

An Unfurling Crisis

When 10 million Americans—1 of every 20 adults—lost their homes,¹ it was clear that homeowners needed an intervention. When Countrywide, which two years earlier had serviced 20% of the mortgages in the United States,² collapsed in July 2008, it was clear that the real estate industry needed to change. When cities and counties around California, Florida, Nevada, and Arizona trembled at a declining tax base, it was clear that municipalities needed a break. Yet, none of these actors wielded much power in the response to the subprime mortgage crisis. Unlike the Great Depression, homeowners barely organized their political power and financial institutions imposed very modest debtor-relief programs. Additionally, the long-term trend of municipal disinvestment emphasized the need to remove neighborhood blight instead of create or subsidize housing.

In response, the Housing and Economic Recovery Act of 2008 (HERA) authorized the Department of Housing and Urban Development (HUD) to distribute \$3.9 billion to state and local governments for the purchase and repair of foreclosed properties.³ This program, later termed the Neighborhood Stabilization Program (NSP), is my focus. In purchasing, repairing, and in most cases reselling foreclosed properties, the NSP sought to mitigate the effects of foreclosures on their surroundings. Primarily, foreclosures tear people from their homes. On top of this comes the stigma of being a “deadbeat”⁴ and mounds of fees—legal, cancellation, transportation-related. But once homeowners have been forced out, the neighborhood and municipality bear the financial weight of that foreclosure.

To nearby homeowners, foreclosures cost \$159,000 on average in decreased property values.⁵ To the city or county that envelops the property, it costs on average \$64,000 for the legal and construction work to demolish and resell a vacant lot, parcels which tend to drop property values even further. When property values drop, a home’s [apparent] equity drops too. This figure, estimated constantly by market research firms such as Zillow and appraised periodically by taxing authorities, determines to a large extent the wealth and borrowing power of homeowners. If the value of an already-mortgaged home rises, homeowners can refinance. While refinancing most often takes advantage of lower interest rates or decreased principal amounts to reduce monthly payments, refinancing was used by in the lead up to the subprime mortgage crisis instead to finance renovations, service debts (eg. student, credit card, and car loans), or cash out. Lending institutions willingly converted apparent value into real value, and as long as home values crept up, refinancing was viable. This use of refinancing reflected a shift in how Americans approached housing, from the home as an utterly private good, to the home as an asset. Homes stand increasingly in the position of pension plans and 401ks; a wise move can transform forty years into four-hundred thousand dollars.

These wise moves seemed to occur constantly from September 1992 until March 2006. As @ref(fig:caseshiller) shows, the intervening 14 years never once saw a drop in the industry’s standard home-price metric, the Case-Shiller U.S. National Home Price Index. As prices rose, homeowners refinanced, effectively paying back the first mortgage while taking out the second. To investors in mortgage-backed securities (MBS), pre-payment from refinancing is usually seen as a risk, but constant and predictable refinance added to the safety of securitization, playing into investors risk-reward calculus. But when prices fell—or even flatlined—this safety evaporated. Without the increased [apparent] home equity, refinancing did nothing. Falling prices thus meant homeowners were saddled with their current mortgage, often one whose interest rates reset after two years, climbing an interest-rate staircase for the next 28 years. Atop the interest payments, living expenses (such as other debts) piled on to borrowers, where previously refinancing had arrived to supplement existing income with cash. Falling prices meant homeowners chose among food, water, and shelter, if they had enough income for that to even be a decision.

These factors make homeowners *very* sensitive to falling or stagnant home prices. In their sensitivity, they may have voted for parties, candidates, and policies they believed would drive up home prices, such as property tax cuts, muscular code enforcement, and spacious zoning regulations. Each of these policies reduces the resources available for non-homeowners, pitting homeowners against renters, the homeless, and anyone else

¹Martin and Niedt, *Foreclosed America*.

²Seabrooke, *The Politics of Housing Booms and Busts*.

³Pelosi, “Text - H.R.3221 - 110th Congress (2007-2008).”

⁴Dayen, *Chain of Title*.

⁵Immergluck, *Preventing the Next Mortgage Crisis*.

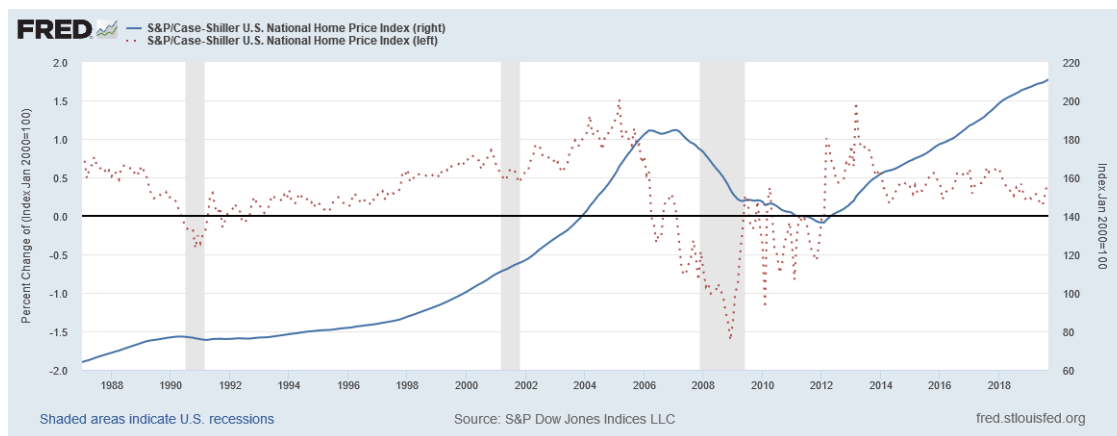


Figure 1: Price (right axis) and growth (left axis) of the Case-Shiller Home Price Index, adjusted for seasonal price fluctuations.

