

# How To Minimize Costs And Risks While Managing Code Violations

A failure to address potential problems can result in significant municipal fines.

By **Brandon Kirkham**

**A** November 2011 report by the U.S. Government Accountability Office (GAO) entitled "Vacant Properties: Growing Number Increases Communities' Costs and Challenges" identified an estimated 10 million vacant properties across the country in April 2010, an increase of 3 million properties from the previous study in 2000. According to the GAO, 10 states have seen the number of vacant properties increase by 70% or more.

Based on this data, it is safe to assume that the number of vacant properties will not decrease anytime soon. Unattended vacant properties deteriorate and contribute to blight, which drives down real estate values and tax revenue. Keeping vacant properties safe, secure and maintained presents financial and administrative challenges for the mortgage industry and municipalities alike.

Even though the vast majority of vacant properties are on a schedule for regular inspections and maintenance, code violations occur: Vacant properties are broken into, inclement weather creates wind and storm damage, people dump trash and debris, a pool cover or fencing around the pool may be compromised, and so forth. All of these events can trigger code violations.

When the process works, city code enforcement officials issue a notice to the mortgage servicer when a violation is noted, and the problem is addressed quickly. When the process fails, however, properties deteriorate, and they

impact the quality of life for surrounding neighbors.

Code enforcement officials become frustrated trying to get violations corrected, and servicers risk heavy fines, penalties and tarnished reputations for failing to correct problems in a timely manner. A number of municipalities have even issued criminal citations against the executives of entities holding title to troubled properties.

Local governments each have a wide array of building, housing and property maintenance codes that establish standards for the appearance and safety of properties within their communities. Cities with high volumes of vacant and foreclosed properties have become more aggressive with their housing inspections in response to safety and nuisance complaints from neighbors.

Many local governments also view code enforcement as an opportunity to generate revenues to relieve tightening budgets. As a result of stronger code enforcement actions, servicers face fines and penalties in the thousands of dollars for failure to correct violations that would have cost only hundreds to address initially.

In fact, conversations with code enforcement officials in cities across the country often reveal three violations as the most common, each of which is relatively easy and inexpensive to remedy: an unsecured property, tall grass, and debris in the yard. Most of the time, fines accumulate - not because the servicer knowingly ignored a citation, but because the servicer wasn't aware of

the violation and failed to address it in a timely way.

Consider this case about a property that incurred violations after it was found unsecured as a result of vandalism: The city issued violations for having an unsecured property, failing to maintain the property, having a dangerous structure, failing to inspect and lacking a permit. As it turned out, a master servicer was overseeing a second servicer that had day-to-day responsibility for the property. The municipality was unaware of the servicing arrangement and sent violation notices to the master servicer, which did not notify the city or forward the violations to the appropriate servicer.

When the violations went uncorrected, the city took enforcement action that ultimately resulted in nearly \$12,000 in civil penalties, more than \$1,000 in fees to cover direct expenses, and additional daily penalties that ranged between \$150 and \$375 per violation. Had the notice been addressed in a timely way, the servicer would have spent only a few hundred dollars to re-secure the property.

In addition to taking stricter enforcement action and levying stiffer fines and penalties, cities have widened the net of violations they cite. In the past, servicers received code notifications only for violations related to the safety and security of the structure.

Recently, municipalities have begun issuing citations for dirty floors, carpets and windows, strong odors in the home, and other items the industry views as cosmetic. Because cosmetics are not included in preservation fee schedules and investor allowables for foreclosed properties, servicers may not be reimbursed for these services. Yet, they are

responsible to the investor for correcting all code violations.

Similarly, servicers face greater risks, as municipalities have begun to issue violation notices on occupied foreclosed properties for problems ranging from missing smoke detectors and window locks to insufficient heat or hot water and broken sink stoppers. Despite the stronger position municipalities have taken to address code violations, it is important to recognize that municipalities and the mortgage industry are on the same side in the battle to protect property values and maintain the quality of life in neighborhoods. By working and communicating more effectively with code enforcement officials and taking steps to improve their systems and processes, servicers can minimize code violations and the associated fines, penalties and reputational risks.

