NOTE*

THE RIGHT TO RENT POST-FORECLOSURE: A LEGISLATIVE PROPOSAL TO ADDRESS WIDESPREAD VACANCIES IN THE ONGOING FORECLOSURE CRISIS

I. Introduction

The financial crisis of 2007-2009 ushered in an unprecedented nationwide foreclosure crisis that has left millions of homes across the United States sitting vacant and millions of Americans without a place to call home.[1] Recent estimates put the number of vacant properties at around 14 million, or over ten percent of housing units across the country.[2] Although the first signs of the foreclosure crisis began to surface back in 2007, it is far from over. As of late 2013, millions of Americans are still at risk of losing their homes, despite government efforts to stem the tide of foreclosures, and further widespread vacancies are likely to follow.[3] While the federal government has sponsored a variety of foreclosure-prevention programs, its efforts have had mixed results.[4] Some state and local governments, however, have adopted groundbreaking policies designed to protect the families and communities most threatened by foreclosures and widespread vacancies. Notably, some have enacted legislation mandating that tenants in foreclosed properties be allowed to continue renting until their homes are sold to new owners who will occupy them.[5] Expanding on this idea, this Note argues that states should consider creating a right to rent for foreclosed owners that would allow them to rent their properties at market rate post-foreclosure until a new buyer who intends to occupy the property comes along. This policy would offer some relief to foreclosed homeowners, help stabilize communities, and preserve the value of foreclosed properties. Such a right-to-rent policy at the state level is the next logical step in minimizing the number of vacant properties across the country and mitigating the impact of the foreclosure crisis in the coming years.

This Note outlines the expected benefits of a right-to-rent policy, drawing largely on economic literature, and considers the primary concerns that

---

[1] Octavio Nuiry, *America's 14.2 Million Vacant Homes: A National Crisis*, RealtyTrac (May 14, 2013), http://www.realtytrac.com/content/news-and-opinion/americas-142-million-vacant-homes-a-national-crisis-7723, *archived at* http://perma.cc/0veKrc8fbzj.

[2] *Id.*

[3] *See* John W. Schoen, *Foreclosure Crisis Still Has Millions in its Grip*, CNBC (May 9, 2013, 7:00 AM), http://www.cnbc.com/id/100722965, *archived at* http://perma.cc/0Pp1ywrw3Ap.

[4] *See infra* notes 15–21 and accompanying text.

[5] *See* discussion *infra* Section II.

such a policy might raise. After examining the impact of the foreclosure crisis and the lackluster federal response, I look at state efforts to address large-scale foreclosures. The Note then turns to the proposed legislative solution of mandating a right to rent for foreclosed owners, outlining how such a policy would work and the ways in which it would benefit former owners, their communities, and even the foreclosing banks. Finally, I examine arguments against a right-to-rent policy and offer rebuttals.

II. The Foreclosure Crisis and Legislative Responses

A. *The Impact of Widespread Vacancies*

A nationwide flood of foreclosures followed the financial crisis of 2007-2009, leaving millions of people across the United States without a place to call home and large numbers of properties sitting vacant.[6] By one estimate, there have been as many as 4.4 million completed foreclosures since September 2008, and 5.6% of mortgages nationwide—about 2.3 million—were seriously delinquent as of May 2013.[7] This suggests that many more foreclosures and vacancies may be on the horizon. As of August 2013, over ten million people—a number roughly equivalent to the entire population of Michigan—have been displaced by foreclosures since 2007.[8] Families facing foreclosure often stay with family or friends or end up out on the street, creating an unstable environment that can lead to various other financial and personal troubles.[9] Beyond the potentially devastating consequences for homeowners themselves, foreclosures and vacancies also negatively impact the value of nearby homes and the foreclosed homes themselves,[10] decrease the community's tax base,[11] and lead to increased criminal activity.[12]

Anecdotal accounts confirm these conclusions. As one observer describes the effects of foreclosures in California, "[s]tagnant swimming pools spawn mosquitoes, which can carry the potentially deadly West Nile virus. Empty rooms lure squatters and vandals. And brown lawns and dead vegetation are creating eyesores in well-tended neighborhoods."[13] Another account from Washington state describes an increasingly common scene: After knocking on the door of an abandoned home, "police counted five teen-

---

[6] Nuiry, *supra* note 1.

[7] John Maxfield, *5 Numbers Illustrating the Ongoing Foreclosure Crisis*, Daily Fin. (July 11, 2013), http://www.dailyfinance.com/2013/07/11/5-numbers-illustrating-the-ongoing-foreclosure-cri, *archived at* http://perma.cc/03oxrf8iMpD.

[8] Laura Gottesdiener, *The Great Eviction*, The Nation (Aug. 1, 2013), http://www.thenation.com/article/175553/great-eviction, *archived at* http://perma.cc/089qYxvcWL3.

[9] *See generally* G. Thomas Kingsley, Robin Smith & David Price, Urban Inst., The Impacts of Foreclosures on Families and Communities (2009).

[10] *See* discussion *infra* Sections III.A.1, III.B.1.

[11] *See* discussion *infra* Section III.A.2.

[12] *See* discussion *infra* Section III.A.3.

[13] David Streitfeld, *Blight Moves in After Foreclosures*, L.A. Times, Aug. 28, 2007, at A1.

age squatters, two wanted on outstanding warrants. They found broken furniture, stained carpets and rotting garbage. Upstairs there were many empty bottles of cough syrup that police say the squatters drank to get high."[14] Both the impact of widespread vacancies on individual families and the larger societal consequences demand a stronger response from policy makers, who have to date done too little to address the ongoing foreclosure crisis and reduce the number of vacant homes across the country.

B. Federal Legislation

The federal response to the post-financial-crisis wave of foreclosures and vacancies has been lackluster overall. Although the Bush and Obama Administrations both recognized the need for policies aimed at mitigating the effects of widespread foreclosures, the programs they put in place have generally made little progress in addressing the problem.[15] By way of example, the most prominent and potentially far-reaching federal foreclosure-prevention program is the Home Affordable Modification Program (HAMP), a scheme under which borrowers can reduce their monthly payments to avoid foreclosure.[16] Under HAMP, qualified borrowers are eligible to reduce their monthly payments to their mortgage servicer to no more than thirty-one percent of their monthly income.[17] Servicers are incentivized to participate in HAMP with an upfront incentive payment for each successful permanent loan modification, an additional payment for modifications made for non-delinquent borrowers, and a "pay-for-success" payment if the borrower remains current after the modification.[18] Although the program was initially intended to help three to four million homeowners, it had not yet reached

---

[14] Sanjay Bhatt, *Empty, Foreclosed Houses Burden Cities, Neighborhoods*, SEATTLE TIMES, Feb. 11, 2012, *available at* http://seattletimes.com/html/businesstechnology/2017486066_covington12.html, *archived at* http://perma.cc/0XpJiYMJVHM.

[15] *See* Patricia A. McCoy, *Barriers to Foreclosure Prevention During the Financial Crisis*, 55 ARIZ. L. REV. (forthcoming 2013) (manuscript at 2) (*available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2254662, *archived at* http://perma.cc/0nQpUPzaNcb) ("The results [of federal foreclosure programs] have been mixed. Under the George W. Bush Administration, two successive programs to refinance distressed borrowers into FHA loans turned out to be a failure. In December 2009, the Obama Administration's ambitious program to increase loan modifications stumbled when the government revealed that most temporary modifications failed to graduate to permanent modifications. While the graduation rate has since improved, the level of permanent modifications remains well below what policymakers had aimed for."); *see generally* Dan Immergluck, Too Little, Too Late and Too Timid: The Federal Response to the Foreclosure Crisis at the 5-year Mark (Sept. 19, 2011) (unpublished manuscript) (*available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1930686, *archived at* http://perma.cc/0hjD6BZH7mW).

