ALAN R. STERN MEMORIAL FELLOWSHIP

Staff Introduction

In April of 2008, the *Review of Banking and Financial Law* lost a valued member and beloved friend. During his too-brief time at Boston University School of Law, Alan Stern, Class of 2009, showed a passion for utilizing his legal education for public service. Particularly, Alan found the shortage of affordable housing in urban areas demanded legal and regulatory attention. As a tribute to Alan, the Stern family, in conjunction with the B.U. School of Law, the Morin Center for Banking and Financial Law and the *Review of Banking and Financial Law*, formed the Alan R. Stern Memorial Fellowship. Through this annual program, a committee selects a B.U. Law student to write on the topic of affordable housing. The Fellowship funds the student's research, and the staff members of the *Review* work with the author to develop, edit and publish the piece.

This is the second annual iteration of the Fellowship. Though we all still feel sadness from the loss of Alan, we feel the Fellowship serves as a fitting and enduring tribute to the spirit and ideals Alan represented.

REDUCING THE SPILLOVER COSTS OF FORECLOSURE: BOSTON'S BLOCK-BY-BLOCK APPROACH TO SAVING NEIGHBORHOODS FROM FORECLOSURE BLIGHT

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I. Introduction

Like hundreds, maybe thousands, of other American cities and towns, the City of Boston ("the City") has struggled to respond to a record number of home foreclosures in recent years and to mitigate the spillover effects of foreclosures, which include dropping property values, reduced tax revenues and increasing crime and other social ills. Boston was one of the first municipalities to directly intervene in the crisis by targeting small areas of the City most affected by foreclosures. Among its other strategies and initiatives, Boston created a pilot program in which City agencies collaborate with non-profit and private partners to stabilize neighborhoods most ravaged by foreclosures. Boston started with a four-block area in the Dorchester neighborhood, providing an intense level of City services, including social services and physical improvements. Boston also purchased several foreclosed properties and resold them to a private developer that rehabilitated the properties and put them back on the market. Boston is supporting efforts to resell the properties to low-income individuals by providing financial incentives and educational programs for prospective buyers. Based on the initiative's early successes, the City is now expanding the program to other neighborhoods. Boston's efforts provide an example for other local governments trying to minimize the spillover costs of the housing crisis on the City as a whole, while also attempting to revitalize areas that have been hardest hit by foreclosures.

II. Spillover Costs Associated with the Housing Crisis

The foreclosure crisis has taken hold of cities and towns following a common pattern. First, borrowers become delinquent on their mortgage payments due to financial stress or the inability to refinance the mortgage on more affordable terms. Loan defaults

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cause lenders to foreclose upon properties, take possession and place them on the auction block.[1] Lenders that cannot resell the foreclosed properties leave homes vacant and abandoned. The now-empty homes cause property values in the surrounding area to drop, usually reducing its neighbors' property values by as much as ten percent.[2] Decreasing property values also reduce homeowners' tax assessments, lowering tax revenue for cities and towns.[3] Reduced tax revenues leave cities with fewer resources with which to respond to the effects of widespread foreclosures.[4] Lower property values may also create problems for neighboring homeowners due to potential spillover effects.[5] In many areas foreclosures may be considered "'contagious,' with one loan failure increasing the likelihood of another,"[6] thereby continuing the cycle of foreclosure and abandonment.

A. Quantifying Spillover Costs

Foreclosures not only have devastating impacts on the affected homeowners and lenders, they also push down property values for innocent neighbors and impose financial pressures on local

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[1] Foreclosure is "[a] legal proceeding to terminate a mortgagor's interest in property, instituted by the lender (the mortgagee) either to gain title or to force a sale in order to satisfy the unpaid debt secured by the property." BLACK'S LAW DICTIONARY 719 (8th ed. 2004).

[2] William C. Apgar & Mark Duda, *Collateral Damage: The Municipal Impact of Today's Mortgage Foreclosure Boom* (Homeownership Preservation Fdn., Minneapolis, Minn.) May 11, 2005, at 23

> In the only published effort to measure the magnitude of these effects, a Temple University study found that Philadelphia properties located within 150 feet of an abandoned unit sold for $7,627 less than those not located near abandoned units, with the effect tapering off to $3,543 at distances of 300-450 feet and becoming negligible beyond 450 feet (the length of a typical block). These findings are consistent with the general literature on the impact of so-called negative externalities on house price appreciation, which suggest that the presence of a deteriorated structure can reduce area property values by as much as 10 percent, and that the largest impacts are on homes located closest to the blighted property.

[3] *Id.* at 7.

[4] *Id.*

[5] *See id.* at 9.

[6] *Id.*

governments. A 1995 study found that a single foreclosure costs the municipality $27,000 in reduced taxes and the provision of social services and costs the neighborhood $10,000 in decreased property values.[7] However, this study was conducted in a very different era, when foreclosures were considered rare and isolated occurrences. The current crisis has seen multiple houses in a particular neighborhood and even on a single street being foreclosed upon, and the corresponding costs to cities and neighborhoods have most likely increased substantially.

Municipalities suffer financial losses from foreclosures in several ways. Local governments incur costs for "increased policing and fire suppression, demolition contracts, building inspections, legal fees, and expenses associated with managing the foreclosure process."[8] After foreclosure, cities may bear the costs of maintaining the property, including "cases where the municipality inherits responsibility for securing and/or demolishing the unit, clearing trash from the lot, and keeping weeds under control."[9] Furthermore, cities may experience future losses as demolished properties are removed from the tax rolls and abandoned properties are assessed at much lower values.[10] Municipalities also lose revenue due to "delayed and uncollected taxes and unpaid service fees for water, gas, and electricity."[11] Local sales and income tax revenue may also fall as foreclosures make "urban neighborhoods less attractive to households and businesses."[12]

Abandoned properties are vulnerable to vandalism, arson and other types of property crime, increasing demand for City services, particularly fire and police services.[13] Additionally abandoned

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[7] Dan Immergluck & Geoff Smith, *The Impact of Single-family Mortgage Foreclosures on Neighborhood Crime,* 21HOUSING STUDIES 851, 853 (2006).
[8] Apgar & Duda, *supra* note 2, at 6.
[9] *Id.*
[10] *Id.* at 7.
[11] *Id.*
[12] *Id.*
[13] Immergluck & Smith, *supra* note 7, at 856.

