The Evolving Crisis in Context: Recent Developments for Tenants in the Foreclosure Crisis

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> "People all over this country who rented, who didn't make an imprudent decision to buy a house, found themselves being evicted because somebody didn't pay the mortgage."[1]
> —Congressman Barney Frank during Congressional debates on the Emergency Economic Stability Act, September 29, 2008

As Congressman Frank's comment demonstrates, the plight of renters in the foreclosure crisis had finally entered the consciousness of national policymakers by the fall of 2008. Unfortunately, renters have more often than not been omitted from the narratives offered to describe the ongoing crisis, particularly in its early months in 2007 and 2008. These narratives instead focus on homeowners and banks (as victims or reckless speculators) and the neighborhoods where foreclosures were concentrated. In fact, despite the lack of attention they have received, many thousands of rent-paying tenants have also been affected by the foreclosure crisis.[2] Many of these renters, tenants in houses and buildings that entered foreclosure, have been forced to move from their homes, often with very little notice, and suffered the direct and indirect costs associated with displacement. And as Congressman Frank points out, as mere bystanders to the unsustainable mortgages and declining property values that drove the foreclosure crisis, tenants as a group are innocent victims by almost any definition. Fortunately, tenants have received specific protections from mortgage giants Fannie Mae and Freddie Mac as well as new rights under new federal laws. But while these new protections and rights should help, tenants still face significant uncertainty as the foreclosure crisis continues to unfold and outreach and communication of these rights will be essential.

OVERVIEW OF ISSUES FACING TENANTS IN FORECLOSED BUILDINGS

Tenants in properties that enter foreclosure have faced a variety of issues resulting from the legal position of their tenancy, the uncertainty of their situation and their landlord's financial distress. Both landlord–tenant law and foreclosure law are historically domains of the states and not the federal government. In most jurisdictions, the traditional rule is that completion of the foreclosure process extinguishes all "junior" liens on, or interests in, the property.[3] Generally, a residential tenant's lease will be among these junior liens or interests. As a result, when a new party (often the foreclosing lender) takes ownership of a residential property through a foreclosure auction, the last step of the foreclosure process in most jurisdictions, the new owner traditionally has had the right to terminate the lease and evict the tenants, regardless of the remaining term of the lease.

Tenants in properties with four or fewer units have faced a particularly high rate of being evicted as a result of foreclosure because of the practices of mortgage servicers and investors. Banks and investors generally consider these smaller properties to be more marketable to prospective buyers if they are vacant, because they can more easily be renovated or used as the buyer's personal residence. In contrast, tenants of larger buildings are less vulnerable to foreclosure-related eviction, because of the expense of prosecuting so many evictions simultaneously and the lost revenue that would result from emptying the building.

Even before the recent legislative and policy changes described later in this article, there were a number of important exceptions to the general vulnerability of tenancies in foreclosed buildings. Tenants in project-based Section 8 apartments or using a Section 8 voucher generally cannot be evicted solely as the result of a foreclosure of their building.[4] Renters in New Jersey, New Hampshire, and Washington, DC are sheltered from eviction by broad "just" or "good" cause laws, which allow eviction only in statutorily defined situations, which do not include foreclosure.[5] Similar municipal laws protect tenants from foreclosure-related evictions in certain cities.[6] In New York City, tenants in rent regulated apartments (which generally do not include units in the City's many 2–4 family properties) are protected by broad "just" or "good" cause laws.

For all tenants unprotected by "just" or "good" cause laws and other exceptions to the general vulnerability of leases to foreclosure, notice regulations have helped mitigate the effects of the foreclosure crisis. Although notice does nothing to prevent eventual eviction, it has provided tenants with valuable time to learn about their rights, find and save for new apartments, and prepare to move. These laws vary by state; some states require notice of foreclosure proceedings to tenants while others do not. And until recently, notice to vacate after foreclosure is complete ranged from as little as three days in Ohio to 120 days in Illinois.[7]

Legal eviction, however, is only one of the threats tenants face when their building enters foreclosure, so notice and anti-eviction laws are far from iron-clad protection. A landlord who is unable to keep up her mortgage payments is often unable or unwilling to spend money on necessary maintenance or even on vital utilities. In such cases, it may be a lack of habitability that forces a tenant to leave, despite her continued right to remain while the foreclosure process continues. In December 2008, city officials in Oakland, California declared that utility shut-offs were a "significant threat to public health and safety," triggering a state law that effectively put in place a temporary utility shut-off moratorium.[8] In New York City, the high-profile financial distress and foreclosure of multiple large rental complexes, including some that have suffered significant physical decline, has drawn attention to this risk to tenants.[9]

