number of concerns with some elements of the database and some sources of the data. For example, we believe that some servicers (1) submitted data that included second liens, (2) contained elements that appeared to be irregular or (3) may not have provided the total charge-offs in lieu of

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<sup>1</sup>A portion of the servicer and GSE databases result in a duplication of coverage because some of the GSE loans are also serviced by the servicers in the servicer database.

<sup>2</sup>The GSE data represent the loan level information underpinning the aggregate data reviewed by FHFA and presented in the FHFA's periodic foreclosure prevention and refinance reports for Congress.



foreclosure associated with their servicing portfolio. While the number of potential second liens were not significant especially among those that we identified as abandoned foreclosures, it is difficult to know with certainty how the remaining issues impacted our results including the descriptive statistics report. For this reason, we have characterized our results in a manner that minimizes the reliability concerns and emphasizes the uncertainty regarding the total number of abandoned foreclosures in the United States. Moreover, we conducted a variety of tests on this data. For example, we were able to use GSE data as a reliability check on some elements of the servicer database. We also cross-checked some of the properties in our database against property tax records for a portion of the data for Baltimore and Chicago. We were able to visually inspect some properties in a few cities. Given these and other steps we have taken, we believe the data is sufficiently reliable for the purposes used in this study.

We used two methods to code the data as vacant or occupied in our database. First, the servicers provided data on whether the property was vacant at the time the loan was charged off in lieu of foreclosure. We found this data to be reliable based on cross-checks with property tax records and visual inspection for a small sample of the database. However, 32 percent of the field was either blank or the servicer indicated that occupancy status was unknown. Moreover, an occupied property may eventually become vacant weeks or even months after charge-off in lieu of foreclosure. Therefore, we augmented this information by using a second method. The second method involved determining occupancy status using U.S. Postal Service (USPS) administrative data on address vacancies. These data represent the universe of all vacant addresses in the United States. We obtained lists of vacant properties from USPS for 6-month increments from June 30, 2008, through June 30, 2010. The USPS codes a property as vacant if there has been no mail delivery for 90 days.<sup>3</sup> The data also included properties the USPS codes as a “no-stat” for urban areas. A property is considered a “no-stat” if it is under construction, demolished, blighted and otherwise identified by a carrier as not likely to become active for some time. We matched these USPS data on address vacancies to actual addresses in our loan database. Therefore, we considered a property vacant if it was either coded as vacant at the time of charge-off in

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<sup>3</sup>The USPS defines “vacant” as an urban delivery point that was active in the past, but is not currently occupied (in most cases unoccupied over 90 days) and not currently receiving delivery. An address is considered vacant if that house or apartment has not been occupied in at least 90 days.

lieu of foreclosure by the servicers or was coded as vacant based on the vacancy lists obtained from USPS.

Users of the report should note the difficulty in determining vacancy and that our exercise may have resulted an understatement or overstatement of the number of vacant properties in our sample.<sup>4</sup> In particular, determining vacancy by matching to USPS data has limitations including, (1) long lags before vacancy is determined, (2) mail carrier delays in reporting vacancies, (3) coding seasonal and recreational properties as vacant, and (4) matching errors due to differences in address formats or incomplete addresses in the loan file.<sup>5</sup> Due to privacy concerns we were not able to leverage USPS expertise to ensure a higher quality match based on lists that included all known delivery points. As a result, our analysis will miss any property that was demolished upon the determination of vacancy or any property deemed a “no-stat” in rural areas. Because of the 90-day lag in determining vacancy and the fact that we are dealing with properties from 2008 to 2010 largely in major metropolitan areas, this is not likely to have a significant impact on our estimates of vacant properties. It should be noted that the data collected by the USPS are designed to facilitate the delivery of mail rather than make definitive determinations about occupancy status. For example, USPS residential vacancy data do not differentiate between homeowner and rental units nor identify seasonal or recreational units.