> First, [foreclosed housing left vacant] can harbor decay. They may be havens for trash, rats or other stray animals, squatters or even criminals. Abandoned houses may also be used as places where drugs are sold and used, or used by predatory criminals who may attack neighborhood residents. Finally, vacant or abandoned homes may be targets of vandalism, the theft of wiring or other building components, or arson. . . . Indirectly, the presence of

properties usually contribute to an increase in violent crime in the surrounding area, including gang activity, drug dealing, prostitution, arson, rape and murder.[14] One study found that even a small increase in home foreclosures in a neighborhood, as low as one foreclosure per 100 properties, resulted in an increase of 2.33% of violent crime.[15] Rising crime rates require the outlay of municipal funds for fire and police services and further erode the quality of life in neighborhoods that have already been demoralized by a large number of foreclosures and the resulting vacant properties.

B. Declining Property Values

In August 2008, the Center for Responsible Lending ("CRL") estimated that subprime[16] foreclosures would drain $352

> boarded-up and abandoned buildings may lead to a lack of collective concern by neighborhood residents with neighborhood crime.

[14] Apgar & Duda, *supra* note 2, at 6.

[15] Immergluck & Smith, *supra* note 7, at 862.

[16] The financial sector does not use one, bright-line definition of subprime loans. Financial regulators attempted to provide a definition in 2001, using traits belonging to the borrower to identify subprime loans. Press Release, Office of the Comptroller of the Currency, Bd. of Governors of the Fed. Reserve Sys., Fed. Deposit Ins. Corp. & Office of Thrift Supervision, Expanded Guidance for Subprime Lending Programs (Jan. 31, 2001), *available at* http://www.fdic.gov/news/news/press/2001/pr0901a.html

> The term "subprime" refers to the credit characteristics of individual borrowers. Subprime borrowers typically have weakened credit histories that include payment delinquencies, and possibly more severe problems such as charge-offs, judgments, and bankruptcies. They may also display reduced repayment capacity as measured by credit scores, debt-to-income ratios, or other criteria that may encompass borrowers with incomplete credit histories. Subprime loans are loans to borrowers displaying one or more of these characteristics at the time of origination or purchase. Such loans have a higher risk of default than loans to prime borrowers. Generally, subprime borrowers will display a range of credit risk characteristics that may include one or more of the following: [t]wo or more 30-day delinquencies in the last 12 months, or one or more 60-day delinquencies in the last 24 months; [j]udgment, foreclosure, repossession, or charge-off in the prior 24

billion in property values from forty million families who live close to a foreclosed property.[17] The decline represents only the drop in values attributed to the nearby foreclosures, not other declines associated with the slowdown in the housing markets.[18] The foreclosures will cost each neighboring family almost $9000 in lost property values, perhaps causing financial instability for neighbors with little or no equity in their own homes.[19] These families may have paid their own mortgages on time every month and never engaged in risky borrowing practices, but they will still suffer from the ill effects of subprime lending.

III. Effects of Foreclosures

A. Foreclosures at the National Level

In January 2009 CRL estimated that 1.5 million homes had been foreclosed upon as a result of the housing crisis that began in

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> months; [b]ankruptcy in the last 5 years; [r]elatively high default probability as evidenced by, for example, a credit bureau risk score (FICO) of 660 or below (depending on the product/collateral), or other bureau or proprietary scores with an equivalent default probability likelihood; and/or [d]ebt service-to-income ratio of 50% or greater, or otherwise limited ability to cover family living expenses after deducting total monthly debt-service requirements from monthly income. This list is illustrative rather than exhaustive and is not meant to define specific parameters for all subprime borrowers. Additionally, this definition may not match all market or institution specific subprime definitions, but should be viewed as a starting point from which the Agencies will expand examination efforts.

When responding to the industry's request for a formal definition, the financial regulators reaffirmed this list of factors for identifying subprime lending. *See* Final Guidance – Statement on Subprime Mortgage Lending, 72 Fed. Reg. 37569, 37570 (July 10, 2007).

[17] CTR. FOR RESPONSIBLE LENDING UPDATED PROJECTIONS OF SUBPRIME FORECLOSURES IN THE UNITED STATES AND THEIR IMPACT ON HOME VALUES AND COMMUNITIES 1 (2008), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/updated-foreclosure-and-spillover-brief-8-18.pdf .

[18] *Id*.

[19] *Id*.

2007.[20] CRL projected that another two million homes were in danger of foreclosure because the owners were already one payment late on their mortgages.[21] CRL also warned that another thirteen million foreclosures would take place over the next five years.[22] Continued growth in the foreclosure rate will likely be fueled by the high number of Americans who cannot meet their mortgage obligations, especially those who are "underwater," meaning they owe more on their mortgage than their homes are worth.[23]

Ten months after the CRL issued its predictions, the Mortgage Bankers Association ("MBA") reported that there were more than two million homeowners who are seriously delinquent on their loans.[24] During these ten months, the rate of new foreclosures increased from 1.07% to 1.47%.[25] In November 2009, the delinquency rate for all outstanding mortgages was 9.64%, the highest level recorded since the MBA started keeping data in 1972.[26] More than 14% of all home loans were in foreclosure or one payment late, which is also a record-breaking figure.[27] Additionally almost 25% of homeowners were "underwater," and more than ten million homeowners had negative equity[28] in their homes.[29]

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[20] SONIA GARRISON, SAM ROGERS & MARY L. MOORE, CTR. FOR RESPONSIBLE LENDING, CONTINUED DECAY AND SHAKY REPAIRS: THE STATE OF SUBPRIME LOANS TODAY 3-4 (2009), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/continued_decay_and_shaky_repairs.pdf.

[21] *Id*.

[22] *Current Trends in Foreclosure and What More Can Be Done To Prevent Them: Hearing Before the Joint Econ. Comm.*, 111th Cong. 12 (2009) (statement of Keith Ernst, Ctr. for Responsible Lending).

[23] *Id*.

[24] Press Release, Mortgage Bankers Ass'n, Delinquencies Continue to Climb in Latest MBA National Delinquency Survey (Nov. 19, 2009), *available at* http://www.mortgagebankers.org/NewsandMedia/PressCenter/71112.htm.

[25] *Id*.

[26] *Id*.

[27] *Id*.

[28] Investor Glossary, Negative Equity, http://www.investorglossary.com/negative-equity.htm (last visited Feb. 22, 2010).

