

## Fixing Foreclosure

Ann M. Burkhardt\*

*Since the American Revolution, mortgage foreclosures have consisted of a public auction of the mortgaged property. Judges and state legislators at the time believed that an auction was the best way to obtain a fair price for the land. Though that belief soon proved to be mistaken, the sale method remains unchanged*

*Before the real estate and mortgage markets crashed in 2007, only two significant empirical studies of foreclosure sales existed, and they involved small numbers of foreclosures. Because the crash resulted in millions of home foreclosures, it has provided a rich data source. As a result, economists, social scientists, and others have produced a wealth of empirical studies on foreclosure sales and their effects both before and after the crash. Three lines of research now clearly establish that foreclosure by public auction is seriously flawed. These studies first prove that, in this country, even a voluntary real estate auction normally produces a lower sale price than a private sale. A second line of studies shows that foreclosure usually is harmful not just for the land owner, but also for the lender, neighboring property owners, and the community. The third line of studies proves that property sells for more when, rather than foreclosing after default, a lender allows a private sale of the property. These studies make a very powerful case for foreclosure reform.*

*Fortunately, an established and effective method for selling foreclosed land already exists—listing it for sale with a real estate agent. Currently, the lender conducts a foreclosure, frequently purchases at the sale, and then lists the property for sale with a real estate agent. This process is time consuming, expensive, and harmful. Initially listing the property for sale with a real estate agent, rather than first auctioning it, eliminates these problems, and the success of the process has been proven. England, Ireland, Wales, and some Canadian provinces use this method very effectively, and it could readily be implemented in the United States.*

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\* Curtis Bradbury Kellar Professor of Law and Distinguished University Teaching Professor, University of Minnesota Law School. With many thanks to Andrew Bury, QC, Partner, Gowling WLG, Vancouver, British Columbia; Abraham Costin, Partner, McCarthy Tetrault LLP, Toronto, Ontario; Silvana M. D'Alimonte, Partner, Blake, Cassels & Graydon LLP, Toronto, Ontario; Professor R. Wilson Freyermuth, University of Missouri School of Law; Professor Emeritus Grant S. Nelson, Pepperdine University School of Law; and Professor Emeritus Dale A. Whitman, University of Missouri-Columbia School of Law, for their help with this Article.

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INTRODUCTION

Since the American Revolution, mortgage foreclosures in the United States have consisted of a public auction of the mortgaged property. Judges and state legislators at the time of the founding believed that an auction was the best way to obtain a fair price for the land. That belief, however, soon proved to be mistaken. From an early date, the foreclosing lender typically was the only bidder at the auction sale, and without competition, it had no incentive to bid the land’s fair value. Despite this obvious and substantial flaw in the foreclosure process, the auction remains by far the predominant method for selling foreclosed real estate in this country, and the foreclosing lender purchases at more than 80 percent of foreclosure sales.<sup>1</sup> Following the 2007 housing and mortgage market crisis, the need for systemic reform has never been clearer.<sup>2</sup>

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1. Peter Chinloy, William Hardin III & Zhonghua Wu, *Foreclosure, REO, and Market Sales in Residential Real Estate*, 54 J. REAL EST. FIN. & ECON. 188, 197 (2017) (noting that the foreclosing lender purchased in 85.3% of single-family home foreclosures in Miami-Dade County from 2010-13); Lauren Lambie-Hanson & Timothy Lambie-Hanson, *Agency and Incentives: Vertical Integration in the Mortgage Fore-*

Before the real estate and mortgage markets crashed in 2007, only two significant empirical studies of foreclosure sales existed, and they involved small numbers of foreclosures. Because the crash resulted in millions of home fore-

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- closure Industry 22* (Fed. Reserve Bank of Phila., Working Paper No. 15-38, 2015), <http://econpapers.repec.org/paper/fipfedpwp/15-38.htm> [<http://perma.cc/5JEB-ZEZA>] (noting that foreclosing lender purchased in 89% of foreclosures in Suffolk County, Massachusetts from 2006-10); Andreas Niedermayer, Artyom Shneyerov & Pia Xu, *Foreclosure Auctions 28* (SFB/TR 15, Discussion Paper No. 522, 2015), <http://hdl.handle.net/10419/121367> [<http://perma.cc/H9ER-7QED>] (noting that foreclosing lender purchased in 81% of foreclosures in Palm Beach County, Florida from 2010-13); see also ATTOM Staff, *U.S. Distressed Sale Share Drops to Nine-Year Low in 2016*, ATTOM DATA SOLUTIONS (Jan. 31, 2017), <http://www.attomdata.com/news/home-prices-and-sales/2016-year-end-home-sales-report> [<http://perma.cc/U8JM-E3XA>] (noting that from 2000-16, foreclosing lender purchased in more than 80% of foreclosures in 13 of 17 years). However, third-party purchases have become significantly more prevalent in some markets. See ATTOM Staff, *424,800 U.S. Properties with Foreclosure Filings in First Six Months of 2017, Down 20 Percent From Year Ago*, ATTOM DATA SOLUTIONS (July 18, 2017), <http://www.attomdata.com/news/heat-maps/midyear-2017-u-s-foreclosure-market-report> [<http://perma.cc/45PL-T3DQ>].
2. Interestingly, public auction is the predominant foreclosure method in a wide variety of countries around the world, including Afghanistan, Albania, Antigua and Barbuda, Argentina, Bangladesh (Chittagong), Bolivia, Botswana, China, Colombia, Dominican Republic, Ecuador, El Salvador, France, Gambia, Germany, Guatemala, Honduras, Indonesia (Jakarta), Iran, Japan, Korea, Kuwait, Lebanon, Liberia, Lithuania, Maldives, Malta, Micronesia, Mozambique, Myanmar, Nicaragua, Nepal, Panama, Paraguay, Qatar, Russia, Samoa, Solomon Islands, Sri Lanka, Swaziland, Sweden, Tajikistan, Thailand, Ukraine, United Arab Emirates, Uruguay, Venezuela, and Zambia. *Study on the Efficiency of the Mortgage Collateral in the European Union*, EUROPEAN MORTG. FED'N 57 (2007), [http://www.law.berkeley.edu/files/bclbe/EU\\_Efficiency\\_Mortgage\\_Collateral\\_2007.pdf](http://www.law.berkeley.edu/files/bclbe/EU_Efficiency_Mortgage_Collateral_2007.pdf) [<http://perma.cc/R6JZ-UVQS>] (Germany); JOSEPH PHILIP FORTE, *GETTING THE DEAL THROUGH: REAL ESTATE* (2018) (Colombia, Dominican Republic, France, Japan, Korea, Lithuania, Russia, Sweden, Thailand, and Ukraine); Dale A. Whitman, *Chinese Mortgage Law: An American Perspective*, 15 COLUM. J. ASIAN LAW 35, 78-79 (2001); Klaus Koch Saldarriaga, Olena Koltko & María Antonia Quesada Gámez, *Resolving Insolvency: Measuring the Strength of Insolvency Laws*, WORLD BANK (2015), <http://www.doingbusiness.org/~media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB15-Chapters/DB15-CaseStudy-Resolving-Insolvency.pdf> [<http://perma.cc/7DTG-5DGF>] (Afghanistan, Albania, Antigua and Barbuda, Argentina, Bangladesh, Bolivia, Botswana, Ecuador, El Salvador, Gambia, Guatemala, Honduras, Indonesia, Iran, Kuwait, Lebanon, Liberia, Maldives, Malta, Micronesia, Mozambique, Myanmar, Nicaragua, Nepal, Panama, Paraguay, Qatar, Samoa, Solomon Islands, Sri Lanka, Swaziland, Tajikistan, United Arab Emirates, Uruguay, Venezuela, and Zambia). Perhaps, as in Australia and other countries, public auction is a typical real estate sale method in these countries. If public auction is not typical, the reasons for switching to private sale may not have been sufficiently clear until now.

closures, it provided a rich data source. As a result, economists, social scientists, and others have produced a wealth of empirical studies on foreclosure sales and their effects both before and after the crash. The research clearly demonstrates that, in the United States, public auctions normally are less effective for selling real estate than private sales because auctions are not the usual method for selling land in this country. The studies also show that allowing the foreclosing lender to buy at the auction is harmful in two ways: (1) The lender usually makes little effort to market the property before the sale in an attempt to attract bidders; and (2) when the lender acquires the property at the sale, it is frequently a neglectful owner, which harms neighboring property owners and the community. These studies make a very powerful case for foreclosure reform. Efforts to improve the existing auction system, as others have proposed,<sup>3</sup> are inadequate because, in this country, even well run auctions usually are not as effective as private sales. The system needs to be overhauled.

Fortunately, an established and effective method for selling foreclosed land already exists—listing it for sale with a real estate agent. Currently, the lender conducts a foreclosure, normally purchases at the sale, and then lists the property for sale with a real estate agent. This process is time consuming, expensive, and harmful. Initially listing the property for sale with a real estate agent, rather than first auctioning it, eliminates these problems, and the success of this process has been proven. England, Ireland, Wales, and some Canadian provinces use this method very effectively, and it could readily be implemented in the United States. Moreover, in another type of involuntary sale, bankruptcy, trustees in this country routinely list land with a real estate agent when selling it for the estate's benefit, rather than selling at a public auction.<sup>4</sup>

This Article proposes a solution to the foreclosure puzzle: "Foreclosure" would consist of the lender listing the property for sale with a real estate agent; the lender would set the asking price based on property appraisals and would negotiate the purchase agreement with the buyer; and the property owner could prevent the sale by repaying the lender at any time before it signs a purchase agreement with a buyer. As a check on the lender's conduct, the owner and any junior interest holder would have a cause of action against the mortgagee to

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3. Some have advocated the use of private sales as one remedy, among others. See, e.g., Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act*, 53 DUKE L.J. 1399, 1440-44 (2004); Debra Poggrund Stark, *Facing the Facts: An Empirical Study of the Fairness and Efficiency of Foreclosures and a Proposal for Reform*, 30 U. MICH. J.L. REFORM 639, 683 (1997); Steven Wechsler, *Through the Looking Glass: Foreclosure by Sale as De Facto Strict Foreclosure—An Empirical Study of Mortgage Foreclosure and Subsequent Resale*, 70 CORNELL L. REV. 850, 893-94 (1985).

4. 11 U.S.C. § 327(a) (2012) (trustee can employ "professional persons" to carry out trustee's duties); 11 U.S.C. § 328(a) (2012) (trustee can pay a "professional person" a commission); *In re McConnell*, 82 B.R. 43 (Bankr. S.D. Tex. 1987) (real estate agents are "professionals" within meaning of Bankruptcy Code); *In re Eastern Inns of New Hampshire, Inc.*, 72 B.R. 418 (Bankr. D. Me. 1987) (same).

challenge deficient marketing efforts or sales price. Most importantly, neither the lender nor anyone associated with it could purchase the property. Because lenders normally lose money when they foreclose under the current system and especially when they buy at the sale, this improved foreclosure method, as explained below, should reduce lending costs.

To understand why the current system is so defective, Part I of this Article describes the evolution of American mortgage foreclosures. Part II explores the reasons that an auction—and a foreclosure auction in particular—is an ineffective method for selling land in the United States. Part III examines the recent empirical research that now documents the harms that foreclosure sales cause. Part IV demonstrates that private sale can work as the usual foreclosure method by describing the processes in Ontario and British Columbia. Finally, Part V addresses the issues that state legislatures will confront when they decide to switch to foreclosure by private sale.

## I. HOW DID WE GET HERE?

In England, the earliest forerunner of the modern mortgage was called a “mort gage” (dead pledge).<sup>5</sup> The mort gage conveyed ownership of the real estate to the lender subject to the borrower’s right to recover it if he repaid the loan in full on due date.<sup>6</sup> If the borrower did not, he automatically forfeited any further interest in the land,<sup>7</sup> though it normally was worth far more than the outstanding debt.<sup>8</sup> To provide some relief for borrowers against this forfeiture, the Court of Chancery began intervening to require the lender to reconvey the land to the borrower if he paid within a reasonable time after the due date.<sup>9</sup> However, as this relief evolved and expanded, some courts held that it was reasonable to pay as much as twenty years after law day and even if the lender had sold the property.<sup>10</sup>

This development made the mort gage far less useful as a security device.<sup>11</sup> In response, Chancery created a tool by which lenders could terminate the borrower’s right.<sup>12</sup> If the lender proved that the borrower defaulted on the loan,

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5. Ann M. Burkhart, *Freeing Mortgages of Merger*, 40 VAND. L. REV. 283, 312 (1987).
  6. LITTLETON’S TENURES § 332 (E. Wambaugh ed. 1903).
  7. GRANT S. NELSON, DALE A. WHITMAN, ANN M. BURKHART & R. WILSON FREYERMUTH, REAL ESTATE FINANCE LAW 6 (6th ed. 2014).
  8. GEORGE E. OSBORNE, HANDBOOK OF THE LAW OF MORTGAGES 14 (2d ed. 1970).
  9. NELSON ET AL., *supra* note 7, at 7.
  10. 2 WILLIAM BLACKSTONE, COMMENTARIES \*158-59 n.29; 3 FRANCIS HARGRAVE & CHARLES BUTLER, NOTES ON LORD COKE’S FIRST INSTITUTE OR COMMENTARY UPON LITTLETON § 337 n.106 (1809).
  11. Burkhart, *supra* note 5, at 317-18.
  12. William M. McGovern, Jr., *Forfeiture, Inequality of Bargaining Power, and the Availability of Credit: An Historical Perspective*, 74 NW. U. L. REV. 141, 150 (1979).

Chancery would give the borrower a specified period of time to pay. If the borrower failed to do so, the court would enter a foreclosure decree that terminated the borrower's right regardless of the land's value.<sup>13</sup>

English settlers brought with them the English method of foreclosure.<sup>14</sup> As in England, mortgages, by their terms, conveyed title to the mortgaged land to the lender, and many courts treated them as conveyances.<sup>15</sup> Also, as in England, the lender's remedy for default was a judicial decree that terminated the borrower's interest in the mortgaged land if he did not pay the debt within a specified time.

The colonists renamed this unsparing process "strict foreclosure," particularly because colonial courts granted borrowers less time to pay than English courts did.<sup>16</sup> Moreover, this foreclosure process often gave lenders an especially large windfall because land values were increasing at a greater rate than had previously occurred anywhere.<sup>17</sup> The high cost of strict foreclosure further fueled popular discontent with this foreclosure method,<sup>18</sup> as did the increasingly widespread notion that a lender's only interest in mortgaged land should be a security interest and not ownership. Consistent with this conception, borrowers normally kept possession of the land despite the wording of a mortgage as a conveyance.<sup>19</sup>

For all these reasons, foreclosure by public auction began to supplant strict foreclosure in the United States by 1705<sup>20</sup> and was by far the dominant method by 1800.<sup>21</sup> In some states, foreclosure by auction was statutorily authorized.<sup>22</sup> In

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13. Wechsler, *supra* note 3, at 857.
  14. MYRON C. WEINSTEIN, 29 N.J. PRAC. § 1.3 *Law of Mortgages, American Developments—In General* 11 (2d ed. 2015); Wechsler, *supra* note 3, at 858.
  15. H.W. Chaplin, *The Story of Mortgage Law*, 4 HARV. L. REV. 1, 12 (1890); William H. Lloyd, *Mortgages—The Genesis of the Lien Theory*, 32 YALE L.J. 233, 240 (1923).
  16. Additionally, colonial courts seldom granted time extensions, though Chancery routinely granted borrowers multiple extensions. Sheldon Tefft, *The Myth of Strict Foreclosure*, 4 U. CHI. L. REV. 575, 595 (1937) ("Foreclosure without sale was really as it is described 'strict'; it operated summarily, harshly and oppressively."); Wechsler, *supra* note 3, at 858.
  17. John W. Brabner-Smith, *Economic Aspects of the Deficiency Judgment*, 20 VA. L. REV. 719, 721 (1934).
  18. EDGAR N. DURFEE, 1 CASES ON SECURITY 172-73 (1951).
  19. Burkhardt, *supra* note 5, at 320; Wechsler, *supra* note 3, at 858.
  20. See, e.g., An Act for Taking Lands in Execution for Payment of Debts, ch. 152 (1705), in 1 LAWS OF THE COMMONWEALTH OF PENNSYLVANIA 57 (Phila., John Bioron 1810); 1 GARRARD GLENN, MORTGAGES, DEEDS OF TRUST, AND OTHER SECURITY DEVICES AS TO LAND 455 (1943).
  21. Burkhardt, *supra* note 5, at 326; Tefft, *supra* note 16, at 589; Wechsler, *supra* note 3, at 858. Strict foreclosure is generally available today only in Connecticut and Vermont. NELSON ET AL., *supra* note 7, at 602.

other states, courts introduced it. In an 1805 decision, the Tennessee Supreme Court explained the reason for rejecting strict foreclosure:

Consistently with the law, as laid down in all the modern books, we can not vest the title in the [foreclosing lender]. The land, or part of it, must be sold at public sale, and the money applied to the payment of the debt and interest. The property may be of much greater value than the debt and interest, and it would be most unjust to vest the whole of it in the [lender], when the mortgage was only intended to secure a debt; it would be equally unjust to decree the property in full satisfaction, for it may be of less value than the debt and interest.<sup>23</sup>

Courts and legislatures believed that a public auction of the property was the best way to determine its fair value<sup>24</sup> because, with appropriate advertising and sales procedures, third parties would bid the price to the land's value.<sup>25</sup>