[16] *Home Affordable Modification Program*, MAKINGHOMEAFFORDABLE.GOV, http://www.makinghomeaffordable.gov/programs/lower-payments/Pages/hamp.aspx (last updated May 28, 2013, 9:21 AM), *archived at* http://perma.cc/0bB7FJHNXU5.

[17] KATIE JONES, CONG. RESEARCH SERV., R40210, PRESERVING HOMEOWNERSHIP: FORECLOSURE PREVENTION INITIATIVES 12 (2013).

[18] *Id.* at 13.

one million by 2012.[19] In its early stages, servicers frequently did not convert trial modifications to permanent ones, an issue HAMP has since tried to address with increased monitoring of servicers and additional upfront documentation requirements for borrowers.[20] Furthermore, the program has been plagued by overly burdensome documentation requirements, seemingly ever-changing eligibility guidelines, and a failure to deal with borrowers' negative equity.[21] Thus HAMP has overall done relatively little to prevent foreclosures and the resulting vacancies.

Indeed, the various federal foreclosure prevention initiatives created over the last several years—including the Foreclosure Mitigation Counseling program, the Hope Now Alliance, the Home Affordable Refinance Program (HARP), and the Neighborhood Stabilization programs—have had mixed results or, in some cases, been almost entirely ineffective.[22] After a thorough review of both the Bush and Obama Administrations' efforts, one commentator concluded that

> [a]t least in comparison to the magnitude of the challenges, the programs have been modest in scale. They have also suffered from significant problems of design and implementation . . . . The federal response is also characterized as moving too slowly in some cases and being too captive to the structures and policy preferences of the mortgage and financial services industry.[23]

In fact, the slow and ineffective federal response to the foreclosure crisis became a political liability during President Obama's reelection campaign: "[S]ome economists and political allies [remarked that] the cautious response to the housing crisis was the administration's most significant mistake."[24] Thus, despite the clear need for governmental action in this area, the federal response has come up short.

C. Legislation at the State Level

In the face of this unpromising federal response, states have taken action. Many states have already introduced new legislation aimed at stemming the wave of foreclosures and helping families remain in their homes.

---

[19] *Id.* at 13–14.

[20] *Id.* at 16; Making Home Affordable, Program Performance Report Through August 2013 (2013), http://www.treasury.gov/initiatives/financial-stability/reports/Documents/August%202013%20MHA%20Report%20Final.pdf.

[21] *See* Nick Timiraos, *Despite Improvement in Loan-Mod Defaults, Report Raises Alarms*, Wall St. J. Blog, (Apr. 24, 2013, 1:51 PM), http://blogs.wsj.com/developments/2013/04/24/despite-improvement-in-loan-mod-defaults-report-raises-alarms, *archived at* http://perma.cc/0qHbZYdKLBS.

[22] *See* Immergluck, *supra* note 15.

[23] *Id.* at 1.

[24] Binyamin Appelbaum, *Cautious Moves on Foreclosures Haunting Obama*, N.Y. Times, Aug. 20, 2012, at A1.

Such legislation includes increased foreclosure notification requirements, with many states mandating that tenants be notified when their home is in foreclosure and extending the notice period.[25] In response to banks' common practice of evicting tenants immediately following a foreclosure, several state and local governments have passed some form of legislation that allows tenants living in foreclosed properties to continue renting from their new landlord, unless they are evicted for cause.[26] For example, in 2010, Massachusetts passed the groundbreaking Act to Stabilize Neighborhoods: "[A] foreclosing owner shall not evict a tenant except for just cause or unless a binding purchase and sale agreement has been executed for a bona fide third party to purchase the housing accommodation from a foreclosing owner."[27] This new legislation has allowed many renters across the state to remain in their homes and helped maintain the quality of neighborhoods that might otherwise face widespread abandonment.[28] Many state governments have taken an active role in resolving the foreclosure crisis and made substantial progress by enacting targeted legislation.

Despite this legislative progress, states can do more to protect those facing foreclosure and reduce widespread vacancies. While tenants in many states are more protected from post-foreclosure vacancies than they were before the financial crisis, homeowners can still face immediate eviction by foreclosing banks. This policy leaves houses sitting empty and people without a place to go. One way for states to address this ongoing problem is to extend the same post-foreclosure right to rent created for tenants to former homeowners. In fact, in a groundbreaking step, the Massachusetts legislature has commissioned a task force to study whether such a policy would be beneficial for the state. Specifically, the task force is charged with

> study[ing] ways in which the commonwealth can encourage the prevention of unnecessary vacancies following foreclosures. This

---

[25] *See State and Local Tenant Protections*, National Housing Law Project (Dec. 18, 2012), http://nhlp.org/node/1341, *archived at* http://perma.cc/0iSz5awNdBR.

[26] *See id.* The District of Columbia (D.C. Code § 42-3505.01), Massachusetts (Mass. Gen. Laws Ann. ch. 186A, § 2 (West 2013)), New Hampshire (N.H. Rev. Stat. Ann. § 540:2 (2013)), New Jersey (N.J. Rev. Stat. §§ 2A:18-61.1–61.12 (2013)), New York City (N.Y. Comp. Codes R. & Regs. tit. 9, § 2204.1 (2013)), Seattle (Seattle, Wash. Code § 22.206.160(c)), and several cities in California (e.g., Berkeley, Cal., Mun. Code § 13.76.130 (2013), Beverly Hills, Cal., Mun. Code ch. 5–6 (2013), East Palo Alto, Cal. Mun. Code § 14.04.160, L.A., Cal., Mun. Code ch. IV, art. 14.1, § 49.92 (2013), San Diego, Cal., Mun. Code § 98.0730 (2013), S.F. Admin. Code §§ 37.9, 37.9D (2013)) have all passed legislation requiring for-cause eviction for the tenants of foreclosed properties.

[27] An Act Relative to Mortgage Foreclosures, 2010 Mass. Acts 1102; *see also* Elaine McArdle, *Massachusetts Enacts Landmark Foreclosure Protections Drafted by Harvard Law School Students*, Harvard Law School (Aug. 10, 2008), http://www.law.harvard.edu/news/2010/08/10_foreclosure.law.html, *archived at* http://perma.cc/0kQMj4R4VL4 (noting that "[the law] is believed to be the first 'just cause' law in the country pertaining specifically to tenants in foreclosed-on properties.").

[28] *See Abandoned Housing Initiative*, Mass.gov, http://www.mass.gov/ago/doing-business-in-massachusetts/economic-development/abandoned-housing-initiative-ahi (last visited Oct. 16, 2013), *archived at* http://perma.cc/0tKF8JmaKfR.

