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Facing the Facts: An Empirical Study of the Fairness and Efficiency of Foreclosures and a Proposal for Reform

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FACING THE FACTS: AN EMPIRICAL STUDY OF THE FAIRNESS AND EFFICIENCY OF FORECLOSURES AND A PROPOSAL FOR REFORM

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Lenders view real estate foreclosures as too expensive and time consuming a process which needlessly increases the costs of making loans. Others complain that the foreclosure process fails to adequately protect the borrower's equity (the value of the property in excess of the debt secured by the property) in the mortgaged property.

This article tests these views by gathering new data on the fairness and efficiency of the foreclosure process. Based on the data collected (which confirms some assumptions but disproves others), the author proposes a reform of the foreclosure process to promote the interest of both lenders and borrowers. Under the proposal, the foreclosure process should take less time and cost less money, yet provide borrowers with a more meaningful opportunity to prevent the forfeiture of their equity in the mortgaged property. The author recommends that Congress consider the data from this study and enact this reform proposal in place of the current draft legislation—legislation which would unnecessarily sacrifice the interests of defaulting borrowers in order to achieve a faster and cheaper foreclosure process.

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INTRODUCTION

Are the real property foreclosure laws in the United States fair to borrowers who default under their mortgage loans, or do they sacrifice the borrower's equity[1] in the mortgaged property to protect the interests of lenders? Can the foreclosure process be reformed to treat defaulting borrowers more fairly while increasing efficiency for recovering lenders?

Although many have written critically about the real property foreclosure process,[2] few have accumulated and analyzed hard data on the process.[3] Even those empirical studies do not contain key data needed to answer two basic questions: 1) Is the foreclosure process fair and efficient? and 2) Can the

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1. As used in this Article, "equity" in property is the extent to which the fair market value of the property exceeds the amount of debt secured by the property. Thus, if there is outstanding debt of $100,000 on a property worth $90,000, the borrower has no "equity" in the property. Conversely, if the amount of the outstanding debt is $90,000 and the fair market value of the property is $100,000, then the borrower has $10,000 of equity in the property. See *infra* Part III.C for a discussion of the carrying costs and resale costs in a typical resale after a foreclosure. These costs should be included when calculating the borrower's true equity in the mortgaged property. *See infra* Part III.C.

2. *See, e.g.*, 1 GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW §§ 7–8 (3d ed. 1993); Rex E. Madsen, *Equitable Considerations of Mortgage Foreclosure and Redemption in Utah: A Need for Remedial Legislation*, 1976 UTAH L. REV. 327, 348–56 (proposing alternative approaches to the foreclosure process in Utah); Grant S. Nelson, *Deficiency Judgments After Real Estate Foreclosures in Missouri: Some Modest Proposals*, 47 MO. L. REV. 151, 160–70 (1982) (suggesting a new standard by which foreclosure deficiency judgment claims could be tested); Robert M. Washburn, *The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales*, 53 S. CAL. L. REV. 843, 844–55 (1980) (surveying defects in the foreclosure and sale process).

3. *See, e.g.*, Robert J. Aalberts & Douglas S. Bible, *Mortgage Default in Louisiana: An Empirical Study of Recent Foreclosures on Residential Property in Caddo Parish*, 15 S.U. L. REV. 215 (1988) (analyzing all foreclosure suits filed in a Louisiana parish during a seven month period in 1986); Patrick B. Bauer, *Judicial Foreclosure and Statutory Redemption: The Soundness of Iowa's Traditional Preference for Protection Over Credit*, 71 IOWA L. REV. 1 (1985) (analyzing Iowa's system of judicial foreclosure and statutory redemption); Patrick B. Bauer, *Statutory Redemption Reconsidered: The Operation of Iowa's Redemption Statute in Two Counties Between 1881–1980*, 70 IOWA L. REV. 343 (1985) (analyzing the operation of Iowa's redemption statute); Homer F. Carey et al., *Studies in Foreclosures in Cook County: Illinois Foreclosure Methods and Redemption*, 27 ILL. L. REV. 595 (1933) (analyzing foreclosures in Cook County, Illinois, and concluding that the use of judicial foreclosure alone is inefficient); 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 (1985) (analyzing 118 foreclosure sales in Onondaga County, New York, in 1979).

foreclosure process be improved to better protect the interests of lenders and borrowers?[4]

The purpose of this empirical study is to answer those two basic questions. As Justice Holmes stated in response to theories regarding the operation and reform of the law, "the first step toward improvement is to look the facts in the face."[5] This Article attempts to look at the facts of the foreclosure process and proposes a reform based on an examination of how foreclosures really operate.

The fairness and efficiency of the foreclosure process is an important issue because foreclosure directly and indirectly affects a large segment of the American population. As of 1995, more than three trillion dollars were invested in residential real estate[6] in the United States.[7] The foreclosure rate for national outstanding residential mortgage loans was approximately one percent at the beginning of the fourth quarter of 1996.[8] Borrowers as well as lenders have an interest in an efficient foreclosure process because lenders will pass along the costs associated with delinquent mortgages to new borrowers in the form of higher loan fees or higher interest rates.

Part I briefly summarizes the basic processes and procedures for real estate foreclosures in the fifty states, noting the primary similarities and differences among the states' foreclosure laws. Because the empirical study in this Article relies on data from real estate foreclosures in Illinois,[9] Part I next describes the foreclosure process in that state. Finally, Part I

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4. See discussion *infra* Part III.C for details on the additional data gathered in this study, such as the percentage of cases that are dismissed prior to judicial sale, and the average carrying costs and resale costs. These costs help to determine the true profit or loss when mortgaged property is resold after a foreclosure.

5. Oliver Wendell Holmes, *Introduction to* RATIONAL BASIS OF LEGAL INSTITUTIONS xxix, xxxii (Ass'n of Am. Law Sch. ed., 1923).

6. As used herein, "residential" describes dwelling units ranging from single family dwellings to six-unit apartment buildings.

7. *See Profits and Balance Sheet Developments at U.S. Commercial Banks in 1995*, 82 FED. RES. BULL. 483, app. at A35, table 1.54 (June 1996).

8. *See Delinquencies on the Rise at Yearend*, THE MORTGAGE MARKETPLACE, Mar. 10, 1997, *available in* 1997 WL 7938104.

9. The source of the data for this empirical study was the foreclosure complaints filed in the Chancery Court in Cook County, Illinois, in July 1993 and July 1994. See *infra* note 85 and accompanying text for an explanation of how these months were selected. Illinois was chosen as the state from which to collect data for three reasons: (i) the Illinois foreclosure process is similar to many other jurisdictions; (ii) the Illinois statute provides special elective reforms; and (iii) the author had easier access to data in Illinois.

summarizes the criticisms that the foreclosure process is unfair and inefficient, and notes the special reform features of the Illinois foreclosure laws enacted in 1987.[10]

Part II describes the types of data collected in the study, the methods of data collection, and the differences between the data collected in this study and the data in other studies of foreclosures.

