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MEMORANDUM

TO: Commission Members

FROM: Lynnisse Roehrich-Patrick
Executive Director

DATE: 31 January 2014

SUBJECT: Foreclosure and Blight

At the request of Senator Kyle, the Commission directed staff to study how the protracted foreclosure process is affecting local governments' ability to remedy blight and to identify strategies that might assist in the redevelopment of these areas. Several strategies implemented in other states seem to have some potential but require further review. At the next meeting, staff will present a draft report that will include analysis of these strategies:

- change trespass law to enable neighbors to maintain the exterior of vacant properties in their neighborhoods
- require servicers to post bond for each foreclosure
- implement a mediation program
- increase civil and criminal penalties for failure to maintain blighted property
- use eminent domain to seize underwater mortgages
- reduce the time to foreclose on properties
- implement vacant and foreclosed property registration systems

The Commission already made some recommendations for addressing blight in its 2012 report *Dealing with Blight: Strategies for Tennessee's Communities* that it may wish to reiterate:

- The Neighborhood Preservation Act, which allows any neighbor or interested party to sue the owner of a property not maintained to community standards, applies in Davidson and Shelby counties.[1]
- The Residential Rental Inspection law, which authorizes a municipality to establish a residential rental inspection program for deteriorated or deteriorating rental properties, applies in Davidson County and in the city of Oak Ridge.[2]
- The Vacant Properties Acquisition Act, which authorizes the use of eminent domain to acquire, hold, manage, and dispose of vacant blighted property, applies in only ten counties. [3]
- The Local Enterprise Zones law allows certain local governments to provide incentives and exemptions to qualified businesses and residents in depressed areas, including exemptions from any local rule or regulation other than health and safety provisions. [4]

State law also authorizes municipalities, but not counties, to establish an office of hearing officer to hear cases involving building and maintenance code violations. These officers can impose $500 fines, which far exceed the $50 fine limit placed on courts by the state's constitution.[5] The Commission recommended that it might be advantageous to extend similar authority to county governments or otherwise provide for the higher $500 fine as has been done in other states. It also recommended that the General Assembly might also wish to consider allowing local governments to provide incentives for the renovation or demolition of derelict buildings, as is done in Virginia.[6]

In 2012, the General Assembly authorized a pilot land bank program in the city of Oak Ridge.[7] In the report, the Commission recommended that extending land bank authority to other jurisdictions is an option that should be considered when the Comptroller's report on the pilot program is complete.

Strategies Addressing Blight Related to Foreclosure Used in Tennessee

Even though the housing market has improved significantly in most of Tennessee since the peak of the foreclosure crisis, many properties are still in foreclosure, vacant, or blighted.[8] Tennessee and its local governments have already taken a number of steps to address the

[1] Tennessee Code Annotated Title 13, Chapter 6, Part 1.
[2] Tennessee Code Annotated Title 13, Chapter 21, Part 3.
[3] Tennessee Code Annotated Title 13, Chapter 21, Part 2.
[4] Tennessee Code Annotated Title 13, Chapter 28, Part 2.
[5] Tennessee Code Annotated Title 6, Chapter 54, Part 10.
[6] Virginia Code Annotated Section 15.2-907.
[7] Tennessee Code Annotated Title 13, Chapter 30.
[8] Please see Appendix A for an overview of the housing and financial collapse of the 2000s.

blight problem associated with the high number of foreclosures. Actions fall into two categories: prevention of blight by keeping homeowners in their homes and dealing with foreclosed properties by maintaining them and reselling or repurposing them.

- ***Monetary assistance is being provided to help borrowers pay mortgage***

  One strategy that is working in Tennessee is helping homeowners with mortgage payments. The Tennessee Housing Development Agency (THDA) administers the Keep My Tennessee Home program, which pays overdue or current mortgage payments. THDA pays these funds directly to the loan servicer or lender. Homeowners in all 95 counties who qualify for the program can receive up to $40,000 to help pay their mortgages for up to 36 months. THDA has made 4,962 loans and has committed to make loans to an additional 283 homeowners. As of June 30, 2013, 95% of homeowners who used this program were able to retain their homes. Another provision of the Keep My Tennessee Home program helps applicants who started with the program when it had a maximum benefit amount below $40,000. Through this program, THDA has provided additional funds to 324 borrowers already in the program.[9] It has committed to make 89 more.

  THDA also assists homeowners who are struggling to make mortgage payments because of long-term medical problems through the Long Term Medical Disability program. THDA has already loaned money to 351 homeowners and has committed to provide loans to an additional 34 homeowners through this program.