Once vacancy is determined and the number of abandoned foreclosures is estimated, our projections of the prevalence of abandoned foreclosures in the United States are based on an extrapolation designed to highlight the uncertainty in the results. While we estimated the total number of abandoned foreclosures directly for a large portion of the mortgage market, we simulated the total number based on assumptions about the remaining mortgage loans not covered in our sample. To form estimates of prevalence we conducted several analyses. First, we formed base prevalence estimates using information from the servicer and GSE databases alone. Second, we combined servicer and GSE databases to

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<sup>4</sup>Outside of visually inspecting each of the properties over a reasonable length of time there is no error-free way of determining vacancy.

<sup>5</sup>Some properties' addresses were either missing too much vital information to be standardized or had extremely complicated address and therefore were not able to be matched to USPS data. For example, our dataset included a significant number of condominiums and duplex properties, some which may have not matched due to non-standard coding of the address.

produce some estimates of prevalence based on information contained in both databases. Third, we made a determination of the possible error rate in determining vacancy through various runs of our matching analysis to USPS data and examining the output. Lastly, we conducted a series of simulations to extrapolate our findings to the 20 percent of the mortgage market not covered in our database and to capture the uncertainty inherent in our data. Although the loans reflected in this report represent servicers that service a large percentage of the overall mortgage industry, they likely do not represent a statistically random sample of all charge-offs in lieu of foreclosure. Rather than assume the large sample can be generalized and produce a point estimate with confidence interval, we simulated the likely number of abandoned foreclosures for the remaining loans under a number of different assumptions about the characteristics of the population. For example, in some runs we assumed a 10 percent error matching rate and that the remaining servicers resemble some combination of the subprime specialty lenders and the large servicers in our sample. In some cases we assumed no error in our matching analysis but formed our estimates eliminating a servicer that raised some concern over the reliability of their data. Lastly, we produced estimates combining elements of both of these sets of assumptions. In extrapolating the findings from our sample we provided a range of estimates that reflect the fact that the characteristics of these loans may differ from the remaining population of mortgages as well as our concerns over data reliability and potential matching error in determining vacancy. We believe these simulations properly characterized the sources and nature of uncertainty in the results. We also acknowledged, throughout the report, cases in which data issues may have affected the results.

To supplement this data analysis and to determine the impacts of incomplete foreclosures on communities and homeowners, we conducted case studies and a literature review. We selected 12 locations to provide a range of states with judicial and statutory foreclosure processes, from different regions of the country, and that had variations in local economic circumstances and responses to abandoned foreclosures. Our case study locations were Atlanta, Georgia; Baltimore, Maryland; Buffalo, New York; Chula Vista, California; Chicago, Illinois; Cleveland, Ohio; Detroit, Michigan; Lowell, Massachusetts; and Cape Coral, Fort Myers, Manatee County, and Hillsborough County, Florida. We conducted in person site visits or phone calls with city and county officials, community development organizations, academic researchers, foreclosure assistance providers, and state banking supervisors in these locations to gain perspectives on the impact and prevalence in each location. Although we selected the case study locations to provide broad representation of

conditions geographically and by type of foreclosure process, these locations may not necessarily be representative of all localities nationwide. As a result, we could not generalize the results of our analysis to all states and localities. In two of the locations we visited, officials provided us with pictures and examples of abandoned foreclosures and vacant properties. In Detroit, Baltimore, and Florida, we visited selected vacant and abandoned properties and took pictures to document property conditions. After the conclusion of our fieldwork, we analyzed the information obtained during the interviews to find common themes and responses. To supplement our case study interviews, we reviewed various relevant journal articles, reports, law review articles, and other literature on the impacts of vacant and abandoned properties. We consulted with internal methodologists to ensure that any literature we used as support for our findings was methodologically sound.