without a direct financial stake in the asset. For example, tax cuts, take they the form of directly-decreased property taxes or the homeowner tax credit, reduce the monies available to fund public goods. In the United States, party ideology also ties higher taxes with explicitly redistributive policies, though Democrats and Republicans archetypically differ as to whether high taxes—more redistribution is good or bad. The rigidity of these ideologies rationalizes the fear that rents extracted from higher taxation will not return to the homeowners. Circling back to the original home-price dynamic, higher home values fund greater consumption, while lower property values and higher taxes (as they always have) limit homeowners’ capacities to spend, an activity Americans very much enjoy.

When prices rose, creditor and debtor interests laid at some angle, intersecting in the particular case of safe, two-year refinancing, but divergent in the general case of refinancing that took advantage of lower interest rates. On the other hand, falling housing prices conformed the immediate interests of creditors and debtors to one another, since delinquency and default eliminated any chance of extracting further rents. Fears of a debt spiral triggered by falling home prices also beset cities,⁶ though there is some doubt that those fears were justified.⁷ With these interests in syzygy, why didn’t homeowners, investors, or cities assert solutions, even ones that were done chiefly in their own interest? I argue in this chapter first that homeowners remained quiet due to changes in the foreclosure process from the Great Depression, the differential character of housing versus farming, and narratives about mortgage debtors. Second, the incongruity—spurred by the demise of savings and loans—between incentives for principals in mortgage-backed securities and agents tasked with servicing the underlying mortgages, along with fraudulent mortgage transfers, resulted in foreclosures that may have otherwise been unwanted by creditors. Third, I point to municipal disinvestment and the trajectory of the Commerce Clause as reasons why cities were unable to handle mass foreclosures. This critique I believe to be sufficient, though by no means necessary, to explaining why each was functionally barred from substantial action.

This argument functions triple purposes. First, it justifies the motives of actors external to the creation of the Neighborhood Stabilization Program, to which internal actors, such as George W. Bush and members of Congress, responded. Second, it offers a story about why external actors may not have acted decisively. Third, this chapter buttresses the above theory of voting with more general insights from political economy literature. Readers should come away from this chapter understanding why federal foreclosure relief programs were necessary and how the subprime mortgage crisis challenges previous theories of asset-based voting.

⁶Muro, “Fiscal Challenges Facing Cities.”

⁷Gross et al., “The Local Squeeze”; Lutz, Molloy, and Shan, “The Housing Crisis and State and Local Government Tax Revenue.”

Why Homeowners were Unable to Organize

Reasons for the powerlessness of anti-foreclosure organizing can be shown through comparison with the most successful anti-foreclosure campaigns of the Great Depression. Legislative movements require a base of public opinion and support, a mouthpiece through which opinion can be articulated, and an powerful audience to hear those articulated opinions and demands. Foreclosed housing's base of public opinion and support was attenuated by geographic particularities of subprime mortgages which limited fora for communication, both internally and externally. In addition, the organizers' audience was blocked partially by other demands, including the presence of mortgage servicers. The Great Depression, however, saw these factors come together in the Midwest, where farms were physically parched and thus, financially underwater. Farmers were positioned similar to homeowners who adopted cash-out refinancing in that they relied on their land for its income. However, farmers in the Great Depression differed from early 2000s subprime borrowers in that farming did not *supplement* wage income, it *replaced* wage incomes. In addition, access to government and stark differences in media portrayal combined with the larger impact of farm foreclosures to drive organizing that led to 27 states enacting *per se* or *de facto* moratoria on foreclosures.⁸ The lack of such conditions pitched the struggle for foreclosure legislation in the subprime mortgage crisis to a severe angle.

The most important differentiator between the foreclosure crisis in the Great Depression and that which preceded the Great Recession was the outsize effect of farm foreclosures. Farms were both the workplace and home of farmers. Unlike the foreclosure crisis in the 2000s, losing a home implied losing a job, though that job could be lost in other ways (drought, crop disease, low prices). This fact raised the stakes for farmers to plead for relief and enlarged the macroeconomic worries with which politicians were just beginning to grapple. Of the 100,000 farmers who lost their farms each year between 1926 and 1940,⁹ the Midwest saw the highest concentrations. @ref(fig:wheelock-farms) shows the high concentration in Minnesota, Iowa, and the Dakotas, and the lesser concentration all around the Midwest. In 1933, by far the worst year for farm mortgages, failure rates topped 3.7%; during the rest of 1926-1940, rates were often above 1.5%.¹⁰ By contrast, U.S. residential foreclosures reached 1.8% in 2008, the worst year of the mortgage crisis.(REFERENCE NEEDED) In part, this is a denominator effect: the 50% down payments and double-digit interest rates caused fewer mortgages to be demanded in the Great Depression. In large part, however, the differences between farms and homes accounted for the scale.