- ***Counseling is being provided to homeowners on options to prevent foreclosure***

  Counseling offers information and referrals to homeowners facing foreclosure to ensure that they are aware of all their options. THDA administers the National Foreclosure Mitigation Counseling (NFMC) program at the state level. In 2007, the federal government created the NFMC to increase the availability of foreclosure counseling services. THDA uses funds from the NFMC to maintain an extensive network of 17 foreclosure prevention-counseling agencies,[10] with over 60 counselors that serve homeowners in all 95 counties. The program provides these services at no cost regardless of homeowner income. Through the second quarter of 2013, THDA has provided counseling to 12,799 Tennessee households facing foreclosure.[11]

  In 2012, THDA in partnership with the Tennessee Office of the Attorney General and Reporter, created a toll-free hotline (855-876-7283) for citizens experiencing difficulties with their mortgage payments or problems with servicers. The hotline is funded with Tennessee's share of the "national mortgage settlement," an agreement 49 states and the federal government reached with the country's five largest mortgage servicers, who

[9] Tennessee Housing Development Agency 2013.
[10] Tennessee Housing Development Agency 2013.
[11] Tennessee Housing Development Agency 2013.

routinely signed foreclosure-related documents outside the presence of a notary public and without really knowing whether the facts they contained were correct. Information about this hotline is prominently featured on the state website and in outreach materials. If hotline staff cannot help the caller immediately, they provide contact information for certified mortgage counseling or for other needed assistance.

In addition to THDA's programs, another resource for Tennessee homeowners is the HOPE NOW Alliance, formed by industry leaders in mortgage lending, investment, and servicing. HOPE NOW manages a multi-state tour of workshops where homeowners can talk to their lender or a housing counselor about their mortgage. HOPE NOW conducted one such workshop in Memphis in 2008 and another in Nashville in 2012. Another workshop is scheduled in Memphis in February 2014.[12] The alliance also has a nationwide toll-free HOPE Hotline that provides counseling to homeowners. Since 2008, hotline counselors have completed 12,312 counseling sessions with Tennessee homeowners.[13]

- ***Local governments are rehabilitating and reselling vacant foreclosed properties***

The most basic impediment to dealing with blight caused by foreclosures and vacant homes is the ability to quickly resell or rehabilitate low-value properties. Banks can usually sell middle- to high-value properties that have been foreclosed on, but low-value properties are often not desirable and don't sell easily at auction. There are many tools local governments can use to get these properties into the hands of interested buyers. These include housing authorities and the Neighborhood Stabilization Program (NSP), which provides emergency assistance to state and local governments to acquire and redevelop foreclosed properties that might otherwise become sources of abandonment and blight within their communities.

NSP provided three rounds of grants. NSP1 and NSP3 provided grants to all states and selected local governments on a formula basis.[14] NSP2 provided grants to states, local governments, and nonprofits on a competitive basis. The total amount received by Tennessee and its cities was $113.2 million. THDA received allocations of NSP1 and NSP3 funds. THDA awarded pass-through funds to local governments and nonprofit organizations according to a set of need-based criteria. Chattanooga, Knoxville, and Shelby County directly received NSP1 funds. Nashville directly received NSP1 and NSP2 awards, and Memphis directly received NSP1 and NSP3 funds. The amounts of the NSP awards are in table 1.[15]

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[12] Hope Now Alliance.
[13] Hope Now Alliance.
[14] U.S. Department of Housing and Urban Development 2013.
[15] OneCPD Resource Exchange.

Table 1. Distribution of Neighborhood Stabilization Program Funds

	NSP1 (formula grant)	NSP2 (competitive grant)	NSP3 (formula grant)	Total NSP
Chattanooga	$2,113,727			$2,113,727
Knoxville	$2,735,980			$2,735,980
Memphis	$11,506,415		$5,195,848	$16,702,263
Nashville	$4,051,398	$30,470,000		$34,521,398
Shelby County	$2,752,708			$2,752,708
Tennessee (THDA)	$49,360,421		$5,000,000	$54,360,421
Total	**$72,520,649**	**$30,470,000**	**$10,195,848**	**$113,186,497**

In addition to the NSP program, housing authorities may acquire and redevelop blighted areas or other real property "for the purpose of removing, preventing, or reducing blight, blighting factors, or the causes of blight."[16] Under the housing authorities law, the authority can completely redevelop properties and whole sections of a community.