To determine what impacts abandoned foreclosures were having on state foreclosure mitigation efforts, we reviewed the findings and recommendations of several state foreclosure task forces and interviewed staff from a national policy research organization who tracks state foreclosure-related legislation. We also contacted the housing finance agencies in the 10 states that were determined as of March 2010 to have been hardest hit by the foreclosure crisis. These states received funding from the Department of the Treasury through its Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets (HFA Hardest-Hit Fund), and included Arizona, California, Florida, Michigan, Nevada, North Carolina, Ohio, Oregon, Rhode Island, and South Carolina.

To determine what impacts abandoned foreclosures were having on federal foreclosure mitigation efforts, we reviewed current federal foreclosure efforts and obtained information from Neighborhood Stabilization Program (NSP) grantees. The current federal foreclosure efforts we reviewed include the Home Affordable Modification Program (HAMP), Federal Housing Administration HAMP, Veterans Affairs HAMP, Second Lien Modification Program, Home Affordable Refinance Program, Home Affordable Foreclosure Alternatives Program, Housing Finance Agency Innovation Fund for the Hardest-Hit Housing Markets, Hope for Homeowners, Hope Now, Mortgage Forgiveness Debt Relief Act and Debt Cancellation, and the Neighborhood Stabilization Program. In conjunction with a separate GAO review of the first phase of the Neighborhood Stabilization Program (NSP 1), we interviewed officials from 12 of the 309 NSP 1 grantees that were selected based on factors including the magnitude of the foreclosure problem in their area, geographic location, and progress made in implementing the program. The grantees were

Orange County, Lee County, and City of Tampa (Florida); State of Nevada, Clark County, City of Las Vegas, City of North Las Vegas, and City of Henderson (Nevada); State of Indiana, City of Indianapolis, and City of Fort Wayne (Indiana); and City of Dayton (Ohio). Additionally, we worked with a national nonprofit organization to obtain written responses to structured questions on the extent to which abandoned foreclosures have impacted their efforts to acquire properties from an additional 25 NSP 1 and NSP 2 grantees and subrecipients from across the country. These grantees may not necessarily be representative of the all grantees. As a result, we could not generalize the results of our analysis to all NSP grantees.

To identify the reasons financial institutions decide to not complete foreclosures, we interviewed six servicers, including some of the largest and those that specialize in subprime loans. These servicers represented 56 percent of all mortgages outstanding. We also analyzed Fannie Mae and Freddie Mac policies and procedures for servicers in handling foreclosures and compared them to other guidance servicers follow, such as pooling and servicing agreements (PSA). We did not do a systematic analysis of a sample of PSAs ourselves, rather we relied on interviews with servicers and academics who research PSAs, relevant literature, and reports to better understand how the terms of PSAs might influence servicers' decisions to pursue or abandon foreclosure under different circumstances, and how losses associated with delinquency and foreclosure are accounted for. Thus, descriptions contained in this report are the opinions of these academics and authors only about those specific PSAs they provided to us or were discussed in their reports. While there may be things that are similar across PSAs, they are contracts between two parties—the trust and the servicer—and the terms apply to just these parties. We reviewed federal regulatory guidance that covers the examination process for reviewing institutions' foreclosure and loss reserve process. We also reviewed whether abandoned foreclosures may violate consumer protection laws such as the Fair Debt Collections Practices Act, and the Federal Trade Commission Act (Unfair or Deceptive Acts or Practices). In addition, we interviewed representatives of Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of Controller of Currency, Office of Thrift Supervision, Department of Housing and Urban Development, Department of Veterans Affairs, and Securities and Exchange Commission.

To determine what actions have been taken or proposals offered to address abandoned foreclosures, we reviewed academic literature and interviewed academics, representatives of nonprofit organizations, local,

state, and federal officials, and other industry participants. We also obtained information about the advantages and disadvantages of these actions through our literature review and interviews. We summarized these potential actions and conducted a content analysis of interviewee viewpoints on their advantages and disadvantages.