Part III presents and analyzes the results of the empirical study. By "looking the facts in the face," the Article assesses the efficiency and fairness of foreclosure in Illinois (which is similar in its foreclosure process to many other jurisdictions) and determines whether the foreclosure process can be reformed to promote the interests of both borrowers and lenders.

Part IV proposes a reform to the foreclosure process for residential mortgages in Illinois and in all of the states by bifurcating the foreclosure system in order to further the goals of both borrowers and lenders. Then Part IV compares this proposed reform with other reform proposals. The Article suggests that bifurcating the foreclosure process will reduce the costs associated with foreclosures while protecting the borrower's equity in the property. The normative basis for this proposal is the belief that the foreclosure process should operate as efficiently as possible and in a manner that will provide the defaulting borrower with a realistic opportunity to prevent a forfeiture of his or her equity in the mortgaged property.

After analyzing the empirical data contained both in this study and in prior studies, this Article concludes that the foreclosure process can be made fairer and more efficient through a bifurcated foreclosure process which would promote the interests of both borrowers and lenders and would best accomplish this transformation.

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10. Numerous reforms were enacted in 1987 to the real estate foreclosure process to attract more third party bidders to foreclosure sales and to increase the amount bid at each sale. *See* discussion *infra* Part I.D.

I. REAL ESTATE FORECLOSURE LAW AND PROCEDURES

A. Summary of Typical Foreclosure Procedures in the United States

A real estate mortgage is a pledge of the mortgagor's interest in the real estate described in the mortgage document.[11] The pledge secures a specified debt.[12] When a mortgagor defaults in the payment of the debt or the performance of any other obligations which the mortgagor has agreed to perform, an acceleration clause usually causes the entire indebtedness to become immediately due and payable. Theoretically, a lender and borrower could agree that upon default and acceleration, the lender would become the fee title holder of the property pledged. English courts of equity, however, developed the concept of an equitable right of redemption to ameliorate the possible harsh consequences of default and acceleration clauses. Under the equitable right of redemption, a borrower has a certain amount of time to pay off the debt and redeem the property, notwithstanding any agreement to the contrary between the borrower and the lender.[13] The lender can cut off this equitable right of redemption through the foreclosure process governed by state statute in each state.[14]

While each state has its own peculiar foreclosure laws and procedures, certain basic features are present in each statutory scheme. Two dominant forms of foreclosure laws exist in America: a judicial foreclosure sale and a non-judicial foreclosure sale (known as a power of sale).[15] In a judicial sale, the lender must bring a court action to foreclose the borrower's equitable right to redeem the mortgaged property.[16] In a power of sale, the lender (or trustee under a deed of trust)

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11. *See* BLACK'S LAW DICTIONARY 1010 (6th ed. 1990). This pledge is usually of an ownership interest, but it can also be of a leasehold interest. *See id.* at 1011.

12. *See id.* at 1153. This specified debt is usually a debt of the mortgagor to the mortgagee.

13. *See id.* at 541.

14. *See generally* FORECLOSURE LAW & RELATED REMEDIES: A STATE-BY-STATE DIGEST (Sidney A. Keyles ed., 1995) [hereinafter STATE-BY-STATE DIGEST] (summarizing the foreclosure laws and processes in every state).

15. *See generally id.*

16. *See* BLACK'S LAW DICTIONARY 849 (6th ed. 1990).

may foreclose the borrower's equitable right to redeem the mortgaged property without bringing a court action.[17]

The following constitutes the typical process followed in a jurisdiction requiring a judicial foreclosure sale:[18]

(i) the mortgagee, or lender, files a foreclosure complaint and serves the mortgagor, or borrower, and any other parties required by statute;[19]

(ii) the lender files a lis pendens against the property;[20]

(iii) there is a court hearing and court judgment of foreclosure;[21]

(iv) the lender sends notice of the sale to the borrower and any other parties required by the statute, and advertises the public sale for a certain period of time prior to the sale and in the manner specified in the statute;

(v) the foreclosure sale of the mortgaged property occurs (conducted by the sheriff or other authorized party) in accordance with statutory requirements;

(vi) the successful bidder receives a certificate of sale;

(vii) the court issues an order confirming the sale and after any applicable statutory redemption rights expire, a deed of sale is issued to the successful bidder;

(viii) the borrower relinquishes possession of the property a certain period of time after the court order confirming

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17. *See id.* at 1172.

18. The following explanation of the foreclosure process is detailed in STATE-BY-STATE DIGEST, *supra* note 14. For an example of a particular state that has incorporated some of these features into its statute, see *id.* at 145–48 (discussing Idaho foreclosure statutes).

19. Some jurisdictions statutorily require a written notice of default and acceleration of the loan before filing. For examples of such jurisdictions, see STATE-BY-STATE DIGEST, *supra* note 14, at 63 (Colorado), 128 (Georgia), and 167 (Indiana).

20. A lis pendens is a notice of the pending foreclosure litigation that is filed or recorded in the official property records kept by the county where the property is located. *See* BLACK'S LAW DICTIONARY 932 (6th ed. 1990).

21. For income-producing properties, lenders commonly seek the appointment of a receiver to handle the revenue and expenses from the property during the pendency of the case.

the sale (in jurisdictions which grant a statutory redemption period after the foreclosure sale, the borrower may sometimes remain in possession after the sale until the expiration of the statutory redemption period); and

(ix) if the amount bid is less than the final judgment, the lender sometimes seeks a deficiency judgment against the borrower following confirmation of the judicial sale (if the jurisdiction's laws do not prohibit or limit a suit for a deficiency through one-action rules, fair value limitations or other anti-deficiency laws).[22]

As previously mentioned, a borrower enjoys an equitable right to redeem the property prior to a foreclosure sale of the property, until such period is extinguished by the foreclosure process. State statutes also provide for a specified period which must expire before the foreclosure sale can occur (this period is referred to as the statutory right of redemption).[23] While some statutes permit a waiver of the statutory right of redemption in certain circumstances,[24] a borrower cannot waive the equitable right of redemption when the loan is first made.[25] Many state statutes also provide a time for the borrower to exercise the right of reinstatement between the filing and the foreclosure sale.[26]

The following is the typical process followed in a jurisdiction permitting a non-judicial foreclosure sale:[27]

(i) the lender or trustee records a notice of default and sends notice of the default and acceleration of the debt to

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22. A one-action rule requires the lender to elect either to foreclose on the mortgage or to sue the guarantor or maker of the note, satisfying any judgment on the note with their assets. A fair value limitation requires the calculation of the deficiency amount by comparing the fair value of the mortgaged property against the final judgment amount instead of comparing the amount bid at the foreclosure sale against the final judgment amount. Another anti-deficiency law is an absolute prohibition from suing borrowers for the difference between the amount bid at a foreclosure sale and the final judgment amount. This prohibition can apply to either an acquisition seller-financed with a purchase money mortgage or a power of sale.

23. *See, e.g.*, N.Y. REAL PROP. ACTS. LAW § 1341 (McKinney 1979).