- ***Local governments can require owners to maintain vacant properties or maintain the properties themselves***

  A number of Tennessee laws enable local governments to combat blight by requiring owners to maintain vacant properties. State laws enable local governments to require owners to remove trash or overgrown vegetation upon notice,[17] and local governments can correct the problems if the owners don't.[18] Local governments can also order the removal or remedy of dangerous or defective building conditions.[19] Code enforcement programs enable local governments to identify blighted vacant properties and take steps to rehabilitate or demolish them.[20]

  Memphis is using these laws to fight blight. Under the "25 Square" initiative, Memphis is cleaning up blight by having crews work in predetermined 25 block zones doing everything from razing dilapidated structures to mowing overgrown yards.[21] After the city's crews finish their cleanup, the city works with local artists to create art installations to brighten boarded up homes and businesses.[22]

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[16] Tennessee Code Annotated Section 13-20-202.
[17] Tennessee Code Annotated Section 6-54-113.
[18] Tennessee Code Annotated Section 5-1-115.
[19] Tennessee Code Annotated Title 68, Chapter 102, Part 1.
[20] Tennessee Code Annotated Sections 6-54-502 and 5-20-102 and Tennessee Code Annotated Title 13, Chapter 21, Part 1.
[21] Baker 2012.
[22] Phillips 2013.

Blight Related Strategies to Foreclosure Not Implemented in Tennessee

New and innovative strategies for dealing with blight have been developed in other states. They run the gamut from mediation programs to requiring servicers to post bond for each foreclosure. Tennessee may find a new method for addressing blight in other states' experiences.

- ***Change trespass law to enable neighbors to maintain the exterior of vacant properties in their neighborhoods***

  Neighbors are often reluctant to go onto a vacant property that is in desperate need of attention because of their concerns that they are in violation of trespass law. Indiana changed its trespass law to give neighbors limited immunity from civil and criminal trespass for taking care of the exterior of vacant and abandoned properties. The law allows neighbors to secure a property; remove trash or debris; and landscape, maintain, or mow.[23] It was amended in 2013 to allow removal of or painting over graffiti.[24] Indianapolis officials indicate that these changes to the law have been very helpful, with many neighbors taking care of vacant properties and preventing blight. While cities may place liens on properties they have to maintain, making them less attractive to potential buyers, neighbors may not.[25]

- ***Require servicers to post bond for each foreclosure***

  Properties often go unmaintained after the foreclosure process is initiated. To ensure maintenance of vacant properties, the Massachusetts cities of Lynn, Lawrence, and Springfield require servicers to post a $10,000 cash bond to the city at the start of a foreclosure. If the property deteriorates, the city can use the bond to pay for maintenance and repair. If the property is maintained, the entire bond is returned to the servicer at the time the property is sold.[26] Youngstown and Camden, Ohio, have essentially the same arrangement, except Youngstown retains a $200 administrative fee from the bond,[27] and Camden intends to keep a portion of the bond, probably $200 to $300, for administrative costs.[28]

- ***Implement a mediation program***

  Mediation offers an opportunity for homeowners to develop plans to retain their homes with their servicers. Tennessee has not adopted a formal state-level mediation

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[23] Indiana Code Title 34 Chapter 30 Part 26.
[24] Rinehart 2013.
[25] Lisa Laflin, Neighborhood Liaison, South Center Region, Mayor's Office of Neighborhood Services, City of Indianapolis, phone interview with David Lewis, January 14, 2014.
[26] A servicer is a business that collects mortgage payments from borrowers and manages the borrower's escrow accounts.
[27] Miliken 2013.
[28] Rink 2013.

program, but nineteen states have.[29] Local governments in six states have implemented mediation programs.[30] The programs appear to be successful. One study found that 35% of those who participated in mediation were able to reach a settlement to remain in their home. Eighty percent of those were still in their homes two years later.[31] Another study found significantly more mortgage modifications in areas with mediation programs than in those without them.[32]

In 2011, a bill was introduced in the General Assembly, Senate Bill 2030 by Ford, House Bill 1967 by Turner, J., that would have required the THDA study establishing a foreclosure mediation program for Tennessee. The bill did not pass, but THDA studied the issue anyway and produced a report in which it concluded that implementing a formal mediation program would have some value but would come at a significant cost:

> . . . if the State of Tennessee were to consider adopting a mandatory mediation program for homeowners facing foreclosure, lawmakers must first identify a funding source and an adequate number of qualified mediators to handle the potential caseload. In states with similar programs, eligible mediators have included attorneys, retired judges, professional mediators, and certified housing counselors.