Tenants may also face uncertainty and confusion if they receive notice about the foreclosure. While some state statutes now mandate a clear notice to tenants explaining their rights, tenants often do not understand the implications of a foreclosure action. They may not know, for example, that they are still obligated to pay their rent to the landlord up until they are notified that the property has been transferred to a new owner or their lease is terminated. Even if a tenant has a legal right to stay in a rental unit following a completed foreclosure, he or she may be intimidated by threats of eviction and inaccurate claims by realtors or unscrupulous new owners that receiving "cash for keys" to move out quickly is the best they can hope for. In December 2008, illegal eviction complaints in New Jersey, for example, prompted a press release warning of real estate agents intentionally misleading tenants in foreclosed buildings about eviction and landlords locking tenants out.[10]

Finally, the foreclosure crisis has created new opportunities for fraud perpetrated against tenants. Unscrupulous owners may lease homes that are already in foreclosure to unsuspecting tenants and then disappear with the security deposit or other prepaid rental payments.[11] Other victims sign leases and pay rent and a security deposit to people who fraudulently misrepresent themselves as the owner of a vacant home that instead belongs to someone else.[12] This crime has been made much easier by the explosion of vacant homes that has resulted from the foreclosure crisis.

THE SCALE OF THE PROBLEM

If the plight of renters in the foreclosure crisis was overlooked for too long, it is not because it was experienced by few or confined to only a handful of cities. Survey data collected by the Mortgage Bankers Association indicated that at least 18% of all mortgages entering foreclosure in the third quarter of 2007 were on properties that were not owner-occupied.[13] The vast majority of these were, presumably, rental properties, many of which contained more than one unit. In 2008, the National Low Income Housing Coalition (NLIHC) reviewed several other studies and regional estimates and concluded that about 20% of all foreclosure filings nationally were on rental properties and that rental households made up about 40% of all affected families.[14] In California, Tenants United, a tenant's rights group, estimated that one third of all units that were in foreclosure in 2008 were rental units.[15] Studies looking at foreclosure and building type data in Minneapolis, Cleveland, and Chicago, among other cities, demonstrate that in urban areas in particular, foreclosure touches many rental units.[16] In New York City, the country's largest rental market, NYU's Furman Center for Real Estate and Urban Policy used foreclosure filing data and building type to estimate the number of rental households affected by foreclosure over the course of the foreclosure crisis.[17] As shown in Table 1, the Furman Center found that a majority of foreclosure filings in New York City were on multi-unit buildings and more than 25,000 rental units were in buildings that entered foreclosure in 2009 alone.

TABLE 1: FORECLOSURE FILINGS AND RENTAL UNITS IN NEW YORK CITY

	2007	2008	2009
Percentage of all foreclosure filings that were on multi-unit buildings	58%	58%	56%
Estimate percentage of affected units that were rentals	50%	51%	54%
Estimated number of affected rental units	14,643	15,523	25,027

Source: Furman Center for Real Estate and Urban Policy

Data availability limits our ability to quantify exactly how foreclosure is affecting these many renter households. Most of the existing research looks at residential foreclosure filings and either owner occupancy or building type to estimate the number of affected rental households. However, foreclosure filings are only the first step in the foreclosure process and are often resolved without displacement of the property's occupants (homeowner or renter) or any noticeable disruption to a tenancy. Estimates based on foreclosure filings, then, provide the upper bounds of the number of affected renter households.

A smaller body of research has focused on the last stages of the foreclosure process—the foreclosure auction—to produce more conservative estimates of the impacts of foreclosure on rental households. To provide a lower bounds estimate of the number of renters affected by foreclosure in New York City, the Furman Center counted the number of rental units in properties that completed the foreclosure process and were transferred at a foreclosure auction, either to a foreclosing lender or to a third-party buyer. The number of such units grew from fewer than 1,000 in 2007 to more than 1,500 in 2008, but even then it was much smaller than the number of rental units in properties that began the foreclosure process that year. A NLIHC study of foreclosures in Connecticut, Massachusetts, New Hampshire, and Rhode Island revealed that of the 15,000 properties that were either scheduled for a foreclosure auction or were acquired by a foreclosing lender ("REO" properties) in 2007 and the first quarter of 2008, 32% were multi-unit buildings.[18] The study estimated that these buildings contained 23,000 units, about 45% of which were rentals. It is important to note that these lower bounds estimates undercount the number of renter households harmed by foreclosure. As described earlier, well before a property finishes the foreclosure process, tenants can be subject to reduced maintenance and utility shutoffs, confusion over the proper party to whom rent should be sent and insecurity about the future of their tenancy.