24. *See* KAN. STAT. ANN. § 60-2414(a) (Supp. 1992).

25. *See* Russo v. Wolbers, 323 N.W.2d 385, 389–90 (Mich. Ct. App. 1982); MacArthur v. North Palm Beach Utilities, Inc., 187 So. 2d 681 (Fla. Dist. Ct. App. 1966), *rev'd on other grounds*, 202 So. 2d 181 (Fla. 1967).

26. *See* CAL. CIV. CODE § 2924c(a)(1) (West 1997); 735 ILL. COMP. STAT. 5/15-1602 (West 1994).

27. The following explanation of a non-judicial foreclosure sale is detailed in STATE-BY-STATE DIGEST, *supra* note 14.

> the borrower and any other party required under the applicable statute;
>
> (ii) if the borrower or other party fails to cure the default within the specified statutory period after the notice of default, the lender or trustee sends out a notice of sale within the specified period of time before the date of the sale and advertises the sale;
>
> (iii) the foreclosure sale occurs unless the borrower redeems or reinstates the loan.[28]

Usually a borrower is not entitled to any post-sale redemption rights in a non-judicial sale[29] and often the lender is not entitled to seek a deficiency action against the mortgagor in a non-judicial sale.[30]

From the lender's perspective, the non-judicial sale is preferable to the judicial sale because the non-judicial sale is quicker and less expensive.[31] The lender's ability to recover the collateral more quickly saves the lender the costs associated with the time value of money and also may reduce the costs of restoring the property because deterioration occurs for only a short time. From the lender's perspective, the only negative aspects of a non-judicial sale are the usual inability to obtain a deficiency judgment and the greater uncertainty—due to the court's lack of involvement—that the foreclosure action is valid.

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28. Most non-judicial sales are conducted by a trustee under a power of sale. The statutes authorizing this manner of sale do not specify as many details regulating the sale as the statutes requiring a judicial sale. The trustee has more discretion but also has a fiduciary duty to hold the sale in a manner which will yield the highest price possible. *See* Debra P. Stark, *The Emperor Still Has Clothes: Fraudulent Conveyance Challenges After the* BFP *Decision*, 47 S.C. L. REV. 563, 594–95 (1996).

29. *See* ALASKA STAT. § 34.20.090(a) (Michie 1996); NEV. REV. STAT. § 107.080(5) (1995). *See generally* STATE-BY-STATE DIGEST, *supra* note 14.

30. *See* ALASKA STAT. § 34.20.100 (Michie 1996); IDAHO CODE § 6-101 (Supp. 1996); MICH. COMP. LAWS § 600.3105(1)–(2) (1987). *See generally* STATE-BY-STATE DIGEST, *supra* note 14.

31. Although it is difficult to generalize the timing in different jurisdictions, a power of sale can typically be accomplished in as little as two to four months compared with a typical minimum of six to twelve months for finalizing a judicial sale. *See generally* STATE-BY-STATE DIGEST, *supra* note 14 (assessing typical time frames and costs in both judicial and non-judicial foreclosures in each state).

From the borrower's perspective, the judicial sale is preferable. First, since it generally takes longer to perform a judicial sale than a power of sale,[32] the borrower has more time to reinstate or redeem the property. Second, the borrower can further delay the foreclosure or have the action dismissed by raising defenses.[33]

In only three jurisdictions (Connecticut, Illinois, and Vermont) can a lender, under certain limited circumstances, recover on the mortgaged property through what is known as a "strict foreclosure."[34] In a strict foreclosure, the lender brings a court action to foreclose on the property and gains full title by decree of the court rather than through bidding at a foreclosure. This is unlike a power of sale, which involves a foreclosure sale without court involvement, or a judicial foreclosure, in which the court is involved both before and after the foreclosure sale.[35] No public or private foreclosure sale of the property occurs in strict foreclosure.[36] In all three of the strict foreclosure jurisdictions, the borrower has a period of time to redeem the property after the court's judgment and decree naming the lender as the owner of the property.[37]

Connecticut and Vermont permit strict foreclosures if it appears that the property is worth less than the debt claimed.[38] In both states, the lender can sue the borrower for a deficiency even after using a strict foreclosure.[39] The deficiency judgment is based on the difference between the amount of debt and the appraised value of the property.[40]

In Illinois, a lender can seek a strict foreclosure if he can show that the borrower is insolvent and the amount of the debt is greater than the value of the mortgaged property.[41]

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32. *See id.*

33. *See id.*

34. *See* PAUL GOLDSTEIN & GERALD KORNGOLD, REAL ESTATE TRANSACTIONS 470–71 (3d ed. 1993) (referencing CONN. GEN. STAT. ANN. § 49-15 (West 1994); 735 ILL. COMP. STAT. 5/15-1403 (West 1994); VT. STAT. ANN. tit. 12, § 4531 (Supp. 1996)).

35. *See id.*

36. *See id.*

37. *See* CONN. GEN. STAT. ANN. § 49-20 (West 1994); 735 ILL. COMP. STAT. 5/15-1603 (West 1995); VT. STAT. ANN. tit. 12, § 4531 (Supp. 1996).

38. *See* GOLDSTEIN & KORNGOLD, *supra* note 34, at 470. A foreclosure by sale may, however, be ordered if the mortgage authorizes it and if the plaintiff or defendant requests it. *See* NELSON & WHITMAN, *supra* note 2, § 7.10, at 576–77.

39. *See* GOLDSTEIN & KORNGOLD, *supra* note 34, at 470.

40. *See id.*

41. *See* Great Lakes Mortgage Corp. v. Collymore, 302 N.E.2d 248 (Ill. App. Ct. 1973).

But unlike Connecticut and Vermont, the lender has no right to a deficiency judgment after a strict foreclosure.[42] The process of strict foreclosure in Illinois is rarely utilized,[43] perhaps because of the insolvency requirement and because the Illinois statute offers no guidelines on how to accomplish a strict foreclosure.[44]

B. Basic Features of Illinois Foreclosure Law

Illinois law requires a judicial sale and does not permit a power of sale.[45] In residential mortgages, the Illinois statute provides for a redemption period for the greater of either seven months from the date the court acquires jurisdiction over all mortgagors or three months after the judgment of foreclosure.[46] In non-residential mortgages, the redemption period runs for the greater of either six months from the date the court acquires jurisdiction over all mortgagors or three months after the judgment of foreclosure.[47] A mortgagor in a commercial mortgage may waive the statutory right of redemption at the time the mortgage is made,[48] but a mortgagor under a residential mortgage may not.[49] A residential mortgagor may waive the right to redemption or reinstatement after a foreclosure action is commenced, but only if the lender waives the right to a deficiency judgment.[50] A "residential mortgage" includes mortgages on residential property containing six or fewer dwelling units, at least one unit of which is occupied by the mortgagor or the spouse of the mortgagor as his or her principal place of residence.[51] A "residential mortgage" does not include a single tract of agricultural real estate

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42. *See id.* at 250.