- ***Increase civil and criminal penalties for failure to maintain blighted property***

  Because of the magnitude of the foreclosure crisis and related blight, states have given local governments authority to impose stiffer penalties on owners who don't maintain properties. Pennsylvania gave cities authority to file criminal charges against owners who fail to address property code violations and to extradite owners who reside out-of-state. Pennsylvania cities can also place a lien on an owner's assets, deny an owner building and zoning permits, and recover the costs to remediate cases.[33] Michigan recently passed a series of new laws increasing penalties for failing to pay fines related to blighted property and allowing local governments to pursue criminal charges, garnish wages, and impose other sanctions on property owners who do not pay fines.[34]

- ***Use eminent domain to seize underwater mortgages***

  Several cities are considering using eminent domain to seize underwater home mortgages. Cities would not be taking possession of the property, only the mortgage. The idea is to provide homeowners a new mortgage that reflects the lower value of the property and allow them to stay in their homes.

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[29] California, Connecticut, Delaware, Hawaii, Indiana, Iowa, Maine, Maryland, Michigan, Minnesota, Nevada, New Jersey, New York, Ohio, Oregon, Rhode Island, Vermont, Washington, and Wyoming.
[30] Illinois, Kentucky, Massachusetts, New Mexico, Pennsylvania, and Wisconsin.
[31] Reinvestment Fund of the Philadelphia Residential Mortgage Foreclosure Diversion Program 2011.
[32] Collins and Urban 2013.
[33] Housingwire 2011.
[34] Associated Press 2013.

The cities propose seizing underwater mortgages and paying the banks fair market value for the property using money from investors who become the mortgagee on a new loan to the homeowner. The owners would no longer owe more on their houses than they are worth.[35] Officials have stated that the federal government will not support this eminent domain approach, and will limit or cease purchasing mortgages where these proposals are approved, closing off most mortgage financing in those jurisdictions.[36]

In September 2013, the Richmond, California, city council authorized the use of eminent domain for this purpose. Other cities that have considered this alternative include Chicago, Illinois, Brockton, Massachusetts, and Irvington and Newark, New Jersey.[37] Similar initiatives in Las Vegas, Nevada, and San Bernardino County, California, have already been defeated because of real estate and mortgage industry opposition.

- ***Reduce the time to foreclose on properties***

  A few states have dealt with the housing crisis by amending their laws to shorten the foreclosure period. Tennessee already has a short foreclosure period when compared with other states. According to RealtyTrac, the average time to foreclose on a property in Tennessee was 209 days in the third quarter of 2013,[38] compared with the national average of 551 days. The average time to foreclose ranged from a high of 1,037 days in New York to a low of 164 days in Texas.[39]

  States fall into two categories based on how home loans are secured, and the length of the average foreclosure period for the two categories differs greatly. In "judicial states," loans are secured by mortgages and foreclosing requires court action, which takes longer. In "nonjudicial states," like Tennessee, loans are secured by deeds of trust, foreclosing does not require court action, and the foreclosure periods are generally shorter. Generally, the judicial states have attempted to reduce the foreclosure period and the nonjudicial states have attempted to increase it.

  Illinois, Florida, and New York are three judicial foreclosure states that have recently taken steps to hasten the foreclosure process. Speeding up foreclosures on vacant properties is intended to help the local residential market as lenders focus on marketing homes instead of preparing for and attending court proceedings. Illinois passed a law allowing banks to foreclose on abandoned homes in as little as 90 days.[40] Florida's new law demands that banks come to court prepared to prove they own the mortgages and have the right to foreclose on them, which at least initially, reduced the number of

[35] Lemov 2013.
[36] Reuters 2011.
[37] Lee 2013.
[38] Tyler White, National Data Solutions Manager, RealtyTrac, phone interview with David Lewis, December 16, 2013.
[39] RealtyTrac 2013.
[40] Maidenberg 2013.

foreclosures filed by 70%.[41] New York's Court of Appeals began working in 2012 to speed up foreclosures by giving judges added control and requiring banks to send to court officials who have the power to alter loans in order to keep people in their homes.[42]

- ***Implement vacant and foreclosed property registration systems***

  One of the major challenges confronting city officials is identifying those responsible for maintaining vacant properties. Registries attempt to address this problem by requiring owners and servicers to provide the city with specific contact information. Registries also can provide better data on the number of vacant and foreclosed properties. Nationwide, the number of vacant or foreclosed property registries jumped from fewer than 20 in 2000 to more than 550 in 2012.[43] Property owners are required to register properties after a certain length of vacancy or after the filing of a formal notice of default or intent to foreclose. Some registries may be a combination of the two. In April 2013, Memphis passed an ordinance[44] that created a registry of vacant and abandoned property. However, it applies only to properties with delinquent property taxes.