> [N]egative equity describes a situation where the debt on real property exceeds the assumed value of the property. With negative equity, the proceeds of a sale may not satisfy the mortgage. Negative equity thus increases the probability of borrower default. Historically, the most

B. Foreclosures in Massachusetts

With one foreclosure for every 603 housing units[30] in the state, Massachusetts is currently seventeen in a ranking of states with the highest number of foreclosures.[31] CRL estimates that over 29,000 foreclosure petitions, the first step in initiating a foreclosure, were filed in Massachusetts during 2009.[32] This number is almost double the number of foreclosure petitions filed in 2006, when Massachusetts experienced 15,887 foreclosure petition filings.[33] CRL further estimates that nearly another 100,000 Massachusetts homes will be foreclosed upon over the next four years.[34]

The spillover effects from foreclosures have dramatically impacted the state's housing market. Foreclosures contributed to a

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> common cause of negative equity was a decline in property values. Excessive borrowing is another independent cause of negative equity. Some loan products are dangerous for the borrower by potentially facilitating negative equity. For example, a negative amortization mortgage may allow for monthly payments that do not even cover the interest on the principal, with the difference being capitalized, or added to the principal balance. If equity is already zero, the increase in principal creates negative equity. In practice, many banks will notify the borrower once the loan balance exceeds 110% of the original appraised value of the property, but by then negative equity may or may not exist.

[29] Ruth Simon & James R. Hagerty, *One in Four Borrowers Is Under Water*, WALL ST. J. (Nov. 24, 2009), at A1.

[30] The national average is one foreclosure for every 409 housing units. Kaiser Family Foundation, Measures of State Economic Distress: Housing Foreclosures and Changes in Unemployment and Food Stamp Participation, http://www.statehealthfacts.org/comparetable.jsp?cat=1&ind=649 (last visited Feb. 22, 2010).

[31] *Id*.

[32] CTR. FOR RESPONSIBLE LENDING, MASS. FORECLOSURES: IMPACT AND OPPORTUNITIES 1 (2009), *available at* http://www.responsiblelending.org/mortgage-lending/tools-resources/factsheets/ma-foreclosure-fact-sheet.pdf [hereinafter MASS. FORECLOSURES].

[33] ASS'N FOR CMTY. ORG. FOR REFORM NOW, HOME INSECURITY: FORECLOSURES IN SUFFOLK CO. NEIGHBORHOODS 2 (2006), *available at* http://www.acorn.org/fileadmin/Reports/MA_Boston_Suffolk_ County.pdf.

[34] MASS. FORECLOSURES, *supra* note 32.

9% drop in home sales in 2009.[35] Foreclosures and the corresponding drop in house sales have cost Massachusetts's economy over $5 billion from housing losses since 2006.[36] CRL estimates that over 1.5 million Massachusetts homes that had neighboring foreclosed properties experienced property devaluation in 2009.[37] According to CRL, the cumulative devaluations cost the state a projected $10 billion in lost home values and tax bases—an average loss of almost $6,500 per home.[38] Over the next three years, CRL projects that another 2.2 million homes in Massachusetts will lose value due to their proximity to foreclosed properties, costing more than $37 billion in lost home values.[39] The average loss in value per home will be $16,722.[40] Dropping property values will have a devastating impact on property tax revenues, especially considering that Massachusetts already suffers from decreased revenue in other types of taxes.[41]

The high number of foreclosures in Massachusetts, specifically in Boston neighborhoods, is largely due to rapid growth in subprime mortgages during the last decade. Subprime mortgages were heavily concentrated in minority and low-income neighborhoods,[42] including many in Boston.[43] Minorities overwhelmingly borrowed using subprime mortgages. From 1998 to 2005, the total share of subprime mortgage originations in Massachusetts by African Americans and Hispanics rose from 6% to 44%.[44] These mortgages were marketed to borrowers with poor credit histories and had high interest rates and other disadvantageous loan terms.[45]

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[35] *Id.*
[36] *Id.*
[37] *See* CTR. FOR RESPONSIBLE LENDING, SOARING SPILLOVER: ACCELERATING FORECLOSURES TO COST NEIGHBORS $502 BILLION IN 2009 ALONE; 69.5 MILLION HOMES LOSE $7,200 ON AVERAGE 3 tbl.1 *(*2009)
[38] *Id*. at 4.
[39] *Id*.
[40] *Id*.
[41] Kaiser Family Foundation, *supra* note 30.
[42] Kristopher S. Gerardi & Paul S. Willen, *Subprime Mortgages, Foreclosures, and Urban Neighborhoods*, 3 (Fed. Reserve Bank of Boston, Pub. Policy Discussion Paper No. 08-6, 2008).
[43] *Id*. at 14.
[44] *Id*. at 11, n. 18.
[45] *See id*. at 7.

Lenders originated more than 23,000 subprime mortgages[46] in the greater Boston area from 2000 to 2008.[47] The percentage of subprime mortgage originations in the area almost doubled, rising from less than 7% in 2000 to more than 15% in 2006.[48] This rise in subprime mortgages helped fuel double-digit growth in housing prices.[49] As subprime mortgages became more available and easier to acquire, interest in the real estate market grew, increasing housing prices from 10% to 17% per year between 2000 and 2005.[50] While subprime mortgages grew as a share of the mortgage market, the foreclosure rate stayed small and stable, never rising above 100 foreclosures per year prior to 2005.[51] From 2000 to 2005, Boston experienced few foreclosures, usually less than fifty a year.[52]

The subprime market peaked in 2005, when lenders originated more than 5000 subprime mortgages, which accounted for almost 14% of Boston's mortgage market that year.[53] However, the housing bubble was already starting to deflate.[54] Growth in housing prices only rose 7% in 2005, down from 10% the previous year.[55] Foreclosures increased from zero in 2004 to seventy-three in 2005.[56]

Slightly fewer subprime mortgages were originated the next year.[57] Almost 5000 were originated, dropping almost 10% from the previous year.[58] Even though fewer subprime mortgages were originated, they represented a larger percentage of the whole mortgage market, increasing to more than 15% in 2006.[59] These figures suggest that prime market lenders had already started to