> shall include, but not be limited to, the feasibility of allowing a foreclosed homeowner to continue to occupy the foreclosed property, in whole or in part, until a binding purchase and sale agreement has been executed with a purchaser who intends to occupy the housing accommodation as such purchaser's primary residence and who is not a foreclosing owner.[29]

Although Massachusetts may be the only state to consider such a policy thus far, homeowners and communities in every state would benefit from a right-to-rent policy for foreclosed owners. The wording of such legislation could mirror the statute protecting tenants and might read as follows: "A foreclosing owner shall not evict a foreclosed owner paying monthly rent at market rate except for just cause or unless a binding purchase and sale agreement has been executed for a bona fide third party to purchase the housing accommodation from a foreclosing owner." Adopting a similar policy that grants foreclosed homeowners the right to rent their properties post-foreclosure on a larger scale would represent a significant improvement to the current foreclosure law.

III. The Right to Rent for Foreclosed Homeowners

This section analyzes the benefits of a right-to-rent policy for homeowners, local communities, and property-owning banks. Allowing foreclosed homeowners to remain on their property would have clear benefits for foreclosed homeowners and their families. Moreover, as explored in detail below, empirical studies reveal that post-foreclosure vacancies have overwhelmingly detrimental effects on local communities.[30] In particular, the effects of a post-foreclosure vacancy—as distinguished from the effects of the foreclosure overall—include negative impacts on the value of surrounding properties, a corresponding erosion of the community's tax base, and increased crime. Turning to the implications for banks holding REO[31] properties, empirical studies suggest that allowing foreclosed homeowners to stay will allow banks to ultimately sell properties for a higher price and may be more profitable for banks in the short term.[32] Thus, creating a right to rent for foreclosed homeowners is a significant step that states can take to mitigate the negative effects of the ongoing foreclosure crisis.

---

[29] 2012 Mass. Legis. Serv. 712 (West).

[30] *See* discussion *infra* Part III.A.

[31] The term "REO" refers to real-estate-owned properties—those owned by a lender (usually a bank).

[32] *See* discussion *infra* Part III.B.

A. *The Effect of Post-Foreclosure Vacancies on Local Communities*

Homes left vacant post-foreclosure harm local communities in numerous ways, all of which could be avoided by a policy allowing foreclosed homeowners to continue to occupy their homes until a new owner purchases the property. As one study explains,

> [f]oreclosures, particularly in lower-income neighborhoods, can lead to vacant, boarded-up, or abandoned properties. These properties, in turn, contribute to physical disorder in a community, create a haven for criminal activity, discourage the formation of social capital, and lead to further disinvestment.[33]

Indeed, the Federal Reserve Bank of Boston has recognized the larger social impacts of foreclosure:

> Although the actual extent of foreclosures' spillover effects . . . needs further research, all studies examined agree that foreclosures' detrimental impacts are communal. That is why foreclosure prevention and mitigation efforts need to go beyond the physical constraints of individual foreclosed houses and instead embrace a more comprehensive approach aimed at protecting local communities' vitality.[34]

While this comment addresses the impact of foreclosures generally, the vacancies that result from foreclosures are crucially important in all of the negative effects it describes. In particular, post-foreclosure vacancies (1) negatively impact the value of nearby homes, (2) decrease the community's tax base, and (3) lead to increased criminal activity. These effects are explored in detail below.

---

[33] Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 HOUS. POL'Y DEBATE 57, 57 (2006).

[34] KAI-YAN LEE, FED. RESERVE BANK OF BOS., FORECLOSURE'S PRICE-DEPRESSING SPILLOVER EFFECTS ON LOCAL PROPERTIES: A LITERATURE REVIEW 11 (2008); *see also* Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys., Housing, Mortgage Markets, and Foreclosures, Speech at the Federal Reserve System Conference on Housing and Mortgage Markets, Washington, D.C., at 3 (Dec. 4, 2008) [hereinafter Bernanke, Housing, Mortgage Markets] ("Foreclosures impose large costs on families who face the loss of their homes and reduced future access to credit. But the public policy case for reducing preventable foreclosures does not rely solely on the desire to help people who are in trouble. Foreclosures create substantial social costs. Communities suffer when foreclosures are clustered, adding further to the downward pressure on property values. Lower property values in turn translate to lower tax revenues for local governments, and increases in the number of vacant homes can foster vandalism and crime.").

1. *Post-foreclosure vacancies negatively impact the value of surrounding homes and are associated with hundreds of millions of dollars in lost home value in recent years.*

Given that many foreclosed homes remain vacant for a significant period of time,[35] one can easily imagine how vacant homes negatively impact the value of nearby properties. Indeed, descriptions of neighborhoods plagued by vacancies often include accounts of unsightly boarded-up properties, gang activity, and houses stripped of pipes, radiators, and anything else that can be sold.[36] In one account from the Chicago area, a resident notes that "[v]acant homes create so many risks to a neighborhood . . . . Murders—we've found people dead in them. Attempted murder, rape, all kinds of things. They catch on fire and burn up the house next door—firemen get hurt."[37] As vacancies accumulate and neighborhoods lose residents, local businesses often suffer from lower sales, creating a cycle of economic decline.[38] These descriptions illuminate how vacant properties' unsightly deterioration, increased crime, and loss of community might lessen the value of nearby homes.[39]

In fact, the negative price impact vacant properties have on nearby homes is well established in the economic literature. One study using data from Philadelphia finds that

> abandoned housing within 450 feet of property (about the size of a typical city block) lowered sales prices in the range of $3,542–7,627, all else equal. The number of abandoned properties on the block brought with it a net loss of $6,869 for one abandoned house up to $11,304 for five abandoned houses. The presence of any abandonment brought with it a net loss of $7,386.[40]

Like any vacant property, properties vacant as a result of foreclosure are associated with a negative impact on the value of nearby homes.

---

[35] STEPHAN WHITAKER, FED. RESERVE BANK OF CLEVELAND, FORECLOSURE-RELATED VACANCY RATES 5 (2011) (noting that "homes that have been through a sheriff's sale have very high vacancy rates for a year and a half afterward" and "[a]s long as a home in REO status sits vacant, it diminishes the sales prices of all nearby homes on the market.").

[36] *E.g.*, Meribah Knight & Bridget O'Shea, *Foreclosures Leave Pockets of Neglect and Decay*, N.Y. TIMES, Oct. 27, 2011, at A21.

[37] *Id.*

[38] WILLIAM APGAR & MARK DUDA, HOMEOWNERSHIP PRESERVATION FUND, COLLATERAL DAMAGE: THE MUNICIPAL IMPACT OF TODAY'S MORTGAGE FORECLOSURE BOOM 5 (2005).

[39] In addition to direct losses in property value, neighbors often suffer lower quality of life from blighted properties: one study found that neighbor complaints about a property tend to significantly increase once the property is in the REO stage. *See* LAUREN LAMBIE-HANSON, FED. RESERVE BANK OF BOS., WHEN DOES DELINQUENCY RESULT IN NEGLECT? MORTGAGE DISTRESS AND PROPERTY MAINTENANCE 2 (2013).

[40] Anne B. Shlay & Gordon Whitman, *Research for Democracy: Linking Community Organizing and Research to Leverage Blight Policy*, 5 AM. SOC. ASS'N. 153, 162 (2006).