  In response to the vacant and foreclosed property registries being implemented nationwide, VacantRegistry.com was formed to provide a range of vacant and foreclosed property services including registries for local governments.[45] The Mortgage Bankers Association worked with the Mortgage Electronic Registration Systems (MERS) to make the MERS database accessible to local government officials at no charge.[46] MERS is an electronic registry designed to track servicing rights and ownership of mortgage loans in the United States. However, MERS does not include all mortgages, and sometimes the information for a property is not available.[47]

[41] Harwell 2013.
[42] Glaberson 2012.
[43] Lee, Terranova and Immergluck 2013.
[44] City of Memphis Ordinance 5477.
[45] See http://vacantregistry.com/.
[46] Mortgage Bankers Association 2014.
[47] MERSCORP Holdings.

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Appendix A. The Collapse of the Housing and Financial Markets During the 2000s, the Slow Recovery, and Federal and State Responses—A Summary

Between 2000 and the peak in early 2007, housing prices in the United States rose by 65%.[48] In Florida, Nevada, and California, housing prices more than doubled. The rise was fueled by a combination of (1) relatively low interest rates, (2) a lack of regulation and oversight on a fast growing sector of the finance industry that aggressively marketed "subprime" or high-risk mortgages[49] that fueled and propelled the housing bubble, and (3) reckless speculation. The rise in housing values eventually could not be sustained, and the inevitable bust began.

If the housing bubble had been the only out-of-control sector of the economy to burst, the recent recession would have been less severe. Housing construction would have declined, along with employment in that industry as well as others, but eventually would have recovered. Household wealth would still have been negatively impacted by the decline in home prices (and therefore homeowner equity) but not as damaged as it ultimately was. Unfortunately, the bubble in the housing industry was further compounded by the rapid growth of mortgage-backed securities or MBSs,[50] many of which included a large proportion of high-risk home mortgages.[51]

The fast growing market in these securities could have been better controlled and restrained by a proper evaluation of the risks associated with such securities. Unfortunately the industry responsible for analyzing the risk of such securities failed miserably in this responsibility. Despite the inclusion of large numbers of risky mortgages in many MBS issues, the majority of such securities were not flagged as risky by the major credit reporting agencies until it was too late.[52] Most of these risky securities were rated AAA and sold to unsuspecting investors.

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[48] House Price Index for the United States (Federal Housing Finance Agency), downloaded from the Federal Reserve Economic Data website, 4/12/2013, http://research.stlouisfed.org/fred2/series/USSTHPI

[49] An inexact term that usually refers to mortgages such as: adjustable rate (ARMs), Alt-A, 2/28 adjustable, balloon payment loans, loans with sudden reset provision, interest-only loan, loans that entailed high loan to value ratios.

[50] Especially Residential Mortgage-Backed Securities (RMBS).

[51] The rapid growth in mortgage-backed securitizations ultimately resulted in more high-risk mortgage originations as the pool of prime borrowers dried up.

[52] Moody's, Standard and Poor's, and Fitch often gave AAA ratings to MBSs that included large proportions of high-risk mortgages. For a full report of the many failures of regulation and oversight, see: United States Senate Permanent Subcommittee on Investigations. "Wall Street and the Financial Crisis: Anatomy of a Financial Collapse." http://www.hsgac.senate.gov/download/report-psi-staff-report-wall-street-and-the-financial-crisis-anatomy-of-a-financial-collapse.

As a result of the collapse of housing prices and housing construction that began as early as 2005 and spread across the country by 2007, the country entered a recession that began in late December 2007. The additional impact of a slowly materializing collapse in housing-related financial instruments (mortgages and mortgage-related securities) and the institutions that dealt in such instruments eventually threatened the whole United States financial system. This additional burden on our already-weakened economy ultimately transformed what could have been a standard recession into the worst recession since 1929, and resulted in a 50% drop in the stock market[53] and ultimately the loss of 8.7 million jobs.

Hardest hit by the recession and its lingering impact was the housing sector. While declining home values had a negative impact on all homeowners, the most seriously impacted were those whose home values were now less than the outstanding mortgage balance on them (underwater homes). Other seriously impacted homeowners included those who had borrowed heavily and/or unwisely in the years leading up to the housing bust, thinking that the rapidly-rising home values would offset any resets or other increases in their initial teaser interest rates, plus high risk borrowers who simply should never have been allowed to borrow at all (destined to fail mortgages). Memphis is a prime example of an area hardest hit by many sub-prime loans that were destined to fail. The specific housing, foreclosure, and blight problems in the Memphis area are well known and have been addressed elsewhere.[54] Specific areas of the city hardest hit by foreclosures have been identified. Federal data shows that the homeowner vacancy rate and the rental vacancy rate for Memphis spiked beginning in 2007 and, while moderating somewhat beginning in 2011, have yet to return to 2005 levels.[55]

The difficult and lengthy process of unraveling the many problems caused by the dramatic decline in housing prices, defaults, and foreclosures, requires both some history of banking regulations, and some detailed fleshing out of the various participants and institutional arrangements that comprised the housing-related financial market during the 2000s. A brief history of banking regulation will be contained in the final report and, while interesting in itself, would distract from the initial focus on the actual perfect storm of players that participated in the events of the 2000s and so is not presented here.