43. None of the 161 sales from the July 1993 Illinois foreclosure cases nor the 115 sales from the July 1994 Illinois foreclosure cases examined in this study involved a strict foreclosure. *See infra* app. A, ¶ 5(f).

44. *See* 735 ILL. COMP. STAT. 5/15-1403 (West 1994) (stating simply that mortgagees may utilize strict foreclosure as a means of foreclosing mortgages).

45. *See* 735 ILL. COMP. STAT. 5/15-1404 to -1405 (West 1994).

46. *See id.* 5/15-1603(b)(1).

47. *See id.* 5/15-1603(b)(2).

48. *See id.* 5/15-1601(b).

49. *See id.* 5/15-1601(a).

50. *See id.* 5/15-1601(c).

51. *See id.* 5/15-1219.

larger than forty acres.[52] The mortgagor may exercise the right of redemption, but other interested persons or entities (such as a junior lienholder) ordinarily may not.[53] The mortgagor also enjoys a right of reinstatement, which is the right to cure the default and reinstate the loan by paying only the amount in default plus costs, rather than paying the entire accelerated loan amount.[54] The right of reinstatement arises upon the filing of the foreclosure action and must be exercised before the earlier of either the entry of the judgment of foreclosure or ninety days after the mortgagor is served.[55]

If the mortgagor fails to redeem or reinstate the loan, a judicial sale occurs following advertising and notice of the sale.[56] It is customary to require the bidding party to deposit 10% of the bid price when making the bid and to require the payment of the balance of the bid within forty-eight hours.[57] If the amount of the successful bid at the sale is less than the final judgment amount, the lender can sue for a deficiency; the statute does not prohibit pursuing a deficiency and does not contain a one-action rule or a fair value limitation.[58]

A court must confirm the sale before the lender may sue for a deficiency.[59] The court is required to confirm a sale unless proper notices were not given, the terms of the sale were unconscionable, the sale was conducted fraudulently, or justice was not otherwise served.[60] In addition to these statutory grounds for invalidating a foreclosure sale, the case law implies that a court may set aside a foreclosure sale if there was both a grossly inadequate bid and a noncompliance with the

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52. *See id.*

53. *See id.* 5/15-1402(b), -1603. Under § 1603, only the "owner of redemption," defined in the statute as the mortgagor or other owner, *see id.* 5/15-1212, may exercise the right of redemption, unless the foreclosure is a consent foreclosure. *See id.* 5/15-1603. If the foreclosure is a consent foreclosure, a party other than the mortgagor who has an interest in the real estate and who objects to the consent foreclosure may exercise the right of redemption under § 1402 of the statute. *See id.* 5/15-1402(b).

54. *See* 735 ILL. COMP. STAT. 5/15-1602 (West 1994).

55. *See id.* The borrower can exercise a right of reinstatement only once every five years. *See id.*

56. *See id.* 5/15-1507.

57. *See* Jeffrey Liss, *Notices of Foreclosure Sales Under the New Law*, *in* MORTGAGE FORECLOSURES IN ILLINOIS 1–25, 1–28 (Ill. Inst. for Continuing Legal Educ. ed., 1988) (*reprinted from* CHI. DAILY L. BULL., Oct. 8, 1987).

58. *See* 735 ILL. COMP. STAT. 5/15-1504(f), -1511 (West 1994). *See generally supra* note 22 (describing the one-action rule and fair value limitation).

59. *See id.* 5/15-1508(e).

60. *See id.* 5/15-1508(b).

foreclosure process.[61] A residential real estate mortgagor has a thirty-day redemption period after the foreclosure sale if the lender elects to sue her for a deficiency.[62] The mortgagor also may be entitled to possession of the home until thirty days after the confirmation of the sale.[63] The mortgagee of residential real estate can seek possession prior to this date if she can satisfy certain requirements.[64]

Due to redemption periods and court calendar delays, Illinois's foreclosure process usually takes nine months to complete even when the mortgagor does not raise any defenses.[65] If there are no court delays, no defenses are raised, and redemption periods are waived, ninety days is the earliest the process can be completed because of the time allowed to answer the complaint (thirty days from the service of summons) and the publication requirements prior to the sale.[66]

C. Criticisms of the Foreclosure Process

The foreclosure process in the United States is criticized primarily on two grounds: unfairness and inefficiency. These two criticisms are based on the assumption that third parties rarely bid at a foreclosure sale. Critics argue that, as a result, the lender himself is able to buy the property at a price far below the fair market value, resell the property at a profit, and then recover more than the original debt by suing the borrower for the difference between the amount bid and the final judgment amount (the deficiency).[67] If the foreclosure

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61. *See* Strauss v. Anderson, 9 N.E.2d 205 (Ill. 1937); Levy v. Broadway-Carmen Bldg. Corp., 8 N.E.2d 671 (Ill. 1937); Lyons Sav. and Loan Ass'n v. Gash Assocs., 545 N.E.2d 412 (Ill. App. Ct. 1989). *See generally* Stark, *supra* note 28, at 583–98 (discussing fraudulent conveyance challenges in different states).

62. *See* 735 ILL. COMP. STAT. 5/15-1604 (West 1994).

63. *See id.* 5/15-1701. The mortgagee must object during the foreclosure and show good cause to be entitled to possession. *See id.* 5/15-1701(b). The mortgagee must be entitled to possession according to the loan documents, and the court must be "satisfied that there is a reasonable probability that the mortgagee will prevail on a final hearing of the cause." *Id.*

64. *See id.* 5/15-1701(b).

65. *See infra* app. B, fig. 15.

66. *See* STATE-BY-STATE DIGEST, *supra* note 14, at 155; *see also* 735 ILL. COMP. STAT. 5/15-1507(c) (West 1994) (requiring publication of notice in at least three publications, once a week for three consecutive weeks "not less than 7 days prior to the sale").

67. *See, e.g.*, Wechsler, *supra* note 3, at 853.

system routinely operated this way, the system would clearly be unfair to borrowers. If third parties rarely bid at foreclosure sales and the lender usually bought the property, then the foreclosure sale process also would be inefficient; if the lender both initiates the foreclosure process and ends the process with ownership, then the sale process is redundant, costly and time-consuming, with no corresponding gains to borrowers. As previously mentioned, one of the key purposes of this study is to test whether these criticisms are well-founded.[68]

It is not difficult to speculate why third parties might rarely bid at or close to the fair market value of the property at a foreclosure sale. First, typical home purchasers may not know that the property is for sale because no signs are posted on the property and the sale is advertised in the legal section of the newspaper, rather than in the real estate section.[69] Second, the bidder does not have an opportunity to inspect the property before bidding. Third, at the sale the bidder customarily is required to pay 10% of the bid price immediately and the balance in forty-eight hours.[70] Finally, in a number of jurisdictions, the mortgagor can redeem the property within six months or more after the foreclosure sale.[71] These standard features of a foreclosure sale may drive the typical home purchaser out of the market. The third parties who attend and bid at a foreclosure sale tend to be experienced real estate investors who are either highly liquid or enjoy a line of credit that enables them to bid at the foreclosure sale and pay off the balance within forty-eight hours. These investors, commonly referred to as "scavengers," are aware that they are taking risks when purchasing property in this manner.[72]

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68. *See infra* notes 172–72 and accompanying text (finding that lenders reaped large profits through resale in only 6% of Cook County's 1993 judicial sales and 7% of 1994 sales).