Additionally, numerous studies find a negative price impact on properties surrounding a foreclosed home,[41] part of which can be attributed to the fact that foreclosed homes often remain vacant following the foreclosure:

> [s]ocial costs associated with foreclosure may arise from . . . any reduction in the value of nearby properties. These costs would seem to be especially acute for vacant properties, which are more likely to attract criminal activity (resulting in higher municipal costs) and be in worse physical condition (depressing property values).[42]

In fact, a study from the Federal Reserve Bank of Cleveland, authored by Brian Mikelbank, confirms that studies examining the impact of foreclosures are in part capturing the effect of vacancies in particular using data from Columbus, Ohio.[43] Mikelbank observes that "the estimated impact of foreclosures is less severe when vacant/abandoned properties are included in the model . . . Thus, in models where the impact of foreclosures is modeled, and the distribution of vacant/abandoned properties is not included, the impact of foreclosures is being overestimated."[44] This statement confirms that estimates of the impact of a nearby foreclosure—which almost universally show a significant negative effect[45]—are capturing, in part, the specific impact of vacancies. The study concludes that each vacant property within the 250 feet around a given property decreases that property's value by about 3.5%, and each vacant property within the next 250 feet is associated with a slightly less than one percent decrease in value.[46] For the 1,670 properties in the data set that were within the first 250 feet of a vacant property, this amounts to about $18 million in lost home value of surrounding homes associated solely with the vacancy status of the homes, not the foreclosures overall.[47]

---

[41] *E.g.*, John Harding, Eric Rosenblatt &Vincent Yao, *The Contagion Effect of Foreclosed Properties*, 66 J. URB. ECON. 164 (2009); Immergluck & Smith, *supra* note 33; Tammy Leonard & James Murdoch, *The Neighborhood Effects of Foreclosure*, 11 J. GEOGRAPHICAL SYS. 317 (2009); Zhengou Lin, Eric Rosenblatt & Vincent Yao, *Spillover Effects of Foreclosures on Neighborhood Property Values*, 38 J. REAL EST. FIN. & ECON. 387 (2009); William H. Rogers & William Winter, *The Impact of Foreclosures on Neighboring Housing Sales*, 31 J. REAL EST. RES. 455 (2009); Jenny Schuetz, Vicki Been & Ingrid Gould Ellen, *Neighborhood Effects of Concentrated Mortgage Foreclosures*, 17 J. HOUS. ECON. 306 (2008); John Campbell, Stefano Giglio & Parag Pathak, *Forced Sales and House Prices* (Nat'l Bureau of Econ. Research, Working Paper No. 14866, 2009).

[42] W. Scott Frame, *Estimating the Effect of Mortgage Foreclosures on Nearby Property Values: A Critical Review of the Literature*, 95 FED. RES. BANK ATLANTA ECON. REV. 1, 2 (2010).

[43] BRIAN A. MIKELBANK, FED. RESERVE BANK OF CLEVELAND, SPATIAL ANALYSIS OF THE IMPACT OF VACANT, ABANDONED AND FORECLOSED PROPERTIES 2 (2008), *available at* http://www.clevelandfed.org/Community_Development/publications/Spatial_Analysis_Impact_Vacant_Abandoned_Foreclosed_Properties.pdf, *archived at* http://perma.cc/0aekLKiFBF6.

[44] *Id.* at 14.

[45] *See id.* at 5–6.

[46] *Id.* at 15.

[47] *Id.* at 16–17.

Indeed, multiple studies have specifically isolated the impact of vacancies resulting from foreclosure on the value of nearby properties. One paper by the Federal Reserve Bank of Cleveland concludes that each vacancy is associated with a decrease of about two percent in the value of homes within 250 feet of the property in "high-vacancy areas" (defined as those above the median vacancy rate).[48] The study uses data from 1999 to 2008 for the Chicago area, and specifically isolates the price effect of the nearby property being vacant, as opposed to the overall price impact of a nearby foreclosure.[49] It finds that vacancies have no effect on price in "low-vacancy areas" (those with foreclosure rates below the median), as opposed to the –2% impact in "high-vacancy areas," with the areas being defined based on 2005-2008 data.[50] It is worth noting that to the extent that foreclosure rates have increased following the financial crisis, it seems likely that –2% is a low estimate for the price impact in areas with significant numbers of foreclosures.

These studies demonstrate the significant cost to homeowners in the area near a foreclosed property that can be attributed to the fact that a property remains vacant following a foreclosure—a cost that represents hundreds of millions of dollars in lost home value in recent years. Using Massachusetts as an example, a back-of-the-envelope calculation of lost home value associated with post-foreclosure vacancies is possible. The Federal Reserve Bank of Boston reports two studies that have estimated the foreclosure spillover effects from subprime loans on New England communities.[51] The first finds that the total spillover effect of foreclosures on subprime loans in Massachusetts from 2005 to 2006 was about $4.5 billion.[52] Using Mikelbank's percentage of overall foreclosure-related losses that can be attributed to vacancy-related losses,[53] the impact of subprime vacancies alone is about $710 million of lost value for nearby homeowners in Massachusetts. This number does not take into account the lost value of the foreclosed homes themselves, which is discussed in Section III.A, *infra*. The second study cited by the Boston Federal Reserve puts the total foreclosure-related spillover losses at about $1.56 billion for subprime loans facing foreclosure between the third quarter of 2007 and the fourth quarter of 2009,[54] with an associated loss of about $13.4 million in tax revenue. Again using Mikelbank's analysis,[55] this

---

[48] Daniel Hartley, *The Effect of Foreclosures on Nearby Housing Prices: Supply or Disamenity?* 20–21 (Fed. Reserve Bank of Cleveland, Working Paper No. 10-11R 2013), *available at* http://www.clevelandfed.org/research/workpaper/2010/wp1011.pdf.

[49] *See generally id.*

[50] *Id.* at 17–18.

[51] *See* Lee, Fed. Reserve Bank of Bos., *supra* note 34, at 6–9.

[52] *See id.* at 8.

[53] *See* Mikelbank, *supra* note 43, at 16–17. Mikelbank's paper finds the vacancy-related losses to be about $18 million, while the overall foreclosure-related losses are about $114 million, so about 16% of the losses can be attributed solely to the vacancy status of the homes. This is, of course, a rough estimate based on data from Columbus, Ohio. *Id.*

[54] Lee, Fed. Reserve Bank of Bos., *supra* note 34, at 9.

[55] *See* Mikelbank, *supra* note 43, at 16–17; *see also supra* note 53.

would represent subprime vacancy-related losses of about $246 million in surrounding home value associated solely with the lost value of homes nearby a foreclosed property in Massachusetts. Although these are rough estimates, they demonstrate the magnitude of losses that communities can face as spillover effects of foreclosure-related vacancies. A policy that keeps families in their homes post-foreclosure would largely mitigate these losses.[56]

2. *Lower property values associated with the vacant status of foreclosed properties have cost communities across the United States millions of dollars in lost tax revenue.*

The decrease in value of nearby homes driven by foreclosed properties' vacant status also has a negative impact on property tax revenue. Vacancies resulting from foreclosures cause surrounding property values to decline, eroding the community's tax base.[57] The vacant home itself also loses value by sitting unoccupied (see Section III.A, *infra*). Taken together, these losses can represent a significant loss in local taxes. Using a rough calculation,[58] one estimate of the loss in tax revenue associated with vacancies of foreclosed homes with subprime loans in Massachusetts from the third quarter of 2007 to the fourth quarter of 2009 is $4.1 million.[59] Thus, in addition to preserving the value of neighboring homes, a policy allowing foreclosed homeowners to remain in their homes until resale would also eliminate a significant portion of the decrease in aggregate property value, potentially saving millions in tax revenue that would otherwise be lost.