Major characters, institutions, and financial instruments at center stage

1. Home Buyers (the borrowers): In 2009, there were 76.4 million owner-occupied housing units in the United States.[56] Of that number, 24.2 million were owned free and clear, while the balance carried some $10 trillion in some type of debt (mortgage and/or some type of home equity loan).

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[53] Based on the DJIA and S&P 500 between their peaks in October 2007 to their troughs in March 2009. Source: Federal Reserve Bank of Atlanta.

[54] Shelby County, Tennessee Department of Housing. "Substantial Amendment to the Program: Annual Action Plan for Neighborhood Stabilization Program."

[55] U.S. Census data downloaded from www.census.gov/housing/hvs/data/ann12ind.html on Aril 11, 2013.

[56] U.S.Census, *The 2012 Statistical Abstract*, table 998.

2. Loan Originators: These are the financial institutions that originally create loans that enable borrowers to acquire real estate, which might be commercial banks, mortgage banks or brokers, credit unions, or other saving institutions.[57] A majority of the financial institutions that dominated the mortgage-origination business back in the "wild west" days are gone, including Countrywide, Washington Mutual, National City Bank, American Home Mortgage, Wachovia Mortgage, New Century Mortgage, and IndyMac Bank.[58]

3. Loan Servicers: These are the financial institutions or businesses that service loans; they can be the originator, but not necessarily. For mortgages pooled into securities, the servicer is chosen by the securitizer (also known as the sponsor). When mortgages go into default, the servicer is usually the entity that deals directly with the borrower and makes decisions on workouts,[59] including modifications of loan terms, short sales, and foreclosures.

4. Mortgage backed securities (MBSs), collateralized mortgage obligations (CMOs), and collateralized debt obligations (CDOs): These are securities (bonds) created when financial institutions pool mortgages and other asset-backed debt they own into securities (securitization using the mortgages and other types of income-producing debt as collateral). The interest income, and in the case of mortgage-backed securities, principal payments, are paid to the investors that own the securities. In 2008, as the housing market and everything related to the housing market were collapsing, outstanding mortgage-related bonds ($8.4 trillion) exceeded both outstanding treasury bonds ($5.8 trillion) and outstanding corporate bonds ($6.4 trillion).[60]

5. Securitizers (a.k.a. sponsors): These are institutions (federal agencies and private businesses) that pool mortgages into securities such as MBSs and CDOs. The process involves acquiring mortgages (originated by themselves or purchased from others), placing them in a trust, issuing securities (representing pieces of the trust) using the underlying mortgages as collateral, and selling the securities to willing investors. The trustee of the trust then distributes the interest and principal payments received from the servicer to the investors.

6. Mortgage Electronic Registration Systems (MERS): This is the system created and designed by mortgage and financial institutions to track changes in mortgage ownership and transfers more efficiently. The MERS process avoids costly and frequent changes in

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[57] Most of the savings and loan associations and savings banks that played a major role in the distant past disappeared over the last 50 years.

[58] O'Brien, Matthew, "Busted: 75% of the Biggest Home Lenders in 2006 No Longer Exist," *The Atlantic*, October 22, 2012, accessed 11/19/2013 at http://www.theatlantic.com/business/archive/2012/10/busted-75-of-the-biggest-home-lenders-in-2006-no-longer-exist/263924/.

[59] Refers to the various options available to servicers in dealing with delinquent mortgages.

[60] Outstanding Treasury bonds now exceed mortgage and asset-backed bonds due to the large amount of federal borrowing required during and after the recent recession. Securities Industry and Finance Market Association (SIFMA) data accessed on 10/15/2013 at www.sifma.org/uploadedfiles/research/.../cm-us-bond-market-sifma.xls.

records of local tax offices as well as the fees local and state governments impose on changes in property records such as current mortgage holders and liens.