69. The Illinois Mortgage Foreclosure Act was modified in 1987 to require publication in both the legal section and the real estate sales section of a newspaper. 735 ILL. COMP. STAT. 5/15-1507(c)(2) (West 1994).

70. *See* Liss, *supra* note 57, at 1–28. Financing the balance payment with a conventional loan is almost impossible in this scenario because a lender may take weeks conducting a credit check and an appraisal of the property.

71. *See* STATE-BY-STATE-DIGEST, *supra* note 14, at 25 (Arkansas), 44 (California), 184, 187 (Kansas).

72. Purchasing property at a foreclosure sale is a risky prospect, since one is unable to inspect the property prior to bidding and there are no warranties on the physical condition of the property.

Consequently, they only bid when they think they are bidding much less than the fair market value of the property.

One commentator has criticized the foreclosure process in which a lender or a third party is able to bid any amount less than the fair market value of the property.[73] According to him, the amount bid should either reflect the fair market value, or, if the amount bid is lower than the fair market value, the borrower should recapture any gain made upon a resale within a short period of time after the foreclosure sale.[74]

A "fair" foreclosure process, however, does not require a process in which the defaulting borrower's interest is considered to the exclusion of the interests of the lender. To the extent that the lender is not made whole through the foreclosure process, the lender will transfer those costs to *all* borrowers in the form of higher fees or interest rates. Consequently, lenders and borrowers share an interest in keeping the costs of the foreclosure process as low as possible. A "fair" foreclosure system attempts to *balance* the interest of lenders and the interest of borrowers who default by maintaining efficiency while providing borrowers with a true opportunity to protect their equity in the property.

D. Special Features of Illinois Law

Illinois foreclosure law was modified in 1987 to address some of these problems.[75] The general purpose of the modifications was to attract third parties, thereby generating bids which better approximate the mortgaged property's fair market value.[76] Two key modifications include the expiration of the redemption period before the foreclosure sale rather than after the sale, and the requirement to advertise the sale in both the legal notices and real estate sections of a newspaper.[77] In addition, the Illinois Mortgage Foreclosure Act provides for fourteen "special matters" or provisions. The special matters were intended to make the sale process more

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73. *See* Wechsler, *supra* note 3, at 885–86.

74. *See id.* at 884.

75. *See generally* 735 ILL. COMP. STAT. 5/11 (West 1994) (showing an effective date of July 1, 1987).

76. *See* Liss, *supra* note 57, at 1–25.

77. *See* 735 ILL. COMP. STAT. 5/15-1507(b) & (c)(2) (West 1994).

commercially reasonable, resulting in more third party bidding and higher bids.[78] The special matters do not automatically apply; the parties must request them in the complaint or by separate motion. The following are the special matters which may be sought:

(1) a manner of sale other than public auction;
(2) a sale by sealed bid;
(3) an official or other person who shall be the officer to conduct the sale other than the one customarily designated by the court;
(4) provisions for non-exclusive broker listings or designating a duly licensed real estate broker nominated by one of the parties to exclusively list the real estate for sale;
(5) the fees or commissions to be paid out of the sale proceeds to the listing or other duly licensed broker, if any, who shall have procured the accepted bid;
(6) the fees to be paid out of the sale proceeds to an auctioneer, if any, who shall have been authorized to conduct a public auction sale;
(7) whether and in what manner and with what content signs shall be posted on the real estate;
(8) a particular time and place at which such bids shall be received;
(9) a particular newspaper or newspapers in which notice of sale shall be published;
(10) the format for the advertising of such sale, including the size, content and format of such advertising, and additional advertising of such sale;
(11) matters or exceptions to which title in the real estate may be subject at the sale;
(12) a requirement that title insurance in a specified form be provided to a purchaser at the sale, and who shall pay for such insurance;
(13) whether and to what extent bids with mortgage or other contingencies will be allowed;
(14) such other matters as approved by the court to ensure sale of the real estate for the most commercially favorable price for the type of real estate involved.[79]

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78. *Id.* 5/15-1506(f); *see* Liss, *supra* note 57, at 1–25.
79. 735 ILL. COMP. STAT. 5/15-1506(f) (West 1994).

In addition,

> If all of the parties agree in writing on the minimum price and that the real estate may be sold to the first person who offers in writing to purchase the real estate for such price, and on such other commercially reasonable terms and conditions as the parties may agree, then the court shall order the real estate to be sold on such terms, subject to confirmation of the sale . . . .[80]

Theoretically, if the parties sought to incorporate some of these special matters into the judgment, the foreclosure sale price would be closer to the fair market value of the property than the price received in a usual foreclosure sale. Special matters were designed to attract average home purchasers to purchase the property.

The special matters added to the Illinois Act were an attempt to make the foreclosure sales process more comparable to a voluntary sale.[81] Under the Act, a broker can be hired to market and advertise the sale in the conventional manner. Thus, a third party can inspect the property, receive title insurance on the property, and bid on the condition that she receive a loan commitment to finance the purchase of the property.

The proponents of the reform hoped that either the mortgagor or the mortgagee would use the special matters to maximize the level of bidding at the foreclosure sale.[82] As previously mentioned, this empirical study collected data on whether the mortgagors and mortgagees used the special matters and the impact, if any, that such utilization had on bidding.

II. THE EMPIRICAL STUDY: DATA COLLECTED AND METHODOLOGY

A. Data Collected for This Study

To assess the fairness of the foreclosure process and the extent to which borrowers are able to preserve their equity

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80. *Id.* 5/15-1506(g).
81. *See* Liss, *supra* note 57, at 1–28.
82. *See id.* at 1–25.

under the process, data from Illinois foreclosures was collected (the Illinois foreclosure process is similar to many other jurisdictions). The data focused on answering the following questions:

(i) In what percentage of the cases in which a foreclosure complaint has been filed are the cases dismissed (i.e., no judicial foreclosure) and on what basis are these cases dismissed? Did the borrower exercise the right of reinstatement or the right of redemption, or did the borrower file a bankruptcy action or settle with the lender? In addition, when during the foreclosure process do borrowers typically exercise their rights to reinstatement and redemption, or instead file for bankruptcy?

(ii) In what percentage of foreclosure sales does a third party or the lender bid at the sale and then resell the property within a year at a profit? In what percentage of the cases does the lender bid less than the final judgment amount and then seek the deficiency from the borrower's other assets? In what percentage of the cases does the lender sue the borrower for a deficiency and resell the property for a profit?

(iii) How soon after the loan is made does the borrower default (to ascertain in a general, although imprecise fashion, the amount of equity that the borrower has invested in the property) and how often does the borrower raise defenses to the foreclosure complaint?

