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THE FORECLOSURE CRISIS IN CHICAGO

by **Ilyas Lakada**

Mr. and Mrs. Smith thought they were living the American dream. As immigrants to the United States, they longed to own their own home some day. The Joneses were in a similar situation. They too imagined that investing in real estate would offer some financial stability for their retirement. But when the market collapsed in 2008, their hopes were shattered as they lost what little remained of their retirement savings. The Smiths and Joneses are just a handful of stories of homeowners desperately trying to save their homes and property from foreclosure, only to find that the laws meant to help them offer little shelter.

In 2010, the Chicagoland area saw a near 16 percent increase in foreclosure related filings.[1] In the third quarter of 2010, Chicago saw a 35 percent increase with one in 84 properties receiving a notice of foreclosure.[2] Even more startling, in 2010 Chicago had the second-highest number of bank repossessions, increasing by 20 percent from the year previous to 45,555.[3] These statistics reveal that Chicago has not been immune to the nationwide foreclosure crisis.

Under the Illinois Mortgage Foreclosure Act (the Act), the term "foreclosure" means "to terminate legal and equitable interests in real estate" due to non-payment of a loan.[4] The nationwide foreclosure epidemic can trace its roots back to 2008.[5] Rising unemployment, consistent underemployment, and increasing loan interest rates due to bait-and-switch tactics of mortgage brokers were all contributory factors to the crisis.[6]

Economists posit that the negative equity of current homeowners, or homeowners who owe more on their house than it is currently worth (sometimes referred to as being underwater), is adding fuel to the fire.[7],[8] In Chicago alone, nearly 386,000, or 25 percent of the area's 1.5 million homeowners, report being underwater.[9] These homeowners often feel that it is more economically prudent to walk away than to simply throw good money after bad.

Under the Act, a homeowner may also opt to hand the deed of the house to the lender, known as a "deed-in-lieu"[10] or a "consent foreclosure."[11] The homeowner is shielded from any personal liability that may have resulted from a foreclosure case.[12]

Many homeowners, however, attempt to mitigate any such outcome by first working with the lender. Under President Obama's Home Affordable Modification Program (HAMP), qualified borrowers may be eligible to have their loan payments reduced to 31 percent of their gross income through interest rate reductions and an extension of the amortization period.[13] Troubled homeowners also have the option of a "short sale."[14] In a short sale transaction, the homeowner places his home on the market and, if a prospective buyer offers less than the total loan due, the bank may accept the reduced settlement. Congress has also incentivized short sales by refusing to tax the principal amount that may have been forgiven—up to $2 million.[15]

A Homeowner's Perspective

In June of 2004, Mr. and Mrs. Smith purchased a brick two-flat building in the North Mayfair community of Chicago for $431,000.[16] The couple had decent jobs and there was a rental unit that could help offset any expenses.[17] In 2008, however, Mr. and Mrs. Smith started to experience difficulties.[18] Their tenant lost her job and moved out to live with another family member.[19] Mr. Smith was deemed disabled and had to quit his job, earning a small Social Security disability payment.[20]

Unable to make ends meet, the couple decided to charge their nearly $3,600 interest-only monthly loan payment on their credit card.[21] "We didn't know what else to do . . . my English is limited and I couldn't afford a lawyer," stated Ms. Smith while wiping away tears.[22] "My husband would wake up in the middle of night scared . . . 'what about the children's school?'"[23] The Smiths had two children in a nearby magnet elementary school and did not want to transfer them to another general enrollment school.[24]

Then, in January 2009, with his medical condition worsening and the household finances in turmoil, Mr. Smith passed away due to a stroke.[25] With the assistance of a family member, Mrs. Smith contacted her lender, JPMorgan

Chase.[26] At first, "they actually wanted me to miss some payments," complained Mrs. Smith.[27] Eventually she did, and formally applied for a loan modification.[28] For a year, her lender lost documents, gave incorrect information, and rejected her trial payment plans.[29] "I didn't understand. First they said 'miss some payments.' Then, they said 'as long as you make your trial payments, you'll be guaranteed a permanent reduced payment.' It never happened."[30]