### **Effective systems**

Servicers cannot fix problems they don't know about, and code enforcement departments don't have the resources to search for the right person to notify within a large, multi-office mortgage servicing organization. Code violations can occur before the loan becomes delinquent. Therefore, servicers should identify a single point of contact within their organizations to respond to complaints regarding current loans or a field service provider who serves as their agent to address code violations after a loan becomes delinquent.

Contact names should be communicated throughout the organization and posted on the servicer's website. Maintaining a single point of contact or intake method for the benefit of municipalities streamlines the notification process.

To manage the sheer volume of properties, servicers also should consider utilizing a code enforcement management system that allows municipalities to post violation notices and enables internal staff to receive, track and manage violations to a successful conclusion. The more efficient and direct the process is between municipalities and servicers to post, monitor and resolve violation notices, the more successful servicers will be in addressing code violations quickly. This is especially critical as code en-

forcement officials become either less willing or have less authority to negotiate reductions in fines and penalties.

When servicers incur penalties, effective dialogue with municipalities can help to stop the accrual of further penalties and even reduce them. A trained and empowered negotiator who understands local codes can develop case resolution plans that are acceptable to the municipality and that can alter the timing and nature of enforcement actions by the municipality.

For example, communication with municipalities can help facilitate the extension of grace periods on violations in cases where a servicer or lien holder will soon take possession or control over a property. Upon initial vacancy, when properties have been in violation of certain codes, it is helpful for the servicer or its field service agent to communicate with code enforcement officials about the completion of standard initial services that would likely correct these conditions.

Furthermore, having knowledge of the code violation can improve the servicer's ability to adjust the initial services work order to sufficiently address the violations. Whenever municipalities can be made to understand what services can or will be performed within certain time frames, they are more likely to suspend enforcement to provide a reasonable time to cure the violation.

### **Proper procedures**

Loans serviced on behalf of the Federal Housing Finance Agency, the government-sponsored enterprises, the Federal Housing Administration and the U.S. Department of Veterans Affairs have guidelines, fee schedules, delegated authority and other options to assist the servicer in protecting and preserving properties. These guidelines, however, do not include provisions to address all of the potential challenges that result in code violations.

Servicers are required to seek approval before certain expenditures can be made. The approval process includes maintaining documentation and obtaining bids and photos before work can be performed to cure the violation.

To facilitate the decision-making process and cost reimbursement, servicers must maintain detailed records and

supporting documentation. Failure to maintain documentation can result in non-reimbursement for fines, penalties and the costs of work performed. Having a single, concise location to manage violations and retain supporting documentation provides transparency and improves recovery.

Code enforcement departments and the mortgage industry share a common goal to protect the condition and value of vacant and abandoned properties. They also have their own unique challenges. The housing crisis has strained municipal budgets and put more pressure on code enforcement departments to address property complaints.

Servicers struggle to maintain growing numbers of vacant properties while complying with myriad local codes and requirements, sometimes putting them in conflict with other laws. Through outreach and dialogue, both sides have begun to listen and share ideas and solutions.

The American Association of Code Enforcement and individual state code enforcement associations have been valuable partners with which to facilitate such dialogue. Representatives from the mortgage servicing industry have participated in educational sessions and roundtable discussions with state and local officials to share expectations and discuss solutions.

The GAO study on vacant properties pointed out the challenges that code enforcement departments and local municipal officials face in identifying a responsible party to maintain properties. Among them are owners who have left their homes, outdated and insufficient property records, and insufficient staffing to identify the right party.

The mortgage servicing industry has come a long way in developing the knowledge and tools to become true partners with municipalities and code enforcement officials across the country to effectively address code violations. And it is in the industry's best interest to utilize such relationships. **SM**

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