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46 *See supra* note 16 (defining subprime mortgages).
47 *See* FED. RESERVE BANK OF BOSTON, FORECLOSURES, HOUSE-PRICE CHANGES, AND SUBPRIME MORTGAGES IN MASSACHUSETTS CITIES AND TOWNS, http://www.bos.frb.org/economic/dynamicdata/module1/bmap.html (providing general data on mortgage origination, subprime origination, and foreclosure rates in Boston from 1990-2008).
48 *Id.*
49 *Id.*
50 *Id.*
51 *Id.*
52 *Id.*
53 *See* FED. RESERVE BANK OF BOSTON, *supra* note 47.
54 *Id.*
55 *Id.*
56 *Id.*
57 *Id.*
58 *Id.*
59 *See* FED. RESERVE BANK OF BOSTON, *supra* note 47.

recognize problems in the housing market and responded by reducing the number of loans they made, while subprime lenders continued to operate business as usual. For the first time in six years, housing prices dipped slightly in 2006, dropping by less than 1%.[60] Most strikingly, foreclosures almost quadrupled, rising to 277.[61]

The effects of the housing crisis became even more apparent in 2007. Subprime originations dropped almost 75% to 1,230 and only accounted for 5% of the total mortgage market.[62] Home prices also dropped more than 7% over the previous year, while foreclosures swelled almost 250% to 708.[63]

Subprime originations in Boston were almost frozen by 2008.[64] Only sixty-seven subprime loans were originated, accounting for less than half a percent of all mortgages originated that year.[65] Housing prices plunged again, falling almost fifteen percent over the previous year, creating a dramatic drop of twenty-two percent since 2005.[66]

Though the Boston area has experienced a steep rise in foreclosures and a corresponding drop in home prices, the changes have not affected the City residents and neighborhoods equally. Subprime borrowers, especially those who took out loans in last years of the bubble, were more likely to have "greater debt burdens and less equity (and likely poorer credit to begin with)."[67] These homeowners "were poorly suited to handle the collapse in housing prices."[68] Subprime borrowers have almost a 20% change of losing their home to foreclosure, a rate that is seven times the foreclosure rate for prime borrowers.[69] Additionally, foreclosures among subprime borrowers showed a racial disparity. Among Massachusetts homeowners using subprime mortgages, ten percent of African American homeowners and 6.8% of Hispanics have experienced

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[60] *Id.*
[61] *Id.*
[62] *Id.*
[63] *Id.*
[64] *Id.*
[65] *See* FED. RESERVE BANK OF BOSTON, *supra* note 47.
[66] *Id.*
[67] Gerardi & Willen, *supra* note 42, at 13.
[68] *Id*.
[69] *Id*. at 6.

foreclosure, but only 4.1% of Caucasian subprime borrowers have experienced foreclosure.[70]

Multi-family homes, usually three-family homes commonly called triple-deckers,[71] are usually found in larger cities in the Northeast, especially in "economically depressed inner City neighborhoods" where the population is "relatively poor, and heavily minority-populated."[72] Triple-deckers, which are the type of structure most likely to have been purchased with a subprime mortgage and then foreclosed on, are predominantly found in poor, minority neighborhoods. In Massachusetts, multi-family homes compose almost 10% of the state's housing stock, but account for almost half of the state's foreclosed properties.[73]

The concentration of subprime mortgages in minority and low-income neighborhoods has resulted in a concentration of foreclosures in those neighborhoods[74] and "clusters of vacant, neglected properties."[75] The spillover effects of these foreclosures negatively impact areas of the City that are the least resilient to such problems. As foreclosures cause dropping property values, rising crime and increased social problems, these depressed neighborhoods fall even deeper into despair.

IV. Boston's Hendry Street Project

Communities seeking to ameliorate the spillover effects of foreclosures have several options. Governments or non-profits can help prevent foreclosures by working directly with at-risk borrowers with counseling or other social services.[76] Massachusetts residents facing foreclosure can access a variety of services. The state and local governments and numerous non-profits offer consumer counseling and education, led by Boston's "Don't Borrow Trouble"

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[70] *Id*. at 17.

[71] Gail Ravgiala, *Second Act for Triple Deckers*, BOSTON GLOBE, July 9, 2006, at H1.

[72] Gerardi & Willen, *supra* note 42, at 16.

[73] *Id.* at 15.

[74] *Id.* at 13 ("In the current housing crisis, foreclosures are highly concentrated in minority neighborhoods, even relative to past foreclosure booms . . . .").

[75] *Id.* at 8.

[76] FURMAN CTR. FOR REAL ESTATE AND URBAN POLICY, TRANSFORMING FORECLOSED PROPERTIES INTO COMMUNITY ASSETS (2009), http://furmancenter.org/files/publications/furman.ford_.whitepaper_.pdf.

public information campaign.[77] Residents can also seek legal education and support for cases of mortgage fraud and violations to the state's strict consumer protection laws.[78] The state has also implemented numerous regulatory changes to make foreclosure more difficult, including a ninety-day right to cure period that gives borrowers additional time to settle loan defaults.[79] MassHousing also offers specialized loan products to help troubled borrowers refinance their loans through its HomeSaver Program.[80] However, these programs and initiatives have not prevented the massive number of new foreclosures, leaving swaths of abandoned properties across the state.

To cope with properties that cannot be saved from foreclosure by social services, governments and non-profits can also directly intervene in the local real estate market.[81] Communities opting to intervene usually adopt an "acquisition and disposition" program, "which puts the property under the direct control of the government or non-profit" and then "returns the property to productive reuse."[82] These programs usually provide for the "maintenance, rehabilitation, resale to responsible owners, or demolition" of the foreclosed property.[83]

Local governments can acquire properties at several points in the foreclosure process. First, the municipality may buy the property from the struggling homeowner before the foreclosure occurs through a negotiated short-sale.[84] Second, the municipality may purchase the property at the foreclosure auction, acting as an

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[77] *See generally* Kai-yan Lee, *Foreclosure Prevention and Intervention Efforts in New England* (Fed. Reserve Bank of Boston/ New England Cmty. Dev., Boston, Mass.) Issue 4, 2007.
[78] *See generally id*.
[79] *See* Myriam Milfort, *New England Updates (*Fed. Reserve Bank of Boston/ New England Cmty. Dev., Boston, Mass.) Issue 4, 2007, at 8.
[80] Lee, *supra* note 77 at 3.
[81] FURMAN CTR. FOR REAL ESTATE AND URBAN POLICY, *supra* note 76, at 11.
[82] *Id.*
[83] *Id.*
[84] *Id.* at 12. A short sale is defined as: "The sale of real property when the outstanding mortgage exceeds proceeds from the sale." AMERICAN HERITAGE DICTIONARY OF BUSINESS TERMS (1st ed. 2009), *available at* http://www.yourdictionary.com/business/short-sale.