The geography of farmland created several features that made easier mass organizing. Lower population densities meant that fewer people exercised political power over a fixed-size jurisdiction, when compared to a densely-populated district. While this feature could not have played into U.S. Congressional politics, which are apportioned by population, it could make collusion easier in counties. Organization at the county level was important in the Great Depression, because foreclosed properties were sold by sheriffs, elected county officials.¹¹ Compounding the numerical ease of collusion was the congruency of interests. While farms produce a variety of crops, soil and climate particularities combine with federal agriculture policy to homogenize production locally. In other words, Tobler's first law of geography holds: "everything is related to everything else, but near things are more related than distant things."¹² In conversation with the realities of the foreclosure crisis in the 2000s, two conclusions—one ecological, the other sociological—emerge.

On the side of ecology, crop failures occurred in conjunction with nearby farms. The same climate or disease that killed a neighbor's crops could not be stopped at the property line. Farmers in the Great Depression shared this feature with homeowners in the mortgage crisis: lowered property values on one side would spillover to the other side. For both populations, spatial correlations were imperfect, as some farmers planted different crops and some foreclosures occurred among conservative borrowers or wholly-owned homes, but the spillover effect matters.¹³ Falling property values decreased the value of neighboring properties, deepening the mortgage crisis for farmers in the Depression and homeowners before the Recession. The conditions of localized, severe economic distress existed in both eras.

⁸Wheelock, "Changing the Rules," 537.

⁹Alston, "Farm Foreclosures in the United States During the Interwar Period."

¹⁰Wheelock, "Changing the Rules," 571.

¹¹Fliter and Hoff, *Fighting Foreclosure*.

¹²Tobler, "A Computer Movie Simulating Urban Growth in the Detroit Region," 236.

¹³DeFusco et al., "The Role of Price Spillovers in the American Housing Boom."

Average Farm Foreclosure Rates, 1929–1932

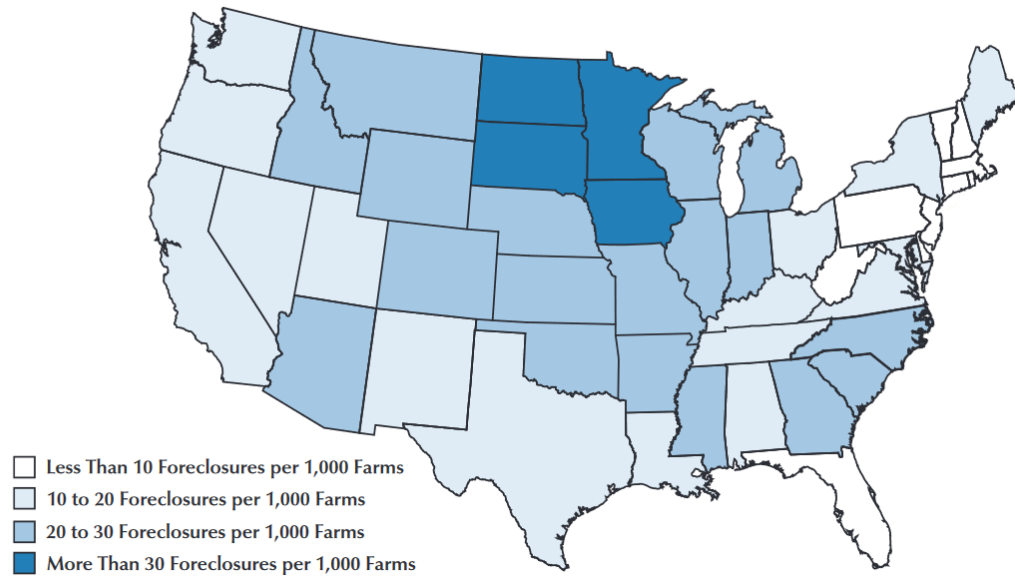


Figure 2: Figure taken from @wheelockChangingRulesState2008

But this comparison did not exist between the sociological features of farming and housing. Farming the same crops entails some degree of visiting the same market, buying the same tools, and asking the same people for advice. Farmers met their neighbors whether they liked them or not, creating a forum to talk shop with nearby people who shared interests. The simple fact of homeownership, however, tends to signify income, but little else, and the larger populations of suburbs facing home foreclosures meant more social and cultural institutions among which residents could choose. The higher density and absolute size of the suburbs separated struggling homeowners from each other, while the lack of farming meant that—even if they had bumped shoulders—their mortgage finances were less likely to be topics of discussion. While the suburban quality of foreclosures in the recent mortgage crisis could have drawn homeowners closer together through their homeowner association (HOA), HOAs were insignificant bulwarks against nearby foreclosures.¹⁴ And more to the point of homeowner behavior, HOA fees were some of the first payments to stop once mortgage debt piled up,¹⁵ suggesting that homeowners disengaged from their homeowner associations entirely. These divergent implications for farming and suburban housing could be added to Robert Putnam's argument of a secular (in both the economic and religious senses) decline in social capital¹⁶ to argue that the sociological character of suburbs blocked organization around increasing mortgage delinquency and household foreclosures.