To assess the efficiency of the foreclosure process, data was collected to answer the following questions:

(i) What are the costs associated with the foreclosure process as a percentage of the amount originally loaned, as a percentage of the amount due at the time the foreclosure action was commenced, and as a percentage of the final judgment amount?

(ii) What are the components of the costs (interest, advances to cure defaults, court costs, attorney's fees, costs to advertise the sale, etc.) and which costs comprise the largest portion of the total costs of foreclosure and

realization on the collateral pledged after a default? What percentage of the costs accrue (a) from the date of the default until the filing of the complaint, (b) from the filing of the complaint until the judgment of foreclosure, and (c) from the judgment of foreclosure until the foreclosure sale?

(iii) What is the typical amount of time it takes for the loss recovery process to occur, i.e., the median time period between (a) the date of default and the date a complaint is filed, (b) the filing of the complaint and the date the final judgment is ordered, (c) the date of final judgment and the date of the foreclosure sale, and (d) the date of the foreclosure sale and the date of the resale of the property?

Data was also collected to answer the following questions:

(i) Did the Supreme Court decision, *BFP v. Resolution Trust Corporation*,[83] affect the number of third parties who bid at foreclosure sales, the amount bid at foreclosure sales, or the percentage of cases in which the lender sues the borrower for a deficiency?

(ii) Were the special matters of the Illinois mortgage foreclosure law being used and did their use lead to more third party bidding and higher bids at the foreclosure sales?

(iii) Did the type of property in foreclosure (i.e., personal residence compared to an income-producing real estate investment) affect how well or poorly the borrower was able to protect her equity in the property?

B. Methodology

The first step in this empirical study involved obtaining a list of all Illinois real estate foreclosures commenced in Cook

83. 511 U.S. 531 (1994).

County Chancery Court in July 1993 and in July 1994.[84] The list included the names of the parties, the property index number for the property in foreclosure, the amount of relief claimed by the mortgagee, the address of the property, and the date of the commencement of the foreclosure action. This list showed 448 real estate foreclosures filed in July 1993 and 422 filed in July 1994.[85]

The second step involved reviewing the official court files of the Cook County Chancery Court for each foreclosure case identified in the list of foreclosures.[86] The report of sale typically indicated the final judgment (including the accrued interest, attorney fees, publication fees, selling fees, and other costs owed to the plaintiff), the highest bidder, any deficiency or surplus, the person selling the property (sheriff or selling officer), the type of property, the date of the sale, and the judgment amount.

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84. Chicago Title Insurance Company (Chicago Title) provided this list from its computer system which tracks every real estate foreclosure filing in Cook County, Illinois.

85. The U.S. Supreme Court decided *BFP* in June, 1994. 511 U.S. 531 (1994). Many wondered whether the case would lead to higher or lower bidding at foreclosure sales and whether it would lead to fewer challenges of foreclosure sales as fraudulent conveyances. *See, e.g.*, Stark, *supra* note 28. Thus, the data collected for this study relates to cases filed approximately one year before the *BFP* decision and cases filed one month after the *BFP* decision, in order to run comparisons.

Twenty-two additional real estate foreclosures in the 1993 sample and 24 in the 1994 sample were excluded from the analysis because they were filed in Federal District Court rather than in Cook County Chancery Court.

86. The files included documents such as the summons, complaint, amended complaint, the answer, motions, the judgment, other court orders, the notices, and the report of sale. Documents were missing, however, from a number of files, requiring us to seek information by other means. For example, some files contained the court order confirming the sale but were missing the report of sale. Thus, one could learn from the court file that a judicial sale occurred and was confirmed, but the file would not have information regarding the details of the judicial sale, such as the date of the sale and the amount bid at the sale. In those cases one could ascertain whether a selling officer was used through Chicago Title's computer database. The database showed whether the deed from the foreclosure named either a selling officer or the sheriff as the grantor.

In addition, sometimes the judgment document in the file would not indicate the type of property in foreclosure (i.e., residential or commercial). When the judgment did not contain this information, one could obtain the information through Lexis/Nexis Research Software. Lexis received its information primarily from the records of the Cook County Tax Assessor's Office, the County Treasurer's Office, and the County Clerk's Office, and updates its records annually. After entering the property index number into the "Illinois Assets Library," Lexis displayed information regarding the property, including the type of land use.

When information sought could not be obtained, the case was excluded from the study sample if the particular calculations on the sample concerned the unavailable information.

For the cases that did not reach the judicial sale stage, the case file usually contained either a motion for dismissal by the mortgagee and a court order dismissing the case or an order to dismiss for want of prosecution. Other files reflected a dismissal because the mortgagor exercised the right of reinstatement or redemption. In some cases, the mortgagor filed for bankruptcy, resulting in a stay and dismissal of the case. In a number of cases, however, the court file did not indicate why the case was dismissed, requiring further research to ascertain the circumstances leading to the dismissal.

After examining all the court files, the third step involved categorizing the cases into seven groups according to their resolutions: (i) cases which went to judicial sale, (ii) cases dismissed after the mortgagor exercised the right of reinstatement, (iii) cases dismissed after the mortgagor exercised the right of redemption, (iv) cases dismissed based on a bankruptcy filing by or against the mortgagor, (v) cases dismissed with no stated reason, (vi) cases dismissed for want of prosecution, and (vii) cases in which the files only contained the foreclosure complaint and no further information.

The fourth step involved using Chicago Title's Tract Index (a computer database tracking every deed recorded with the Recorder's Office of Cook County, Illinois) to obtain information on the resale of properties originally sold by judicial sale. After entering the property index number for a specific property, the Tract Index database identifies any deed recorded against the property and often notes the amount of the sale.[87]

The fifth step involved ascertaining the reason for the dismissals when it was not indicated in the court files and

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87. Illinois imposes a transfer tax of $1 per $1,000 of the purchase price for the sale of real estate located in Illinois. *See* Real Estate Transfer Tax Law, 35 ILL. COMP. STAT. 200/31-10 (West 1994). The transfer stamps purchased must be affixed to the deed in order to record the deed. *See id.* 200/31-20. When Chicago Title's Tract Index did not contain the sale price, the purchase price could be ascertained by counting the number of State of Illinois transfer stamps on the deed and multiplying that amount by $1,000. In addition, the Cook County Recorder's Office keeps computer databases which identify the purchase prices of properties calculated in this manner. When Chicago Title's Tract Index lacked information regarding a property we checked either the Cook County Recorder's database (by identifying the property under its property index number) or Lexis (which obtained its information from the Cook County Recorder's Office). If, however, a sale of property was exempt from the payment of transfer taxes (such as properties being sold by the Department of Housing and Urban Development), then the sale amount could not be ascertained from the deed and we were unable to obtain the resale price of these properties. There were 64 exempt sales in the 1993 sample and 16 exempt sales in the 1994 sample.

when the cases were dismissed for want of prosecution. These cases fell into four categories: (i) the mortgagor refinanced the mortgage (in which case the Tract Index database listed a release of mortgage and a new mortgage), (ii) the mortgagor sold the property herself (in which case the Tract Index noted a deed to the purchaser), (iii) the mortgagor worked out a settlement with the mortgagee (in which case the Tract Index listed a modification of the mortgage), or (iv) the mortgagor executed a deed in lieu of foreclosure (in which case the Tract Index showed a deed of the property to the mortgagee or its nominee).