However, the predictions about the benefits of foreclosure by auction soon proved to be wrong.<sup>26</sup> One critical error was allowing the foreclosing lender to bid at its foreclosure sale.<sup>27</sup> With the right to bid at the auction, the foreclosing lender had little incentive to spend time and money advertising the sale and otherwise attempting to stimulate competitive bidding. Instead, the lender usually wanted to conduct the sale as quickly as possible and minimize its costs by

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22. *E.g.*, 2 PA. STATS. AT LARGE 247 (Act of 1706); 2 Kilty, *Laws of Maryland, Acts of 1785*, Ch. 72, § 3.
23. *Hord v. James*, 1 Tenn. 201 (1805); *see also* DURFEE, *supra* note 18, at 180 (“The Age of Enlightenment (or do you call it the Age of Innocence?) saw that all the faults of strict foreclosure could be eliminated by judicial sale of the land. If it is worth more than the debt, the excess is saved to the mortgagor as surplus proceeds of the sale. If, on the other hand, value is less than debt, the sale accurately measures the deficiency and does so without the expense attending trial of the issue of value . . .”).
24. Milton R. Friedman, *The Enforcement of Personal Liability on Mortgage Debts in New York*, 51 *YALE L.J.* 382, 383 (1942).
25. Harold C. Vaughan, *Reform of Mortgage Foreclosure Procedure—Possibilities Suggested by Honeyman v. Jacobs*, 88 *U. PA. L. REV.* 957, 963 n.33 (1940).
26. McGovern, *supra* note 12, at 152 (“[S]ad experience has taught us that a power of sale . . . can be harder on the debtor than strict foreclosure ever was. . . .” Thus, it may be a mistake to regard the rise of foreclosure by sale as a major landmark in the history of the law’s protection against forfeitures.”); Tefft, *supra* note 16, at 589-90; Vaughan, *supra* note 25, at 962-63; Wechsler, *supra* note 3, at 860.
27. R.W. Turner, *An English View of Mortgage Deficiency Judgments*, 21 *VA. L. REV.* 601, 604 (1935) (“This seems to be the main flaw in American practice, the allowing of the mortgagee to bid for the property on auction sale.”). Some states statutorily authorize lenders to buy at their own power of sale foreclosure. *See, e.g.*, MASS. GEN. LAWS, ch. 183, § 25 (2018); MICH. COMP. LAWS § 600.3228 (2018); MINN. STAT. ANN. § 580.11 (2017).

advertising the sale only to the extent legally required.<sup>28</sup> Therefore, from an early date, the foreclosing lender frequently was the only bidder, as illustrated by a case involving a foreclosure sale in 1784.<sup>29</sup> As the sole bidder, the lender could get the land for less than its fair market value and could get a deficiency judgment against the borrower if the lender's bid was for less than the outstanding debt.<sup>30</sup>

England, by contrast, took a very different approach when it allowed lenders to auction mortgaged land when the borrower defaulted.<sup>31</sup> Although Chancery permitted mortgage auctions as early as the seventeenth century, it very seldom granted that remedy.<sup>32</sup> Not until 1852 did Parliament make auction a generally available remedy,<sup>33</sup> and it did so for the same reason as in the United States—to obtain a fair price for the property.<sup>34</sup> However, no matter in what century the auction occurred, the mortgagee could not buy because, if it did so, the borrower's interest in the property was not eliminated.<sup>35</sup> As a result, mort-

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28. Tefft, *supra* note 16, at 589-90.

29. *Bergen v. Bennett*, 1 Cai. Cas. 1 (N.Y. 1804); *see also* *Lucas v. Fairbanks Capital Corp.*, 618 S.E.2d 488, 501 (W. Va. 2005) (Starcher, J., concurring in part, dissenting in part) (“As time went on, strict foreclosure was supplanted by foreclosure followed by a judicial or public sale, and by the 1830s strict foreclosure had virtually vanished from the American legal landscape. Further, American courts allowed the lenders to bid on the property at the judicially-ordered public auction . . . .”); Wechsler, *supra* note 3, at 860 (“During the economic depression of the 1820s, it became apparent that the public was only willing to pay bargain prices at foreclosure sales. Absent serious competitive bidding, mortgagees usually were the successful bidders at foreclosure sales, and they paid low prices.”).

30. *Lucas v. Fairbanks Capital Corp.*, 618 S.E.2d 488, 501 (W. Va. 2005) (Starcher, J., concurring in part, dissenting in part); Vaughan, *supra* note 25, at 966 (“[T]he inequities of the established practice of foreclosure and sale, with a deficiency judgment for the balance, were tremendously enhanced by the nation-wide economic depression which began in 1929. Such slight market as previously existed at foreclosure sales rapidly disappeared. The sale became a farce at which mortgagees obtained properties, often of great intrinsic value, for mere nominal bids.”); Wechsler, *supra* note 3, at 860. Today, some states have enacted statutes that prohibit or limit deficiency judgments. *See* NELSON ET AL., *supra* note 7, at § 8.3.

31. The sale was not called “foreclosure,” because that term applied to the process that is called “strict foreclosure” in the United States. Tefft, *supra* note 16, at 577.

32. McGovern, *supra* note 12, at 150.

33. Edgar Noble Durfee & Delmar W. Doddridge, *Redemption from Foreclosure Sale—The Uniform Mortgage Act*, 23 MICH. L. REV. 825, 827 (1925); Tefft, *supra* note 16, at 580.

34. Robert M. Washburn, *The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales*, 53 S. CAL. L. REV. 843, 846 (1980).

35. Turner, *supra* note 27, at 605 (“The allowing of the mortgagee to bid is foreign to the fundamental English conception of the equity of redemption.”).



gagees actively promoted the sale and normally did not sell without having located at least one willing and able purchaser.<sup>36</sup>

The problem in this country of allowing the foreclosing lender to purchase at its own sale was compounded when it also was allowed to conduct the sale.<sup>37</sup> Originally, a court conducted all mortgage foreclosures with the attendant judicial oversight.<sup>38</sup> To avoid the cost and time required for a judicial foreclosure, lenders began including a “power of sale” clause in mortgages that empowered the lender to sell the mortgaged land without judicial action.<sup>39</sup> Use of the power of sale clause was common by 1774, when the New York legislature enacted a law that confirmed its enforceability.<sup>40</sup> Today, thirty-five jurisdictions allow power of sale foreclosures.<sup>41</sup>

Courts in some states have been rightly concerned about the inherent conflict of interest that exists when the mortgagee is both the buyer and the seller in a power of sale foreclosure and have held such sales to be void<sup>42</sup> or voidable.<sup>43</sup>

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36. Tefft, *supra* note 16, at 581; *see also* Turner, *supra* note 27, at 605. Interestingly, this process apparently worked effectively though, as in most states in this country, the lender could get a deficiency judgment if the property sold for less than the outstanding debt. Tefft, *supra* note 16, at 581.
37. Tefft, *supra* note 16, at 591 (“[T]he sale under a power tends to be in practice a formality for the barring of the right to redeem and in an even more intensified degree is vulnerable to all of the objections to the American foreclosure by judicial sale.”); Washburn, *supra* note 34, at 847 (“The two features of the judicial sale designed to achieve fairness of price—judicial supervision and public competitive bidding—are often absent . . . if the property is sold by the mortgagee under a power of sale or by a trustee under a deed of trust. Mortgagee and trustee sales are subject to minimal judicial supervision as to fairness of procedure or price; in many states mortgagee and trustee sales do not require confirmation by the court.”); Donald L. Schwartz, *Power of Sale Foreclosure After Fuentes*, 40 U. CHI. L. REV. 206, 213 (1972) (“The efficiency and savings that are possible through the use of power of sale foreclosures are . . . at least partially offset by the potential for injustice that seems to be inherent in nonjudicial remedies.”).
38. David M. Madway, *A Mortgage Foreclosure Primer*, 8 CLEARINGHOUSE REV. 146, 169 (1974).
39. *Lucas v. Fairbanks Capital Corp.*, 618 S.E.2d 488, 501 (W. Va. 2005) (Starcher, J., concurring in part, dissenting in part).
40. An Act for the more effectual Registry of Mortgages and for securing the Purchasers of Mortgaged Estates, Laws of the Colony of New York, 1774, Ch. 39, *reprinted in* 5 THE COLONIAL LAWS OF NEW YORK 687 (Lyon 1894); *Bergen v. Bennett*, 1 Cai. Cas. 1, 4 (N.Y. 1804) (“It seems that previous to the year 1775, it had been a practice to introduce into mortgages, clauses authorizing a sale by mortgagees, and that many estates were then held under such sales.”); DURFEE, *supra* note 18, at 173-74.
41. NELSON ET AL., *supra* note 7, at 634 n.459.
42. *E.g.*, *Thornton v. Irwin*, 43 Mo. 153, 158 (1869); *Very v. Russell*, 23 A. 522, 523 (N.H. 1874) (“[T]he safer course is to discourage every appearance or suspicion

As one court wrote, “one man cannot perform conflicting duties and interests—it being the duty of the seller to get the highest price, and the interest of the buyer to get the property at the lowest.”<sup>44</sup> Courts in other states, however, have held that a lender should be allowed to buy at its own foreclosure sale to protect its security interest. These courts reason that, if the lender cannot bid at the sale, a third party might buy the land for far less than both the property’s value and the outstanding debt amount.<sup>45</sup>

In those states in which courts held that a foreclosing lender’s purchase makes the sale void or voidable, lenders found a way to preserve their ability to buy without being subject to challenge. In these states, lenders largely stopped using mortgages and now instead use a deed of trust to take a security interest in real property. Unlike a mortgage, which has two parties, the deed of trust has three parties—the borrower (“settlor”), the lender (“beneficiary”), and a third-party trustee. If the borrower defaults, the trustee conducts the foreclosure sale, which enables the lender to purchase without being subject to challenge.<sup>46</sup> As a result of power of sale clauses and deeds of trust, today, the foreclosing lender frequently is the only bidder at foreclosure sales throughout the country.<sup>47</sup>

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of fraud, by adopting strictly the rule . . . that a purchase of the mortgaged estate by the mortgagee must, as to the mortgagor, be regarded as *ipso facto* fraudulent and void.”).

43. See, e.g., *Williams v. Wilson*, 87 So. 549 (Ala. 1920); *Jackson v. Blankenship*, 105 So. 684 (Ala. 1925); *Blockley v. Fowler*, 21 Cal. 326 (1863); *Houston v. Nat’l Mut. Bldg. & Loan Ass’n*, 31 So. 540, 542 (Miss. 1902) (prohibition on mortgagee purchase is “bottomed on the fundamental principle that no man shall be placed in a position where there shall arise a conflict between interest and integrity”); *Owens v. Branning Mfg. Co.*, 84 S.E. 389 (N.C. 1915); *Davis v. Doggett*, 194 S.E. 288 (N.C. 1937); *Mills v. Mut. Bldg. & Loan Ass’n*, 6 S.E.2d 549 (N.C. 1940).
44. *Thornton*, 43 Mo. at 153, 158 (1869).
45. E.g., WILLIAM F. WALSH, *A TREATISE ON MORTGAGES* 350 (1934) (“It is . . . necessary that the [foreclosing mortgagee] be permitted to protect his security by bidding up the property to the amount of the debt due him . . .”); see also *Galvin v. Newton*, 36 A. 3, 4 (R.I. 1896).
46. As described in the next section, the trustee’s participation generally does improve the sale process, because it is a neutral party that generally owes no fiduciary duties to the borrower or lender. Terry Schaplow, *Oregon’s Statutory Right of Redemption—Any Redeeming Qualities?*, 16 WILLAMETTE L. REV. 891, 915 (noting that the lender bought at 73.61% of sales in three Oregon counties from 1970-79).
47. Charles A. Capone, Jr., *Providing Alternatives to Mortgage Foreclosure: A Report to Congress*, U.S. DEP’T HOUSING & URB. DEV. 110 (1996), [www.huduser.org/Publications/pdf/alt.pdf](http://www.huduser.org/Publications/pdf/alt.pdf) [<http://perma.cc/UL2K-XMYM>] (“The most common criticism leveled against current law regards lack of competitive bidding at foreclosure sales.”); Robert K. Lifton, *Real Estate in Trouble: Lender’s Remedies Need an Overhaul*, 31 BUS. LAW. 1927, 1937 (1976); Rex E. Madsen, *Equitable Considerations of Mortgage Foreclosure and Redemption in Utah: A Need for Remedial Legislation*, 1976 UTAH L. REV. 327, 329 (1976); Madway, *supra* note 38, at 170; Nelson & Whitman, *supra* note 3, at 1423.

When that is the case, it may bid only a nominal amount for the property and then sue the borrower for the deficiency, unless the jurisdiction prohibits deficiency judgments.<sup>48</sup> Particularly in jurisdictions with statutory redemption, the lender normally bids the amount it is owed, so that the debt will be repaid in full if the owner or junior lienor redeems.<sup>49</sup> However, it rarely bids more than the outstanding debt amount, even when the land's value is substantially greater.<sup>50</sup> Therefore, properties often sell at foreclosure auctions for less than their fair market value.<sup>51</sup> Moreover, without third party bidders, the foreclosure sale is a formality that wastes time and money. Because the lender acquires the property regardless of its value in relation to the debt, the foreclosure auction reaches the same result as strict foreclosure, which is the process that the auction was designed to cure.<sup>52</sup>

## II. THE PROBLEMS WITH AUCTIONS

Although real estate auctions are effective in several other countries, auctions normally are not as effective as private real estate sales in the United States. A large part of the problem is that an auction is not the usual method for selling land in the United States.<sup>53</sup> The only exception is forced sales, such as

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48. A minority of states have anti-deficiency statutes that prohibit or limit a lender's ability to get a deficiency judgment. Additionally, some states have one-action rules that allow the lender to foreclose or sue on the debt but not to do both. NELSON ET AL., *supra* note 7 at 704-07.
49. Statutory redemption gives the property owner and, in some states, junior lienors a period of time after the foreclosure sale to recover the property, usually by paying the foreclosure purchaser the amount it paid at the sale. For this reason, the foreclosing lender normally bids the full debt amount. *Id.* at 744-45.
50. A lender can bid up to the debt amount and credit the bid against the debt ("credit bid") without paying any cash for the property. The amount of its bid is credited against the outstanding debt. Richard A. Lee, *A Comparison of Arms-Length Verses Non-Arms-Length Residential Home Sales: The Impact of Small Scale Investors*, 5 J. INTL' BUS. MGMT. & RES. (2013), <http://www.barton.edu/pdf/faculty-publications/lee-richard-arms-length-vs-non-arms-length-home-sales.pdf> [<http://perma.cc/M8CQ-5VHJ>]; Grant S. Nelson, *Deficiency Judgments After Real Estate Foreclosures in Missouri: Some Modest Proposals*, 47 MO. L. REV. 151, 152 (1982); Stark, *supra* note 3, at 664.
51. NELSON ET AL., *supra* note 7, at 760; Durfee & Doddridge, *supra* note 33, at 832.
52. Schaplow, *supra* note 46, at 915 (noting that the lender bought at 73.61% of sales in three Oregon counties from 1970-79).
53. Nelson & Whitman, *supra* note 3, at 1415 ("The prevalence of [foreclosure] auctions in itself raises questions, given that auctions are not a common way of arranging arms-length market sales of real estate in the United States"); Bruce Vanderporten, *Timing of Bids at Pooled Real Estate Auctions*, 5 J. REAL EST. FIN. & ECON. 255, 255 (1992). *But see* Steven L. Good & Celeste M. Hammond, *Real Estate Auctions—Legal Concerns for an Increasingly Preferred Method of Selling Real*

foreclosures.<sup>54</sup> Distressingly, though auctions are most commonly used for foreclosures, the process is far worse than for even voluntary real estate auctions. For example, unlike voluntary auctions, foreclosures normally are conducted by nonprofessional auctioneers and are not widely advertised. A foreclosure bidder normally cannot inspect the property before buying it and is in an inferior bidding position to the foreclosing mortgagee. Moreover, in states with statutory redemption, the successful bidder normally will be unable to get possession of the property for as long as two years and may never get it if the owner redeems. Recognizing the serious flaws in the current foreclosure process and the benefits of private sales, the federal government encourages lenders to allow the borrower to sell property, rather than to foreclose, and studies have shown that the private sales have been more effective than foreclosure.

#### A. *Voluntary Auctions Versus Private Sales*

Simply reforming the auction process is not enough. Studies demonstrate that private sales normally are superior to both voluntary and involuntary auctions.<sup>55</sup> In one study that compared real estate auctions with private sales, the researchers concluded that, in the United States, “[a]uctions are never optimal” for the sale of real estate.<sup>56</sup> This conclusion was supported by two other studies that found that auctioned real estate sold for three to thirty-seven percent less than privately sold property.<sup>57</sup>

Additional studies on sales in Dallas and Los Angeles provide specific examples of the sub-optimal results of public auctions.<sup>58</sup> Though the price differences between auctioned and privately sold real estate were less than in the other studies, they still are consistent with those studies’ conclusions. The study in

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*Property*, 40 REAL PROP. PROB. & TR. J. 765 (2006) (discussing how real estate auctions are becoming more common).