FEDERAL ACTION AND GSE POLICY CHANGES

Landlord-tenant relationships and the foreclosure process are by and large governed by state law. However, the depth of the broader financial crisis and its impact on homeowners and tenants alike have prompted federal legislation and policy changes by the two large "government-sponsored enterprises" (Fannie Mae and Freddie Mac). The first federal response to the crisis that benefited tenants was the Emergency Economic Stability Act (more commonly referred to as EESA or the "Bailout Bill"), enacted in October 2008. EESA, the product of intense debate about the best response to the growing global economic crisis, authorized the Secretary of the Treasury to spend up to $700 billion to purchase troubled assets from financial institutions.[19] This was the basis for what came to be known as the Troubled Asset Relief Program (TARP). EESA also included short provisions promoting foreclosure mitigation, homeowner assistance and tenant protections in connection with the mortgages that the federal government would come to own (directly or indirectly through mortgage-backed securities) as a result of the program.[20] Perhaps most importantly, the provisions ensured that federal ownership of mortgage assets would not preempt any state or local tenant protections for the occupants of the properties at the bottom of those mortgage assets.

Policy changes by Fannie Mae and Freddie Mac (which had entered federal conservatorship in September 2008) marked another step in the evolution of national tenant protections. Both entities take ownership of defaulting mortgages in pools whose securities they insure, so they are effectively the foreclosing lender for thousands of homes every month. Prompted in part by pressure from legal services groups and litigation, Fannie Mae began its National Real Estate Owned (REO) Rental Policy in January 2009. The policy permits renters in houses that Fannie Mae acquires through foreclosure to remain under a month-to-month lease instead of facing eviction.[21] In March 2009, Freddie Mac launched a similar program, the REO Rental Initiative, though it applies both to tenants and defaulting homeowners and requires occupants to prove their ability to pay rent.[22] Under both programs, tenants are also offered financial assistance to move out of the property as an alternative to staying on as tenants. Both programs came on the heels of broader eviction moratoria that the companies had announced in late 2008, but the programs remain in place even after the moratoria expired in early 2009. Though significant, neither program provides help to tenants in the many homes with subprime mortgages that were neither held nor guaranteed by the companies.

In February 2009, the enactment of the American Recovery and Reinvestment Act (ARRA or more commonly known as the "Stimulus Bill") provided some tenants with further protection. Under ARRA and a previous act (the Housing and Economic Recovery Act), congress dedicated almost $6 billion to the Neighborhood Stabilization Program. Under this program, HUD has allocated money to local governments and nonprofit agencies for, among other things, the purchase and rehabilitation of foreclosed houses. ARRA mandates that purchasers of foreclosed properties using Neighborhood Stabilization Program money provide existing tenants 90 days' notice before eviction or, if there is an existing lease, honor its remaining term.[23] Although this provision was likely to affect only a small portion of the many renters facing foreclosure-related displacement, it signaled the federal government's determination not to aggravate the problem through its own neighborhood development programs.

Finally, in May 2009, the President signed into law the Protecting Tenants at Foreclosure Act (PTAF), the most comprehensive federal measure to date addressing the plight of renters in the current crisis. PTAF, part of a broader foreclosure prevention and mitigation bill, effectively extends ARRA-like protections to renters in *any* residential property that goes into foreclosure after May 20, 2009. Specifically, the Act requires those who acquire properties out of foreclosure to provide at least 90 days' notice before evicting any tenant (provided the tenant continues to pay rent) or, if longer, honor the remaining term of a tenant's existing, bona fide lease. If a purchaser of a foreclosed property intends to occupy it as her primary residence, an existing lease can be terminated, but the tenant must still be provided 90 days' notice before he or she is required to leave the property. The Act does not undercut any existing state-level protections or provisions governing federal housing subsidies that may be stronger, but provides a minimum level of protection throughout the country. The provisions of PTAF, which are an extraordinary federal foray into to the traditional domain of state and local law, expire on December 31, 2012.

Unfortunately, protecting a tenant's legal right to stay in his or her home addresses only one of the risks tenants face when their landlord is in foreclosure.