We conducted this performance audit from December 2009 through November 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

# Appendix II: Comments from Federal Reserve



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

SANDRA F. BRAUNSTEIN  
DIRECTOR  
DIVISION OF CONSUMER  
AND COMMUNITY AFFAIRS

November 1, 2010

A. Nicole Clowers  
Acting Director  
Financial Markets and Community Investment  
U.S. Government Accountability Office  
Washington, DC 20548

Dear Ms. Clowers:

Thank you for the opportunity to comment on the draft report entitled "Mortgage Foreclosures: Additional Mortgage Servicer Actions Could Help Reduce the Frequency and Impact of Abandoned Foreclosures," GAO-11-93. The draft report finds that there are only a small number of "abandoned foreclosures," less than one percent of vacant homes nationally in recent years. The report, however, goes on to note that abandoned foreclosures, when they do happen, are clustered geographically and can significantly affect the areas in which they occur.

Based on the information that we have obtained through our supervisory reviews and outreach efforts, the GAO report's findings are generally consistent with the Board's understanding of abandoned foreclosures. In late 2009, based largely on anecdotal but recurring concerns about abandoned foreclosures, Board staff spoke with issue experts, Reserve Bank staff in hard-hit geographies, and pursued a number of leads with individuals and organizations that said they had first-hand knowledge of abandoned foreclosures.

We also incorporated questions about abandoned foreclosures into our loan modification initiative. Through this initiative, Federal Reserve examiners are assessing whether servicers we supervise – including state member banks and nonbank subsidiaries of bank holding companies – are executing loan modification programs in full legal and regulatory compliance. As the report notes, through this initiative, we identified two institutions that sometimes abandoned the foreclosure process, and we advised the institutions to amend their practices to proactively alert the consumer that foreclosure proceedings had been curtailed. Both institutions agreed to do so.

The results of our review to date reinforces the GAO's findings that the number of instances of such cases is likely to be small nationally, but may be concentrated in certain markets where housing demand is weak and home prices are very low. For these communities, abandoned foreclosures may have significant effects, and the Federal Reserve takes these concerns seriously.

A. Nicole Clowers  
Page 2

The draft report recommends three actions that the Chairman of the Federal Reserve Board should take, and also advises that he should work with Congress should he determine that the Board lacks sufficient authority to carry out the three actions. First, the report recommends that the Board should require mortgage servicers to notify borrowers when they decide not to pursue foreclosure action, and to inform them of other obligations and responsibilities.<sup>1</sup> The Board agrees that, while such action may not be required by law, such notification represents a responsible and prudent business practice. In the instances in which the Board has identified institutions abandoning foreclosures, we have advised that they provide similar notifications to the affected borrowers and our intent is to continue doing so with other institutions that we supervise.

The second recommendation is that the Board require mortgage servicers to notify local authorities when they decide not to pursue a foreclosure action. As the report notes, some communities are already requiring servicers to report such properties to a centralized registry. In areas that have enacted such requirements, we fully expect servicers to comply with local laws.

The third recommendation is that the Board require mortgage servicers to obtain updated property valuations in advance of initiating foreclosures in areas associated with high concentrations of abandoned foreclosures. We agree that having the best possible information, including up-to-date valuations, before initiating such actions is important and may reduce the frequency of abandoned foreclosures. It should be noted, however, that there may be practical limitations that hinder a servicer's ability to obtain optimal information. For instance, the servicer may not have the legal right to send someone inside the property prior to the completion of the foreclosure process, which can significantly limit the accuracy of an updated valuation.

Given these factors, the Board's existing guidance sets forth supervisory expectations on collateral valuation requirements for properties obtained through foreclosure.<sup>2</sup> Moreover, a regulated institution is expected to have appropriate policies and procedures for updating collateral valuation information on foreclosed properties.

We will continue to monitor these issues and instruct our supervised institutions to take reasonable steps to mitigate the problems caused by abandoned foreclosures. We appreciate the professionalism of the GAO's review team in conducting this study.