54. BARLOW BURKE, JR., LAW OF REAL ESTATE BROKERS § 19.07 (rev. 3d ed. 2017); Christopher J. Mayer, *Assessing the Performance of Real Estate Auctions*, 26 REAL EST. ECON. 41, 41 (1998).
55. One study found that realty sold for more at auction, but its methodology has been criticized. See Orley Ashenfelter & David Genesove, *Testing for Price Anomalies in Real-Estate Auctions*, 82 AM. ECON. REV. 501, 505 (1992). But see Simon Stevenson & James Young, *An Analysis of Residential Auction Sale Prices and Quoted Guide Prices*, EUR. REAL EST. SOC’Y 1 (2005), <http://www.areuea.org/conferences/pdf/52/808.pdf> [<http://perma.cc/4TRK-R23B>].
56. Paul D. Adams, Brian D. Kluger & Steve B. Wyatt, *Integrating Auction and Search Markets: The Slow Dutch Auction*, 5 J. REAL EST. FIN. & ECON. 239, 240 (1992).
57. Mayer, *supra* note 54, at 42 (citing A. Wright, *The Effectiveness of Various Methods of Selling Single-Family Houses: A Statistical Analysis*, (1989) (unpublished manuscript); G. Gau & D. Quan, *Market Mechanism Choice and Real Estate Disposition: Negotiated Sales Versus Auction* (1992) (unpublished manuscript)).
58. Mayer, *supra* note 54, at 42.

Dallas compared auctions and private sales of single-family homes and of condominiums that were spread over a large area during a falling real estate market from 1985-90. The auctioned properties sold for nine to twenty-one percent less than privately sold properties.<sup>59</sup> The Los Angeles study involved condominium sales. Though the sales occurred in a boom market from 1981-87, the auctioned properties still sold for zero to nine percent less than properties sold by private sale.<sup>60</sup>

The most surprising and revealing study involved an auction by the Department of Housing and Urban Development (HUD) in 1998.<sup>61</sup> HUD auctioned 170 homes that it had acquired in southern Florida as part of a Federal Housing Administration (FHA) insurance program for mortgage loans. Under the program, when a lender foreclosed and bought at the sale, it could file an insurance claim for any loss on the loan. The lender transferred title to the property to HUD, and HUD listed the property for sale with a real estate agent or, when it had a large number of properties in one area, hired an auctioneer.<sup>62</sup>

For the auction that was the subject of the study, the auctioneer publicized the sale by direct mail, newspaper ads, and the Internet. HUD allowed prospective bidders to inspect the properties before the sale and offered a “buyer’s awareness seminar.” HUD agreed to convey the best possible title to the buyer—marketable title free and clear of liens and other title encumbrances, such as mortgages and easements.<sup>63</sup> Although the properties were sold “as is,” HUD provided escrow funds for repairs for some properties. It also encouraged real estate agents to find buyers and paid a 3 percent commission if the agent’s buyer was a successful bidder. HUD paid the closing costs for the sale, such as the closing agent’s fee and the cost of document preparation, and only required buyers to make a 3 percent down payment if they were going to occupy the home.<sup>64</sup> Despite the marketing efforts, the very favorable selling terms, and a

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59. *Id.* at 41. The study compared 234 auctions of single-family homes with 139,480 private sales and 235 condominium auctions compared with 10,423 private sales. *Id.* at 53. The properties were spread over a wide area. The auctions were ordered by a large institution, such as the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, or a private bank. *Id.* at 52.

60. *Id.* at 53. The study compared 285 condominium auctions with 124,420 private sales. The auctions were ordered by a condominium developer or lender that wanted to dispose of the remaining units in a development. *Id.* at 52.

61. Marcus T. Allen & Judith Swisher, *An Analysis of the Price Formation Process at a HUD Auction*, 20 J. REAL EST. RES. 279 (2000).

62. *Id.* at 281.

63. “Marketable title” is a title free of any encumbrances and not subject to any reasonable challenge. ROGER BERNHARDT & ANN M. BURKHART, *REAL PROPERTY IN A NUTSHELL* 293-94 (7th ed. 2016).

64. Allen & Swisher, *supra* note 61, at 281-83.

strong economy, the selling prices averaged 17.45 percent less than the market values.<sup>65</sup>

The experiences in several other countries demonstrate that auction can be an effective way to sell real estate. For example, studies on sales in Australia found that auction prices for homes in Melbourne were 8 percent higher than for private sales<sup>66</sup> and 3.6 percent higher for homes in Sydney.<sup>67</sup> In Christchurch, New Zealand, homes in two of four study areas had auction prices that were 5.9-9.5 percent higher than private sales, though the other two areas had no price difference.<sup>68</sup> In Dublin, Ireland,<sup>69</sup> and Singapore,<sup>70</sup> auction prices for real property also are higher than private sale prices. However, important differences exist between real estate auctions in other countries and foreclosure auctions in the United States. Auctions are most commonly used in other countries to sell the most desirable, premium properties because there are fewer comparable sales, which makes valuation difficult. In contrast, most foreclosures in the United States do not involve higher end properties.<sup>71</sup> Moreover, overseas realty auctions generally attract many bidders, which is essential to a successful auction. As described above, that is not the norm here and will not be for the foreseeable future, even for sales that are not forced sales.<sup>72</sup> It is very tell-

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65. *Id.* at 285. The authors also explain their method for calculating fair market value. *Id.*
66. Kenneth M. Lusht, *A Comparison of Prices Brought by English Auctions and Private Negotiations*, 24 REAL EST. ECON. 517 (1996).
67. Stevenson & Young, *supra* note 55, at 2. *Contra* Alex Frino, Maurice Peat & Danika Wright, *The Impact of Auctions on Residential Property Prices: Australian Evidence*, 52 ACCT. & FIN. 815 (2012) (no price difference between auction and private sale).
68. Mark G. Dotzour, Everard Moorhead & Daniel T. Winkler, *The Impact of Auctions on Residential Sale Prices in New Zealand*, 16 J. REAL EST. RES. 57, 66 (1998). *Contra* Frino et al., *supra* note 67, at 815 (finding no price difference between auction and private sale).
69. Simon Stevenson, James Young & Constantin Gurdgiev, *A Comparison of the Appraisal Process for Auction and Private Treaty Residential Sales*, 19 J. HOUSING ECON. 145, 153 (2010); *see also* Stevenson & Young, *supra* note 55, at 2.
70. Yuen Leng Chow, Isa E. Hafalir & Abdullah Yavas, *Auction Versus Negotiated Sale: Evidence from Real Estate Sales*, 43 REAL EST. ECON. 432 (2015).
71. Mayer, *supra* note 54, at 42; Nelson & Whitman, *supra* note 3, at 1418; Vanderporten, *supra* note 53, at 255.
72. Adams et al., *supra* note 56, at 251 (“If an auction attracts greater arrival of buyers than the traditional market format, then this can serve to offset the advantage of a [private sale] . . . . In the long run, it is doubtful that auctions will permanently increase the willingness of buyers to purchase and sell property, thus it is doubtful that an increase in buyer arrival will be observed for auctions [in the United States].”). One study indicated that the absence of third-party bidding is not attributable to the defective foreclosure process alone. In an empirical study of foreclosures in 1993 and 1994 in Cook County, Illinois, Professor Debra Pogrun-

ing that when lenders sell the properties that they purchased at their foreclosure sales, only two percent are sold by auction.<sup>73</sup>

### B. Foreclosure Auctions Versus Voluntary Auctions

More disturbingly, important differences exist between foreclosure auctions and voluntary real estate auctions in the United States, and the foreclosure auction is vastly inferior. “[I]t would be difficult to design a sale procedure less apt to result in market prices than the usual foreclosure auction. The absence of so many features that buyers in negotiated sales have come to expect virtually ensures that below-market prices will prevail.”<sup>74</sup> The flaws pervade the process.

Voluntary real estate auctions are conducted by a professional auctioneer. To protect sellers and buyers, most states in this country require that auctioneers be licensed. The government conducts a character and fitness examination of license applicants and regulates them after they are licensed.<sup>75</sup> The auctioneer is the seller’s agent and, as such, owes fiduciary duties to the seller. One of those duties—diligence—obligates the auctioneer to maximize the sale price.<sup>76</sup> In addition to the ethical duty to maximize the price, the auctioneer has an economic incentive—her commission usually is a percentage of the sale price.<sup>77</sup>

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Stark determined that, in about 90% of the sales, the property was worth less than the debt amount, plus the carrying and resale expenses. Stark, *supra* note 3, at 663-64. While the carrying and resale expenses would be relevant to a speculator who is considering bidding at the sale, they should not affect the price paid by a bidder who intends to occupy or lease the property. Professor Stark’s study indicated that, in fact, most third party foreclosure purchasers were not speculators who intended to resell the property quickly. She found that successful third party bidders re-sold the property within one year after purchasing it in only 50% of the 1993 foreclosures and 27% of the 1994 foreclosures. *Id.* at 666.

73. Kate Berry, *Banks Face Tough Choices Unloading REO Properties*, 177 (F307) AM. BANKER 1 (Feb. 24, 2012).

74. Nelson & Whitman, *supra* note 3, at 1423.

75. BURKE, *supra* note 54, at § 19.07; Good & Hammond, *supra* note 53, at 773, 802.

76. Good & Hammond, *supra* note 53, at 773.

77. BURKE, *supra* note 54, at § 19.07. The commission rate varies quite a bit. *See, e.g.*, Annette Law, *How Much of a Commission to [sic] Real Estate Auctioneers Take and Where Do I Find a List of Reputable Companies?*, TRULIA (July 25, 2014), [http://www.trulia.com/voices/Home\\_Selling/How\\_much\\_of\\_a\\_commission\\_to\\_real\\_estate\\_auctioneer-23155](http://www.trulia.com/voices/Home_Selling/How_much_of_a_commission_to_real_estate_auctioneer-23155) [<http://perma.cc/DJ8T-7D78>] (noting commission rate of 11-16%); M. Diane McCormick, *Selling a Property at Auction Has Its Pros and Cons*, PENN LIVE (Sept. 20, 2012), [http://www.pennlive.com/midstate/index.ssf/2012/09/selling\\_a\\_property\\_at\\_auction.html](http://www.pennlive.com/midstate/index.ssf/2012/09/selling_a_property_at_auction.html) [<http://perma.cc/TS7N-7V7E>] (noting commission rate of 1.5-4%).

The auctioneer actively advertises the sale to attract bidders<sup>78</sup> and prepares an information package about the property for distribution to prospective bidders. The package may include detailed plans of the property, a title report and title insurance commitment, an environmental inspection report, and a description of the property's expenses.<sup>79</sup> Bidders normally can inspect the property, and the seller may give express warranties about the property's physical condition.<sup>80</sup> The seller also may arrange financing for the buyer.<sup>81</sup>

In marked contrast, in the great majority of states, the foreclosure auctioneer is not a professional auctioneer, is not the borrower's agent, and owes the borrower no fiduciary duties.<sup>82</sup> Depending on the jurisdiction, the auction is conducted by a public official or another third party or even by the mortgagee.<sup>83</sup> In states in which lenders commonly use a deed of trust, rather than a mortgage, courts sometime state that the trustee is a fiduciary for both the borrower and lender. However, recognizing that the borrower and lender have conflicting goals in a foreclosure sale, courts normally do not hold the trustee to the same fiduciary standard as other trustees. In a frequently cited passage, the California Supreme Court described the reality of the trustee's role:

The similarities between a trustee of an express trust and a trustee under a deed of trust end with the name. "Just as a panda is not a true bear, a trustee of a deed of trust is not a true trustee." . . . [T]he trustee under a deed of trust does not have a true trustee's interest in, and control over, the trust property. Nor is it bound by the fiduciary duties that characterize a true trustee.<sup>84</sup>

Also unlike voluntary auctions, foreclosure auctions receive little publicity. Because the foreclosing lender normally is not interested in stimulating bidding at the sale and wants to minimize its costs, it usually provides only the legally-required notice. Depending on the state, a foreclosure advertisement may be published in a local legal newspaper of limited circulation. The ads normally employ technical legal terminology and generally do not provide meaningful information concerning the property or its location.<sup>85</sup> Moreover, because the

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78. BURKE, *supra* note 54, § 19.07; Good & Hammond, *supra* note 53, at 771.

79. Good & Hammond, *supra* note 53, at 779; Nelson & Whitman, *supra* note 3, at 1421.

80. Nelson & Whitman, *supra* note 3, at 1421-22.

81. *Id.* at 1421.

82. In some states, foreclosing lenders must hire a private auctioneer to conduct the sale. Lambie-Hanson & Lambie-Hanson, *supra* note 1, at 1.

83. NELSON ET AL., *supra* note 7, at 634.

84. *Monterey S.P. P'ship v. W.L. Bangham, Inc.*, 777 P.2d 623, 628 (Cal. 1989).

85. RESTATEMENT (THIRD) OF PROP. (MORTG.) § 8.3 cmt. a (Am. Law Inst. 1997); NELSON ET AL., *supra* note 7, at 758; Capone, *supra* note 47, at 111.



lender may be legally required to advertise the sale for a relatively short period of time, such as three weeks, the owner normally will be unable to sell the property before the foreclosure in an attempt to recover some of her equity in the property.<sup>86</sup> Astoundingly, the lender may not be legally required to notify the owner of the sale,<sup>87</sup> and junior interest holders often are not entitled to notice, though the sale will terminate their interest in the property.<sup>88</sup> Moreover, no “for sale” sign is posted on the property in the great majority of states.

People who do find out about the sale and are potentially interested in bidding face daunting obstacles. In a voluntary sale, a prospective purchaser examines the property and may have it professionally inspected and surveyed and an environmental assessment conducted. In contrast, owners who are about to lose their property to foreclosure normally do not permit property inspections, though it would be in their best interest to do so to increase bidding at the sale.<sup>89</sup> Gambling on the property’s condition is particularly dangerous in the foreclosure context, because a borrower experiencing financial difficulties often does not maintain the property and sometimes succumbs to the temptation to strip it of everything of value, including appliances and even plumbing and wiring.<sup>90</sup>

At a foreclosure auction, the foreclosure purchaser and seller do not enter into a purchase agreement that tailors the transaction to their specific needs and that conditions the buyer’s performance on matters such as the seller having marketable title to the property.<sup>91</sup> The absence of these conditions lowers the sale price because a buyer does not want to incur the expense of due diligence, such as a title examination, before reaching an agreement with the seller on the price and other sale terms. Prospective foreclosure purchasers must incur these expenses with no guarantee of being the successful bidder. Or, as is often the case, they do not perform the due diligence and later discover, when a problem arises, that they should have.<sup>92</sup> The problem is compounded because the buyer has no recourse against the seller. Unlike a voluntary sale, the seller does not

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86. Zachary T. Brumfield, *The “Short Cut” to the Stabilization of the Underwater Housing Market: How the New FHFA Short Sales Guidelines Promote Economic Efficiency*, 41 REAL EST. L.J. 456, 461 (2013).

87. See, e.g., MINN. STAT. § 580.03 (2017) (foreclosure notice must be served “upon the person in possession of the mortgaged premises, if the same are actually occupied”).

88. NELSON ET AL., *supra* note 7, at 634-35.

89. *Id.* at 1110.

90. RESTATEMENT (THIRD) OF PROP. (MORTG.) § 8.3 cmt. A (Am. Law Inst. 1997); Brumfield, *supra* note 86, at 461-62; Yianni D. Lagos, *Fixing a Broken System: Reconciling State Foreclosure Law with Economic Realities*, 7 TENN. J. L. & POL’Y 84, 92 (2011).

91. Lifton, *supra* note 47, at 1937; Nelson & Whitman, *supra* note 3, at 1419 n.98.

92. Nelson & Whitman, *supra* note 3, at 1422.

give a warranty deed with title covenants or any other warranties or representations concerning the property.<sup>93</sup>

If the prospective bidder makes it past these hurdles and decides to bid at the foreclosure sale, the sale itself presents more hurdles. The foreclosing lender is in a superior bidding position to any third party. The lender can bid up to the amount it is owed without paying any cash. It offsets its bid against the amount it is owed, in what is called a “credit bid.”<sup>94</sup> In contrast, the third-party buyer normally has to pay cash for the property up front and may be required to do so immediately at the sale. Because lenders normally will not finance a real estate purchase before the buyer has a purchase agreement, the third-party buyer will have to pay cash from its own resources, which is atypical for real estate sales.<sup>95</sup>

Perhaps the biggest barrier to third party bidding exists after the sale—statutory redemption. More than half the states give the foreclosed owner and, in some states, junior lienors, the right to nullify the sale by repaying the foreclosure purchaser, typically the amount of the winning bid, plus interest.<sup>96</sup> Depending on the state, the statutory redemption period lasts from six months to two years after the sale.<sup>97</sup> In most states, the foreclosed owner can possess the property during that time.<sup>98</sup> Statutory redemption is intended to give the foreclosed owner additional time to sell the property or refinance to get the money to redeem. It also is intended to increase the amount paid at the foreclosure sale. The theory is that the foreclosure purchaser will realize that, if it pays too little, the foreclosed owner or junior lienor is more likely to redeem.<sup>99</sup> Unfortunately, statutory redemption has had the opposite effect. It discourages third party bidding and decreases the amount bidders are willing to pay.<sup>100</sup> An English commentator has described American statutory redemption as “absurd” and has said that “only the worst type of parasite speculator” would bid at a foreclosure sale that is subject to statutory redemption.<sup>101</sup> To add insult to inju-

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93. RESTATEMENT (THIRD) OF PROP. (MORTG.) § 8.3 cmt. a (Am. Law Inst. 1997); Nelson & Whitman, *supra* note 3, at 1422.

94. RESTATEMENT (THIRD) OF PROP. (MORTG.) § 8.3 cmt. a (Am. Law Inst. 1997); NELSON ET AL., *supra* note 7, at 757-58; Washburn, *supra* note 34, at 849.