She applied for a modification three times only to be rejected each time.[31] No formal reason was given.[32] She has written to the U.S. Treasury Department and Freddie Mac (the original investor of the loan) but has not received a response.[33] Finally, on the advice of a family member, she "short-sold" her home in December 2010.[34] "I am relieved [that the loan is gone] but upset—this was designed to help people like me. Why didn't they help? Why did they lie to me for two years? I placed so much hope in them."[35]

An Investor's Perspective

Mr. Jones, on the other hand, is considered a strategic-defaulter. In April 2006, he and his wife purchased a one-bedroom condominium unit for nearly $300,000 in the Gold Coast neighborhood of Chicago.[36] At the time, the developer offered to pay the first two years of the interest-only loan payment. Mr. Jones also had a tenant there.[37] "It was great. We had no out-of-pocket cost and the market was rising," said Mr. Jones.[38] "The unit next door sold for $400,000 a year later."[39]

But, in 2009, Mr. Jones noticed values were declining rapidly.[40] Other unit owners were selling their condos for nearly 50 percent less than what Mr. Jones purchased his unit for.[41] "What's the point?" said Mr. Jones.[42] "Why should I make payments on something that is never going to come back?"[43] Mr. Jones now claims that the price of his unit has further declined to less than $100,000. He contacted his lender, Citibank.[44] "The bank's response was 'Since you don't live there, you don't qualify,'" said an angered Mr. Jones.[45]

The couple submitted documentation about the situation, but the bank would not consider the information.[46] "I told them the keys are in the mail," said Mr. Jones.[47] When asked about the moral hazard of strategically defaulting, he responded, "If they threw me a bone, I would have considered. But they're not helping anybody, even the people who are living in their houses. Why should we then care about morals? What about the bank's morals? No doubt I was in over my head, but just give me some hope."[48]

Local Solutions

With the national HAMP program failing to net mortgage modifications for borrowers like the Smiths or Joneses, local governments are trying to fill the gap, as foreclosures have a tremendous negative impact on the local economy.[49] In Cook County, the Chancery Division created the Cook County Foreclosure Mediation program to bring to homeowners and lenders together to work out a solution.[50] The program, however, has had only mild success with "less than ten percent" of eligible homeowners participating.[51]

In the state capitol, lawmakers have proposed legislation including a "Mortgage Foreclosure Prevention Fee" applied to purchasers of foreclosed homes, known in the industry as Real Estate Owned properties (REOs).[52] In Chicago, similar legislation was dubbed the "Sweet Home Ordinance," which would use money from tax-increment financing districts to create affordable housing from REOs.[53] The Community Investment Corporation in Chicago (CIC) has begun such projects, taking on large-scale REOs and converting them into affordable housing units.[54]

CIC's president Jack Markowski wishes to take the program further and work with struggling homeowners, lenders, and investors to convert occupied homes into affordable housing.[55] Nonetheless, it is clear, without government support, the foreclosure crisis in Chicago and nationwide will continue to worsen.

Notes

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4 735 ILCS 5/15-1203.

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7 *Id*.
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13 *Home Affordable Modification Program*, US Dept. of Treasury, Apr. 3, 2011, *available at* http://www.makinghomeaffordable.gov/programs/lower-payments/Pages/hamp.aspx.
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16 Interview with Mrs. N. Smith (pseudonym), Defaulting Homeowner, in Chicago, Ill. (Mar. 18, 2011).
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18 *Id*.
19 *Id*.
20 *Id*.
21 *Id*.
22 *Id*.
23 *Id*.
24 *Id*.
25 *Id*.
26 *Id*.
27 *Id*.
28 *Id*.
29 *Id*.
30 *Id*.
31 *Id*.
32 *Id*.
33 *Id*.
34 *Id*.
35 *Id*.
36 Interview with Mr. and Mrs. Jones (pseudonym), Strategically Defaulting Homeowners, in Chicago, Ill. (Mar. 3, 2011).
37 *Id*.
38 *Id*.
39 *Id*.
40 *Id*.
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42 *Id*.
43 *Id*.
44 *Id*.
45 *Id*.
46 *Id*.
47 *Id*.

48 *Id*.
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50 Pat Milhizer, *Lawyers Needed for Foreclosure Mediation Program*, CHI. DAILY LAW BULLETIN, Oct. 25, 2010.
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55 *Id*.