Sincerely,



<sup>1</sup> For this and the following recommendation, the GAO report actually advises that such notification be given when servicers decide to "charge off" loans. Based on conversations with GAO staff, we believe the issue in question is the decision not to pursue foreclosure, not charging off the loan, which we consider to be a specific accounting action that may or may not apply.

<sup>2</sup> Refer to SR Letter 95-16, Real Estate Appraisal Requirements for Other Real Estate Owned.



# Appendix III: Comments from Treasury



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

November 1, 2010

Thomas J. McCool  
Director, Center for Economics  
Applied Research and Methods  
U.S. Government Accountability Office  
441 G Street, NW  
Washington, DC 20548

Dear Mr. McCool:

Thank you for providing the Department of Treasury ("Treasury") an opportunity to review and comment on your draft report on abandoned foreclosures, entitled *Mortgage Foreclosures: Additional Mortgage Servicer Actions Could Help Reduce the Frequency and Impact of Abandoned Foreclosures* ("Draft Report").

The Draft Report is informative and helpful in describing the extent and nature of abandoned foreclosures. Although they are relatively uncommon—the Draft Report estimates that abandoned foreclosures affect less than one percent of vacant homes—they are a serious problem. The Draft Report highlights the potential negative impact of vacant homes on economically distressed areas and provides suggestions to help address the issue.

As you know, the statutory goal of Treasury's housing programs is to prevent avoidable foreclosures. As a result, the recommendations in the Draft Report are not directly relevant. Nonetheless, the recent reports of improper foreclosure documentation and other alleged misconduct have underscored the importance of holding servicers accountable. Treasury is working with numerous other federal agencies to ensure that servicers improve their practices and follow the law. Your study is timely and helpful in this regard, and we look forward to reviewing the final report.

Thank you again for your attention to this important issue.

Sincerely,

A handwritten signature in black ink, appearing to read "Tim Massad".

Tim Massad  
Acting Assistant Secretary for Financial Stability

# Appendix IV: Selected Federally Funded Foreclosure-Related Programs

As part of our assessment of how abandoned foreclosures (properties on which a foreclosure has been initiated but not completed and are vacant) might affect federal foreclosure-related programs, we reviewed several current programs and their eligibility requirements. Most programs listed below were designed to help homeowners avoid foreclosure and require that those who receive assistance be owner-occupants of their homes.

**Table 4: Selected Federally Funded Foreclosure Related Programs**

Institution	Program	Purpose/description	Owner occupancy requirement
Treasury	HAMP First-Lien Modification	Prevent foreclosure through first-lien loan modifications	Must be owner-occupant of a one to four unit home
	HAMP Second-Lien Modification	Modify second liens for borrowers participating in HAMP first-lien modification	Must be owner-occupant of a one to four unit home
	HAMP Principal Reduction Alternative	Address negative equity by allowing principal reduction for HAMP-eligible borrowers with high loan-to-value ratios	Must be owner-occupant of a one to four unit home
	HAMP Unemployed Borrowers	Provide relief for unemployed borrowers through temporary principal forbearance	Must be owner-occupant of a one to four unit home
	Home Affordable Foreclosure Alternatives	Prevent foreclosure by providing incentives for short sales or deeds-in-lieu of foreclosure	Must be owner-occupant of a one to four unit home
	HFA Hardest-Hit Fund	Prevent foreclosure and improve housing market stability by providing funding for selected state housing finance agencies	Determined by state housing finance agencies
Housing and Urban Development	HOPE for Homeowners	Preserve homeownership by reducing principal and refinancing into Federal Housing Authority (FHA) insured loans with a shared equity agreement <sup>a</sup>	Must be owner-occupant and cannot own a second home
	Federal Housing Administration (FHA) Short Refinance	Preserve homeownership by reducing principal and refinancing underwater borrowers into FHA loans <sup>b</sup>	Must occupy 1-4 unit property as primary residence
	Neighborhood Stabilization Program	Stabilizing communities through the purchase and redevelopment of foreclosed and abandoned homes and residential properties	Not applicable, target population is communities that have suffered from foreclosure and abandonment
Government-Sponsored Enterprises (Fannie Mae and Freddie Mac)	Home Affordable Refinance Program	Preserve homeownership by refinancing borrowers with loans owned or guaranteed by Fannie Mae or Freddie Mac into fixed rate loans at the current market rate	Must be owner of a one-to-four unit home