95. Brumfield, *supra* note 86, at 461; Stephen Guynn, *A Market-Based Tool to Reduce Systemic Undervaluation of Collateral in Residential Mortgage Foreclosures*, 100 VA. L. REV. 587, 595 (2014); Lifton, *supra* note 47, at 1936-37.

96. NELSON ET AL., *supra* note 7, at 744-45.

97. See, e.g., MINN. STAT. ANN. § 580.23, subd. 1 & 2 (2017) (6 months or 12 months depending on a variety of factors); TENN. CODE ANN. §§ 66-8-101, 66-8-102 (2016) (2 years).

98. NELSON ET AL., *supra* note 7, at 744-45.

99. *Brown v. Trujillo*, 88 P.3d 881, 887 (N.M. Ct. App. 2004).

100. NELSON ET AL., *supra* note 7, at 747; Brabner-Smith, *supra* note 17, at 722; Lifton, *supra* note 47, at 1940; Washburn, *supra* note 34, at 854.

101. Turner, *supra* note 27, at 606.

ry, it has proven to be largely ineffective. In one recent study of 1,860 single-family home foreclosures in Alabama from 2004-12, only .59 percent of the homes were statutorily redeemed.<sup>102</sup> Earlier studies found that owners redeemed after 1.4,<sup>103</sup> .7,<sup>104</sup> 9.78,<sup>105</sup> or 10<sup>106</sup> percent of foreclosure sales.<sup>107</sup> The results vary based on a variety of factors, such as market conditions, but they clearly demonstrate that statutory redemption has generally been a failure, particularly considering its adverse impacts on foreclosure sales.

Faced with these realities concerning our current foreclosure system, the federal government created the Home Affordable Foreclosure Alternatives Program that provides incentives for lenders to let defaulting borrowers sell their home, rather than to foreclose.<sup>108</sup> The Federal Housing Finance Agency,<sup>109</sup> the

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102. Bruce L. Gordon & Daniel T. Winkler, *Statutory Right of Redemption and the Selling Price of Foreclosed Houses*, 51 J. REAL EST. FIN. & ECON. 365, 367 (2015) (statutory redemption exercised 11 times in 1,860 foreclosures). The authors found that the negative impact of statutory redemption on the foreclosure selling price was \$250 on a \$90,000 foreclosure sale price. *Id.*; see also Brabner-Smith, *supra* note 17, at 722; Lifton, *supra* note 47, at 1940.
103. Jim Blanco & David Crumbaugh, *Foreclosures, Redemptions, and Homeowners*, 1975 U. ILL. L.F. 335, 351 (1975) (19 redemptions for 1,343 single-family foreclosures in Cook County, Illinois in 1964).
104. *Id.* at 351-52 (24 redemptions by owners and 4 by judgment creditors for 3,015 single-family foreclosures in Cook County in 1974).
105. Schaplow, *supra* note 46, at 915 (72 redemptions for 736 sales in three Oregon counties from 1970-79).
106. Patrick B. Bauer, *Statutory Redemption Reconsidered: The Operation of Iowa's Redemption Statute in Two Counties Between 1881-1980*, 70 IOWA L. REV. 343, 350-51 (1985) (191 redemptions for 1,832 foreclosures).
107. Stark, *supra* note 3, at 674.
108. *Home Foreclosure Affordable Alternative Program: Overview*, MAKING HOME AFFORDABLE (2017), [http://www.hmpadmin.com/portal/programs/foreclosure\\_alternatives.jsp](http://www.hmpadmin.com/portal/programs/foreclosure_alternatives.jsp) [<http://perma.cc/JX74-Q325>].
109. See FHFA Announces New Standard Short Sale Guidelines for Fannie Mae and Freddie Mac, FED. FIN. HOUS. AGENCY (Aug. 21, 2012), <http://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-New-Standard-Short-Sale-Guidelines-for-Fannie-Mae-and-Freddie-Mac.aspx> [<http://perma.cc/Z24G-T8P5>]; *Fannie Mae Standard Short Sale/HAFA II and Deed-in-Lieu of Foreclosure Requirements*, FANNIE MAE (Aug. 22, 2012), <http://www.fanniemae.com/content/announcement/svc1219.pdf> [<http://perma.cc/V2UL-HKTL>]; *Freddie Mac Bulletin No. 2012-16*, FREDDIE MAC (Aug. 21, 2012), <http://www.freddiemac.com/sell/guide/bulletins/pdf/bl1216.pdf> [<http://perma.cc/HEH9-66N8>]; see also Brumfield, *supra* note 86; Philip J. Vacco, *Surviving a Short Sale: Guidelines for a Rewarding Short Sale Experience*, 27 PROB. & PROP. MAG. 40 (2013).

Department of Housing and Urban Development,<sup>110</sup> and the Treasury Department<sup>111</sup> have promulgated guidelines to help accomplish that goal, and empirical studies demonstrate that these private sales by defaulted borrowers are more effective than foreclosure auctions.

The studies focus on the sale of properties that are worth less than the debt they secure (“short sales”). They show that, when a borrower defaults on a mortgage loan, a short sale produces a higher sale price than a foreclosure auction,<sup>112</sup> which is unsurprising. In contrast to a foreclosure auction, a short-sale property is actively marketed by a professional salesperson. Additionally, a short sale does not present the same obstacles to prospective buyers as a foreclosure auction. For example, the buyer can inspect the property before agreeing to buy it, does not have to pay all cash at the time of sale, and is not subject to statutory redemption.

When the lender buys at the foreclosure sale, the property is classified as “real estate owned” (REO). Lenders’ post-foreclosure REO sales also are less effective than short sales, which further demonstrates the benefit of avoiding a foreclosure auction. Short sales are for higher prices than REO sales,<sup>113</sup> because properties that are sold in a short sale remain in better physical condition than REO properties.<sup>114</sup> A short sale property is less likely to be abandoned and neglected than when a lender forecloses and acquires the property.<sup>115</sup> Additionally,

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110. See Letter from Carol J. Galante, Assistant Sec’y for Hous., on Updated Pre-Foreclosure Sale (PFS) and Deed in Lieu (DIL) of Foreclosure Requirements (July 9, 2013), <http://www.hud.gov/sites/documents/13-23ML.PDF> [<http://perma.cc/LCT2-KGEQ>]; Vacco, *supra* note 109.
111. *Handbook for Servicers of Non-GSE Mortgages*, MAKING HOME AFFORDABLE (May 26, 2016), [http://www.hmpadmin.com/portal/programs/docs/hamp\\_servicer/mhahandbook\\_51.pdf](http://www.hmpadmin.com/portal/programs/docs/hamp_servicer/mhahandbook_51.pdf) [<http://perma.cc/5G3U-LAWJ>].
112. Brumfield, *supra* note 86, at 457 (short sale price 10% less than fair market value; foreclosure sale price 30% less); Nasser Daneshvary, Terrence M. Clauretie & Ahmad Kader, *Short-Term Own-Price and Spillover Effects of Distressed Residential Properties: The Case of a Housing Crash*, 33 J. REAL EST. RESEARCH 179, 186 (2011); Calvin Zhang, *A Shortage of Short Sales: Explaining the Under-Utilization of a Foreclosure Alternative* 29 (Oct. 11 2017), <http://ssrn.com/abstract=3050600> [<http://perma.cc/X6Q5-JVE9>] (short sale prices 8.5% greater than foreclosure sale prices); *Existing-Home Sales Improve in July, Prices Continue to Rise*, NAT’L ASSO’N OF REALTORS (Aug. 22, 2012), <http://www.realtor.org/news-releases/2012/08/existing-home-sales-improve-in-july-prices-continue-to-rise> [<http://perma.cc/XPC8-5HY3>] (short sale price 15% less than fair market value; foreclosure sale price 17% less).
113. Daneshvary et al., *supra* note 112, at 186, Exhibit 3.
114. *Id.* at 187, Exhibit 4.
115. See generally Ingrid Gould Ellen, Josiah Madar & Mary Weselcouch, *The Foreclosure Crisis and Community Development: Exploring REO Dynamics in Hard-Hit Neighborhoods*, 30 HOUSING STUD. 535, 538 (2015) (REO properties tend to be vacant and in poor physical condition); Keith Ihlanfeldt & Tom Mayock, *The Im-*

a property's physical condition generally improves when it is listed for sale with a real estate agent. The agent often has the property repaired and maintained for sale purposes and monitors it throughout the listing period.<sup>116</sup>

A short sale property also remains in better condition than an REO because short sales occur more quickly than REO sales, which also enables the lender to recover on the debt sooner from a short sale than from a foreclosure. A study found that, for a short sale, the time from the borrower's default until the sale is 19 months. In contrast, the foreclosure sale occurred 25 months after the borrower's default. And when the lender purchases at the foreclosure sale, it will not recover on the loan until it later resells the property, and it incurs the expenses of foreclosing, owning, and reselling the property.<sup>117</sup>

Defaulting borrowers, neighboring property owners, and the community also benefit from short sales. For borrowers, a short sale results in more of their debt being paid, and they avoid the stigma and stress of going through a foreclosure or of filing for bankruptcy to stay the sale. Because a short sale property normally is in better condition than an REO, the short sale property generally does not cause neighboring property values to decline<sup>118</sup> or decline to the same extent as a foreclosed property.<sup>119</sup> As a result, a short sale has less adverse effect on the community's property tax base than a foreclosure.

As the studies described above show, private sales of real estate are superior to voluntary and involuntary auctions. The problems with involuntary auctions, such as foreclosure, are compounded by the lender's right to buy at the sale, which stifles marketing of the property and competitive bidding. Although foreclosure by auction was intended to generate a fair price for the foreclosed property, it has been unsuccessful in doing so almost since its inception. The many deficiencies in the process render that result inevitable. The need to reform the process is particularly acute because it inflicts losses not just on the borrower, but also on the foreclosing lender, neighboring property owners, and the community, as described in the next section.

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*pact of REO Sales on Neighborhoods and Their Residents*, 53 J. REAL EST. FIN. & ECON. 282, 283 (2016) (REO properties are less well maintained than owner-occupied properties); Lauren Lambie-Hanson, *When Does Delinquency Result in Neglect? Mortgage Distress and Property Maintenance*, 90 J. URB. ECON. 1, 8-9 (2015) (foreclosing lenders tend to neglect properties acquired at foreclosure sales).

116. Lambie-Hanson, *supra* note 115, at 2, 10.

117. Daneshvary et al., *supra* note 112, at 184 (noting the lender's expenses); *see also* Capone, *supra* note 47, at 89 (noting that HUD saved a significant amount of money by allowing a short sale, rather than foreclosing).

118. Daneshvary et al., *supra* note 112, at 203.

119. Zhang, *supra* note 112, at 3.

## III. ADVERSE EFFECTS OF FORECLOSURE

The crash of the real estate and mortgage markets in 2007 generated a great deal of interest in measuring the effects of the millions of foreclosures that followed. Before 2007, only two empirical studies were published that examined the effectiveness of foreclosure sales, and both involved a relatively small number of sales. One study analyzed 118 sales,<sup>120</sup> and the other analyzed 276 sales.<sup>121</sup>

Since 2007, economists, social scientists, and others have produced a wealth of empirical studies, some of which analyze more than a million foreclosures each.<sup>122</sup> The new research also examines a wide variety of foreclosure impacts that had not previously been systematically studied. In light of the wide variety of variables that affect the outcomes, such as the location of the foreclosed properties, local market conditions, and the physical condition of the properties, the results unsurprisingly vary significantly. Generalizing from the research also can be difficult because people involved in foreclosures behave in different ways. For example, some lenders secure and maintain abandoned properties that are in foreclosure, while others do not. Additionally, because this is a relatively new area of research, researchers still differ in their definitions of various terms, the ways that they measure impacts, and the variables they consider.

However, the research does clearly demonstrate that foreclosures impose substantial monetary and nonmonetary costs on borrowers, lenders, neighbors, and local communities. Although the market crash magnified the costs, they existed before the crash, too.<sup>123</sup> The research also shows that the current method of foreclosure is the least efficient way to address borrower default. In a report to Congress, the Department of Housing and Urban Development described foreclosure as “the costliest way to resolve borrower difficulties.”<sup>124</sup> An examination of the great variety of costs generated by foreclosures demonstrates why.

## A. Borrowers

The current foreclosure process imposes significant costs on borrowers, po-

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120. Wechsler, *supra* note 3.

121. Stark, *supra* note 3.

122. See, e.g., John Y. Campbell, Stefano Giglio & Parag Pathak, *Forced Sales and House Prices*, 101 AM. ECON. REV. 2108 (2011) (1.05 million foreclosures); Hanqing Zhou, Yuan Yuan, Christopher Lako, Michael Sklarz & Charles McKinney, *Foreclosure Discount: Definition and Dynamic Patterns*, 43 REAL EST. ECON. 683 (2015) (1.34 million foreclosures).

123. See, e.g., Zhou et al., *supra* note 122, at 688 (chart showing magnitude of the foreclosure discount from 2000-2012).

124. Capone, *supra* note 47, at 3; see also Brent W. Ambrose & Charles A. Capone, Jr., *Cost-Benefit Analysis of Single-Family Foreclosure Alternatives*, 13 J. REAL EST. FIN. & ECON. 105, 106 (1996); Samuel C. Waters, *A View from the Trenches: The Legal Practitioner and Loss Mitigation*, 60 S.C. L. REV. 807, 808 (2009).

tentially including lost equity, higher taxes, and a dramatic disruption in residential and family stability. As described in Section II, the foreclosing mortgagee normally is the only bidder at the sale, and it normally bids only the outstanding debt amount. Therefore, if the property is worth more than the debt, the borrower will lose its equity in the property. When the property's value does exceed the debt amount, the borrower can attempt to sell the property before the foreclosure sale and use the proceeds to pay off the debt. However, borrowers often do not do so. If the foreclosure is by power of sale, the process often is too fast for the borrower to sell or may be taking place during a depressed real estate market.<sup>125</sup> Additionally, health or other personal issues may prevent the borrower from taking action.<sup>126</sup> If the borrower does sell while the foreclosure is pending, the sale's distressed nature will decrease the sale price, on average, by 9.78 percent from the property's normal market value.<sup>127</sup>

If the successful foreclosure bid is less than the outstanding debt, the borrower is liable for the deficiency in most states.<sup>128</sup> If, as is usual, the lender does not sue to recover the deficiency, the borrower may have to recognize that amount as income for federal income taxes. At the same time, the borrower is losing the tax deductions associated with ownership.<sup>129</sup>

If the foreclosure is on a home, the sale will be disruptive for the residents, particularly if they include children.<sup>130</sup> The owner will incur costs searching for and moving to a new home. The search will be particularly difficult, because a foreclosure substantially damages the borrower's credit rating for several years.<sup>131</sup> Therefore, implementing a foreclosure process that mitigates or pre-

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125. Nelson & Whitman, *supra* note 3, at 1429.

126. *Id.*

127. Lee, *supra* note 50, at 9.

128. NELSON ET AL., *supra* note 7, at § 8.3.

129. Before December 31, 2016, a discharged debt was not taxable income if it was secured by the borrower's primary residence and if the borrower used it to buy, build, or improve the residence or to refinance a loan for that purpose. 26 U.S.C. § 108(a)(1)(E)(i). A bill is pending to extend the expiration date to December 31, 2018. S. 122, 115<sup>th</sup> Cong. § 2 (2017). Capone, *supra* note 47, at 3; George McCarthy, Shannon Van Zandt & William Rohe, *The Economic Benefits and Costs of Homeownership: A Critical Assessment of the Research* 30 (Research Inst. for Hous. Am., Working Paper No. 01-02, 2001), [http://www.mba.org/assets/Documents/Research/RIHA/48517\\_RIHAWp01-02.pdf](http://www.mba.org/assets/Documents/Research/RIHA/48517_RIHAWp01-02.pdf) [<http://perma.cc/C3BD-UY6E>].

130. Daniel Bahls & Katherine Hunt, *Abhorring a Forfeiture: The Importance of Equitable Jurisdiction in a Foreclosure Crisis*, 41 STETSON L. REV. 779, 794 (2012); Alan M. White, *Foreclosure Diversion and Mediation in the States*, 33 GA. ST. U. L. REV. 411, 428 (2017).

131. Darryl E. Getter, N. Eric Weiss, Oscar R. Gonzales & David H. Carpenter, *The Process, Data, and Costs of Mortgage Foreclosure*, in AMERICA'S FORECLOSURE CRISIS: CAUSES AND RESPONSES 157, 166 (Russell Burns & Roy A. Foster eds., 2012).

vents these harms is in the best interests of not only the property owners and their families, but also the community.<sup>132</sup>

### B. Lenders

As described above, the foreclosing lender normally is the successful bidder at the foreclosure auction. However, “successful” can be a rather misleading adjective. As HUD reported to Congress: “Contrary to popularly held myths, mortgage finance institutions lose money on nearly all foreclosures.”<sup>133</sup> HUD estimated that foreclosing lenders suffer losses of up to 60 percent of the outstanding loan amount, depending on variables such as the loan-to-value ratio and the difficulty of complying with state foreclosure laws.<sup>134</sup> The reason is that the lender normally is unable to sell the property for enough to recoup its unpaid loan proceeds, foreclosure costs, and carrying costs for its period of ownership, such as taxes and insurance. The problem is caused in part by the “foreclosure discount,” which depresses the property’s value, and by lenders’ frequent neglect of properties they acquire in foreclosure.