ordinary buyer.[85] Early intervention tactics "may prevent some physical decline" of the property and limit spillover effects on neighboring properties.[86] Third, the municipality can purchase the property post-auction from the winning bidder,[87] usually the mortgage holder. While this type of purchase allows the local government to buy in bulk or negotiate a discounted price, it also provides an opportunity for foreclosure blight to take hold of the vacant property and its neighborhood.[88] Once the municipality acquires the property, it also has several options for disposition of the property: demolition, rehabilitation for market-rate sale or rental or rehabilitation for affordable resale or rental.[89]

Boston has adopted a limited intervention program to assist one of its most depressed neighborhoods. Boston targeted the Hendry Street area of the Dorchester neighborhood for a pilot project that involved the post-foreclosure acquisition of vacant properties followed by rehabilitation of the properties for affordable resale. However, Boston has gone beyond the traditional "acquisition and disposition" model. Boston added an assistance component by integrating social services aimed at reducing spillover effects of the foreclosures with the purchase and rehabilitation of foreclosed properties. By supplementing its "acquisition and disposition" program with concentrated social services, Boston hopes to arrest and counteract the spillover effects of foreclosure in targeted communities.

A. Why Hendry Street?

Hendry Street was a prime target for subprime lenders looking to make predatory loans, and it was the logical choice when the City government sought a neighborhood in which it could make a concentrated response effort. In a City that has suffered thousands of foreclosures, the Hendry Street area of Dorchester is considered the epicenter of Boston's housing crisis. It has been called a "foreclosure freefall zone."[90]

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[85] FURMAN CTR. FOR REAL ESTATE AND URBAN POLICY, *supra* note 76, at 13.
[86] *Id.*
[87] *Id.* at 14.
[88] *Id.*
[89] *Id.* at 17.
[90] Ric Kahn, *Opportunity Knocks*, BOSTON GLOBE, Aug. 10, 2008, at B1.

Located in a neighborhood with a large population of minorities and low-income families, Hendry Street residents were attractive targets for subprime lenders. According to the 2000 Census, the zip code for Hendry Street held a total population of 33,618.[91] Dorchester's population was approximately thirty percent black and sixteen percent Hispanic.[92] Approximately one in four (23.5%) residents lived below the federal poverty line, almost twice the national average (12.4%).[93] The area also contained 12,078 housing units.[94] Approximately 28% of the units were owner-occupied, 72% were rental units and almost 6% were vacant.[95] Less than 1000 units were owner-occupied, single-family homes.[96] The area's median home value was $151,400 in 2000.[97] As a poor, predominately minority neighborhood with low ownership rates, Dorchester is the type of community that subprime lenders find attractive. As a result of its demographics and high level of subprime mortgages, Dorchester currently ranks second in the state's communities with the highest foreclosure rates and third in the number of foreclosures.[98] In 2006, Dorchester experienced 131 foreclosures.[99] That number more than doubled to 364 in 2007 and climbed to 509 in 2008.[100] During that three-year period, more than 1000 foreclosures took place in a community with only 21,829 properties, resulting in a foreclosure rate of almost 5%.[101] The community suffered a corresponding decline in home sales prices, dropping from an average of $349,000 in 2006 to $336,000 in 2007

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[91] U.S. Census Bureau, Fact Sheet, http://factfinder.census.gov (search "Fast Access to Information" for "02125") (last visited Feb. 22, 2010).
[92] *Id*.
[93] *Id*.
[94] *Id*.
[95] *Id*.
[96] *Id*.
[97] U.S. Census Bureau, *supra* note 91.
[98] FOX25NEWS.COM, *Mass. Foreclosure Rates*, http://media.myfoxboston.com/news/foreclosures/list.html (last visited Feb. 22, 2010).
[99] Posting of Michael DiMella to Boston Real Estate and Condo Blog, http://blog.charlesgaterealty.com/bid/7365/Boston-Foreclosures-5-Neighborhoods-in-Top-25-Massachusetts-towns-hardest-hit (Nov. 17, 2008, 10:07 EST).
[100] *Id*.
[101] FOX 25NEWS.COM, *supra* note 98.

and then to $288,000 in 2008.[102] Home sales also declined, dropping from 198 in 2006 to 135 in 2008.[103]

The neighborhood's "vicious cycle" of foreclosures occurred in "clusters."[104] Joseph Kriesberg, executive director of the Massachusetts Association of Community Development Corporations, expressed concern about the effects of a single foreclosure that then encourages other foreclosures by negatively affecting property values and leads to abandoned and vacant properties.[105] Kriesberg said, "The number of foreclosures in Dorchester is insane and it's definitely clustered in pockets. There is a ripple effect.''[106]

By 2008 sixteen homes on Hendry Street, a short, four-block road with fewer than two dozen properties, had been foreclosed upon or abandoned.[107] Hendry Street and its surrounding streets were pock-marked with properties that have been foreclosed, were in the process of being foreclosed, were bank-owned or had been simply abandoned. Crime in the area also spiked. In particular, "opportunistic squatters who seize on vulnerable living spaces" are a common problem.[108] After finding loaded handguns, drugs and squatters during their visits, City inspectors reported that several vacant buildings on Hendry Street were being used as safe houses for criminals.[109] "The street had the highest concentration of foreclosed houses in the City and came to symbolize the local mortgage crisis."[110] Mayor Thomas Menino said that the City targeted Hendry Street to assist a neighborhood that had been "troubled by foreclosure-related blight and crime."[111] The City government decided to focus its intervention on a street where the some of the most damage had been wrought.

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[102] *Id*.
[103] *Id*.
[104] Scott Van Voorhis, *The Streets of Despair; Foreclosures Devastate Neighborhoods*, BOSTON HERALD, Feb. 16, 2008, at 20.
[105] *Id*.
[106] *Id*.
[107] Meghan Irons, *Signs of a Turnaround on a Troubled Street*, BOSTON GLOBE, May 12, 2009, at B2.
[108] Kahn, *supra* note 90.
[109] *Id*.
[110] Irons, *supra* note 107.
[111] *Id*.