3. *Vacant homes are also associated with increased crime.*

Post-foreclosure vacancies tend to invite increased criminal activity. In an all-too-common account of areas with high vacancy rates, Chicago police officials interviewed about the effects of widespread vacancies "cited the

---

[56] Note also that to the extent a bank also owns any of the other properties near a foreclosed home, the decrease in surrounding property values is a direct loss to the bank. As Fannie Mae's vice president for REO Alternative Disposition explained,

> because empty homes depress neighboring homes' values, which deepens the loss that Fannie Mae incurs on each of our properties, we continue to manage our REO pipeline as efficiently as possible, both to minimize our losses and to stabilize neighborhoods. Managed correctly, our REO dispositions can help the housing market recover and protect the interests of taxpayers.

Jay N. Ryan, Jr., *REO Disposition and Neighborhood Stabilization: A Servicer's View*, *in* REO & VACANT PROPERTIES: STRATEGIES FOR NEIGHBORHOOD STABILIZATION (A JOINT PUBLICATION OF THE FEDERAL RESERVE BANKS OF BOSTON AND CLEVELAND AND THE FEDERAL RESERVE BOARD) 95, 95 (2010).

[57] *See generally* LEE, FED. RESERVE BANK OF BOS., *supra* note 34.

[58] This figure is based on Mikelbank's analysis. *See* MIKELBANK, *supra* note 43, at 16–17.

[59] *See* LEE, FED. RESERVE BANK OF BOS., *supra* note 34, at 9 (estimating the total foreclosure-related loss in tax revenue in Massachusetts for Q3 2007–Q4 2009 as about $26 million).

damage to quality of life from empty, foreclosed properties, including gang activity, drug dealing, prostitution, arson, rape, and murder."[60] This anecdotal evidence from police officers is confirmed by economic analysis that measures the impact of foreclosures and vacancies on nearby crime. A comprehensive study by Lin Cui finds that "on average, violent crime within 250 feet of foreclosed homes increases by more than fifteen percent *once the foreclosed home becomes vacant*, compared to crimes in areas between 250 and 353 feet away. Foreclosure alone has no effect on [violent] crime."[61] As one would expect, longer vacancies have a larger effect on crime rates.[62] Another paper confirms this result, finding that an increase of one standard deviation in the foreclosure rate—approximately 2.8 foreclosures for every 100 owner-occupied properties in a year—is associated with a 6.7% increase in violent crime in the neighborhood.[63] These studies provide powerful support for a policy that reduces post-foreclosure vacancies. Indeed, Cui specifically calls for such a policy: "While the majority of current federal and state level foreclosure programs are focusing on loan modification, my results strongly indicate that policies aiming at post-foreclosure vacancy reduction will most effectively alleviate the external cost of foreclosure."[64]

The preceding sections demonstrate the variety of negative impacts foreclosure-related vacancies can have on the surrounding community. Allowing foreclosed homeowners to remain in their homes until resale could largely avoid these negative community effects. As Danilo Pelletiere of the National Low Income Housing Coalition explains, "[t]he first step to stabilize housing markets reeling from the foreclosure crisis is to keep as many current residents in their neighborhoods as possible, preferably in their own homes. Such actions will minimize the disruption to communities, schools, and of course the households themselves."[65] A policy that permits foreclosed homeowners to stay in their homes would go far in combating the negative social costs of foreclosure.

B. The Implications of Post-Foreclosure Vacancies for Banks Owning REO Properties

In addition to foreclosed homeowners and their communities, the banks that own the majority of foreclosed properties also have an obvious interest in the effects of a right-to-rent policy. Empirical studies reveal that post-

---

[60] APGAR & DUDA, *supra* note 38, at 4.

[61] LIN CUI, FORECLOSURE, VACANCY AND CRIME 23 (2010), *available at* http://www.ewi-ssl.pitt.edu/econ/files/faculty/wp/Lin_Foreclosure,%20Vacancy%20and%20Crime.pdf.

[62] *Id.*

[63] Immergluck & Smith, *supra* note 33, at 59.

[64] CUI, *supra* note 61.

[65] Danilo Pelletiere, *Embracing Renting to Accelerate Neighborhood Recovery*, *in* PROPERTIES: STRATEGIES FOR NEIGHBORHOOD STABILIZATION (A JOINT PUBLICATION OF THE FEDERAL RESERVE BANKS OF BOSTON AND CLEVELAND AND THE FEDERAL RESERVE BOARD) 131, 133 (2010).

foreclosure vacancies have negative implications on the banks that own the vacant properties; indeed, banks have largely failed at maintaining the condition of most REO properties, often leaving them open to vandalism and looting.[66] During the period in which a bank owns an REO property, that property is an investment; leaving it unoccupied without proper upkeep degrades the value of that investment. Allowing foreclosed homeowners to remain as occupants (1) will allow banks to ultimately sell properties for a higher price and (2) may actually be more profitable for banks in the short term. These findings are discussed in detail below.

1. Keeping homes occupied preserves their resale value.

Both the practices of the real estate community and empirical research support the conclusion that permitting foreclosed homeowners to remain in their homes as renters would protect banks' investment in REO properties. Leaving a home unoccupied can lead to deterioration of its physical condition, weaken the seller's bargaining position, and prolong the stigma of foreclosure.[67] An unoccupied house will likely be in greater need of repair, since no resident is invested in maintaining the property and vacancy often invites vandalism.[68] The seller will almost certainly have more bargaining power when the house is occupied—a vacant home can create the impression that the seller is desperate to sell.[69] Furthermore, the stigma of foreclosure is likely to linger much longer if the house sits vacant, serving as a reminder to potential buyers that the home is on the market as a result of a foreclosure.

In fact, the practices of the real estate community itself provide evidence that occupied homes are easier to sell. As one journalist explains, "[m]ost realtors will tell you a furnished house is easier to sell. That's why there's a whole home-staging industry."[70] Indeed, there are companies that specialize in renting foreclosed homes for the very purpose of making them

---

[66] *See, e.g.*, Ben Austen, *The Life and Death of Chicago*, N.Y. TIMES, May 29, 2013, at MM (noting that "a nine-month study conducted by the National Fair Housing Alliance revealed what everyone in these neighborhoods [in the Chicago area] already knew: After forcing out families in foreclosure, banks failed to properly market, maintain and secure the vacated homes. Thieves subsequently entered many of the properties and stripped them of copper and anything else that could be trafficked.").

[67] *See* Kai-yan Lee, *Examining REO Sales and Price Discounts in Massachusetts*, *in* REO & VACANT PROPERTIES: STRATEGIES FOR NEIGHBORHOOD STABILIZATION (A JOINT PUBLICATION OF THE FEDERAL RESERVE BANKS OF BOSTON AND CLEVELAND AND THE FEDERAL RESERVE BOARD) 55, 55–56 (2010).

[68] *See* Campbell, Giglio & Pathak (2009), *supra* note 41, at 3 (in a comprehensive study of Massachusetts homes over 20 years, noting that "mortgage lenders must protect foreclosed houses while they are vacant; the threat of vandalism may be greater in bad neighborhoods, and costs of protection likely account for a larger fraction of the value of a low-priced house.").

[69] *The Challenge: Vacant Houses Can Be Hard to Sell . . .*, SHOWHOMES (2010), http://www.showhomes.com/about_presentation.php, *archived at* http://perma.cc/0jB5mCrTAwL.