#### 1. Foreclosure Costs

Throughout the foreclosure process, the lender is incurring costs. Interest continues to accrue on the loan but normally is unpaid, which is lost revenue for the lender. In many cases, the borrower has abandoned the property as a lost cause, and the mortgagee may have to secure and maintain it and pay the property taxes<sup>135</sup> and insurance premiums<sup>136</sup> even before acquiring it at the fore-

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132. Prentiss Cox, *Foreclosure Reform Amid Mortgage Lending Turmoil: A Public Purpose Approach*, 45 HOUS. L. REV. 683 (2008).

133. Capone, *supra* note 47, at 38-39; *Foreclosure Statistics*, FED. DEPOSIT INS. CORP. (July 13, 2007), [http://www.fdic.gov/about/comein/files/foreclosure\\_statistics.pdf](http://www.fdic.gov/about/comein/files/foreclosure_statistics.pdf) [<http://perma.cc/9DRW-LVP7>]; Getter et al., *supra* note 131, at 166; *see also* Stark, *supra* note 3, at 667-68 (noting that in a study of Cook County, Illinois foreclosures, the mortgagee made a profit in approximately 20% of foreclosure sales in 1993 and 10% of sales in 1994). *Contra* Wechsler, *supra* note 3, at 880-81 (mortgagees profited on approximately half the properties they acquired at foreclosure); Capone, *supra* note 47, at 39 has criticized this study’s conclusions.

134. Capone, *supra* note 47, at 39-40.

135. If the property owner does not pay the taxes, the government has a lien on the property for the unpaid taxes. In most states, this lien has priority over the mortgage. Therefore, if the government sells the land to satisfy the tax lien, the sale eliminates the mortgage and often leaves the lender without security for the loan. Therefore, the lender often pays the taxes even before it acquires the property. 4 POWELL ON REAL PROPERTY § 37.28[3] (Michael Allan Wolf ed., 2000).

136. The lender often will pay the insurance premiums if the borrower does not because, if the mortgaged property is damaged and is not repaired or rebuilt, it may



closure sale. The lender must pay the foreclosure sale expenses, which can include the foreclosure notice publication cost and fees for an attorney, a process server, and the person who conducts the sale. Although mortgage documents normally impose liability for foreclosure costs on the borrower,<sup>137</sup> lenders seldom recoup them.<sup>138</sup>

The lender can incur these costs for a substantial period of time. During normal economic conditions, a power of sale foreclosure can be completed in a matter of weeks, but a judicial foreclosure can take up to two years.<sup>139</sup> However, since the 2007 market crash, foreclosures have taken substantially longer. A table that Fannie Mae publishes for its loan servicers indicates the magnitude of the delays now associated with foreclosure.<sup>140</sup> For each state, the table specifies the maximum number of days that Fannie Mae will allow from the borrower's last payment until the foreclosure sale. Depending on the state, the times for power of sale foreclosures range from 300 days to 1,020 days. The times for judicial foreclosures range from 480 days to 1,230 days.

Although the length of the foreclosure process eventually should return to approximately pre-2007 levels, a two-year study of foreclosures in Cook County (Chicago), Illinois shows that the lender's costs up to and including the foreclosure sale will still be substantial. The study found that the lender's costs totaled 19.61 percent of the outstanding debt amount in 1993 and 18.43 percent in 1994. The largest costs were for accrued interest and to secure the property.<sup>141</sup>

## 2. Ownership Expenses

When the lender buys at the foreclosure sale, it becomes responsible for the costs of ownership, including property taxes, insurance premiums, any homeowner's association assessments, utilities, and maintenance costs. The lender also may pay a management company to monitor and maintain the property.

Obviously, the lender's total ownership expense depends on how long the property remains REO. The REO period varies substantially depending on the property's location and local market conditions. For example, before the market crash, the median REO period ranged from 175-250 days in Chicago and from 277-308 days in Atlanta. After the crash, the median REO period ranged

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no longer be worth as much as the secured debt. NELSON ET AL., *supra* note 7, at 155-56.

137. Vaughan, *supra* note 25, at 977-78.

138. See, e.g., Wechsler, *supra* note 3, at 877-78.

139. Capone, *supra* note 47, at 3.

140. *Foreclosure Time Frames and Compensatory Fee Allowable Delays Exhibit*, FANNIE MAE (Mar. 14, 2016), [http://www.fanniemae.com/content/guide\\_exhibit/foreclosure-timeframes-compensatory-fees-allowable-delays.pdf](http://www.fanniemae.com/content/guide_exhibit/foreclosure-timeframes-compensatory-fees-allowable-delays.pdf) [<http://perma.cc/6AAS-9F5D>].

141. Stark, *supra* note 3, at 669-70.

from 178-608 days in Atlanta, 359-1,113 days in New York City, and 175-450 days in Miami-Dade County.<sup>142</sup> A study of foreclosures in the Raleigh-Cary, North Carolina metropolitan area found that properties remained REO an average of 203 days.<sup>143</sup> However, a significant number of properties remain REO for more than three years.<sup>144</sup> These figures certainly refute the commonly offered justification for foreclosure by auction—that it is a quick remedy for the lender.

In addition to incurring the costs of foreclosing and owning the property, the lender incurs additional expenses to sell it. Typically, the lender retains the services of a real estate agent and must pay the agent a real estate commission. In addition to the other selling costs, the lender may have to pay for property repair and rehabilitation to get the property market-ready.<sup>145</sup>

The total costs can be substantial. The United States Department of Veterans Affairs estimates that the lender's post-foreclosure holding and selling costs total 15.95 percent of the property's value.<sup>146</sup> In 2002, Freddie Mac cited a study that estimated the average costs for the foreclosure sale, unpaid interest, and property disposition to be \$58,759 per loan.<sup>147</sup> These costs, on top of the amount the borrower owed at foreclosure, can exceed the lender's return from selling the property, especially because the lender normally cannot sell it for its full pre-foreclosure value, as described in the next section.

### 3. Foreclosure Discount

After incurring the costs of foreclosure and property ownership, the lender normally experiences another loss when it sells the REO property due to the "foreclosure discount." The discount is the difference between the sale price for an REO property and the fair market value for a comparable property. The researchers do not yet agree on the factors that should be considered when calculating the foreclosure discount.<sup>148</sup> But, despite their differences, they virtually all

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142. Ellen et al., *supra* note 115, at 540-41, 552.

143. Lee, *supra* note 50, at 9.

144. Ellen et al., *supra* note 115, at 552.

145. Campbell et al., *supra* note 122, at 2121; Lee, *supra* note 50, at 6; Stark, *supra* note 3, at 675.

146. VA Net Value Factor – Effective – 12/23/2015, U.S. DEP'T OF VETERANS AFFAIRS (Dec. 2, 2015), [http://www.benefits.va.gov/HOMELOANS/servicers\\_valeri.asp](http://www.benefits.va.gov/HOMELOANS/servicers_valeri.asp) [<http://perma.cc/4958-LH8L>].

147. Amy Crews Cutts & Richard K. Green, *Innovative Servicing Technology: Smart Enough to Keep People in Their Houses?* 5 (Freddie Mac, Working Paper No. 04-03, 2004), [http://www.innovations.harvard.edu/sites/default/files/fmwp\\_0403\\_servicing\\_0.pdf](http://www.innovations.harvard.edu/sites/default/files/fmwp_0403_servicing_0.pdf) [<http://perma.cc/LET8-WHS5>].

148. See, e.g., Esther Cho, *Ten States with the Biggest Foreclosure Discounts: RealtyTrac*, D.S. NEWS (Sept. 3, 2012), <http://www.dsnews.com/news/foreclosure/09-03->

agree that REOs sell for less than comparable properties.<sup>149</sup>

The magnitude of the foreclosure discount varies among the studies. The estimates range from 7.7 to 50 percent.<sup>150</sup> This difference is partly a function of the different measures that researchers employ and the different real estate markets they are studying. However, recent research is uncovering numerous other variables that affect the discount amount, such as the number of REOs in the area, market conditions, whether the state has statutory redemption, and housing prices in the area.<sup>151</sup>

The most consistently identified cause of foreclosure discount is the REO property's deteriorated condition. As described above, when borrowers experience financial difficulties, they may be unable to continue maintaining the property.<sup>152</sup> After losing the property to foreclosure, they may strip it or otherwise damage it.<sup>153</sup> When the lender acquires the property, it normally continues to deteriorate because lenders and their loan servicers frequently do not properly maintain REO properties.<sup>154</sup> Although the lender has an economic incentive to preserve the property's value for resale, competing economic considerations

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2012/ten-states-with-biggest-foreclosure-discounts-realtytrac-2012-09-03 [http://perma.cc/9Z33-G725] (combining foreclosure sales and REO sales); Lee, *supra* note 50, at 11 (using median foreclosure sale price versus county-wide median sale price); Albert J. Sumell, *The Determinants of Foreclosed Property Values: Evidence from Inner-City Cleveland*, 18 J. HOUS. RES. 45, 51 (2009) (measuring REO sale price versus property's estimated market value); Zhou et al., *supra* note 122, at 683 (using REO sale price versus property's estimated market value).

149. In a relatively early study, the researchers determined that "no statistically significant foreclosure discount exists," but a Financial Economist and Policy Adviser in the Atlanta Federal Reserve Research Department has characterized this finding as "unusual relative to the other studies." W. Scott Frame, *Estimating the Effect of Mortgage Foreclosures on Nearby Property Values: A Critical Review of the Literature*, 95 ECON. REV. 1, 4 (2010).
150. See, e.g., Berry, *supra* note 73, at 25-30; Campbell et al., *supra* note 122, at 2129 (27%); Cho, *supra* note 148 (10 states with foreclosure discount greater than 40%); Stan Humphries, *What's the Real Discount on a Foreclosure?*, ZILLOW (Nov. 9, 2012), <http://www.zillow.com/research/whats-the-real-discount-on-a-foreclosure-3229/> [http://perma.cc/C84G-GYEZ] (7.7%); Lee, *supra* note 50, at 2 (24.13%); U.S. *Real Estate Statistics & Foreclosure Trends Summary*, REALTYTRAC (Aug. 28, 2012), <http://www.realtytrac.com/statsandtrends> [http://perma.cc/ULF3-3YEE] (44%); Sumell, *supra* note 148, at 51 (50%); Zhou et al., *supra* note 122, at 687 (15% average from 2000-2012).
151. See Campbell et al., *supra* note 122, at 2110; Sumell, *supra* note 148, at 57-58; Zhou et al., *supra* note 122, at 717.
152. Lambie-Hanson, *supra* note 115, at 2.
153. Sumell, *supra* note 148, at 46.
154. Ihlanfeldt & Mayock, *supra* note 115, at 283; Lambie-Hanson, *supra* note 115, at 8-9; cf. Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 YALE J. ON REG. 1, 42-43 (2011).

may outweigh that incentive. If the property is not generating income and the borrower is not making payments, the lender or servicer cannot recoup its expenditures for maintenance and repairs.<sup>155</sup> The lender also may determine that the work will not sufficiently enhance the property's value for the lender to recover the cost when it sells the property.

The other reason that REO properties tend to deteriorate is that lenders frequently fail to adequately monitor them.<sup>156</sup> This neglect can lead to nonstructural problems, such as overgrown lawns and unshoveled sidewalks, and to much larger problems, such as a burst pipe that floods the basement. Untended properties also attract trespassers, such as squatters, drug dealers, and vandals, who can take over the property and seriously damage it.<sup>157</sup> As a result of lenders' failures to monitor and maintain their REO properties, they are the subject of 3.8 times more citizen complaints than properties that are not in foreclosure.<sup>158</sup>

Three additional aspects of an REO sale also contribute to the foreclosure discount. REO properties normally are vacant.<sup>159</sup> A study has established that a vacant home, whether REO or non-REO, sells for about 6 percent less than an occupied home.<sup>160</sup> The same study showed that vacant homes take longer to sell than occupied homes.<sup>161</sup> However, the lender normally wants to sell quickly to limit the cost and responsibility of ownership. With this knowledge, a prospective buyer may make a below-market offer, which the lender may accept.<sup>162</sup> Fi-

155. Lee, *supra* note 50, at 6.

156. Ellen et al., *supra* note 115, at 538; Lambie-Hanson, *supra* note 115, at 2.

157. WILLIAM C. APGAR & MARK DUDA, COLLATERAL DAMAGE: The MUNICIPAL IMPACT OF TODAY'S MORTGAGE FORECLOSURE BOOM 14 (2005), [http://www.researchgate.net/publication/238785386\\_Collateral\\_Damage\\_The\\_Municipal\\_Impact\\_of\\_Today's\\_Mortgage\\_Foreclosure\\_Boom](http://www.researchgate.net/publication/238785386_Collateral_Damage_The_Municipal_Impact_of_Today's_Mortgage_Foreclosure_Boom) [http://perma.cc/84KF-BHZN]; Ryan M. Goodstein & Yan Y. Lee, *Do Foreclosures Increase Crime?* 24 (FDIC Ctr. For Fin. Research, Working Paper No. 2010-05, 2010), <http://www.fdic.gov/bank/analytical/cfr/2010/wp2010/2010-05.pdf> [http://perma.cc/BJR7-C6RY]; Lambie-Hanson, *supra* note 115, at 8.

158. Lambie-Hanson, *supra* note 115, at 10; *see also* Jackelyn Hwang, *Racialized Recovery: Post-Foreclosure Pathways in Distressed Neighborhoods in Boston* 24 (Joint Ctr. for Hous. Studies, Harv. Univ., Working Paper No. 15-1, 2015), [http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w15-1\\_hwang.pdf](http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w15-1_hwang.pdf) [http://perma.cc/5HBB-LUU9]. One large-scale purchaser of REO homes estimated that it would have to spend \$5,000-\$20,000 on each home to prepare it for rental. Lee, *supra* note 50, at 12.

159. Ellen et al., *supra* note 115, at 537-38.

160. Chien-Chih Peng & Lary B. Cowart, *Do Vacant Houses Sell for Less? Evidence from the Lexington Housing Market*, 72 APPRAISAL J. 234, 240 (2004).

161. *Id.*

162. *See* Campbell et al., *supra* note 122, at 2121; Stephan Whitaker & Thomas J. Fitzpatrick IV, *The Impact of Vacant, Tax-Delinquent, and Foreclosed Property on Sales Prices of Neighboring Homes* 4 (Fed. Reserve Bank of Cleveland, Working Paper

nally, the property is tainted by the stigma of foreclosure. HUD has estimated that REO sale prices are “at least” five percent lower because of that stigma alone.<sup>163</sup>

Though a foreclosing lender sometimes reaps a windfall,<sup>164</sup> foreclosure by auction normally is, on average, not beneficial for it. It incurs costs in the foreclosure process that it normally does not recover from the borrower. If the lender purchases at the auction, which it frequently does, it bears the responsibilities and costs of ownership. To recover its investment in the property, the lender must sell it and incur the costs of selling. However, it often will not recover its entire investment from the sale, particularly because the price will be reduced by the foreclosure discount. Moreover, foreclosure by auction is slow when measured by how long it takes the lender to recoup at least some of its money by selling the property.

Clearly, foreclosure by auction is not an effective or efficient remedy for lenders or for borrowers. However, they did contract for that remedy in the mortgage. On the other hand, the neighboring property owners and the local government did not, and they also suffer negative consequences from the process, as described in the next sections.

### C. Neighbors

Recent research clearly establishes that foreclosure adversely affects not only the foreclosed property’s value, but also nearby property values. The studies are uniform in finding a negative price effect, though the results concerning the magnitude of the price effect vary. Most studies find that neighboring properties suffer a 1-2 percent price decline for each foreclosed home in the area. Some studies have found significantly greater adverse effects.<sup>165</sup> For example, a study of more than 1 million foreclosures in Massachusetts found that, on average, the fair market value of each home within a quarter mile of a foreclosed

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No. 11-23R, 2012), <http://www.clevelandfed.org/en/newsroom%20and%20events/publications/working%20papers/2011%20working%20papers/~/~medi a/9dbd4474499a4e3bbc1523271930bace.ashx> [<http://perma.cc/JJ2V-UXGH>].

163. Capone, *supra* note 47, at 38; *see also* Zhou et al., *supra* note 122, at 685.

164. Stark, *supra* note 3, at 668.

165. *See, e.g.*, Daneshvary et al., *supra* note 112, at 203 (1.06% within 0.1 miles and 0.4-0.7% within 0.1-0.5 miles); Kristopher Gerardi, Eric Rosenblatt, Paul S. Willen & Vincent Yao, *Foreclosure Externalities: New Evidence*, 87 J. URB. ECON. 42, 44 (2015) (2.6% decrease if nearby REO is in poor condition; 1.5% if in average condition; small positive impact if in good condition); John P. Harding, Eric Rosenblatt & Vincent W. Yao, *The Contagion Effect of Foreclosed Properties*, 66 J. URB. ECON. 164, 165 (2008) (1% decrease for each nearby foreclosed property); Whitaker & Fitzpatrick, *supra* note 162, at 19 (1.4% value decrease if a vacant or delinquent property is within 500 feet). *But see* Helen Mason, *No One Saw It Coming—Again: Systemic Risk and State Foreclosure Proceedings: Why a National Uniform Foreclosure Law Is Necessary*, 67 U. MIAMI L. REV. 41, 55-57 (2012).

home decreased by 1.1 percent but that the average value of homes within one-tenth of a mile decreased by 7.2 percent.<sup>166</sup> The aggregate loss in value for neighboring properties was as much as \$477,000 for each foreclosure.<sup>167</sup> Although the total loss calculation was based on foreclosures that occurred in 2008, the percentage loss calculations for individual properties were based on foreclosures from 1987-2009, so the price decreases it found were not simply a function of the 2007 market crash.