The sixth step involved searching the Chicago Title's Tract Index for personal judgments against an individual or entity to ascertain if the mortgagee had sued the mortgagor for a deficiency in any of the cases which went to judicial foreclosure and resulted in a sale price which was less than the final judgment amount.[88]

The seventh step involved looking at cases which were dismissed or stayed due to a bankruptcy filing. This required checking Chicago Title's Tract Index to determine if any deed or other document had been recorded in the Cook County Recorder's Office. It also involved checking the computer records of the Bankruptcy Court of the Northern District of Illinois to ascertain whether a Chapter 7, 11, or 13 bankruptcy was filed and, if so, to determine the number of days after the filing of the foreclosure complaint that the bankruptcy action was filed.

The eighth step involved looking at the cases in which the property was sold at a foreclosure sale to ascertain whether the mortgagor filed for bankruptcy at any time either before the filing of the foreclosure complaint, during the pendency of the foreclosure case, or after the sale (up to one year after the foreclosure sale). This was completed by checking Chicago

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88. An in rem judgment against the mortgagor was not included as a true deficiency action because it was a suit by the mortgagee against the mortgaged property, not the other assets of the mortgagor.

In Illinois, there is a special right of redemption valid for thirty days after the judicial sale in cases where the lender is the high bidder and the bid produces a deficiency. *See* 735 ILL. COMP. STAT. 5/15-1604 (West 1994). As a result, lenders must protect themselves in such cases with an in rem judgment so that if the mortgagor redeems by paying the bid amount, the lender can still recover against the property for the deficiency amount.

Title's Tract Index.[89] A further search of the computer databases kept by the Federal District Court for the Northern District of Illinois ascertained not only whether the mortgagor filed under Chapter 7, 11, or 13 of the Bankruptcy Code, but also the timing of the bankruptcy filing relative to the filing of the foreclosure complaint and the foreclosure sale. Finally, to discover whether the foreclosure sales were challenged and set aside as fraudulent conveyances, the bankruptcy court files were pulled on all of the bankruptcy cases filed after the foreclosure sale.

C. The Difference Between This Study and Prior Foreclosure Studies

There are several important types of data collected in this study. This study examined the foreclosure sale and resale of the property, as did Steven Wechsler's excellent study of foreclosures in Onondaga County, New York.[90] In addition, and equally important, this study determined the percentage of all foreclosure cases filed that were dismissed before the foreclosure sale. As previously mentioned, the percentage of foreclosure cases that are dismissed and do not go to foreclosure sale is important when assessing the fairness and efficiency of the foreclosure process. When a borrower is able to avoid a foreclosure sale, the borrower is able to protect her equity in the property either by retaining ownership of the property (through reinstating the loan in foreclosure or refinancing the debt) or by selling the property and realizing the equity in the property after paying off the debt. The ability of the borrower to have a reasonable opportunity to protect her equity in the mortgaged property is the key factor in evaluating how fair the foreclosure process is to borrowers. Other studies have been flawed because they did not consider mortgagor actions which preempt the foreclosure sale. As previously discussed, foreclosure laws were developed to create a process by which a borrower's equitable right to redeem the property would terminate, thereby providing the lender with an opportunity to realize on the collateral pledged

89. Chicago Title's Tract Index includes bankruptcy filings.
90. *See* Wechsler, *supra* note 3.

and minimize the losses incurred after a loan goes into default. Foreclosure laws balance the competing interests of the lender and borrower.

This study applies a more sophisticated analysis to the assessment of whether the lender or third party bidder reaps a profit or loss upon the resale of the property and the amount of such profit or loss. It is not sufficient to compare the amount bid (for a third party bidder) or the final judgment amount (for the lender) against the resale amount when calculating the profit or loss upon resale of the foreclosed property. One must also take into account the expenses incurred by the third party or lender in carrying the property and reselling the property in order to calculate accurately any resale profits or losses. Instead of attempting to contact the lenders and third party bidders in each of the cases in this study in which the property was sold at a foreclosure sale, we collected data from various banks regarding the average costs to carry and resell property on which they have foreclosed (less any income that is generated from the property).

A simple comparison of the final judgment amount to the resale price may indicate profits where profits do not in fact exist. For example, in the introduction to Wechsler's study, he refers to a case in which the lender resold the foreclosed property for $8,000 more than the amount of the final judgment due the lender, suggesting an $8,000 profit. An $8,000 profit would indicate a flawed foreclosure system in which lenders reap profits at the expense of the borrower's equity in his or her property.[91] This author contacted numerous banks to ascertain what the typical carrying and resale costs are on the properties that they take over at foreclosure sales. These costs can easily constitute 10% of the resale price[92] and hence any resale for less than 10% of the final judgment amount would in fact be at a true loss rather than a profit. In Wechsler's example, the true profit decreases after subtracting the carrying and resale costs.

This study commenced after the U.S. Supreme Court decision in *BFP v. Resolution Trust Corporation*.[93] In this case, the Supreme Court held that the amount bid at a noncollusive foreclosure sale conducted in accordance with state foreclosure

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91. *See* Wechsler, *supra* note 3, at 851.
92. *See infra* Part III.C.
93. 511 U.S. 531 (1994).

laws would be presumed conclusively to be for "reasonably equivalent value" for purposes of section 548 of the Bankruptcy Code, and therefore not subject to being set aside as a fraudulent conveyance.[94] The Court rejected the requirement of a federal standard of fairness (such as requiring that the amount bid exceed 70% of the fair market value of the property) and instead entrusted state foreclosure laws to prevent the bidding of a peppercorn for a valuable piece of property.[95] While some argued that *BFP* would lead to lower bidding because it would be more difficult to challenge the amount bid, others argued that more third parties would bid, and they would bid amounts more approximate to fair market value.[96] Hence, this study has compared data from cases filed in July 1993 (more than one year prior to the decision) with data from cases filed in July 1994 (one month after the decision). The study compared the results in foreclosure sales prior to the *BFP* decision with the results in foreclosure sales occurring after the decision to determine whether the decision had an effect on the type of bidder and the amount bid at foreclosure sales.

This study also collected data to determine whether the *BFP* decision affected the number of mortgagors who file a bankruptcy proceeding (or have one filed against them) up to a year after the foreclosure sale. The study compared the degree to which the borrower or junior lender was able to set aside the foreclosure sale as a fraudulent conveyance in cases filed before and after the decision.

Finally, because this study focuses on Illinois case law and because it was initiated after a major reform of the foreclosure laws in Illinois, the study collected data to determine which reform features have been utilized and the impact of such utilization on the fairness and efficiency of the foreclosure process.

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94. *Id.* at 535.
95. *See id.* at 540.
96. *See* Stark, *supra* note 28, at 565–66, 574.