B. One House's Path to Foreclosure

Recent transactions involving one house, 15 Hendry Street, exemplify the path to foreclosure taken by many homeowners in the Hendry Street area and across Boston over the past decade. Built in 1905,[112] 15 Hendry Street is a classic Boston triple-decker. Filling almost 3400 square feet, the three-family home contains an apartment with three bedrooms and one bathroom on each floor.[113]

In October 2001, Taslim Chowdury bought the property from Eric Layne for $260,000.[114] In April 2002, Mr. Chowdury "flipped" the house, selling it for $355,000 and realizing a profit of almost $100,000 after owning the house for just six months.[115] In 2002, the property's assessed value was only $193,900,[116] over $150,000 less than its sale price in that same year.[117] Mr. Chowdury sold the house to Anthony and Aracelis Oyola, who financed the purchase with three mortgages. First, the City of Boston, through its Local Development Corporation's BostonHome Initiative, provided the Oyolas with a no-interest loan of $8,100 to be applied to their down payment.[118] The Oyolas took out two additional mortgages totaling $337,250 from Fleet National Bank.[119] These mortgages

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[112] *Id.*
[113] *Id.*
[114] Deed from Eric A. Layne to Taslim M. Chowdhury (Oct. 9, 2001) (recorded at Suffolk County, Mass. Registry of Deeds, Book 27178, p. 43). All records filed with Mass. Registry of Deeds can be found at http://www.masslandrecords.com. To find the records related to 15 Hendry Street: Select "Suffolk County"; click on the property search tab; then type in 15 Hendry into the proper address fields. The files are listed by date in reverse chronological order.
[115] Deed from Taslim M. Chowdhury to Anthony Oyola and wife (Apr. 4, 2002) (recorded at Suffolk County, Mass Registry of Deeds, Book 28316, p. 108).
[116] The assessed value is the value that the tax assessor, not the marketplace, assigns to the property. Comparing the sale price to the assessed value is helpful to the extent that it shows the market's exuberance for house prices in recent years and the striking difference between the sales prices and more conservative assessed values.
[117] City of Boston, Assessing On-Line, Value History for 15 Hendry St., http://www.Cityofboston.gov/assessing/search/default.asp?mode=value&pid=1502864000 (last visited Feb. 22, 2010).
[118] Mortgage of Anthony Loyola and wife, (Apr. 4, 2002) (recorded at Suffolk County, Mass Registry of Deeds, Book 28316, p. 128).
[119] *Id.* at 132.

were traditional financial instruments with thirty-year terms and fixed interests rates.[120] After financing $345,350 of the purchase price with loans, the Oyolas likely contributed less than $10,000 from their own funds, less than 3% of the purchase price.

Fifteen months later the Oyolas started refinancing their Fleet National mortgages. In June 2003, the Oyolas refinanced for the first time, taking out a new mortgage for $425,000 with an adjustable interest rate starting at 8.435%.[121] At this time, the property's assessed value was only $228,000, almost $200,000 less than the mortgage on the property.[122] The interest rate on the new loan reset every six months and could grow as high as 14.435%.[123] Through this refinancing, the Oyolas would have received a cash infusion of almost $90,000 minus any closing costs, fees or pre-payment penalties from the earlier mortgages.

Another fifteen months elapsed, and the Oyolas refinanced again. This time they took out a $476,000 mortgage[124] from Ameriquest Mortgage Company.[125] This mortgage had an adjustable interest rate starting at 8.990% that would reset every four months and could rise as high as 14.99%.[126] Through their second refinancing, the Oyolas received $50,000 in cash minus any closing costs or pre-payment penalties from the earlier mortgages. At this time, the property's assessed value had grown to $290,900, but this is still $185,000 less than the amount the Oyolas owed on their latest mortgage.[127] At this point, the Oyolas would have had negative equity in their home due to the repeated refinancings.

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[120] *Id.*

[121] Mortgage of Anthony Loyola and wife, (June 30, 2003) (recorded at Suffolk County, Mass Registry of Deeds, Book 31881, p. 23).

[122] City of Boston, *supra* note 117 (showing historical assessed value of the property in 2003 was $228,000).

[123] June Mortgage of Anthony Loyola and wife, *supra* note 121, at 40-41.

[124] Mortgage of Anthony Loyola and wife, (Oct. 28, 2004) (recorded at Suffolk County, Mass Registry of Deeds, Book 35769, p. 13).

[125] Kimberly Blanton, *Customers Accuse Ameriquest of Excessive Fees, Altered Terms*, BOSTON GLOBE, Aug. 3, 2005, at D1 (stating that Ameriquest Mortgage was a leading lender of subprime refinancing in the greater Boston area. In 2005 the company settled with Massachusetts and 29 other states for $325 million over allegations that it violated state lending and consumer protection laws).

[126] October Mortgage of Anthony Loyola and wife, *supra* note 124.

[127] City of Boston, *supra* note 117.

In December 2005, Ameriquest assigned the 2004 mortgage to WM Specialty Mortgage ("WM").[128] On that same day, WM recorded a foreclosure deed for the property, alleging that the Oyolas still owed $432,000 on the 2004 mortgage.[129] WM held on to the property for almost three years until September 2008, when WM sold the property to Liquidation Properties, a subsidiary, for $10.[130] On the day that it acquired the property, Liquidations Properties sold the property to the Boston Redevelopment Authority ("BRA") for $69,000.[131] Two months later the BRA sold the property to Hendry Street LLC, a subsidiary of Bilt-Rite Construction, for $69,950.[132] As of May 2010, the improved 15 Hendry Street has not yet been purchased by an individual homebuyer.

The recent history of 15 Hendry Street demonstrates how homeowners and lenders both benefitted and suffered harm during the housing boom. The Oyolas may have received more than $100,000 in cash settlements through their two loan refinancings, even though they put down a small down payment and built up little equity in their house during the brief period that they owned it and were making payments on the mortgages. As a result of these risky refinancings, the Oyolas were unable to keep up with their ever-growing mortgage payments. The Oyolas no longer own the Hendry Street property, and their credit history is marred by a foreclosure.

Ameriquest and WM, the two lenders involved in the Oyolas's refinancings, specialized in subprime loans, particularly refinancings. Both lenders brought in record profits through imposing transaction fees and charging high interest rates. However, as the subprime mortgage market started to fall apart in 2007, Ameriquest, formerly the largest subprime lender in the United

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[128] Assignment from Ameriquest Mortgage Company to WM Specialty (Dec. 19, 2005) (recorded at Suffolk County, Mass Registry of Deeds, Book 38703, p. 69).