Source: GAO analysis.

<sup>a</sup>HOPE for Homeowners requires that borrowers share a portion of any newly created equity with FHA.

<sup>b</sup>“Underwater” refers to borrowers who owe more money on their mortgage than their loan is worth.

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# Appendix V: Text for Figure 4, Areas Where Abandoned Foreclosures Are Concentrated, January 2008 through March 2010

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The following information appears as interactive content in the body of the report when viewed electronically. The content associated with various states on the map describes housing market conditions that likely explain the elevated levels of abandoned foreclosures in three different groups of states. The content appears in print form below. This categorization is based in part on judgment and trends in the data for the MSAs with the most abandoned foreclosures in these states. Because other researchers may posit alternative categorizations that may also fit the data and other types of abandoned foreclosure exist, this analysis should not be considered definitive.

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**Figure 6: Economically Struggling Cities**



**Economically struggling cities**

(OH, MI, IN, MO, PA, TN):

Based on our analysis, the elevated levels of abandoned foreclosures likely results from the distressed nature of several MSAs in these states. Some of the economic challenges in these MSAs predate the financial crisis. Although these MSAs did not experience significant home price increases, some suffered significant home price declines after 2006, which contributed to an increase in the proportion of low-value homes on which it was not financially prudent for servicers to foreclose. Some MSAs also may have experienced increases in nonprime mortgage lending.

Source: GAO.

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**Figure 7: Distressed Urban Areas within Areas Experiencing Housing Booms**



**Distressed urban areas within areas experiencing housing booms**

(IL, GA):  
Based on our analysis, the elevated levels of abandoned foreclosures in these states likely results from a combination of the distressed nature of certain urban areas in the identified MSAs and the effects of the housing boom and collapse.

Source: GAO.

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**Appendix V: Text for Figure 4,  
Areas Where Abandoned  
Foreclosures Are Concentrated,  
January 2008 through March  
2010**

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**Figure 8: Areas That Experienced Significant House Price Increases Followed by Declines**



**Areas that experienced significant house price increases followed by declines (FL, CA):** Based on our analysis, the elevated levels of abandoned foreclosures in these states likely results from the effects of the housing boom and collapse. Specifically, certain MSAs in these states experienced substantial increases in home prices and mortgage originations followed by significant declines in home prices. These areas are likely to have abandoned foreclosures as a result of strategic defaults, higher priced homes that lose value due to vacancy, and instances where the properties were significantly overvalued when loans were originated. In addition, abandoned foreclosures also may have occurred on properties that are second or vacation homes or those that had nonprime loans.

Source: GAO.

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# Appendix VI: GAO Contact and Staff Acknowledgments

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## GAO Contact

A. Nicole Clowers (202) 512-8678 or [clowersa@gao.gov](mailto:clowersa@gao.gov)

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## Staff Acknowledgments

In addition to the contact named above, Cody Goebel (Assistant Director); Emily Chalmers; William R. Chatlos; Kate Bittinger Eikel; Lawrance Evans, Jr.; Simon Galed; Jeff R. Jensen; Matthew McHale; Courtney LaFountain; Tim Mooney; Marc Molino; Jill Naamane; Rhiannon Patterson; Linda Rego; Jeff Tessin; and Jim Vitarello made key contributions to this report.

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