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Banks Starting to Walk Away on Foreclosures

By SUSAN SAULNY

SOUTH BEND, Ind. — Mercy James thought she had lost her rental property here to foreclosure. A date for a sheriff's sale had been set, and notices about the foreclosure process were piling up in her mailbox.

Ms. James had the tenants move out, and soon her white house at the corner of Thomas and Maple Streets fell into the hands of looters and vandals, and then, into disrepair. Dejected and broke, Ms. James said she salvaged but a lesson from her loss.

So imagine her surprise when the City of South Bend contacted her recently, demanding that she resume maintenance on the property. The sheriff's sale had been canceled at the last minute, leaving the property title — and a world of trouble — in her name.

"I thought, 'What kind of game is this?' " Ms. James, 41, said while picking at trash at the house, now so worthless the city plans to demolish it — another bill for which she will be liable.

City officials and housing advocates here and in cities as varied as Buffalo, Kansas City, Mo., and Jacksonville, Fla., say they are seeing an unsettling development: Banks are quietly declining to take possession of properties at the end of the foreclosure process, most often because the cost of the ordeal — from legal fees to maintenance — exceeds the diminishing value of the real estate.

The so-called bank walkaways rarely mean relief for the property owners, caught unaware months after the fact, and often mean additional financial burdens and bureaucratic headaches. Technically, they still owe on the mortgage, but as a practicality, rarely would a mortgage holder receive any more payments on the loan. The way mortgages are bundled and resold, it can be enormously time-consuming just trying to determine what company holds the loan on a property thought to be in foreclosure.

In Ms. James's case, the company that was most recently servicing her loan is now defunct. Its parent company filed for bankruptcy and dissolved. And the original bank that sold her the loan said it could not find a record of it.

"It is what some of us think is the next wave of the crisis," said Kermit Lind, a clinical professor at the Cleveland-Marshall College of Law and an expert on foreclosure law.

For older industrial cities like South Bend, hard times in the mortgage market began before the recent national downturn, as did the problem of bank walkaways. In the case of Ms. James, a home health care administrator, the foreclosure proceedings began in the summer of 2007, when she could not keep up with the adjustable rate on her mortgage.

In Buffalo, where officials said the problem had reached "epidemic" proportions in recent months, the city sued 37 banks last year, claiming they were responsible for the deterioration of at least 57 abandoned homes; the city chose a sampling of houses to include in the lawsuit, even though the banks had walked away from many more foreclosures. So far, five banks have settled.

In Kansas City, Rachel Foley, a lawyer who handles housing cases, said bank walkaways were "a rare occurrence two to three years ago."

"We're seeing them dumped more and more at the moment," she said.

Experts suggest the bank walkaways are most visible in states where foreclosures are processed through the courts and therefore tend to be more transparent. Other states, like Indiana and New York, have court-mandated foreclosures, but roughly half of the states allow foreclosures to proceed without court intervention, making it difficult to accurately count the number of bank walkaways in recent months.

The soft housing market and the vandalism that often occurs when a house sits empty are the two main factors influencing the mortgage holders' decisions to walk away, said Larry Rothenberg, a lawyer for Weltman, Weinberg & Reis, one of the larger creditors' rights firms in the country.

"Oftentimes when the foreclosure starts out, it's a viable property," Mr. Rothenberg said, "but by the time it gets to a sheriff's sale, it might not have enough value to justify further expense. We've always had cases where property was vandalized or lost value, but they were rare compared to these times."

The problem seems most acute at the bottom of the market — houses that were inexpensive to begin with — and with investment properties, where investors and banks want speedy closure by writing off bad loans as losses. Banks and investors typically lose 40 percent to 50 percent of their investment on every foreclosure.

Guy Cecala, publisher of Inside Mortgage Finance, an industry newsletter, said some properties had become such liabilities for investors that it was not even worth holding on to them to strip valuable fixtures, like kitchen appliances, toilets and hardware.

"The whole purpose of foreclosure is to take title of the property, sell it and recoup what money you can," Mr. Cecala said. "It's just a sign of the times that things are so bad no one wants to take possession of the property."

In South Bend, boarded-up houses for whom no one has stepped forward are dotting the landscape, adding a fresh layer of blight to communities that were already scarred from the area's industrial decline.

The city is hoping to create a new type of legal mediation process that would bring together the homeowners and the mortgage holders to settle their disputes while allowing the owners to remain in the home — considered crucial to any stabilization effort.

“I’d say in the last three or four months, we’ve seen dozens of these cases,” said Chuck Leone, the South Bend city attorney. “We see it one of two ways. One is that the bank will simply dismiss the foreclosure complaint. The other is that the mortgage holder will follow through and take a judgment of foreclosure, but then not schedule the property for sheriff’s sale.”

In Ms. James’s case, it has been impossible to determine who canceled the sheriff’s sale, since her last mortgage holder went out of business. Even the city clerk’s records did not provide an answer.

“Nobody has any idea who owns what or who’s responsible,” said Judy Fox, Ms. James’s lawyer at the Notre Dame Legal Aid Clinic. “It’s a very common story.”

Mayor Stephen J. Luecke of South Bend added: “It’s just a crime the way it puts people in limbo. They first off have gone through the grief of losing their house, then they move out and find out that they still own it and have responsibility for it.”

In Jacksonville, Fla., Sylvester Kimbrough Jr. found himself caught in the limbo between foreclosure and ownership last year, 10 years into his 30-year mortgage on a $42,000 two-bedroom house.

Mr. Kimbrough, 56, a former driver for a car dealership who is now unemployed, had already moved out when he learned that the foreclosure had been stopped.

“That move really almost destroyed us,” Mr. Kimbrough said. “It was all for nothing.”