[129] Foreclosure Deed, (Dec. 19, 2005) (recorded at Suffolk County, Mass Registry of Deeds, Book 38703, page 73).

[130] Deed from WM Specialty Mortgage to Liquidation Properties, (Sept. 19, 2008) (recorded at Suffolk County, Mass Registry of Deeds, Book 44059, p. 349).

[131] Deed from Liquidation Properties to Boston Redevelopment Authority, (Sept. 19, 2008) (recorded at Suffolk County, Mass Registry of Deeds, Book 44051, p. 6).

[132] Deed from Boston Redevelopment Authority to Hendry Street LLC, (Nov. 7, 2008) (recorded at Suffolk County, Mass Registry of Deeds, Book 44224, p. 325).

States, stopped making new loans and laid off almost 4000 employees.[133] The company also settled a lawsuit for $325 million with thirty states over allegations that it engaged in deceptive marketing and unfair lending practices.[134]

The City also suffered financial losses associated with this home purchase. In addition to the spillover costs associated with a home foreclosure, the City lost the balance on the loan it gave the Oyolas for their down payment.[135] While the Oyolas still owned the house, they also fell behind on their local property tax payments.[136]

With transactions involving investor speculation, risky loan underwriting, refinancings into subprime products and rapid escalation of home prices, the history of 15 Hendry Street is a typical story for many of the homes that have been foreclosed upon in Boston and across the country in recent years.

C. What is the Hendry Street Project?

In August 2008, the City of Boston began to take a more proactive approach to the housing crisis. The City initiated a new program, the Hendry Street Project, by which it would institute an intense intervention to a small area in the hopes of reversing the foreclosure crisis block by block. The city government hopes that the program will arrest the neighborhood's decline.[137] Likening the effects of the foreclosure crisis to a "cancer," Mayor Menino said, "Our job as the city government is to restore these neighborhoods. We can't let this cancer continue."[138]

The Hendry Street Project ("the Project") has two components: (1) increased city services to stabilize property values, prevent crime and avert additional foreclosures; and (2) the purchase,

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[133] KATALINA BIANCO, CCH, THE SUBPRIME LENDING CRISIS: CAUSES AND EFFECTS OF THE MORTGAGE MELTDOWN, 12 (2008), *available at* http://business.cch.com/bankingfinance/focus/news/ Subprime_WP_rev.pdf.
[134] *Id*.
[135] June Mortgage of Anthony Loyola and wife, *supra* note 118.
[136] Municipal Lien Certificate, (Dec. 19, 2005) (recorded at Suffolk County, Mass Registry of Deeds, Book 38703, p. 68).
[137] *See* Vikas Bajaj, *Responding To a Housing Crisis*, N.Y. TIMES, Aug. 26, 2008, at C1.
[138] *Id.*

rehabilitation and sale of foreclosed properties. The Project's motto is "This is not an empty house. It's our neighbors' future homes."[139]

Boston is not the first community to consider such a direct intervention. Neighborhood Housing Services of Chicago ("NHSC") implemented a similar program in the early 1970s.[140] In collaboration with the Department of Housing and Urban Development, NHSC acquired and rehabilitated a hundred properties in two Chicago neighborhoods.[141] NHSC's program "had concentrated effects that demonstrably improved entire city blocks."[142]

Building on the success of NHSC and other initiatives, Boston's program goes further. While other communities seek to address the financial spillover costs of foreclosure—namely, by dropping property values and tax revenue, and/or by reintroducing vacant properties to the market—Boston also seeks to stop the non-financial costs, including crime, unemployment, credit problems, and other social ills.

Boston first identified a four-block section of Dorchester, including Hendry, Coleman and Clarkson streets, that was suffering from foreclosure-induced blight.[143] Led by the City's Foreclosure Intervention Team, various city agencies focused services and programs on the area and its residents.[144] The City also assigned additional police patrols and social workers to the area.[145] City agencies held homeowner education workshops to help residents understand how they could avoid foreclosure by making responsible choices before purchasing a home and after they start struggling to meet their mortgage obligations.[146]

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[139] Peter Gelzinis, Op-Ed., *Foreclosure Crisis Needs More Than Cleanup Crews*, BOSTON HERALD, Feb. 15, 2008, *available at* http://www.bostonherald.com/news/opinion/columnists/view.bg?articleid=1073676.

[140] FURMAN CTR. FOR REAL ESTATE AND URBAN POLICY, *supra* note 76, at 30.

[141] *Id.*

[142] *Id.*

[143] John Drake, *City Tries to Nip Blight From Foreclosures*, BOSTON GLOBE, Feb. 28, 2008, at B2.

[144] *Id*.

[145] *See* Press Release, City of Boston, Mayor Menino Celebrates Continued Progress in Hendry Street Area (May 11, 2009), *available at* http://www.cityofboston.gov/news/Default.aspx?id=4206 ("The FIT immediately began to focus its resources and services in the area, including an increased police presence. . . and the provision of social services to residents.").

[146] *Id*.

Government officials also identified several abandoned properties within the area that were contributing to decreasing property values and increasing crime.[147] Officials made physical improvements to those buildings and the area, working to secure the abandoned properties, removing graffiti, cleaning and repaving streets, planting trees and replacing missing or damaged street signs and lights.[148] City and non-profit workers also canvassed the neighborhood to educate tenants about their rights when their landlord faces foreclosure.[149]

Through the BRA, Boston also initiated the purchase of abandoned and foreclosed properties in the targeted area. The City chose not to demolish the properties to make room for green space or other uses, but instead retained the homes as affordable housing units.[150] When selecting properties it wanted to acquire, the BRA identified properties on which the City already had tax liens and that could be acquired at a "deep discount."[151] The BRA originally wanted to spend around $24,000 to $30,000 per unit, or $72,000 to $90,000 for a triple-decker, to buy properties that it could "quickly fix up, and resell to keep them from deteriorating and hurting neighborhoods."[152] Initial estimates reflected the cost of properties that the City could acquire through tax liens or negotiations with lenders, like Washington Mutual and Wells Fargo, which owned many of the area's foreclosed properties.[153] In addition to the purchase price, the BRA also estimated that the rehabilitation of the properties it sought to purchase would cost about $100,000 per property.[154]

The BRA purchased four triple-decker houses on Hendry Street from banks that had foreclosed on the previous owners.[155] The City spent a little over $300,000 to buy all four houses, properties

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[147] *Id.*

[148] *Id.* ("The City . . . made a variety of physical improvements to the neighborhood, including the removal of graffiti, repaving of roads, planting of new street trees, and replacements of streetlights.").