As I mentioned above, the lack of local fora was important. In the Great Depression, not only were county sheriff offices the location of foreclosure sales, they were also the location of foreclosure sale stoppages. Midwest farmers tried boycotting markets and sabotaging crops in transport to grab attention and force up prices, but they “did not seriously threaten urban food supplies or raise prices or the cost of production.”¹⁷ Rather, farmers succeeded through intimidation tactics. The “ropes under [farmers’] coats [...] stopped thousands more foreclosures than did” self-organized arbitration, according to the then-president of the Farmers’ Holiday Association, Milo Reno.¹⁸ There were more than 100 recorded instances of farmers, sometimes numbering in the thousands, packing county sheriff offices to discourage any would-be buyers, allowing the borrower to

¹⁴Cheung, Cunningham, and Meltzer, “Do Homeowners Associations Mitigate or Aggravate Negative Spillovers from Neighboring Homeowner Distress?” 87.

¹⁵Perkins, "Privatopia in Distress," 561.

¹⁶Putnam, *Bowling Alone*.

¹⁷Fliter and Hoff, *Fighting Foreclosure*, 4.

¹⁸Fliter and Hoff, 65.

re-purchase their farm in full for sometimes as little as a penny.¹⁹ Direct action of this nature was nowhere in the subprime mortgage crisis; @ref(fig:tradingecon) shows the spike in existing home sales after several million foreclosures had been filed.

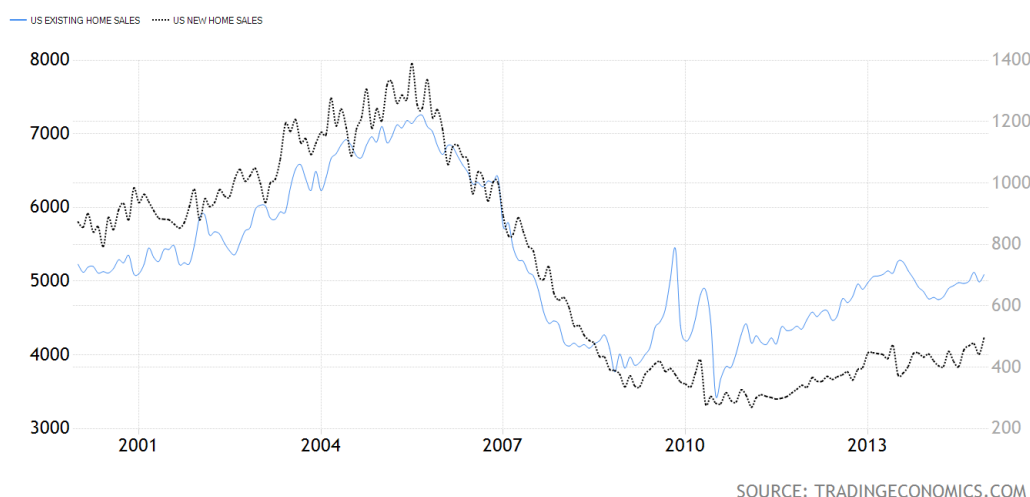


Figure 3: Existing versus New Home Sales, 2000-2014

But organizing need not adopt the character of halting foreclosure sales; rather, the foreclosure itself could have been the point of action. Changes to bankruptcy laws made foreclosures less defensible by making judicial hearings an opt-in rather than mandatory system. The hearings provide both the legal forum to contest evidence, claims, and standing, as well as the social forum to support other defendants.²⁰ Courts' docket sizes also elongated the period a delinquent borrower could stay in their home, during which alternative remedies may be sought.²¹ Collins, Lam, and Herbert²² found that even such vanilla advocacy as mailings to suggest loan modification were more effective in states with judicial foreclosures. However, evidence regarding the change of this process over time is a mixed bag. Cheung, Cunningham, and Meltzer²³ argues that the rights of residents have been eroded due to the increase in states where non-judicial foreclosure is the *norm*, though the actual number of states where non-judicial foreclosure is legally available has decreased.²⁴

Judicial foreclosure briefly entered the national news cycle in 2010, when former homeowners alleged fraud against several large mortgage servicers, termed foreclosure mills for their prolific business. Allied state attorneys general settled with 13 banks over their roles in using falsified titles, signatures, and documents to foreclose on 3.8 million borrowers.²⁵ The fraudulent documents meant that contestation in foreclosure courts was possible, against the assumptions for foreclosures. In fact, the New Jersey Supreme Court in 2010 ordered lower courts to stop hearing foreclosure cases due to the prevalence of fraudulent documents.²⁶ Organizers cited the political influence of foreclosure mills—particularly in hard-hit Florida, the only Sand State with mandatory judicial foreclosure—as cause for the inefficacy of activism around foreclosure fraud. In several cases, the Florida Attorney General and elected representatives backed out of supporting investigations after meeting with employees of mortgage servicers (who were, in two cases, also employees of the Attorney General).²⁷ Whatever the cause, the fraudulent mortgage documents offered a concrete opportunity for

¹⁹Fliter and Hoff, 63.