[70] Blake Farmer, *Banks Try to Make Vacant Foreclosures Look 'Lived-in,'* MARKETPLACE (May 2, 2011), http://www.marketplace.org/topics/business/banks-try-make-vacant-foreclosures-look-lived, *archived at* http://perma.cc/0xAxJu57Nt6.

easier to sell.[71] One such firm, Showhomes, explains that "[p]rospective buyers often see a vacant house as stark and uninviting . . . Many buyers can't begin to visualize furniture placement or understand how the house will function for them."[72] Furthermore, "[o]lder houses may suffer from wear and dated finishes. These details become glaring defects when the house is vacant."[73] The existence of an entire industry that aims to make homes look lived-in to increase their selling price demonstrates that permitting foreclosed owners to remain in their homes will help maintain property values.[74]

Empirical research further supports this conclusion. Multiple studies that address the effect of vacancy on a home's sale price find a negative impact. In a thorough study controlling for various property and neighborhood qualities (including home condition, age, square footage, number of bedrooms, number of bathrooms, whether the home has a garage, whether the home has a pool, and various other characteristics), Clauretie and Daneshvary find that vacancy has a negative impact of 0.9% on home price.[75]

Similarly, Pennington-Cross, using a sample of over 12,000 REO properties nationwide, finds that the price discount on a REO property increases over time.[76] The paper defines the "foreclosure discount" as the difference between the percentage change in the value of house prices in the relevant location and the percentage change in the foreclosed property's value from loan origination through sale; thus, this discount represents the marginal impact of the lender's REO holding period, during which time the home is presumably vacant, on price appreciation.[77] The study finds that for the first six months in REO, the foreclosure discount is about fifteen percent.[78] The discount then begins to increase: 18% for six to eight months, 20% for eight to ten months, 22% for ten to twelve months, and 25% for properties sitting as REO homes for over a year.[79]

---

[71] *See id.*

[72] *The Challenge: Vacant Houses Can Be Hard to Sell . . .*, *supra* note 69.

[73] *Id.*

[74] There may be a legitimate concern that former owners will be uncooperative in their dealings with realtors trying to market their home to other parties. Indeed, the report on Showhomes emphasizes that its renters must be willing to keep the home extremely tidy and to leave on short notice for showings. Farmer, *supra* note 70. However, the law could be designed to address this challenge, perhaps by making a demonstrated lack of cooperation in efforts to sell the home a basis for eviction. Of course, it would be important to make sure that banks could not use such a provision to evict any tenant because of his alleged lack of cooperation.

[75] Terrence Clauretie & Nassar Daneshvary, *Estimating The House Foreclosure Discount Corrected for Spatial Price Interdependence and Endogeneity of Marketing Time*, 37 REAL EST. ECON. 43, 60–62 (2009).

[76] Anthony Pennington-Cross, *The Value of Foreclosed Property*, 28 J. REAL EST. RES. 193, 194, 210 (2006).

[77] *Id.* at 194.

[78] *Id.* at 209–10.

[79] *Id.* at 209.

In sum, numerous economic studies find a statistically significant negative price effect associated with vacancy.[80] These findings suggest that banks will actually be able to sell REO properties at higher prices if they are occupied by foreclosed homeowners, who will maintain the condition of the property, ward off vandalism, and ensure that the home appears "lived-in" to potential buyers.

2. Renting REO properties may actually be more profitable than selling them in the short term.

There is also empirical evidence suggesting that banks may in fact profit from renting REO properties for a period of time instead of selling them immediately. One clear benefit of having tenants in a home while it is on the market is the rent revenue a bank would receive. Since foreclosed homes often sit on the market for a significant period of time, taking in rent over that period offers a potentially large source of revenue. In fact, a Federal Reserve white paper published in January 2012 found that

> many REO properties . . . appear to be viable rental properties in terms of improving loss recoveries to the REO property holder. One method of gauging the profitability of renting a particular property is to calculate its capitalization rate, or cap rate—the expected annual cash flows from renting the property relative to the price at which the REO property holder could expect to sell it in the owner-occupied market. Preliminary estimates suggest that about two-fifths of Fannie Mae's REO inventory would have a cap rate above 8 percent—sufficiently high to indicate renting the property might deliver a better loss recovery than selling the property. Estimated cap rates on the FHA's REO inventory are a bit higher—about half of the current inventory has a cap rate above 8

[80] *See also* William G. Hardin & Marvin L. Wolverton, *The Relationship Between Foreclosure Status and Apartment Price*, 12 J. Real Est. Res. 101, 105–06 (1996) (finding a vacancy discount for apartment sales to non-institutional buyers in Phoenix, Arizona between January 1993 and November 1994); Paul Anglin et al., *The Trade-off Between the Selling Price of Residential Properties and Time-on-the-Market: The Impact of Price Setting*, 26 J. Real Est. Fin. & Econ. 95, 104–05 (2003) (finding that vacancy has a statistically significant impact on selling price using data on single family homes in Arlington, TX in 1997, and noting that such a result is "[t]ypical for studies of this type"); Geoffrey K. Turnbull & Velma Zahirovic-Herbert, *Why Do Vacant Houses Sell for Less: Holding Costs, Bargaining Power or Stigma?*, 39 Real Est. Econ. 19, 41 (finding "robust vacancy effects on price and liquidity across all market phases consistent with greater seller holding cost and diminished bargaining power that does not vary systematically over the market cycle."). Additionally, there is some evidence that occupied homes sell in a shorter period of time. *See* Anglin, *supra*, at 105 (finding a small but statistically significant positive vacancy effect on the time a house sits on the market before being sold).

> percent—because FHA properties tend to have somewhat lower values relative to area rents.[81]

The Federal Reserve thus concluded that for a significant number of REO properties held by Fannie Mae and the FHA, renting would be *more* profitable than selling, at least in the short term.[82] The same is likely true for many REO properties held by banks.

C. Potential Concerns About Permitting a Foreclosed Homeowner to Continue to Occupy the Foreclosed Property

Despite the many beneficial effects that a right-to-rent policy would have for homeowners, their communities, and banks, there are some potential concerns with the policy. Banks may be reluctant to act as landlords and lack the capacity to do so efficiently. If homeowners were previously unable to make their mortgage payments, they may not be able to afford to rent the same property. Finally, allowing foreclosed owners to remain in their homes may encourage more owners to default on their mortgages, thus creating a moral hazard. Each one of these concerns is discussed in detail below.

1. Banks as Landlords

One potential concern with a policy allowing foreclosed homeowners to remain in their properties is that it would force banks into the role of landlords—a role that they are not well-equipped to undertake. However, existing programs established by Fannie Mae, community development organizations, and even some banks demonstrate the feasibility of renting REO properties. Fannie Mae introduced its "Deed-for-Lease" program in November 2009.[83] As Fannie Mae's vice president for REO Alternative Disposition explains, Fannie Mae

> offers a rental option for owners who would otherwise lose their homes to foreclosure, but would like to remain in their homes as renters. Through the Deed-for-Lease program, qualified borrowers of properties transferred through deed-in-lieu of foreclosure can remain in their homes by executing a lease of up to 12 months in conjunction with the deed-in-lieu.[84]

---

[81] Ben Bernanke, Bd. of Governors of the Fed. Reserve Sys., The U.S. Housing Market: Current Conditions and Policy Considerations 11, (Jan. 4, 2012), *available at* http://federalreserve.gov/publications/other-reports/files/housing-white-paper-20120104.pdf, *archived at* http://perma.cc/0NBm3jRKSsW.