7. Trustees: These are legal entities chosen by securitizers to represent the interests of investors in an asset-based security. A trustee is most often a unit of a major financial institution that offers trust services. Trustees perform many custodial duties including distributing interest and principal payments received from servicers (who collect these payments from borrowers) to investors in the security.
8. State and Local Governments: When defaults occur, the speed and ease of the foreclosure process is greatly affected by the state's foreclosure process. The process is generally lengthier in states that require judicial review of foreclosures. Tennessee is not one of those states.
9. MBS Investors: These are investors including Fannie Mae and Freddie Mac, both of which hold billions of mortgage-backed securities in their own portfolios; pension funds; insurance companies; state and local governments; foreign governments and banks; domestic financial institutions; mutual funds; and even the U.S. Federal Reserve, which has recently started to buy and hold MBSs.
10. Taxpayers in General: When the federal government bailed out Fannie and Freddie in 2008 by guaranteeing the payment of mortgages and interest by defaulting homeowners, taxpayers in general footed the bill. In addition to the bailout of Fannie and Freddie, various federal programs funneled trillions of dollars to the major private financial institutions in danger of collapse at the time,[61] and since the slow recovery, federal programs have been implemented that assist homeowners in danger of foreclosure. The total cost to taxpayers of all these programs is yet to be determined.[62]

After the collapse of the housing bubble and housing-related debt, delays upon delays

The run-up to the housing bust seemed to benefit all the participants: borrowers found easy financing for homes as well as easy financing from home equity loans, home values kept rising, originators made money providing the mortgages and then selling them (a process called originate to sell), servicers made money servicing the loans, securitizers made money pooling mortgages into mortgage-backed securities, trustees made money providing trustee services for securities, and investors that purchased the securities benefited since such securities generally paid 1% to 2% more than equivalent U.S. Treasury securities and generally had risk ratings similar to U.S. Treasury securities (AAA).

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[61] Greenberger, Michael. "Is Our Economy Safe? A Proposal for Assessing the Success of Swap Regulation," in *Financial Reform: Will It Work and How Will We Know?*, ed. Michael Konczal (Roosevelt Institute), p. 31. Accessed at http://www.rooseveltinstitute.org/sites/all/files/Will%20It%20Work%20How%20Will%20We%20Know_0.pdf on 11/4/2013.

[62] See summary description of programs at http://portal.hud.gov/hudportal/HUD?src=/topics/avoiding_foreclosure.

The various participants did not fare so equally during the housing and financial collapse. Understanding the participants and institutions provides a foundation for understanding how the various participants fared on the downside, especially the slow resolution (workouts) of mortgage defaults and foreclosures, that contributed to the growth in unoccupied homes and the development of blight in several major housing markets.

First, some clarification about the different participants in the mortgage process described above is needed. Many originators, servicers, securitizers, and mortgage-backed security trustees were and still are often parts of a single larger financial corporation, many of which have departments, units, or divisions that perform such functions. As a result, there were and continue to be clear opportunities for conflicts of interest among these participants. Examples include the following:

- Loan servicers make extra revenue when dealing with defaults and foreclosures; the longer the process lasts, the more additional revenue they can generate.
- When defaults occur, loan servicers are often limited in their workout options by the "pooling and servicing agreement" between them and securitizers. The workouts allowed are frequently too restrictive in providing for any quick resolutions, especially for homes underwater.
- Many defaults and foreclosures involve not only first mortgages, but also second and third liens such as home equity loans and home equity lines of credit. This situation results in conflicts on loan resolutions and modifications between the various lien holders, and contributes to delays.
- Servicers who are supposed to safeguard MBS investors (who actually own the first mortgages) are often a part of a larger institution that holds second mortgages (junior liens) on the same property. This places the servicer in the delicate position of having to choose between safeguarding the interests of MBS investors or safeguarding the interest of another division of their organization, clearly a conflict of interest.
- Many CDOs and some MBSs are structured with tranches, senior and junior slices of the whole MBS security. In this situation, losses on any of the individual mortgages contained in a MBS first affect junior tranches (loss in value). This situation causes conflicts among the MBS investors themselves on loan modifications since any resulting losses are not evenly distributed. This type of potential conflict of interest can further delay the resolution process.

  Tennessee, and especially Shelby County, has the highest bankruptcy-filing rate in the country; especially in the form of Chapter 13 filings. Such bankruptcy filings automatically forestall any ongoing foreclosure process, adding additional potential delay to the resolution process.[63]

[63] In some cases, a bankruptcy filing can result in homeowners being allowed to stay in their home longer than would otherwise be possible.