²⁰Dayen, *Chain of Title*.

²¹Cheung, Cunningham, and Meltzer, "Do Homeowners Associations Mitigate or Aggravate Negative Spillovers from Neighboring Homeowner Distress?"

²²"State Mortgage Foreclosure Policies and Lender Interventions."

²³"Do Homeowners Associations Mitigate or Aggravate Negative Spillovers from Neighboring Homeowner Distress?"

²⁴Ghent, "The Historical Origins of America's Mortgage Laws," 22–23.

²⁵Orol, "U.S. Breaks down \$9.3 Bln Robo-Signing Settlement."

²⁶"New Jersey Courts Take Steps to Ensure Integrity of Residential Mortgage Foreclosure Process."

²⁷Dayen, *Chain of Title*.

organizing that resulted in the dislocation of millions, and undermined a tradition of impeccably-kept land records that extended well before 1776.

Geographic and economic features of farming compounded its larger-scale mortgage crisis to foment conditions ripe for organizing compared to the subprime housing crisis. The Internet forums where foreclosures were discussed and debated turned out to be silos, with arguments accumulating while few asked outside sought answers. In contrast, farming's power to determine social interactions pushed together those in distress, joining a long line of Progressive debtor's rights movements in the Midwest. These movements organized, articulating political demands most remarkably on March 22, 1933, when "a caravan of two to three thousand farmers descended upon St. Paul from southern Minnesota, in an astonishing array of antediluvian automobiles, and swarmed over the capitol."²⁸ This swarm presaged the unanimous passage of the Minnesota Moratorium Act, a key piece of state mortgage legislation whose constitutionality would be upheld in,²⁹ paving the way for further states to enact statutory protections for mortgagors during the Great Depression. In contrast, each call for mortgage moratoria in the subprime mortgage crisis was met with consternation, as scholarly opinion soured on *Blaisdell*. More broadly, fewer government resources—legal or fiscal—were donated to the relief on individual debtors in the Great Recession than in the Great Depression. (REFERENCE NEEDED) To see why state resources went unspent, I look again to the legal history of economic regulation in the United States, and tour briefly the trend of municipal disinvestment.

Why City & State Administrations Could Not Handle Foreclosures

The Commerce Clause was written, and did develop, with the express purpose of pre-empting states' right to economic legislation. Indeed, its development in legal precedent followed such a pattern in the 1800s and 1900s, upholding regulation based on the Commerce Clause as constitutional essentially whenever business touched multiple states. This criterion is important to foreclosure policy because I analyze in later chapters the spillover effect of foreclosures. Spillover effects respect no legal boundary, and, as such, found themselves under federal jurisdiction by way of the Commerce Clause. Later in the twentieth century, taxpayer reform organizations yanked the reins of state and municipal budgets. This influence combined with the altered expectation of federal policy regulating economics, leaving only growth-oriented tax incentives and zoning regulations in the regulatory toolbox of cities and states. This turn away from local economic regulation starved states and cities of the resources needed to handle foreclosures.

Features of the U.S. Constitution were interpreted by the Supreme Court to justify federal action, which is partially responsible for the shift in spending from states and municipalities to the federal government as seen in @[\(fig:spending-shift\)](#). While scholarship has elaborated (and debated) Charles Beard's story of private interests in the Constitutional Convention, Beard³⁰ retains its value by its analysis of primary sources. In it, Beard argues that the United States has a long history of enforcing the rights of creditors over the sovereignty of states. Linking uprisings such as Shays Rebellion to foreign credit demands and the interests of individual urban bondholders, he suggests that the Constitution can be seen broadly as a struggle between farmers and bondholders, not unlike Depression-era rhetoric between Midwest farmers laden with debts and their Eastern creditors.

The primary result of this struggle was the Contract Clause: >No State shall [...] coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts; pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contracts³¹

The Contract Clause limited state powers for economic regulation in three main ways. First, it removed from states the ability to print money, and, thus, to overprint money. While a central bank had not been created yet, the Contract Clause ensured that no state could chip away at debt by deflating their currency. Two, the Clause made standard payment in metal, limiting their purchasing power. Third, this bit of the Constitution, in its statements regarding "ex post facto Law" and "impairing the Obligation of Contracts", removed from states the ability to cancel debts by removing the ability to cancel any contracts at all. Debt cancellation or

²⁸Fliter and Hoff, *Fighting Foreclosure*.

²⁹"Home Building & Loan Assn. V. Blaisdell."

³⁰*An Economic Interpretation of the Constitution of the United States*.

³¹Madison, "The Constitution of the United States."

reduction was a primary aim of uprisings like Shays Rebellion and, more softly, wealthy planter political connections.³²

In the Great Depression, the meaning of the Contract Clause was challenged, as mentioned, in.³³ But scholarly opinion had soured on Chief Justice Charles Hughes' words that, "While emergency does not create power, emergency may furnish the occasion for the exercise of power." Richard Epstein, one of the Chicago School's leading legal scholars, writes that, "the police power exception has come to eviscerate the contracts clause,"³⁴ and he is not alone. Indeed, Tim Geithner's approach to the foreclosure policies emphasized legality as one of its tenets, and pointed to state usage of the Contract Clause as a grey area.³⁵ Constitutional limits on state (and thereby local) economic regulation were bolstered by scholarly backlash and the significant influence of originalism and textualism on the Court. If Beard's interpretation of the Contract Clause is correct, then conservative justices would likely have blocked any such attempts to establish the foreclosure moratoria imposed during the Depression.