Instead, the same factors that depress the price of REO properties also depress the prices of neighboring properties. The typically poor or non-existent maintenance of the REO property and its vacancy have spillover effects,<sup>168</sup> and those effects normally increase as the property's condition deteriorates from the time of the borrower's default until the lender's REO sale.<sup>169</sup> Although the spillover usually diminished after the REO sale, at least one study has found that the negative spillover continues after the lender's sale if the purchaser is an investor, rather than a person who will occupy the home.<sup>170</sup> Investors buy homes to convert them to rental properties. Because rental properties normally are not as well maintained as owner-occupied homes, the property's deterioration continues and the spillover effect increases. This problem is particularly significant because investors today may purchase as many as half of all REO properties.<sup>171</sup>

Researchers suggest other factors that may contribute to the spillover effect. For example, an appraiser or real estate agent may include a nearby foreclosed home as a comparable in determining the value of a home that has not been foreclosed. Another potential factor is that foreclosures increase the supply of properties for sale, thereby reducing prices.<sup>172</sup> Regardless of the reason, neighbors of a foreclosed property are losing value in their property, temporarily or permanently.

Beyond economic loss, research shows that a vacant and run-down foreclosed property diminishes the neighborhood's quality of life, satisfaction, and sense of community.<sup>173</sup> This occurs in part because of the increase in crime associated with foreclosed properties, particularly when the property is REO and

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166. Campbell et al., *supra* note 122, at 2126-27.

167. *Id.* at 2128.

168. Ihlanfeldt & Mayock, *supra* note 115, at 283; Whitaker & Fitzpatrick, *supra* note 162, at 3-4, 31; White, *supra* note 130, at 428.

169. Harding et al., *supra* note 165, at 164.

170. Ihlanfeldt & Mayock, *supra* note 115, at 300.

171. *Id.* at 283.

172. Frame, *supra* note 149, at 5; Whitaker & Fitzpatrick, *supra* note 162, at 3-4.

173. See, e.g., Christie D. Batson & Shannon M. Monnat, *Distress in the Desert: Neighborhood Disorder, Resident Satisfaction, and Quality of Life During the Las Vegas Foreclosure Crisis*, 51 URB. AFF. REV. 205 (2015); Misun Hur, Yanmei Li & Kathryn Terzano, *Breaking the Chain: Understanding the Association Between Foreclosure Intensity and Neighborhood Satisfaction*, 58 APPLIED GEOGRAPHY 7 (2015).

vacant.<sup>174</sup> “Police officials interviewed for th[e] study . . . cited the damage to quality of life from empty, foreclosed properties, including gang activity, drug dealing, prostitution, arson, rape, and murder.”<sup>175</sup> One study found a 19 percent increase in violent crimes within 250 feet of foreclosed vacant properties compared to 250 to 353 feet away.<sup>176</sup>

The fallout from the 2007 market crash has vividly demonstrated the devastating effects that foreclosures can have on neighborhoods. However, even in normal economic times, foreclosed properties—and REO properties in particular—negatively affect surrounding properties and their residents. Diminishing these impacts by eliminating REOs will benefit not only those who are most directly affected, but also their communities, as described in the next section.

#### D. Communities

Although commentators have noted that foreclosures impose direct costs on local governments and a loss of property tax revenue,<sup>177</sup> no empirical research supported these statements until recently. The first study that attempted to quantify the costs that local governments incur in connection with a foreclosure was a 2005 study on foreclosures in Chicago.<sup>178</sup> The authors identified 26 different costs that the city could bear in connection with a foreclosure, from document filing fees to demolition expenses. The authors then estimated the city’s costs for seven different foreclosure scenarios, ranging from a sale in which the property is never vacant and all property taxes are paid to a situation in which the owner and lender both abandon the property and it later catches fire and has to be demolished. The estimated costs range from \$27 for the former case to \$34,199 for the latter case.<sup>179</sup>

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174. Ingrid Gould Ellen, Johanna Lacoé & Claudia Ayanna Sharygin, *Do Foreclosures Cause Crime?*, 74 J. URB. ECON. 59, 59 (2013); Goodstein & Lee, *supra* note 157, at 3; Hwang, *supra* note 158, at 26.

175. APGAR & DUDA, *supra* note 157, at 6.

176. Lin Cui & Randall Walsh, *Foreclosure, Vacancy and Crime*, 87 J. URB. ECON. 72, 84 (2015).

177. See, e.g., Ellen et al., *supra* note 115, at 538; Getter et al., *supra* note 131, at 166; McCarthy et al., *supra* note 129, at 31; White, *supra* note 130, at 428.

178. William C. Apgar, Mark Duda & Rochelle Nawrocki Gorey, *The Municipal Cost of Foreclosures: A Chicago Case Study*, HOMEOWNERSHIP PRESERVATION FOUNDATION (2005), <http://www.issuelab.org/resources/1772/1772.pdf> [<http://perma.cc/BT5U-JUDC>].

179. *Id.* at 24-26 (explaining the seven scenarios); *id.* at 39-40 (estimating costs of each scenario).

The first empirical study analyzed the impact of foreclosures on the property tax base.<sup>180</sup> It examined foreclosures in Georgia from 2006-2011. The researchers found that the median number of home foreclosures during that period increased by 1 percent. That increase caused a 3 percent decrease in the property tax base, which had a significant negative impact on property tax revenues.<sup>181</sup> This loss is particularly problematic because local governments derive most of their revenue from property taxes.<sup>182</sup>

A 2015 empirical study is the first to comprehensively analyze foreclosures' impacts on both property tax revenues and local government expenditures. It examined the foreclosures in 55 of Florida's 67 counties from 1997-2011.<sup>183</sup> With respect to property tax revenue, each REO decreased the county tax base by \$782,123.<sup>184</sup> Three factors caused the decrease: (1) lenders sold REOs at a discount, (2) the negative spillover effect on neighboring properties, and (3) REOs increased the supply of homes for sale, which depressed prices.<sup>185</sup> This decrease in the tax base diminished the tax revenue by \$5,068 for each foreclosure.<sup>186</sup> The aggregate county tax base loss was \$208,147,860, which reduced the tax base by 1.65 percent.<sup>187</sup>

With respect to expenditures, the study found that each foreclosure increased the median county's costs by \$3,981 for activities such as maintaining neglected REOs.<sup>188</sup> The study also determined the amount by which each REO decreased government spending for the following public services and the total spending reduction for each of these services.<sup>189</sup>

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180. James Alm, Robert D. Buschman & David L. Sjoquist, *Foreclosures and Local Government Revenues from the Property Tax: The Case of Georgia School Districts*, 46 REGIONAL SCI. & URB. ECON. 1 (2014).

181. *Id.* at 8 (noting 3 percent decrease); *id.* at 10 (calling this decrease a significant impact).

182. *Id.* at 1.

183. Keith Ihlanfeldt & Tom Mayock, *Foreclosures and Local Government Budgets*, 53 REGIONAL SCI. & URB. ECON. 135, 136 (2015). The study did not include small rural counties for which the necessary data were unavailable. *Id.* at 138.

184. *Id.* at 145.

185. *Id.* at 137; Email from Keith Ihlanfeldt, DeVoe Moore Eminent Scholar and Professor of Economics, Florida State University, to Ann M. Burkhardt, Curtis Bradbury Kellar Professor of Law, University of Minnesota Law School (January 4, 2017) (on file with author).

186. Ihlanfeldt & Mayock, *supra* note 183, at 146.

187. *Id.* at 145.

188. *Id.* at 146.

189. *Id.* at 145 tbls 7 & 8. "Court Administration" includes the costs for the court, state attorney, public defender, and juries. "Culture/Recreation" includes the costs for cultural and recreational facilities. "General Government" includes local government's costs for providing legislative and administrative services. "Human Ser-



FIXING FORECLOSURE

	Reduction/REO	Total Reduction	% Decrease
Court Administration	\$251	\$67,206	6.6%
Culture/Recreation	\$1,959	\$523,989	8.7%
General Government	\$2,472	\$627,345	1.2%
Human Services	\$1,113	\$297,588	5.0%
Public Safety	\$3,384	\$904,788	1.2%

At the median county REO inventory level, the combination of increased foreclosure-related costs and lost revenue caused a deficit of \$2,416,083, which was 1 percent of the median county’s total budget.<sup>190</sup> Although the increased number of REOs after the 2008 market crash magnified the losses, the number of REOs had been increasing significantly even before the crash. From 1997-2007, the number of REOs doubled. They more than doubled again from 2007-2011.<sup>191</sup> Therefore, without significant change in the foreclosure process, foreclosures and REOs will likely continue to be an ongoing problem for governments.

Although generalizing from these three studies can be dangerous, especially because two of them include foreclosures that occurred after the market crash, the studies show significant public costs and diminished public goods for both pre- and post-crash foreclosures. When coupled with the losses to borrowers, lenders, and neighbors, the existing foreclosure system is extremely difficult to justify. Foreclosure by auction is over 200 years old in this country, and it has not functioned properly for most of that time. It is time to switch to a commercially reasonable means of selling land. By listing the property for sale with a real estate agent, the losses currently caused by foreclosure auctions and REOs can be substantially mitigated and possibly eliminated.

The prospect of changing foreclosure to private sale often also raises concerns about matters such as setting the asking and sale prices, negotiating the purchase agreement, and dealing with an uncooperative seller. However, several legal systems successfully employ private sale to foreclose, as described in the next section.

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vices” includes treatment of sick, injured, and handicapped individuals and community welfare. “Public Safety” includes law enforcement and fire control costs. *Id.* at 137 tbl 1.

190. *Id.* at 146.

191. *Id.* at 141.

## IV. FORECLOSURES IN ONTARIO AND BRITISH COLUMBIA

England,<sup>192</sup> Ireland,<sup>193</sup> Wales,<sup>194</sup> and the Canadian provinces of Alberta,<sup>195</sup> British Columbia,<sup>196</sup> Ontario,<sup>197</sup> and Quebec<sup>198</sup> have efficiently and effectively implemented foreclosure by private sale. These systems differ in many respects, but all have successfully addressed the types of process issues raised in the preceding paragraph. This section discusses the Ontario and British Columbia procedures because foreclosure by private sale is used in virtually every foreclosure in those provinces. Their comparison also is instructive because they differ in some significant ways, such as judicial involvement and the lender's right to buy. But the details about these procedures are less important than the larger point that foreclosure by private sale is eminently workable.

## A. Ontario

The Ontario system works effectively and is widely accepted. It also demonstrates that foreclosure by private sale can be implemented in the United States because the Ontario power of sale and private sale procedures are very similar to those in this country. The Ontario process emphasizes speed and cost savings. Although a mortgagee has three available remedies when a mortgagor defaults,<sup>199</sup> it virtually always chooses "power of sale," which allows it to sell the

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192. European Mortgage Federation, *Study on the Efficiency of the Mortgage Collateral in the European Union* 167 (2007), [http://www.law.berkeley.edu/files/bclbe/EU\\_Efficiency\\_Mortgage\\_Collateral\\_2007.pdf](http://www.law.berkeley.edu/files/bclbe/EU_Efficiency_Mortgage_Collateral_2007.pdf) [<http://perma.cc/25UU-DQ5C>].

193. *Id.* at 108.

194. *Id.* at 167.

195. Alberta Rules of Court, A.R. 124/2010 § 9.32(2) (Can.); AM. COLL. OF MORTG. ATT'YS, INC., MORTGAGE LAW SUMMARY Canada-2 (2015); Dave Fitzpatrick, *Foreclosure Process in Alberta*, ALBERTA HOME LENDING (Nov. 24, 2017), <http://albertalending.ca/foreclosure-process/> [<http://perma.cc/ZX8Q-947V>].

196. *See infra* Part V.B.

197. *See infra* Part V.A.

198. Civil Code of Québec, L.R.Q. c. C-1991, §§ 2784 (sale by creditor) & 2791 (sale by court) (Can.); AM. COLL. OF MORTG. ATT'YS, INC., *supra* note 195, at Canada-53 & 54; E-mail from Antoine Leduc, Partner, BCF, LLP, in Montreal, Québec, to Ann M. Burkhart, Curtis Bradbury Kellar Professor of Law, University of Minnesota Law School (Aug. 29, 2016, 9:15 CDT) (on file with author).

199. Whether the mortgaged property is residential or commercial, the mortgagee's remedies are (1) "foreclosure," in which a court transfers title to the mortgagee without a sale; (2) judicial sale, which is a judicially-supervised sale; or (3) "power of sale," in which the mortgagee sells the property without judicial supervision. However, the mortgagee may use a judicial sale if the property is "unusual, complex, or difficult to sell" or if an improvident sale claim is likely. AM. COLL. OF MORTG. ATT'YS, INC., *supra* note 195, at Canada-39.

property without judicial supervision. This remedy is substantially faster and less expensive than the other two remedies.<sup>200</sup> Additionally, mortgagees can sue for a deficiency after a power of sale but not after an alternative remedy, foreclosure, which is the equivalent of strict foreclosure in the United States. As an indication that power of sale is also the government's preferred method, a mortgagee that fails to include a power of sale clause in the mortgage has a statutory power of sale.<sup>201</sup> However, mortgagees rarely need to rely on the statutory power, because mortgages virtually always include the clause.

A mortgagee can initiate a power of sale after the loan has been in default for only 15 days.<sup>202</sup> The mortgagee gives a Notice of Power of Sale to the mortgagor and other interested parties, such as subsequent (junior) encumbrancers.<sup>203</sup> If the mortgagor pays the debt within 35 days after the mortgagee gave the notice (the "redemption period"), the mortgagee cannot proceed with the sale.<sup>204</sup> Alternatively, the mortgagor has a statutory right to stop the sale process by paying just the amount of the default (the "arrears") and the costs that the mortgagee incurred in connection with the default.<sup>205</sup>

To raise the funds to redeem or pay the arrears, the mortgagor may attempt to sell the property or to refinance. The mortgagee cannot interfere with the mortgagor's attempts by taking any action to sell the property during the redemption period.<sup>206</sup> For example, the mortgagee cannot advertise the property for sale or enter into a purchase agreement to avoid interfering with the mort-

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200. E-mail from Andrew Bury, QC, Partner, Gowling WLG, in Vancouver, British Columbia, to Ann M. Burkhart, Curtis Bradbury Keller Professor of Law, University of Minnesota Law School (Aug. 17, 2017, 0:25 CDT) [hereinafter E-mail from Andrew Bury (Aug. 17, 2017)] (on file with author).
201. Mortgages Act, R.S.O. 1990, c. M.40, § 24 (Can.).
202. *Id.* at § 32 (Can.). The loan must be in default for at least three months for a statutory power of sale. *Id.* at § 24. Of course, the mortgagee can elect to wait longer, or the mortgage document may require more time. See FALCONBRIDGE ON MORTGAGES 35-8 (Walter M. Traub ed., 2003); JUDITH M. WOLF, A PRACTICAL GUIDE TO MORTGAGE REMEDIES IN ONTARIO 82 (2d ed. 2013).
203. Mortgages Act, R.S.O. 1990, c. M.40, § 31 (Can.). The redemption period for a statutory power of sale is 45 days. *Id.* at § 26(1).
204. *Id.* at § 32 (Can.). Interestingly, subsequent encumbrancers do not have the right to redeem. Ontario Rules of Civil Procedure, R.R.O. 1990, Reg. 194, r. 64.04(6).
205. Mortgages Act, R.S.O. 1990, c. M.40, § 22(1) (Can.).
206. *Id.* at § 42(1); FALCONBRIDGE, *supra* note 202, at 35-22. Increasing the debt during the redemption period with new selling expenses also complicates redemption because the mortgagor will not know the exact redemption amount. E-mail from Abraham Costin, Partner, McCarthy Tetrault, LLP, in Toronto, Ontario, to Ann M. Burkhart, Curtis Bradbury Keller Professor of Law, University of Minnesota Law School (Sep. 18, 2017, 9:30 CDT) (on file with author).

gagor's sales efforts.<sup>207</sup> The mortgagee cannot even have the property appraised because a potential lender could hear about it and refuse to make a loan to the mortgagor or do so only on more onerous terms.<sup>208</sup> The other purpose for this restriction on the mortgagee is to prevent additional expenses being added to the debt,

If the mortgagor neither redeems nor pays the arrears during the redemption period, the mortgagee can start the sale process, though the mortgagor can stop it by tendering the debt or the arrears before the mortgagee signs a purchase agreement with a buyer.<sup>209</sup> Based on the power of sale, the mortgagee can sell the property by private sale, public auction, or tender.<sup>210</sup> However, mortgagees "rarely use" public auction or tender. They virtually always list the property for sale with a real estate agent.<sup>211</sup>

The sale process is facilitated by the mortgagee's right to possess the property when the mortgagor defaults.<sup>212</sup> If the mortgagor does not voluntarily leave the property, the mortgagee has a judicial action, and the sheriff will enforce the judicial writ of possession by eviction.<sup>213</sup> Although the mortgagee's assertion of its right to possess terminates any leases that are junior to the mortgage, senior leases are not extinguished. Instead, the mortgagee can collect rents from the senior tenants, which it uses to pay the property's operating expenses and the outstanding debt. The mortgagee also cannot terminate residential tenancies,<sup>214</sup>

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207. PETER D. QUINN & DANNY C. GRANDILLI, *REAL ESTATE PRACTICE IN ONTARIO* 416 (8th ed. 2016).