[82] *Id.*

[83] Barbara Kiviat, *Renting Your House Back: A Solution to Foreclosures?*, Time (Nov. 12, 2009), http://www.time.com/time/business/article/0,8599,1938255,00.html, *archived at* http://perma.cc/0bqsBtgvffe.

[84] Ryan, *supra* note 56, at 96.

Furthermore, some banks have themselves launched programs allowing foreclosed owners to remain as renters. Bank of America created a deed-for-lease program in May 2012 aimed at 1,000 borrowers in certain areas, and Citigroup followed suit with its "Home Rental Program" in August 2012.[85] As Ron Sturzenegger, the Bank of America executive in charge of the unit that handles troubled mortgages, explains, "[e]xecutives . . . began to ask themselves 'isn't there a way to sort of combine that whole process and keep the borrower in the property? It's just better for the market.'"[86]

2. *Foreclosed Owners' Inability to Pay Rent*

Another potential concern is that foreclosed owners who were not able to make their mortgage payments will also be unable to pay rent. Indeed, in order for foreclosed owners to remain in their homes as renters, the monthly rent, calculated at market value, would need to be lower than their mortgage payments were in most cases. However, this is exactly what should be expected in most markets. According to the Center for Economic and Policy Research, the market rental rate for most properties should be well below comparable ownership costs.[87] The following table summarizes the Center's estimations of foreclosed owners' reduction in monthly payments after switching to a lease:[88]

RENTING VS. OWNING: MONTHLY SAVINGS, BEFORE TAX

METROPOLITAN STATISTICAL AREA (MSA)	MEDIAN HOUSE PRICE, 2006-2007	MONTHLY OWNERSHIP COSTS*	MONTHLY FAIR MARKET RENT	MONTHLY SAVINGS GAINED BY RENTING
Baltimore-Towson, MD	$306,550	$1,666	$1,037	$ 629
Boston-Cambridge-Quincy, MA-NH	$400,300	$2,175	$1,345	$ 830
Chicago-Naperville-Joliet, IL-IN-WI	$256,400	$1,393	$1,004	$ 389
Cleveland-Elyria-Mentor, OH	$150,850	$ 820	$ 694	$ 126
Detroit-Warren-Livonia, MI	$172,100	$ 935	$ 809	$ 126
Los Angeles-Long Beach-Santa Ana, CA	$608,600	$3,307	$1,361	$1,946
Minneapolis-St. Paul-Bloomington, MN-WI	$243,400	$1,323	$ 873	$ 450
New York-Northern New Jersey-Long Island, NY-NJ-PA	$463,550	$2,519	$1,313	$1,206
Philadelphia-Camden-Wilmington, PA-NJ-DE-MD	$235,300	$1,279	$1,005	$ 274
Phoenix-Mesa-Scottsdale, AZ	$263,300	$1,431	$ 877	$ 554
Portland-Vancouver-Beaverton, OR-WA	$283,800	$1,542	$ 809	$ 733
Sacramento-Arden-Arcade-Roseville, CA	$412,700	$2,243	$1,022	$1,221
San Diego-Carlsbad-San Marcos, CA	$564,250	$3,066	$1,418	$1,648
San Francisco-Oakland-Fremont, CA	$704,350	$3,828	$1,658	$2,170
Tucson, AZ	$207,750	$1,129	$ 743	$ 386
Washington-Arlington-Alexandria, DC-VA-MD-WV	$456,300	$2,480	$1,131	$1,349

*Ownership costs based on selling for 75% of the median.

[85] Stephanie Dhue, *Citigroup's New Housing Plan: Own to Rent*, CNBC (Aug. 2, 2012, 4:57 PM), http://www.cnbc.com/id/48576542, *archived at* http://perma.cc/0or2nxape9p.

[86] Nick Timiraos, *BofA Tests an Option to Foreclosure*, WALL ST. J., Mar. 23, 2012, at C1.

[87] *See* DEAN BAKER & HYE JIN RHO, CENTER FOR ECONOMIC AND POLICY RESEARCH, THE GAINS FROM RIGHT TO RENT 2 (2009), *available at* http://www.cepr.net/documents/publications/gains-right-to-rent-2009-07.pdf, *archived at* http://perma.cc/08ULiZcKR92.

[88] *Id.* at 2.

Thus for many of the properties currently in foreclosure across the country, fair market rent falls below the existing ownership costs.

Furthermore, the difference between the rental market value and the mortgage payment would serve as an automatic check that would limit widespread use of the rental option in non-crisis times:

> During ordinary years, homeowners would not gain much from having a right to rent, since the gap between ownership costs and rental costs is usually not very large. However, because of the run-up in house prices during the housing bubble years, ownership costs vastly exceeded rental costs in many bubble markets.[89]

This dynamic helps to ensure that a policy allowing foreclosed homeowners to remain in their properties would be effective in times of crisis, but not unnecessarily burdensome in ordinary times.

3. *Creating a Moral Hazard*

A final concern that might arise is whether allowing borrowers to remain in their homes after defaulting on a mortgage will actually encourage defaulting, creating a moral hazard that will in turn decrease banks' willingness to make mortgage loans in any state that adopts a right-to-rent policy and increase interest rates on loans they do make. Any policy designed to provide relief to homeowners facing foreclosure is likely to create some degree of moral hazard by shrinking the consequences of default to some extent. However, the nature of a right-to-rent policy minimizes the impact of any such moral hazard because former owners will still face serious consequences stemming from default. Indeed, borrowers who default on their mortgages face a variety of long-lasting negative consequences, including, of course, losing ownership of their home. As Fannie Mae explains to mortgagors on its website:

> Foreclosures are very damaging to your credit and may impact your credit rating for as long as seven to ten years. A foreclosure can make it difficult to get a loan for a future home purchase or college expenses, get a major credit card, or it may even potentially affect future employment (many employers screen for credit as a part of a background check). In addition, when you are able to get credit, your interest rates will likely be higher.[90]

It is highly unlikely that homeowners will willingly face such serious and long-lasting consequences solely because they will be able to remain in their homes as renters until the properties are sold. In fact, allowing foreclosed

---

[89] *Id.* at 1.

[90] *Frequently Asked Questions*, KnowYourOptions.com by Fannie Mae (2013), http://knowyouroptions.com/find-resources/information-and-tools/faqs, *archived at* http://perma.cc/0A43azSQFqb.

homeowners to rent is one of the options that will minimize the harms of any moral hazard: "[t]here is no 'inequity' because the homeowner has given up ownership of the property . . . The lender, now the landlord, would be free to recoup its investment as the lease matures and dispose of the property under more normal market conditions, presumably mitigating losses."[91] Thus there is little chance of creating a substantial moral hazard by allowing foreclosed owners to occupy their properties until resale.