But while the federal government has shown its willingness to increase the rights of tenants in properties that face foreclosure, it has conspicuously omitted many rental units from its efforts to prevent foreclosures. The Making Home Affordable program (MHA), the Obama administration's marquee foreclosure prevention effort, only allows owner-occupants to refinance or modify their mortgages to avoid foreclosure.[24] Thus, while the goal of the restriction is to avoid aiding a specific class of "undeserving" homeowners (property investors), it also has the effect of excluding many tenants from the stability that foreclosure avoidance would offer. The administration did, however, promise $1.5 billion in assistance to renters as part of its roll-out of MHA.[25]

CONCLUSION

In October 2008, in one of the more dramatic responses to the foreclosure crisis by local government, Sheriff Thomas Dart of Chicago unilaterally decided to halt evictions because he felt justice was not served by forcing rent-paying tenants out of their homes.[26] At that stage of the foreclosure crisis, tenants were still largely vulnerable to foreclosure in jurisdictions without "just" or "good" cause protections. Since the fall of 2008, however, federal legislation addressing the broader financial and foreclosure crises has tracked the growing awareness of national legislators of the risks facing renters. PTAF in particular, with its significant protections and broad national coverage was a major milestone.

Unfortunately, protecting a tenant's legal right to stay in his or her home addresses only one of the risks tenants face when their landlord is in foreclosure. Ensuring that vital utilities are paid for and provided and that basic maintenance is performed continues to be a serious challenge when so many landlords are in financial distress. Furthermore, because of the complexity of landlord-tenant and foreclosure laws, many tenants are likely still confused about what their rights are and could benefit from continued outreach. Accordingly, despite the awareness of the issues exhibited by national policymakers in the past two years, local public officials and advocates still have a crucial role in protecting renters from a foreclosure crisis that was not of their making.