The Contract Clause's intent, and the recent turn back towards honoring such intents, has limited states from pursuing such monumental measures as moratoria. But within the scheme of regulating business dealings, the Clause left states with great room to move. This range of movement was restricted further by the twentieth century interpretation of the Commerce Clause. While both the Contract and Commerce Clauses reflected Hamiltonian designs on state sovereignty, they have been invoked differentially by Republicans and Democrats, situating themselves on an axis whose ends represent pro- and anti-business interests. Defenders of the Contract Clause's intended usage prioritize the right to contract as a pre-political right over the right of local government. Defenders of the Commerce Clause prioritize the federal government's capacity and judgment to regulate business that stretches across state lines over the right of local government. Unlike the Contract Clause, whose recent judgments and scholarship point to unconstitutionality of state-passed foreclosure moratoria,³⁶ the Commerce Clause has been granted broad powers, with conservatives on the Court only tinkering at the edges of its range of freedom.

For instance, where³⁷ was squeaked by with a 5-4 decision,³⁸ unanimously upheld the authority of the Agricultural Adjustment Act to regulate private acts—ones that had never seen a marketplace—which substantially effected the business of another state.³⁹ capped five to seven years of the Commerce Clause's usage to authorize New Deal policies. If the powers extended down to peoples' private properties, what jurisdiction did the federal government *not* possess? For the subprime mortgage crisis, this history of Commerce Clause-facilitated pre-emption meant that the federal government was expected to intervene during economic crises. All that was needed to authorize pre-emption was the substantial effects test employed in.⁴⁰ Let me be clear on this point: pre-emption via the Commerce Clause did not crowd out state investment; in fact, there is ongoing debate as to whether federal dollars *increase* state investment.⁴¹ Rather, the New Deal wielded the Commerce Clause to achieve its own ends. Over time, the the substantial effects test came to mean that even supposedly-private activities could be federally regulated. Home construction, and possibly foreclosure, given their spillover effects, certainly hit this threshold. Effectively, I argue that a coincidence of responsibility, and a history of the federal government taking on responsibility in times of crisis, meant that states presumed the ball was in Washington's court. This stands in contrast to the Contract Clause, the interpretation of which has limited state options.

Running alongside these legal developments and historical acts by the federal government, taxpayers had been throttling local revenues. The tax revolts, beginning with California in 1978, play a crucial part in the ideological formatting of reactions to the subprime mortgage crisis, but for now I will focus on their effects on revenues. Tax revolts, and tax reform movements more generally, have been significant political forces at all

³²Beard, *An Economic Interpretation of the Constitution of the United States*.

³³"Home Building & Loan Assn. V. Blaisdell."

³⁴Epstein, "Toward a Revitalization of the Contract Clause," 738.

³⁵McNamara, "Yale Program on Financial Stability Interview."

³⁶Note that the New Jersey "moratorium" was neither a legislative act nor a blanket moratorium. It affected the litigation of foreclosures and referenced the validity of evidence itself, which would hypothetically be inadmissible regardless of the order.

³⁷"Home Building & Loan Assn. V. Blaisdell."

³⁸"Wickard V. Filburn."

³⁹"Wickard V. Filburn."

⁴⁰"Wickard V. Filburn."

⁴¹Cf. "flypaper effect" in public finance scholarship.

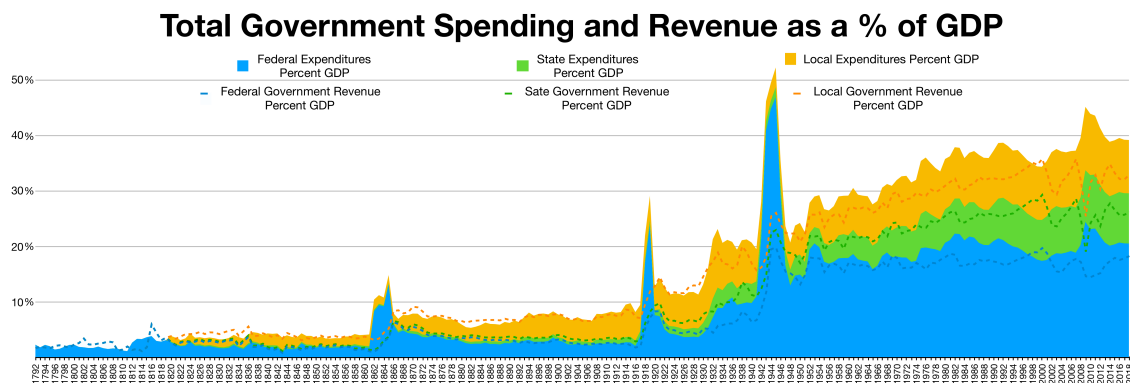


Figure 4: While secular growth is present at all levels of government, note the spikes during the Great Depression and Recession, and of course in wars.

levels of American politics. Whether in regards to a specific tax or taxation generally, taxpayer movements focus on limiting or rolling back tax rates and taxable activity. Their efficacy, however, has been limited; in many cases, revenue and spending provisions can be circumvented to meet legislative and administrative desires.⁴² So, while specific taxes have been reined in by voters, the level of taxation is difficult to wrangle.