208. WOLF, *supra* note 202, at 77.

209. QUINN & GRANDILLI, *supra* note 207, at 405; FALCONBRIDGE, *supra* note 202, at 19-20.

210. For tender, the mortgagee and a real estate broker identify potentially interested buyers and request that they tender an expression of interest in buying the property and at what price. The lender may then negotiate with one or more of those who respond. QUINN & GRANDILLI, *supra* note 207, at 418-19; E-mail from Silvana M. D'Alimonte, Partner, Blake, Cassels & Graydon LLP, Toronto, Ontario, to Ann M. Burkhart, Curtis Bradbury Kellar Professor of Law, University of Minnesota Law School (Oct. 4, 2017, 12:24 CDT) (on file with author).

211. AM. COLL. OF MORTG. ATT'YS, INC., *supra* note 195, at Canada-40; Telephone Interview with Abraham Costin, Partner, McCarthy Tétrault, LLP, in Toronto, Ontario (Aug. 24, 2016) [hereinafter Telephone Interview with Abraham Costin].

212. QUINN & GRANDILLI, *supra* note 207, at 406; FALCONBRIDGE, *supra* note 202, at 22-3 ("Notwithstanding that the mortgagee is entitled by law to possession [when the mortgagor executes the mortgage], it is usual in Ontario to insert in a mortgage a proviso that the mortgagor until default shall have quiet possession of the lands . . .").

213. WOLF, *supra* note 202, at 116, 141.

214. Mortgages Act, R.S.O. 1990, c. M.40, § 48(1) (Can.).

though it has a statutory right to show an occupied single-family home to prospective purchasers.<sup>215</sup>

As in the United States, the mortgagee can elect to have a receiver manage the property.<sup>216</sup> Also as in the United States, if the mortgagee instead takes possession, it has “extensive and sometimes onerous obligations with regard to the maintenance and operation of the property.”<sup>217</sup> In an important difference from the United States, the mortgagee may have to use its own funds to pay the property expenses if the property does not generate enough income to cover them, though the mortgagee can add those advances to the outstanding debt.<sup>218</sup> The American approach seems preferable, because it reduces the cost of foreclosure and limits the mortgagee’s potential loss on the defaulted loan.

In addition to potential duties with respect to the property, the mortgagee has duties to those who are affected by the power of sale. If the property has residential tenants, the mortgagee becomes responsible for all the landlord’s duties under the Residential Tenancies Act,<sup>219</sup> including returning the tenants’ deposits though the mortgagee did not receive them from the mortgagor. The mortgagee in possession also has a strict duty to account to the mortgagor and junior encumbrances for all income and expenses.<sup>220</sup>

The mortgagee also bears a heavy burden to the mortgagor and subsequent encumbrancers to get the best possible price for the property.<sup>221</sup> The mortgagee’s best practice is to list the property with an agent who is experienced in selling properties of the same type in the area where the property is located.<sup>222</sup> Once the property is listed, the agent shows it like any other property.<sup>223</sup> In fact, the mortgagee should direct the agent not to disclose that the sale is pursuant to

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215. *Id.* at § 55.

216. AM. COLL. OF MORTG. ATT’YS, INC., *supra* note 195, at Canada-41.

217. QUINN & GRANDILLI, *supra* note 207, at 407; *see also* Silven Properties Ltd. v. Royal Bank of Scotland, EWCA [2003] Civ. 1409, ¶ 13.

218. QUINN & GRANDILLI, *supra* note 207, at 407; NELSON ET AL., *supra* note 7, at 218 (“[In the United States,] the mortgagee is not bound to contribute funds out-of-pocket and thus need not expend more than the rents and profits received from the premises.”).

219. R.S.O. 2006, c. 17 (Can.).

220. QUINN & GRANDILLI, *supra* note 207, at 407.

221. FALCONBRIDGE, *supra* note 202, at 35-24 (The courts “have imposed a high duty on the selling mortgagee to take all reasonable steps to ensure that the best possible price is obtained, taking into account the fact that it is a forced sale and, further, that market conditions may not be favorable.”).

222. QUINN & GRANDILLI, *supra* note 207, at 418; FALCONBRIDGE, *supra* note 202, at 35-29.

223. WOLF, *supra* note 202, at 149.

a power of sale to avoid depressing any offers.<sup>224</sup> In addition to acting “bona fides” in conducting the sale and considering the mortgagor’s interests, the Ontario Supreme Court has said that the mortgagee often also must take the following actions:

- Advertise the property in ways that reach a large number of prospective buyers;
- Obtain a “proper” appraisal;
- Post “For Sale” signs on the property;
- List the property on a multiple listing service; and
- Market the property for a reasonable amount of time.<sup>225</sup>

The mortgagee typically sets the asking price by getting two appraisals.<sup>226</sup> The appraisals must be based on the usual standards.<sup>227</sup> If the appraisals are not close, Abraham Costin, a leading Toronto real estate lawyer, recommends getting a third appraisal both to set a fair asking price and to protect against any challenge to the sale.<sup>228</sup>

Although the mortgagee does have a duty to obtain the best possible price, some limitations exist. For example, the mortgagee does not have to try to increase the sale price by painting the property or by undertaking other pre-marketing activities.<sup>229</sup> If the mortgagee does incur expenses to enhance the property, it can add the costs to the outstanding debt only if they are reasonably balanced by the resulting benefits.<sup>230</sup> Additionally, the mortgagee can choose to sell even if the real estate market is depressed, rather than wait until the market improves in an attempt to sell the property for a higher price.<sup>231</sup> Finally, the mortgagee can accept a lower price in exchange for a faster sale, rather than holding out for a higher price while interest continues to accrue on the loan.<sup>232</sup>

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224. See QUINN & GRANDILLI, *supra* note 207, at 419; FALCONBRIDGE, *supra* note 202, at 35-28.

225. Broos v. Robinson, [1984], O.J. No. 236, 556 ¶¶ 4 & 5 (Can. Ont. H.C.J.); AM. COLL. OF MORTG. ATT’YS, INC., *supra* note 195, at Canada-40.

226. WOLF, *supra* note 202, at 105.

227. FALCONBRIDGE, *supra* note 202, at 35-28; WOLF, *supra* note 202, at 105.

228. Telephone Interview with Abraham Costin, *supra* note 211.

229. Silven Properties Ltd. v. Royal Bank of Scotland, EWCA [2003] Civ. 1409, ¶ 16.

230. *Id.* at ¶ 17. For this reason, Mr. Costin advises his commercial lender clients not to make tenant improvements, because a court may not view them as an allowable expense. Telephone Interview with Abraham Costin, *supra* note 211.

231. Silven Properties Ltd. v. Royal Bank of Scotland, EWCA [2003] Civ. 1409, ¶ 15; FALCONBRIDGE, *supra* note 202, at 35-24.

232. WOLF, *supra* note 202, at 106.

The sale must be at arm's length. Therefore, unlike in the United States, the mortgagee or any closely related person or entity cannot buy the property.<sup>233</sup> If the mortgagee violates this restriction and purchases, it is merely a mortgagee in possession, rather than the owner. On the other hand, subsequent encumbrancers can buy the property.<sup>234</sup>

When a buyer is identified, the mortgagee and buyer negotiate the purchase agreement.<sup>235</sup> It must include the same types of terms as for a voluntary sale,<sup>236</sup> though the mortgagee usually makes no representations, including about the property.<sup>237</sup> At the closing, the mortgagee signs the deed and gives the buyer written declarations about (1) the mortgagor's default, (2) service, with the original or notarial copy of the post office receipt of registration, if any, attached, and (3) the sale's compliance with the statutory requirements. These declarations are recorded with the deed and constitute conclusive evidence of compliance.<sup>238</sup> Additionally, if the mortgagee gave notice in accordance with the statutory requirements, the buyer's title cannot be defeated by other errors in the sale,<sup>239</sup> unless the buyer had actual or constructive notice of a defect.<sup>240</sup>

As in the United States, the title transfer eliminates the mortgage that was the basis for the sale, as well as the owner's and subsequent encumbrancers' interests in the property.<sup>241</sup> Therefore, the mortgagee must account for the sale price and expenses.<sup>242</sup> The mortgagee uses the sale proceeds to first pay the sale expenses, then loan interest and costs, and then the remaining principal balance.<sup>243</sup> If any proceeds remain, the mortgagee gets a statement from the subsequent encumbrancers about how much they are owed and pays them in order of seniority. If any proceeds still remain, the mortgagee pays it to the mortgagor.<sup>244</sup> Conversely, if the sale proceeds are insufficient to repay the mortgagee, it has an action for the difference between the sale price and debt amount (the

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233. QUINN & GRANDILLI, *supra* note 207, at 420; FALCONBRIDGE, *supra* note 202, at 35-26.

234. FALCONBRIDGE, *supra* note 202, at 35-33 & -34.

235. Kevin Marron, *Powers of Sale: Good Deals, Bad Karma, Hard Work for the Lawyer*, 33 CANADIAN LAW. 19, 19 (2009).

236. QUINN & GRANDILLI, *supra* note 207, at 418.

237. Marron, *supra* note 235.

238. Mortgages Act, R.S.O. 1990, c. M.40, § 35 (Can.).

239. *Id.* at § 36.

240. QUINN & GRANDILLI, *supra* note 207, at 421; FALCONBRIDGE, *supra* note 202, at 35-37.

241. WOLF, *supra* note 202, at 150.

242. QUINN & GRANDILLI, *supra* note 207, at 404.

243. WOLF, *supra* note 202, at 152.

244. QUINN & GRANDILLI, *supra* note 207, at 404.

“deficiency”) against anyone who is liable for the debt, including any guarantors.

The owner, subsequent encumbrancers, and guarantors can assert a claim that the sale price is less than the property’s fair market value (an “improvident sale”).<sup>245</sup> That claim can be made in an action against the mortgagee or as a defense to an action for a deficiency.<sup>246</sup> If the claim is successful, the mortgagee is liable for the difference between the sale price and the price the mortgagee should have obtained. The mortgagee also may lose its right to sue for a deficiency.<sup>247</sup> To avoid an action for improvident sale, two lawyers who have written a treatise on Ontario real estate law counsel:

Throughout the conduct of a sale under power of sale, the mortgagees must always act defensively with an eye to the potential attack by others demanding after completion that they make up an alleged deficiency. There is very little opportunity to correct mistakes made in the conduct of the proceedings, with the result that mortgagees may find themselves vulnerable to an attack at a later date, at which point they are unable to do much to protect themselves. It is essential that mortgagees and their solicitors conduct the sale with the utmost care in order to minimize the possibility of liability at a later date.<sup>248</sup>

They also state that “the results of a mismanaged sale proceeding can be devastating.”<sup>249</sup> Interestingly, absent fraud, courts generally do not grant injunctive relief to stop a sale or to invalidate it. They reason that the person seeking the injunction will not suffer irreparable damage if the sale occurs because the action for damages is available.<sup>250</sup>

### B. British Columbia

Although mortgages in British Columbia often include a power of sale clause, as in Ontario and the United States, mortgagees cannot sell property without judicial oversight unless the mortgagor and all other affected parties agree.<sup>251</sup> Instead, mortgagees normally use foreclosure by sale,<sup>252</sup> which is a hy-

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245. WOLF, *supra* note 202, at 154.

246. According to Mr. Costin, a claim of improvident sale most frequently is asserted when a mortgagee sues guarantors for a deficiency. Telephone Interview with Abraham Costin, *supra* note 211.

247. QUINN & GRANDILLI, *supra* note 207, at 404; FALCONBRIDGE, *supra* note 202, at 35-24.

248. QUINN & GRANDILLI, *supra* note 207, at 405.

249. *Id.* at 410.

250. Broos v. Robinson, [1984], O.J. 236, 8 (Can. Ont. H.C.J.); FALCONBRIDGE, *supra* note 202, at 35-25, 35-27.

251. AM. COLL. OF MORTG. ATT’YS, INC., *supra* note 195, at Canada-10.



brid of private sale and public auction. It provides greater protections for the mortgagor than the Ontario system, but, as a result, it is slower and somewhat more expensive.<sup>253</sup>

When a mortgagor defaults, the mortgagee begins the foreclosure by sale with a demand letter to the mortgagor.<sup>254</sup> If the mortgagor does not comply with the letter's terms, the lender files a petition, an affidavit in support of the petition, and a certificate of pending litigation with the Supreme Court<sup>255</sup> and registers the certificate in the local land title office to alert potential buyers, new lenders, tenants, and others about the foreclosure.<sup>256</sup> The mortgagee must join everyone whose interest in the property will be terminated, as well as anyone against whom the mortgagee wants a personal judgment for the debt.<sup>257</sup> The respondents have 21 days to defend by filing a Response to Petition.<sup>258</sup> At the end of that time, the court holds a hearing and, if the mortgagee prevails, issues an Order Nisi. The Order allows the mortgagee to proceed with the foreclosure and grants judgment against the respondents who are personally liable for the debt.<sup>259</sup>

The court usually allows the borrower to reinstate the mortgage by bringing it current and paying the lender's collection expenses.<sup>260</sup> The court also normal-

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252. *Id.* at Canada-9; Andrew Bury, *Mortgage Collections in British Columbia*, GOWLING WLG 2-3 (Aug. 2017), [http://gowlingwlg.com/getattachment/People/Andrew-Bury/Mortgage\\_Collections\\_-\\_brochure.pdf.xml?lang=en-GB](http://gowlingwlg.com/getattachment/People/Andrew-Bury/Mortgage_Collections_-_brochure.pdf.xml?lang=en-GB) [<http://perma.cc/Q3YC-LQMJ>].

253. The mortgagee also can petition the court to transfer the property to it without a sale ("foreclosure," which term also refers to the entire mortgage enforcement process), which is equivalent to strict foreclosure in the United States. However, mortgagees rarely use this remedy because a deficiency judgment is unavailable and because the mortgagee must pay the property transfer tax. AM. COLL. OF MORTG. ATT'YS, INC., *supra* note 195, at Canada-9; Bury, *supra* note 252, at 2-3.

254. AM. COLL. OF MORTG. ATT'YS, INC., *supra* note 195, at Canada-8.

255. Supreme Court Civil Rules, B.C. Reg. 168/2009, § 21-7(1) (Can.). The Supreme Court is the provincial superior trial court. *Supreme Court*, THE COURTS OF BRITISH COLUMBIA (2018), [http://www.courts.gov.bc.ca/supreme\\_court/](http://www.courts.gov.bc.ca/supreme_court/) [<http://perma.cc/2D27-4YQG>].

256. Supreme Court Civil Rules, B.C. Reg. 168/2009, § 21-7(4) (Can.); AM. COLL. OF MORTG. ATT'YS, INC., *supra* note 195, at Canada-8; Bury, *supra* note 252, at 4.

257. Supreme Court Civil Rules, B.C. Reg. 168/2009, § 21-7(2) (Can.); 40 THE CANADIAN ENCYCLOPEDIA DIGEST, MORTGAGES, TITLE 104 (WESTERN) § 268 (4th ed. 2016); Allan McEachern, *On Foreclosure Practice*, 41 THE ADVOCATE 583, 584 (1983).

258. AM. COLL. OF MORTG. ATT'YS, INC., *supra* note 195, at Canada-8.

259. *Id.*; Bury, *supra* note 252, at 4-5.

260. *Moore v. North Pacific Fish Ltd.*, 23 B.C.J. 2407 [1980]; CANADIAN ENCYCLOPEDIA DIGEST, *supra* note 257, at § 409; McEachern, *supra* note 257, at 594. Judicial ap-

ly provides a redemption period in the Order that gives the mortgagor additional time to pay the debt before the mortgagee can sell the property.<sup>261</sup> If the mortgagor does not redeem during the redemption period, the mortgagee applies to the court for an Order for Conduct of Sale.<sup>262</sup> Interestingly, the court normally will not grant an Order for Conduct of Sale to the mortgagee during the redemption period,<sup>263</sup> though it may grant an Order to a subsequent chargeholder (junior lienor) to enable it to try to sell the property before the mortgagee's sale terminates the junior interest.<sup>264</sup>

When the mortgagee gets the Order for Conduct of Sale, it almost always lists the property for sale with a real estate agent, whether the property is residential or commercial.<sup>265</sup> Because the mortgagee must act in a commercially reasonable manner in setting the listing price, it normally gets a current appraisal and a recent opinion of value from an experienced real estate agent who

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proval normally is unnecessary because mortgagees usually voluntarily allow a mortgagor to reinstate the loan. Bury, *supra* note 252, at 5.