Longer term programs and legislation

In the aftermath of the housing collapse, financial collapse, and economic recession that followed, Congress acted on two major fronts to deal with the national financial disaster and economic recession. The Financial Crisis Inquiry Commission (FCIC) was created in May 2009 (Public Law 111-12) to "examine the causes, domestic and global, of the current financial economic crisis in the United States"[64] and report its findings by December 2010. The report, released in January 2011, proved controversial for identifying and placing blame on various U.S. private and public institutions, partly reflecting the composition of the ten-member commission.[65] The Commission's report [66] contained nine main conclusions:[67]

1. The financial crisis was avoidable.
2. Widespread failures in financial regulation and supervision proved devastating to the stability of the nation's financial markets.
3. Dramatic failures of corporate governance and risk management at many systemically important financial institutions were a key cause of this crisis.
4. A combination of excessive borrowing, risky investments, and lack of transparency put the financial system on a collision course with crisis.
5. The government was ill-prepared for the crisis and its inconsistent response added to the uncertainty and panic in the financial markets.
6. There was a systemic breakdown in accountability and ethics.
7. Collapsing mortgage-lending standards and the mortgage securitization pipeline lit and spread the flame of contagion and crisis.
8. Over-the-counter derivatives contributed significantly to this crisis.
9. The failures of credit rating agencies were essential cogs in the wheel of financial destruction.

At approximately the same time as the FCIC was created to investigate the causes of the financial collapse, the Obama Administration proposed drafting legislation to specifically deal with already identified contributing factors responsible for the housing and financial collapse. The legislation was eventually introduced in the House of Representatives in December 2009 and called "The Wall Street Reform and Consumer Protection Act." The original legislation

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[64] Fraud Enforcement and Recovery Act of 2009 (FERA), Section 5(a), Pub. L. No.111-21, 123 Stat. 1617 (2009) Downloaded 12/13/2013 from http://www.gpo.gov/fdsys/pkg/PLAW-111publ21/pdf/PLAW-111publ21.pdf.

[65] The Commission had six Democratic members and four Republican members.

[66] The Republican members released a separate dissenting report.

[67] National Commission on the Causes of the Financial and Economic Crisis in the United States. *The Financial Crisis Inquiry Report*, xvii-xxv. Downloaded 12/13/2013 from http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

went through some changes and was finally signed into law on July 21, 2010.[68] The general purpose of the legislation is summed up in its opening paragraph:

> To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end "too big to fail", to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.

The law runs almost 850 pages and contains sixteen major provisions dealing with a vast array of financial transactions; financial institutions, both private and governmental; and financial regulation and supervision. Most of the provisions in the law required significant new rules, many of which have yet to be finalized.[69] The general provisions in the law are:

1. financial stability
2. orderly liquidation authority
3. transfer of powers to the comptroller of the currency, the corporation, and the board of governors
4. regulation of advisers to hedge funds and others
5. insurance
6. improvement to regulation of bank and savings association holding companies and depository institutions
7. Wall Street transparency and accountability
8. payment, clearing and settlement supervision
9. investor protections and improvement to the regulation of securities
10. Bureau of Consumer Financial Protection
11. federal reserve system provisions
12. improving access to mainstream financial institutions
13. Pay It Back Act
14. Mortgage Reform and Anti-Predatory Lending Act

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[68] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010). Downloaded 12/15/2013 from http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf.

[69] For summaries of the act, see Morrison & Foerster, "The Dodd-Frank Act: a cheat sheet." Downloaded 12/16/2013 at http://www.mofo.com/files/uploads/images/summarydoddfrankact.pdf.
Also U.S. Senate Committee on Banking, Housing, and Urban Affairs, "A Brief Summary of The Dodd-Frank Wall Street Reform and Consumer Protection Act," downloaded 12/16/2013 at http://www.banking.senate.gov/public/_files/070110_Dodd_Frank_Wall_Street_Reform_comprehensive_summary_Final.pdf.

15. miscellaneous provisions
16. section 1256 contracts

The law was intended to fix many of the harmful behaviors and practices identified as factors in the financial collapse. A list of all of the new controls, rules, agencies, and regulations contained in the Dodd-Frank Act is too long for this appendix, but a list of the most egregious practices and behaviors it was designed to modify or curtail includes the following (not presented in any particular order):

- Prohibition against commission payments to mortgage brokers that provide incentives for brokers to direct borrowers to higher cost loans when borrowers are eligible for lower cost loans.
- Rules requiring proper documentation of all mortgage loans.
- Requirement that mortgage securitizers keep part of pooled mortgages in their own portfolio ("have skin in the game").
- Regulations making mortgage derivatives and trades in such instruments more transparent.