One might have a somewhat stronger moral hazard concern in cases in which foreclosed homeowners are ultimately able to repurchase their homes after a rental period for a lower price than they originally paid. However, even in this scenario it is unlikely that the changed incentives of current homeowners will be particularly problematic. Again, it is worth noting that defaulting on a mortgage brings a whole host of future problems in obtaining credit and possibly employment.[92] Furthermore, there are ways in which banks can structure new mortgages made to former-homeowners-turned-renters to minimize the chance of creating a moral hazard. In reselling properties to former owners who have gone through foreclosure, Boston Community Capital (BCC) limits the amount an owner can receive on resale as one way of reducing any gain from the initial default: "BCC includes a zero-percent, zero-amortizing, shared-appreciation second mortgage, which limits return to the borrower to a fraction of eventual appreciation equal to the principal balance of the new mortgage, divided by the outstanding principal balance of the foreclosed mortgage."[93] As an example, if the homeowner's initial mortgage was $300,000 and BCC purchases the property for $150,000, then issues a new mortgage for that amount, the homeowner will only realize half of any gains above that amount on resale (i.e. if the home sells for $250,000, BCC will recoup $50,000, half of the $100,000 increase in value).[94] Furthermore, the scenario described does little more than achieve the same result as a drawn-out loan modification with principal reduction, a policy solution that has already been embraced in other programs.[95] In sum, there is little reason to think that allowing foreclosed owners to remain in their homes as renters will create a significant moral hazard, and there are

---

[91] Alexander R. M. Boyle, *How to Help Homeowners, Without Creating Moral Hazard*, American Banker (Jan. 17, 2012, 11:47 AM), http://www.americanbanker.com/bankthink/foreclosure-crisis-moral-hazard-rental-conversions-1045760-1.html, *archived at* http://perma.cc/0vscG7cz4b6.

[92] *Frequently Asked Questions, supra* note 90.

[93] Elyse D. Cherry & Patricia Hanratty, *Purchasing Properties from REO and Reselling to Existing Occupants: Lessons from the Field on Keeping People in Place*, *in* REO & Vacant Properties: Strategies for Neighborhood Stabilization (A Joint Publication of the Federal Reserve Banks of Boston and Cleveland and the Federal Reserve Board) 115, 120 (2010).

[94] *Id.*

[95] *See, e.g.*, *Principal Reduction Alternative (PRA)*, MakingHomeAffordable.gov, Feb. 10, 2012, http://www.makinghomeaffordable.gov/programs/lower-payments/Pages/pra.aspx, *available at* http://www.perma.cc/0S4Sd7CrM38/.

steps banks can take in issuing another mortgage to a former owner to further reduce this risk.

IV. A Larger Shift

Beyond the beneficial effects of a right-to-rent policy for homeowners, their communities, and ultimately property-owning banks, such a policy would represent a step in the larger rebalancing of the relative power of large banks, corporations, and individuals. The financial crisis of 2007-2009 ushered in a new social movement that questioned how powerful banks and large corporations have become in the United States today. From Occupy Wall Street to the creation of the Consumer Financial Protection Bureau, a variety of groups came to recognize that outdated legal structures—designed long before large banks and corporations came to dominate the economic landscape—could not effectively protect the average consumer.[96] Indeed, on the first anniversary of the Wall Street Reform and Consumer Protection Act, Senator Tim Johnson, Chairman of the Committee on Housing, Banking, and Urban Affairs, remarked that

> [W]e should all be reminded of a basic lesson we learned from the Great Recession: failing to protect consumers has consequences not only for individuals and families, but also for the health of America's economy. The failure by regulators to hold Wall Street banks and unscrupulous mortgage lenders accountable for complying with consumer protection laws was detrimental to American families and brought the global financial system to near collapse. The cost of that failed oversight and accountability has been the loss of millions of American jobs, millions of homes, and trillions of dollars in retirement, college, and other savings.[97]

---

[96] *See, e.g.*, *About*, OccupyWallstreet, http://occupywallst.org/about/ (last visited Aug. 11, 2013) (stating that Occupy Wall Street "is fighting back against the corrosive power of major banks and multinational corporations over the democratic process, and the role of Wall Street in creating an economic collapse that has caused the greatest recession in generations. The movement . . . aims to fight back against the richest 1% of people that are writing the rules of an unfair global economy that is foreclosing on our future."), *archived at* http://www.perma.cc/0ZDTFaBmF4K/; Joe Nocera, *Knee Jerks for Reform Are Overdue*, N.Y. Times, Mar. 29, 2008, at C (describing how, after the financial crisis, Rep. Barney Frank (D-Ma.) began "to think hard about a critical, longer-term issue: whether the country's financial regulatory apparatus, which was first erected in the 1930s in response to the Great Depression, still makes sense today . . . . As the crisis on Wall Street, and Main Street . . . deepened, Mr. Frank has come to believe that the country needs new regulations that take into account, for instance, the enormous rise in lending—largely unregulated—that takes place outside the banking system, and that can better monitor the huge risks many Wall Street firms now take as a matter of course.").

[97] *Enhanced Consumer Financial Protection After the Financial Crisis: Hearing Before the S. Comm. On Banking, Housing, and Urban Affairs*, 112th Cong. (2011) (statement of Sen. Tim Johnson, Chairman, Comm. on Banking, Housing, and Urban Affairs), *available at* http://www.gpo.gov/fdsys/pkg/CHRG-112shrg72575/pdf/CHRG-112shrg72575.pdf, *archived at* http://perma.cc/0JqJ9RLLywE.

This statement captures the sentiment that many Americans felt after the financial crisis: the law should do more to protect the average consumer in the face of ever-more-powerful banks and corporations.

The law on foreclosures presently in place in every state falls squarely into the category of laws that should be updated to afford greater protection to the average consumer. The foreclosure system was largely designed to handle individual defaults; it cannot effectively handle widespread, systemic defaults that threaten entire communities. As Chairman of the Federal Reserve Ben Bernanke explained in a 2008 speech,

> [d]uring more normal times, mortgage delinquencies typically were triggered by life events, such as unemployment, illness, or divorce, and servicers became accustomed to addressing these problems on a case-by-case basis. Although taking account of the specific circumstances of each case remains important, the scale of the current problem calls for greater standardization and efficiency . . . . The federal banking regulators have urged lenders and servicers to work with borrowers to avoid preventable foreclosures.[98]

As this explanation makes clear, the foreclosure crisis required fundamental changes to the way the legal system handles foreclosures. To some extent, the federal government and various states have begun to recognize this fundamental disconnect, as is reflected in policy changes made since the beginning of the financial crisis. Creating a right to rent post-foreclosure for homeowners would contribute to this more general rebalancing of the relative power of the consumer and banks in our society.

V. Conclusion

The ongoing foreclosure crisis and resulting vacancies continue to threaten families and communities across the United States. While federal efforts to stem the tide of foreclosures and assist those affected have largely been mediocre at best, some state and local governments have made progress in creating increased protection for those facing foreclosure. In particular, many states have passed legislation requiring foreclosing banks to allow tenants to stay in rental properties until they are sold to new owners. A parallel right for foreclosed homeowners would go far in protecting families and communities from widespread vacancies. Allowing foreclosed owners to continue occupying their properties as tenants would help stabilize communities, stave off criminal activity often associated with foreclosures, and protect banks' investment in REO properties. Such a right-to-rent policy for

[98] Bernanke, Housing, Mortgage Markets, *supra* note 34.

homeowners would be a substantial step in giving the average consumer more protection in the wake of the financial crisis.

* Lindsey Beckett, A.B. in Economics, Dartmouth College, 2011; J.D. Candidate Harvard Law School, Class of 2014. Many thanks to Max Weinstein, Lecturer on Law, Harvard Law School, and member of the Massachusetts Foreclosure Impacts Task Force for his guidance and insightful comments.