[149] Laura Crimaldi, *Menino on a Mission; Mayor Moves in to Cure Neighborhood "Cancer*," BOSTON HERALD, Feb. 15, 2008, at 5.

[150] Abby Goodnough, *Hard Times for the 3-Decker, New England's City Backdrop*, N.Y. TIMES, June 20, 2009, at A1.

[151] Crimaldi, *supra* note 149.

[152] Drake, *supra* note 143.

[153] *See* Crimaldi, *supra* note 149.

[154] *See id.*

[155] Bajaj, *supra* note 137.

that had previously sold for more than $500,000 a piece.[156] The City then resold the houses to Bilt-Rite, a local developer, who refurbished them and put them back on the market.[157]

In an interesting twist, the City and Bilt-Rite secured the volunteer labor of apprentice carpenters to save money on the renovations and keep the resale prices low.[158] The partnership allowed Bilt-Rite to save on labor costs, while the local carpenters' union retrained apprentices whose previous experience had been with commercial or new residential construction.[159] While a minor point, this partnership reflects the City's commitment to making sure that the Project has positive effects on all types of residents who have been hurt by the housing crisis and the economic downturn.

Bilt-Rite initially expected to sell the renovated properties for approximately $400,000.[160] It has already sold the 17 Hendry Street property for $390,000,[161] and the other three properties are currently on the market. Through the Boston Home Center, the City offers qualified purchasers financial assistance of up to $25,000.[162] Prospective buyers of the Hendry Street properties or other foreclosed properties acquired by the City may be eligible for the City's Cash-to-Close LIMITED program, which offers qualified borrowers $15,000 or $25,000 through ten-year, low interest conditional loans.[163] Qualified borrowers must meet income eligibility requirements, be first-time homeowners, complete homebuyer education programs and make mandated contributions to the purchase price and closing costs.[164]

The City's work on these four properties has already had a noticeable effect on private investment in the area. A year after the

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[156] *Id.*
[157] *Id.*
[158] *See* Video: The Hendry St. Project, United Bhd. of Carpenters and Joiners of Am., *available at* http://www.youtube.com/watch?v=3mBbkqamXTc (last visited Feb. 22, 2010).
[159] *Id.*
[160] Alison King, *Revitalizing Boston's Forgotten Homes*, NECN.COM, May 11, 2009, http://www.necn.com/Boston/New-England/2009/05/11/Revitalizing-Bostons/1242080862.html.
[161] Deed from Hendry St. LLC to Francisco A. Montrond, (Dec. 18, 2009) (recorded at Suffolk County, Mass Registry of Deeds, Book 46047, p. 26).
[162] King, *supra* note 160.
[163] City of Boston Dep't of Neighborhood Serv., http://www.cityofboston.gov/dnd/bhc/Buying_a_Home.asp (last visited Feb. 22, 2010).
[164] *Id.*

City bought these four properties, all but two of the original sixteen foreclosed and abandoned properties in the area have been rehabilitated by the City or other investors and readied for new owners.[165]

D. The Next Steps for the Hendry Street Project

The City has already started to expand the Hendry Street model to other areas of Boston. In May 2009, the City announced that its Foreclosure Intervention Team, which facilitated the Project, is initiating similar efforts for Dacia and Woodbine streets in Roxbury.[166] One home being renovated on Woodbine Street was featured on PBS's "This Old House" in January 2010.[167] As the program has expanded, the City has also expanded its pool of partners for the rehabilitation projects. The City is still working with private developer Bilt-Rite, but it has also brought in non-profit developers like Nuestra Comunidad.[168] To expand the acquisition and disposition component of the program beyond the targeted blocks, the City also initiated the Cash-to-Fix SALES program. This program offers homebuyers the opportunity to buy other foreclosed properties that the City acquires. The City offers the buyers "an affordable [purchase] price for which they can also receive financial and technical rehab assistance from the Boston Home Center to cover needed renovations before they move in."[169] While the affected community does not receive the intensive social services provided in the Project under this grant program, the financial assistance helps keep foreclosed properties from becoming abandoned and depressing property values.

V. Conclusion

Local governments have lost a lot in the foreclosure crisis: new homeowners, stable tax revenue and rising property values.

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[165] *See* Press Release, City of Boston, *supra* note 145.

[166] *See* Tony Lee, *Hendry Street Gets Makeover*, METRO BOSTON, May 11, 2009, http://www.metro.us/us/article/ 2009/05/12/03/3040-80/index.xml.

[167] *Id*.

[168] *See* Keith Pandolfi, *Roxbury House Project*, THIS OLD HOUSE, http://www.thisoldhouse.com/toh/tv/current-house-project (last visited Feb. 22, 2010).

[169] *Id*.

They have also borne the brunt of the crisis by taking on the responsibility of keeping up abandoned properties and providing social services to former homeowners. The City of Boston has created a unique program to address a small segment of the City that has been marred by the foreclosure crisis. In addition to providing an immense supply of social services and physical improvements to a part of a neighborhood, the City has also purchased properties that can be rehabilitated and resold to low-income buyers. While the City is spending approximately $70,000 on each property it purchases, it will hopefully save on the spillover costs associated with high levels of foreclosure. The City's investment involves using public money for a proactive approach to containing and reducing spillover costs. The money it spends on buying these properties can be recouped as the rehabilitated properties are put back on the market and start to generate tax revenue. Once the properties are occupied, they no longer depress property values for the neighborhood or encourage crime in the surrounding area. The City's investment in the neighborhood may also encourage private investment. Prospective homebuyers and investors would be encouraged to invest in an area where the City has already made a financial commitment and is providing extra city services, including physical improvements which can increase property values. Hendry Street has already attracted private investment as an increasing number of abandoned and foreclosed properties are bought by new owners for rehabilitation and occupation. The City's expansion of the program into other hard-hit areas and its partnership with non-profit partners are encouraging signs that the program's success will continue and reach even more low-income buyers in need of affordable housing.