261. Supreme Court Civil Rules, B.C. Reg. 168/2009, § 21-7(5)(b) (Can.). For residential properties, the redemption period normally is six months. However, the court may grant an extension if the property's fair market value exceeds the debt amount and if the borrower is actively marketing the property or seeking refinancing. Conversely, the court may not allow any redemption period or may grant a shorter one if the mortgagor has damaged the property or abandoned it or if the property's value is less than the debt. Because commercial properties normally are more unique than a home and often take longer to market, the court determines the redemption period based on the situation and often grants more than six months. AM. COLL. OF MORTG. ATT'YS, INC., *supra* note 195, at Canada-9; Bury, *supra* note 252, at 6-7; British Columbia Branch, *Foreclosure*, THE CANADIAN BAR ASS'N (April 2015), <http://www.cbabc.org/For-the-Public/Dial-A-Law/Scripts/Housing/415> [<http://perma.cc/FYB7-WX7Y>].
262. CANADIAN ENCYCLOPEDIA DIGEST, *supra* note 257, at § 255. In the very unusual case in which the mortgagee requests the court to transfer title directly to it, the mortgagee applies for an Order Absolute, rather than an Order for Conduct of Sale. AM. COLL. OF MORTG. ATT'YS, INC., *supra* note 195, at Canada-8; Bury, *supra* note 252, at 7.
263. McEachern, *supra* note 257, at 588-89; *see also* HSBC Bank Canada v. A.S. Bains Developments Ltd., 2015 B.C.S.C. 2194 [2016]; CIBC Mortgage Corp. v. Gomez, 71 A.C.W.S. (3d) 375 [1997].
264. Reliable Mortgages Investment Corp. v. Longiye, 2015 B.C.S.C. 903 [2015]; Canlan Investment Corp. v. Gibbons, 42 B.C.L.R. 199 [1983]; Bury, *supra* note 252, at 6, 8; McEachern, *supra* note 257, at 589. The subsequent chargeholder can sell only if the sale price is enough to pay the foreclosing mortgagee in full. E-mail from Andrew Bury (Aug. 17, 2017), *supra* note 200.
265. E-mail from Andrew Bury, QC, Partner, Gowling WLG, in Vancouver, British Columbia, to Ann M. Burkhart, Curtis Bradbury Kellar Professor of Law, University of Minnesota Law School (Aug. 24, 2016, 21:17 CDT) [hereinafter E-mail from Andrew Bury (Aug. 24, 2016)](on file with author); *see also* McEachern, *supra* note 257, at 589.

works in the area where the property is located. The mortgagee often initially lists the property for somewhat more than the higher of the two value estimates, which helps to establish in any subsequent challenge that the listing price was commercially reasonable.<sup>266</sup>

Unlike in Ontario, mortgagors normally retain the right to possess the property, and they generally cooperate with the sales efforts.<sup>267</sup> A distinguished British Columbia foreclosure lawyer, Andrew Bury, estimates that more than 95 percent of owners recognize that, if they are unable to pay the mortgage, the property must be sold, and they cooperate with the mortgagee's realtor and others involved in the sale process.<sup>268</sup> Additionally, residential tenants are legally obligated to allow showings of their residence.<sup>269</sup> Mr. Bury said that allowing mortgagors and their tenants to retain possession during the listing period "works remarkably well." For the very small minority of mortgagors who seriously interfere with the sale efforts, a mortgagee can get a court order that enables it to get possession or even title to the property.<sup>270</sup>

When the listing agent receives a written offer to buy, the mortgagee's lawyer negotiates the purchase agreement with the prospective buyer.<sup>271</sup> The mortgagee must be cautious in drafting the agreement. If it does not properly disclaim liability, the mortgagee can be treated as the vendor for all purposes. For example, in *Wiebe v. Rook*,<sup>272</sup> the court held that both the mortgagee and the mortgagor were liable to the buyer for damage to the property and for fixtures that the mortgagor removed. Although the mortgagor was the sole wrongdoer,

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266. E-mail from Andrew Bury (Aug. 17, 2017), *supra* note 200.

267. E-mail from Andrew Bury (Aug. 24, 2016), *supra* note 265.

268. E-mail from Andrew Bury, QC, Partner, Gowling WLG, in Vancouver, British Columbia, to Ann M. Burkhart, Curtis Bradbury Kellar Professor of Law, University of Minnesota Law School (Aug. 25, 2016, 11:00 CDT) [hereinafter E-mail from Andrew Bury (Aug. 25, 2016)] (on file with author).

269. AM. COLL. OF MORTG. ATT'YS, INC., *supra* note 195, at Canada-10.

270. The court has considerable discretion in determining whether to take possession from the owner. Law and Equity Act, R.S.B.C. 1996, Chapter 253, § 15 ("The court may, before or after judgment in a proceeding . . . by a mortgagee, for the foreclosure of the equity of redemption in mortgaged property . . . direct a sale of the property or land on the terms the court considers just."); Supreme Court Civil Rules, B.C. Reg. 168/2009, § 13-5(1) (2009) (Can.) ("If in a proceeding it appears necessary or expedient that property be sold, the court may order the sale and may order a person in possession of the property . . . [to] deliver up the possession . . . to the purchaser or person designated by the court.")

271. E-mail from Andrew Bury (Aug. 17, 2017), *supra* note 200; Ian Watt, *House and Condo Foreclosure Process in Vancouver, British Columbia*, MON CHATEAU (2018), <http://www.monchateau.ca/ForBuyers.php> [<http://perma.cc/2QMF-JX6H>].

272. [1985] 67 B.C.L.R. 257 (B.C.C.C.); *see also* No. 269 *Sail View Ventures v. Angell*, [1993] B.C.W.L.D. 2141 ¶ 3.

the court held that the mortgagee was liable to the buyer because it was the vendor in the purchase agreement!

After the parties sign the agreement, the buyer normally has a relatively short period of time to perform due diligence. If the buyer wishes to proceed after conducting the due diligence, all the contract conditions, except one, are eliminated from the agreement. The condition that remains is getting the court's approval for the sale, because that approval is legally required.<sup>273</sup> Therefore, after the buyer eliminates the other conditions, the mortgagee applies to the court for a hearing and an order that approves the sale.<sup>274</sup> The court will not approve the sale unless it finds that the property was properly marketed and that the sale price is the fair market value.<sup>275</sup>

To address the court's concerns about the sale, the mortgagee usually provides a relatively recent appraisal and the listing agent's written description of the sales efforts, including matters such as the advertising, the number of showings and open houses, offers and counter-offers, and any issues with the property.<sup>276</sup> The owner and subsequent chargeholders can oppose the mortgagee's application by challenging the sales efforts and the sale price.<sup>277</sup> The challengers commonly offer a recent appraisal that includes a higher fair market value and another realtor's written opinion that criticizes the listing agent's marketing efforts.<sup>278</sup> Interestingly, purchase by the mortgagee is not a cause for objection as long as the price is fair.<sup>279</sup>

The other very important check on the mortgagee's sale price is the bidding that often occurs during the hearing. One to four weeks before the hearing, the listing agent notifies other realtors and potentially interested buyers about the hearing and publicly discloses the sale price.<sup>280</sup> During the hearing, the presiding Master asks if anyone in the courtroom, including the contract purchaser,

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273. Watt, *supra* note 271; see also No. 269 *Sail View Ventures v. Angell*, [1993] B.C.W.L.D. 2141, at ¶ 7.

274. AM. COLL. OF MORTG. ATT'YS, INC., *supra* note 195, at Canada-9.

275. CANADIAN ENCYCLOPEDIA DIGEST, *supra* note 257, at § 333; E-mail from Andrew Bury (Aug. 24, 2016), *supra* note 265; see also No. 269 *Sail View Ventures v. Angell*, [1993] B.C.W.L.D. 2141, at ¶ 10.

276. E-mail from Andrew Bury (Aug. 17, 2017), *supra* note 200.

277. Bury, *supra* note 252, at 7.

278. E-mail from Andrew Bury (Aug. 17, 2017), *supra* note 200.

279. *Bank of Montreal v. Butler*, [1990] B.C.W.L.D. 869. However, the mortgagee normally is permitted to purchase only in exceptional circumstances, such as when no third party has made an offer to purchase. "[T]he reason for reluctance to allow a trustee/mortgagee to purchase has been the basic concern in all court-ordered mortgaged sales, namely, that it may result in an inadequate price being obtained." *Id.* at ¶ 29.

280. Watt, *supra* note 271.

wants to make an offer, and often they do.<sup>281</sup> Bids must be condition free.<sup>282</sup> The listing agent puts the competing bids and each bidder's certified deposit check or bank draft in a sealed envelope.<sup>283</sup> The Master reviews the bids and normally awards the property to the highest bidder.<sup>284</sup> Therefore, if the contract buyer is willing to pay more for the property, he must attend the hearing to bid.<sup>285</sup> If no one bids and if the Master is satisfied that the contract price is the fair market value, she approves the sale to the contract buyer.<sup>286</sup> However, if the Master is dissatisfied with the price, she can decline to approve the contract, and the property will be re-listed for sale.<sup>287</sup>

If people want to buy the property, why not contact the listing agent, rather than waiting to bid at the hearing? They frequently do contact the agent. However, sophisticated buyers, particularly those who are buying a commercial property, prefer to wait for the competitive advantage they gain by learning the contract price before bidding, which is a problem created by a dual system of private sales and public auctions.<sup>288</sup>

When the Master approves the sale, she issues a "Vesting Order" that vests title to the property in the buyer, free of any charges that were subsequent to the foreclosed mortgage.<sup>289</sup> The buyer does not receive a deed but, instead, registers the Vesting Order in the land title office, which creates a new title in the buyer's name.<sup>290</sup> The Master specifies the date on which the buyer can take possession of the property.

As in Ontario, this process is well accepted and works effectively.<sup>291</sup> It is slower and somewhat more expensive, which mortgagees dislike. However, the bidding frequently produces a higher—and often substantially higher—price. The price increase offsets the additional expense, reduces any potential defi-

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281. AM. COLL. OF MORTG. ATT'YS, INC., *supra* note 195, at Canada-9; McEachern, *supra* note 257, at 591.

282. McEachern, *supra* note 257, at 591.

283. CANADIAN ENCYCLOPEDIA DIGEST, *supra* note 257, at § 368.

284. *Id.*; see also No. 269 *Sail View Ventures v. Angell*, [1993] B.C.W.L.D. 2141 ¶¶ 4 & 5.

285. Watt, *supra* note 271.

286. AM. COLL. OF MORTG. ATT'YS, INC., *supra* note 195, at Canada-9.

287. E-mail from Andrew Bury (Aug. 17, 2017), *supra* note 200.

288. E-mail from Andrew Bury (Aug. 25, 2016), *supra* note 268.

289. British Columbia Branch, *supra* note 261.

290. McEachern, *supra* note 257, at 591; E-mail from Andrew Bury, QC, Partner, Gowling WLG, in Vancouver, British Columbia, to Ann M. Burkhart, Curtis Bradbury Kellar Professor of Law, University of Minnesota Law School (Oct. 14, 2016, 10:49 CDT) (on file with author).

291. E-mail from Andrew Bury (Aug. 25, 2016), *supra* note 268.

ciency, and may provide a surplus for distribution to the subsequent chargeholders and the owner.<sup>292</sup>

## V. REFORM CONSIDERATIONS FOR THE UNITED STATES

As described in the earlier sections of this Article, foreclosure by auction is time consuming and expensive. It imposes costs not just on the borrower and foreclosing lender, but also on neighboring property owners and the community. To eliminate the foreclosure auction and implement foreclosure by private sale in the United States, state legislatures must consider several issues.

*First, is the lender the appropriate person to conduct the sale?* The experiences in both Ontario and British Columbia clearly demonstrate that the lender is fully capable of hiring a suitable real estate agent, setting the asking price, negotiating the sale price and purchase agreement, transferring title to the buyer, and accounting to the owner and junior interest holders for the sale proceeds and expenses. However, to help eliminate collusion and self-dealing, the lender and anyone closely associated with it must be disqualified from purchasing the property. As a further check on the lender's actions, it should be personally liable if the owner or any other interested party successfully challenges the sales price, as in Ontario.

*Second, should the borrower have the right to possession during the sales period?* This question raises both jurisprudential and practical issues. The Ontario approach, which gives the lender possession, presents a jurisprudential issue in many states. In the so-called title theory and intermediate theory states, the issue would not exist because they characterize a mortgage as giving a mortgagee the right to take possession of the mortgaged property when the mortgagor defaults.<sup>293</sup> However, the majority of states—the lien theory states—reject the notion that a mortgage gives the lender any right to possess the property. In these states, a mortgage merely conveys a lien to the lender, which it can foreclose upon default.<sup>294</sup>

In contrast, the British Columbia approach, in which the borrower retains possession, presents a practical issue. Would American owners be as cooperative with the lender's efforts to sell their property as owners in British Columbia? Presumably, some owners who have stopped paying their mortgage will want to remain on the property, rent-free, for as long as possible and, therefore,

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292. E-mail from Andrew Bury, QC, Partner, Gowling WLG, in Vancouver, British Columbia, to Ann M. Burkhart, Curtis Bradbury Kellar Professor of Law, University of Minnesota Law School (Sept. 24, 2017, 20:10 CDT) (on file with author).

293. In its earliest form, title theory characterized a mortgage as immediately giving the mortgagee title and the right to possess the mortgaged land. However, title theory states today generally prohibit the lender from taking possession until the borrower defaults. RESTATEMENT (THIRD) OF PROPERTY (MORTG.) § 4.1 cmt. a (Am. Law Inst. 1997).

294. NELSON ET AL., *supra* note 7, at 9.

will interfere with the sales efforts. However, other owners facing foreclosure have cooperated with the lender by voluntarily selling their property.<sup>295</sup>

Because defaulting owners do behave differently, the better rule is to allow them to stay in possession unless they impede the sales efforts. Leaving owners in possession is consistent with their expectations and with lenders' normal practices because, even in title and intermediate theory states, lenders normally do not take possession based on the right that the mortgage confers. To deal with owners who interfere with the sales efforts, states can statutorily authorize a lender to petition a court for possession, as in British Columbia. This approach is consistent not only with the title and intermediate theories, but also with lien theory, because, even in lien theory states, a lender can have a receiver appointed to take possession.<sup>296</sup> Moreover, in some states, the lender can be the receiver.<sup>297</sup>

Although courts differ on the circumstances that justify appointment of a receiver, many require the lender to prove that the owner is committing waste or engaging in other wrongdoing and that the lender's security is thereby impaired because the property's value has declined to less than the outstanding debt.<sup>298</sup> However, this standard is inappropriate in a system of foreclosure by private sale. Instead, the standard should be one that focuses on whether the owner is interfering with the sales efforts. In that type of system, obstructive owners are not just impairing the lender's security, they are attempting to deprive the lender of its entire security. Therefore, they should lose their right to possess.

*Third, should the borrower continue to have a post-foreclosure statutory right of redemption?* No, because it has proven to be a failed attempt to help owners. Though it does give the owner an additional period of rent-free possession, it depresses foreclosure sale prices and, if the owner does not expect to redeem, contributes to property deterioration because the borrower is unlikely to invest in maintenance. Moreover, the right is seldom exercised.<sup>299</sup>

A better approach is to provide enough time before the foreclosure sale for the owner to have a realistic chance to sell the property or to refinance. Illinois follows this approach, and it has proven to be far more effective than post-foreclosure statutory redemption. For mortgages on residential property, the statutory redemption period is either seven months after the court gets jurisdiction of the foreclosure action or three months after it enters judgment, which-

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295. Zhang, *supra* note 112.

296. NELSON ET AL., *supra* note 7, at 223-29.

297. *Id.* at 222-23.

298. *Id.* at 223-29. Other states have a less stringent standard. For example, the Uniform Commercial Real Estate Receivership Act, which three states have enacted, provides that equitable grounds, including the owners' inability to pay their debts, can be sufficient for appointment of a receiver. UNIF. COM. REAL EST. RECEIVERSHIP ACT § 6(a)(3) & cmt. 1 (Unif. Law Comm'n 2015).

299. See *supra* text and accompanying notes 102-07.

ever is later. For other mortgages, the period is six months after the court gets jurisdiction or three months after it enters judgment, whichever is later.<sup>300</sup> The sale cannot occur until the redemption period expires.

Before Illinois provided these pre-foreclosure statutory redemption rights, it provided only post-foreclosure statutory redemption. To test the effectiveness of each approach, an empirical study compared the number of redemptions under both. The study showed that when owners and junior lenders had only a post-foreclosure redemption right, they seldom exercised it. In contrast, owners statutorily redeemed in "a very large percentage of cases" when they could do so before the foreclosure sale.<sup>301</sup> With pre-foreclosure statutory redemption, not only were redeeming owners more likely to keep their property, but they also could avoid the additional expense of a foreclosure sale.

*Finally, should every foreclosure include judicial involvement?* A hearing should be available but not mandatory. When no one disputes the sale process or price, a hearing unnecessarily increases the time and expense of foreclosure. Moreover, a mandatory hearing should be unnecessary as a check on the foreclosing lender's sales efforts if it is personally liable for selling the property for less than its fair market value. Although British Columbia's post-sale hearing often results in a higher price, the price may be higher because the prospect of the hearing, like the prospect of statutory redemption, depresses the amount that a contract buyer is willing to offer. Buyers who enter into a purchase agreement with a lender that is exercising its power of sale must incur the costs of negotiating the agreement and of due diligence, such as title examination and property inspection, with no guarantee that the property will be theirs. Moreover, disclosure of the contract price facilitates savvy bidders' ability to get the property from the buyers.

## CONCLUSION

For many decades, legal commentators and others have criticized the ineffectiveness of foreclosure by public auction. The voluminous empirical research that the market crash generated now clearly establishes that the process is not only ineffective, it also is often harmful to lenders, borrowers, neighbors, and the communities where foreclosures occur. Research also shows that in the United States, even voluntary real estate auctions often produce lower sales prices than private sales and that, when a borrower defaults, private short sales are preferable to foreclosure sales. This research all points to eliminating foreclosure auctions and to selling properties by private sale instead. Other countries' experiences and this country's experience with real estate sales in bankruptcy prove that this reform is feasible and effective. It is long past due in the United States.

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300. 75 ILL. COMP. STAT. 5/15-1603(b)(1) & (2), 5/15-1507(b); *In re Carter*, 312 B.R. 356 (Bankr. N.D. Ill. 2004).

301. Stark, *supra* note 3, at 674-75.



## FIXING FORECLOSURE

For many years, states have resisted substantially reforming their foreclosure laws even though the process is seriously flawed. Hopefully, the recent empirical studies will provide the necessary impetus, because they clearly demonstrate the widespread hardships that our current foreclosure systems can cause. Converting to foreclosure by private sale is a relatively easy reform because it takes advantage of an existing sale system, and it would be an effective reform, as demonstrated by the experiences of other countries.