The one area secured by taxpayer reform efforts have been measures that require legislative supermajorities or popular referenda to raise rates. For instance, the original California movement succeeded in restraining property tax rates from climbing above 1% and required a legislative supermajority equal to that needed to amend the state constitution in order to raise special taxes. Provisions such as this have been successful at limiting property tax receipts,⁴³ effects which bear directly on state and local abilities to raise revenue from housing. In housing-rich states—such as California, Florida, Nevada, and Arizona—that saw so much of their housing stock go vacant, this feature puts a double-bind on states and localities. It implements a strongly pro-cyclic revenue structure that conflicts with the anti-cyclic need for government investment,⁴⁴ though such a gap would not grow until assessments had revalued property in the face of the housing bust. In 2007, 2008, and 2009, this feature likely acted as the lower arm of a pair of price scissors to homeowners—though they were *very* rusty, unable to close completely since property taxes rarely top 2%—holding stable as housing prices plummeted. There is little research of this effect on municipal finances, but more recent scholarship points to large decreases beginning in 2009 or 2010 and extending as late as 2013.⁴⁵ The size of this lag may account for the lack of consensus on the topic, with 2011 research by the Federal Reserve Board of Governors denying significant fiscal effects of foreclosures.⁴⁶ At any rate, while property taxes did strain municipal budgets, and while cities did not feel the effects until after the foreclosure crisis elicited policy responses, anxiety over the coming problems mounted.⁴⁷

I have outlined structural forces that limited the legal and fiscal capacities of states to intervene in private activities, even when such activities have heavily public effects. While the structural forces clearly affect much more than housing, the funding of American states and towns is heavily indebted towards property taxes, bringing one of every three municipal dollars.⁴⁸ While property taxes had not yet declined when the foreclosure crisis hit its lows, anxieties were rising, and taxpayer reform movements had already bit large chunks out of the ability to raise money. These forces starved states and cities of the resources necessary to handle foreclosure. Endowed only with powers to issue zoning regulations, tax *incentives*, and other

⁴²Gross et al., “The Local Squeeze.”

⁴³Kioko and Martell, “State-Level Tax and Expenditure Limits.”

⁴⁴Keynes and Krugman, *The General Theory of Employment, Interest, and Money*.

⁴⁵Chernick, Reschovsky, and Newman, “The Effect of the Housing Crisis on the Finances of Central Cities”; Gross et al., “The Local Squeeze.”

⁴⁶Lutz, Molloy, and Shan, “The Housing Crisis and State and Local Government Tax Revenue.”

⁴⁷Dennis, “Falling Home Values Mean Budget Crunches for Cities”; Saulny, “Financial Crisis Takes a Toll on Already-Squeezed Cities.”

⁴⁸Gross et al., “The Local Squeeze,” 1.

growth-oriented policies,⁴⁹ cities and states were less able to handle the wave of foreclosures that pushed one of every twenty American adults out of their home.⁵⁰

Why Investors were Unable, and Banks Unwilling, to Limit Foreclosures

The separation of investors from mortgage servicers constituted a separation of ownership from control. Following the neoclassical literature, (Berle & Means) this separation led to perverse incentives: while investors lost money from foreclosures, the trustees of mortgage-backed securities gained money from foreclosures. Securitization, an act of legal incorporation, severed the communicative link between investing and mortgage servicing. When their interests were pitted against one another, the legal priority fell to the trustee, in whose interest it was to foreclose. Before the separation of ownership from control in mortgages, a bank could decide—as many did in the Great Depression—not to foreclose in spite of its legal right.

Securitization is a complicated process, legally incorporating the collection of mortgages that back a residential mortgage-backed securities (MBS).

Legal incorporation has historically been treated by U.S. courts as a way to separate ontologically the individual assets from their controlling parties.[dewey]

The practical particularities of REMICs sever any remaining lines of communication by which investors could express their interests.

By removing the principal from the process, MBS securitization granted the agent free[r] reign.

Foreclosures were in the interests of the mortgage-servicing agents to mortgage-backed securities.

Thus, investors' hands were tied.

Alston, Lee J. "Farm Foreclosures in the United States During the Interwar Period." *The Journal of Economic History* 43, no. 4 (1983): 885–903.

Beard, Charles A. *An Economic Interpretation of the Constitution of the United States*. New York: The Macmillan Company, 1913.

Chernick, Howard, Andrew Reschovsky, and Sandra Newman. "The Effect of the Housing Crisis on the Finances of Central Cities." In *Housing Markets and the Fiscal Health of US Central Cities*, 18, 2017.

Cheung, Ron, Chris Cunningham, and Rachel Meltzer. "Do Homeowners Associations Mitigate or Aggravate Negative Spillovers from Neighboring Homeowner Distress?" *Journal of Housing Economics*, Housing Policy in the United States, 24 (June 2014): 75–88. <https://doi.org/10.1016/j.jhe.2013.11.007>.