NOTES

1. 110 Cong. Rec. H 10,393 (2008).
2. For a fuller discussion on renters in foreclosure see Vicki Been & Allegra Glashausser, *Tenants: Innocent Victims of the Nation's Foreclosure Crisis*, 2 Alb. Gov't L. Rev. 1, 1 (2009).
3. Because of the variation in state real estate law and landlord tenant law, this generalization comes with many caveats and exceptions. For more information about individual states, see *Without Just Cause: A Review of the (Lack of) Rights of Tenants in Foreclosure*, Report (NLCHP & NLIHC), Feb. 25, 2009.
4. Section 8 tenants are protected by 42 U.S.C.S. § 1437 (d)(1)(5); NYCRR § 2524. For more information, see *Preserving Section 8 Tenancies After Foreclosure* for an outline of the legal issues Section 8 tenants may face after foreclosure. Esme Caramello, Clinical Instructor, Harvard Law School, Presentation before Shriver Center National Center on Poverty Law (Oct. 2, 2008) (presentation available at http://www.povertylaw.org//poverty-law-library/research-guides/foreclosure-webinar/caramello.pdf).
5. D.C. Code 42-3505.01 (1985); N.J. Stat. 2A: 18-61.1; N.H. Title LV, Ch 540-2. The N.H. law is more restricted than the others because it does not apply to single-family homes acquired through foreclosure or rental units in an owner-occupied building with four units or fewer. N.H. Ch 540: 1-(a) (I).
6. *See, e.g.,* Seattle Municipal Code § 22.206.160 (C); Chicago Residential Landlord Tenant Ordinance § 5-12-130; Berkeley Rent Stabilization and Eviction for Good Cause Ordinance Sec. 13.76.130; Rent Stabilization Ordinance of L.A. § 151.09 (1979).
7. Ohio Rev. Code Ann. § 1923.04 (requiring notice be provided to tenants that they have three days to vacate the property before an eviction action is commenced); Ill. Comp. Stat. 5/15-1701 (h)(4) (2007).
8. *E.g.,* Press Release, City of Oakland Office of the City Attorney, City of Oakland Declares Utility Shut-Offs in Foreclosed Buildings to be a Significant Threat to Public Health and Safety (Dec. 22, 2008). (http://www.oaklandcityattorney.org); Lynda Carson, *Oakland declares 120-day delay in utility shut-offs, S.F. Bay View*, Dec. 24, 2008, www.sfbayview.com.
9. Manny Fernandez and Jennifer 8. Lee, *Struggling Landlords Leaving Repairs Undone, NY Times*, Jul. 14, 2009. www.nytimes.com.
10. Press Release, Dep't of the Public Advocate. Tenants in Foreclosed Properties Have Rights—Cannot be Evicted Due to Foreclosure Under NJ Law (Dec. 23, 2008), available at www.state.nj.us/publicadvocate/news.
11. *See, e.g.,* Hillary Copsey & Nadia Vanderhoof, *Foreclosures Have Rental Fraud Cases on the Rise in Florida, TCPALM* (Palm City), Apr. 26, 2008, http://www.tcpalm.com/news (reporting on a victim of renter fraud, and quoting local officials on a recent spike in rental fraud cases).
12. *See, e.g.,* Press Release, South Carolina Dep't of Consumer Affairs, Residential Rental Scam: Combining Fraud with Risk of Identity Theft (Aug. 6, 2008), available at http://www.scconsumer.gov (warning issued after reports of rental fraud in neighboring states); Commercial Crimes Bureau, Victim's Guide to Real Estate Fraud, L.A. County Sheriff's Dep't, available at http://www.lasd.org/sites; Brent Whiting, *Family Stung By Rental Fraud, Ariz. Republic,* Aug. 5, 2008, www.azcenral.com.
13. Brinkman, Jay, "An Examination of Mortgage Foreclosures, Modifications, Repayment Plans and Other Loss Mitigation Activities in the Third Quarter of 2007." 2008. Available at: http://www.mbaa.org/files/News/InternalResource/59454_LoanModificationsSurvey.pdf.
14. Pelletiere, Danilo, "Renters in Foreclosure: Defining the Problem, Identifying Solutions." 2008. Available at: http://www.nlihc.org/doc/renters-in-foreclosure.pdf.
15. Tenants Together, "Hidden Impact: California Renters in the Foreclosure Crisis," 2009, available at: http://www.tenantstogether.org/downloads/ForeclosureReport.pdf.
16. See, e.g., Woodstock Institute, "Foreclosure crisis impacts Chicago's rental housing market," 2008, available at www.woodstockinst.org/publications/research-reports/; Rothstein, David, "Collateral Damage: Renters in the Foreclosure Crisis," 2008, available at www.policymattersohio.org/pdf/CollateralDamage2008_0619.pdf; and Hennepin County Foreclosure Task Force, "Report–October 18, 2007," 2007, available at www.co.hennepin.mn.us/files/HennepinUS/TSD/Mortgage%20Foreclosure/MortForeRpt2007.pdf.
17. Data provided by the Furman Center for Real Estate and Urban Policy on March 24, 2010. For methodology and analysis of 2007 data, see Press Release, Furman Center for Real Estate and Urban Policy, New Analysis of NYC Foreclosure Data Reveals 15,000 Renter Households Living in Buildings that Entered Foreclosure in 2007 (Apr. 14, 2008), available at http://furmancenter.org/files/pr/Furman_Release_Renters_in_Foreclosure_4_14_2008.pdf.
18. Wardrip, K.E., & Pelletiere, D. "Research Note #08-10, Properties, units and tenure in the foreclosure crisis: An initial analysis of properties at the end of the foreclosure process in New England." 2008. Available at http://www.nlihc.org/doc/RN-08-01-Multi-Unit-Foreclosure-FINAL-05-06-08.pdf.
19. 12 U.S.C. § 5201.
20. 12 U.S.C. § § 5219, 5220.
21. Press Release, Fannie Mae, Fannie Mae Announces National REO Rental Policy (January 13, 2009), available at www.fanniemae.com/newsreleases/2009/4581.jhtml.
22. Press Release, Freddie Mac Freddie Mac Officially Launches REO Rental Initiative for Tenants, Owner-Occupants After Foreclosure (March 5, 2009), available at www.freddiemac.com/news/archives/servicing/2009/20090305_reo-rental-initiative.html; More information available at www.freddiemac.com/corporate/buyown/english/avoiding_foreclosure/rental_initiative.html.
23. American Recovery and Reinvestment Act, H.R. 1, signed Feb. 17, 2009, at Title 11, available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h1enr.pdf.
24. U.S. Dep't of Treasury, *Borrower Frequently Asked Questions*, www.makinghomeaffordable.gov/borrower-faqs.html (visited August 6, 2010).
25. U.S. Dep't of Treasury, *Making Home Affordable Updated Detailed Program Description*, Mar. 4, 2009, www.ustreas.gov/press/releases/reports/housing_fact_sheet.pdf.
26. John Leland, *Sheriff in Chicago Ends Evictions in Foreclosures, N.Y. Times*, Oct. 9, 2008.