Collins, J. Michael, Ken Lam, and Christopher E. Herbert. "State Mortgage Foreclosure Policies and Lender Interventions: Impacts on Borrower Behavior in Default." *Journal of Policy Analysis and Management* 30, no. 2 (2011): 216–32. <https://doi.org/10.1002/pam.20559>.

Dayen, David. *Chain of Title: How Three Ordinary Americans Uncovered Wall Street's Great Foreclosure Fraud*. New York: The New Press, 2016.

DeFusco, Anthony, Wenjie Ding, Fernando Ferreira, and Joseph Gyourko. "The Role of Price Spillovers in the American Housing Boom." *Journal of Urban Economics* 108 (November 2018): 72–84. <https://doi.org/10.1016/j.jue.2018.10.001>.

Dennis, Brady. "Falling Home Values Mean Budget Crunches for Cities." *Washington Post*, n.d.

Epstein, Richard. "Toward a Revitalization of the Contract Clause." *University of Chicago Law Review* 51, no. 3 (June 1984).

Fliter, John A., and Derek S. Hoff. *Fighting Foreclosure: The Blaisdell Case, the Contract Clause, and the Great Depression*. Landmark Law Cases & American Society. Lawrence, Kansas: University Press of Kansas, 2012.

⁴⁹Stein, *Capital City*.

⁵⁰Martin and Niedt, *Foreclosed America*, 5.

Ghent, Andra. “The Historical Origins of America’s Mortgage Laws.” Special Report. Research Institute for Housing America, October 2012.

Gross, Liz, Kil Huh, Abigail Sylvester, and Robert Zahradnik. “The Local Squeeze: Falling Revenues and Growing Demand for Services Challenge Cities, Counties, and School Districts.” Edited by Susan Urahn. Philadelphia, Pa., United States: Pew Research Center, 2012.

“Home Building & Loan Assn. V. Blaisdell,” January 1934.

Immergluck, Daniel. *Preventing the Next Mortgage Crisis: The Meltdown, the Federal Response, and the Future of Housing in America*. Lanham: Rowman & Littlefield Education, 2015.

Keynes, John Maynard, and Paul R. Krugman. *The General Theory of Employment, Interest, and Money*. Houndmills, Basingstoke, Hampshire ; New York, NY: Palgrave Macmillan, 2007.

Kioko, Sharon N., and Christine R. Martell. “Impact of State-Level Tax and Expenditure Limits (TELs) on Government Revenues and Aid to Local Governments.” *Public Finance Review*, May 2012. <https://doi.org/10.1177/1091142112438460>.

Lutz, Byron, Raven Molloy, and Hui Shan. “The Housing Crisis and State and Local Government Tax Revenue: Five Channels.” *Regional Science and Urban Economics*, Special Issue: The Effect of the Housing Crisis on State and Local Governments, 41, no. 4 (July 2011): 306–19. <https://doi.org/10.1016/j.regsciurbe.2011.03.009>.

Madison, James. “The Constitution of the United States,” June 1788.

Martin, Isaac William, and Christopher Niedt. *Foreclosed America*. Stanford, California: Stanford Briefs, an imprint of Stanford University Press, 2015.

McNamara, Christian. “Yale Program on Financial Stability Interview,” October 2019.

Muro, Christopher W. Hoene and Mark. “Fiscal Challenges Facing Cities: Implications for Recovery.” *Brookings*, November 1BC.

“New Jersey Courts Take Steps to Ensure Integrity of Residential Mortgage Foreclosure Process.” New Jersey Courts, December 2010.

Orol, Ronald D. “U.S. Breaks down \$9.3 Bln Robo-Signing Settlement.” *MarketWatch*. <https://www.marketwatch.com/story/us-breaks-down-93-bln-robo-signing-settlement-2013-02-28>, n.d.

Pelosi, Nancy. “Housing and Economic Recovery Act of 2008,” July 2008.

Perkins, Casey. “Privatopia in Distress: The Impact of the Foreclosure Crisis on Homeowners’ Associations.” *Nevada Law Journal* 10, no. 2 (January 2010).

Putnam, Robert D. *Bowling Alone: The Collapse and Revival of American Community*. 1. touchstone ed. New York, NY: Simon & Schuster, 2001.

Saulny, Susan. “Financial Crisis Takes a Toll on Already-Squeezed Cities.” *New York Times*, June 2008, 16.

Seabrooke, Leonard. *The Politics of Housing Booms and Busts*. Edited by H. Schwartz. International Political Economy Series. Palgrave Macmillan UK, 2009. <https://doi.org/10.1057/9780230280441>.

Stein, Samuel. *Capital City: Gentrification and the Real Estate State*. Jacobin Series. London ; Brooklyn, NY: Verso, 2019.

Tobler, W. R. “A Computer Movie Simulating Urban Growth in the Detroit Region.” *Economic Geography* 46 (1970): 234–40. <https://doi.org/10.2307/143141>.

Wheelock, David C. “Changing the Rules: State Mortgage Foreclosure Moratoria During the Great Depression.” *Federal Reserve Bank of St. Louis Review* 90, no. 6 (n.d.): 569–83.

“Wickard V. Filburn,” October 1942.