III. AN ANALYSIS OF THE RESULTS OF THE EMPIRICAL STUDY

A. An Assessment of the Foreclosure Process in Light of the Data Collected in This Study

One of the most significant pieces of information gleaned from the data collected in this study was that 64% of the foreclosure cases filed in July 1993 and 73% of the foreclosure cases filed in July 1994 were dismissed and did not result in a foreclosure sale.[97] Therefore, only a third or fewer of the foreclosure cases filed ended in a foreclosure sale.[98] So in approximately two-thirds of the cases filed, borrowers were able to protect their equity in the property and avoid the foreclosure sale.[99]

Another key piece of data involved the extent and the effect of third party bids in a foreclosure sale. In most cases, the only people present at the foreclosure sale are the lender, the borrower, and the party conducting the foreclosure sale. Third parties successfully bid in only 11.2% of the 1993 judicial sales cases and only 9.6% of the 1994 judicial sales cases.[100] This inability to attract third party bidders *appears* to reflect a failure in the foreclosure sale process because a lack of third party bids allows the lender to bid below market value. But a lack of third party bids does not mean that the borrower loses equity. In about 90% of the cases, the value of the property does not exceed the amount of the debt secured by the property plus the typical costs to carry and resell the property.[101] Thus, the level of third party bidding is not as inadequate as it appears, it is merely reflective of market realities. The fact that when lenders successfully bid, they resold for a loss in

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97. *See infra* app. A, ¶ 3(a); *infra* app. B, figs. 3a, 3b; *see also id.*, figs. 4–9.

98. *See infra* app. A, ¶ 3(a).

99. *See infra* app. B, figs. 5–9 (detailing the various ways that borrowers can avoid the foreclosure sale and protect their equity in the property).

100. *See infra* app. A, ¶ 4(g); *infra* app. B, figs. 10, 11 (reporting the identities of the successful bidders).

101. This is also a reflection of the fact that the borrower will almost always exercise the right of reinstatement or redemption prior to the foreclosure sale if the borrower has equity in the property.

72% percent of the 1993 cases and resold for a loss in approximately 90% of the 1994 cases[102] supports the conclusion that third parties bid less often at foreclosure sales because bidding more than the debt amount would not be profitable in many of the cases which go to foreclosure sale.

Another important factor in assessing the fairness of the foreclosure process is the number of foreclosures in which lenders bid less than the debt and less than the fair market value of the property, and then sue the borrower for the deficiency. In the vast majority of the judicial sales cases in both samples, the lender bid the final judgment amount exactly.[103] The amount bid was less than the final judgment amount in only 24.2% of the 1993 cases and 27% of the 1994 cases.[104] Of the approximately 25% of the judicial sales cases in which a deficiency occurred, the lender pursued the deficiency in only 28.2% of such cases in the 1993 sample and 12.9% of such cases in the 1994 sample.[105] Typically when a deficiency occurred, the mortgagor had less equity in the property than in non-deficiency cases.[106] In addition, in the 1993 cases in which a deficiency occurred, the property still typically resold for less than the amount bid than in cases without a deficiency bid.[107] These two facts suggest that in a number of cases, the fair market value of the property did not exceed the deficiency amount bid. However, in approximately 25% of the deficiency cases in both 1993 and 1994, when the

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102. Only two of the nineteen 1994 foreclosure cases where the property resold within one year resulted in a profitable resale.

103. The median bid price for both samples was 100% of the final judgment amount. *See infra* app. A, ¶ 4(a).

104. *See infra* app. A, ¶ 4(i).

105. *See infra* app. A, ¶ 4(o).

106. The ratio of the principal due on the date of default to the original amount of the mortgage in all of the 1993 judicial sales cases was 96.97%; while the ratio for 1993 judicial sales cases with a deficiency bid was 97.33%. It is interesting to note that according to one study, lenders forebear from foreclosing after a borrower's default and allow longer delinquencies when there is a very high positive equity level, but as the borrower's equity level drops, the lender is more likely to bring a suit. *See* Thomas M. Springer & Neil G. Waller, *A New Look at Forbearance*, MORTGAGE BANKING, Dec. 1995, at 81, 83. Based on this study, a similar pattern seems to exist regarding deficiency suits; the lower equity level characteristic in deficiency suits reflects the fact that the lender has taken a bigger loss, inducing her to sue the borrower for the deficiency.

107. The ratio of the resale price to the amount bid was 102.49% in all 1993 judicial sales cases, *see infra* app. A, ¶ 4(c), and 93% in the 1993 judicial sales cases with a deficiency bid. The ratio of the resale price to the amount bid, however, was 103.65% in all 1994 judicial sales cases, *see infra* app. A, ¶ 4(c), and 112% in the 1994 judicial sales cases with a deficiency bid.

lender pursued a deficiency action against the borrower, the lender was able to resell the property for more than the amount bid.[108]

The main criticism of the foreclosure process is that the lender obtains an unfair double recovery by bidding less than the debt due to her, bringing a deficiency action against the borrower, and then reselling the property within one year for more than she bid. This occurred in only approximately 6% of all the 1993 judicial sales cases and in approximately 7% of all the 1994 judicial sales cases.[109] Expressed as a percentage of all foreclosure cases filed, this inequity occurred in only approximately 2% of the 1993 and 1994 cases in this study. The infrequency of double recoveries may surprise critics of the foreclosure process. Yet, it may still be appropriate to lament a system which produces inequitable results, however rare, and to strive for even fewer such cases. Hopefully, this can be accomplished without creating greater costs to lenders, who in turn may pass the costs on to all borrowers through loan fees and higher interest rates. Part IV will explore the possibility of further reducing inequitable outcomes without increasing the costs of foreclosure.

The final major component in assessing the fairness of the foreclosure process to borrowers is the extent to which lenders and third party bidders bid less than the fair market value of the property and then resell the property within one year after the foreclosure sale. The first important point is that a surprisingly large number of the properties sold at judicial sale did not resell within one year after the foreclosure sale (41.6% of the 1993 judicial sales cases and 59.1% of the 1994 sales cases).[110] Indeed, when the foreclosing lender was the successful bidder at the judicial sale, the percentage of cases that did not resell within one year after the judicial sale was even higher.[111] Third party bidders did not resell the property

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108. *See infra* app. A, ¶ 4(e).

109. There were ten such cases in the 1993 sample and eight such cases in the 1994 sample. *See infra* app. A, ¶ 4(e).

110. *See infra* app. A, ¶ 4(x).

111. The percentage of such cases in which resale did not occur was 72.5% in 1993 and 62.5% in 1994. *See infra* app. A, ¶ 4(t). The conventional wisdom is that lenders do not want to be in the real estate business. Thus, one wonders why the lenders failed to resell so many of these properties. One possibility is that the loss they would take if they resold the property quickly was so large that they elected to hold onto the property and hope for better prices in the future. Another possible explanation is that the lender had so many properties on the market that she was

within one year after purchase at a foreclosure sale in 50% of the 1993 cases and in 73% of the 1994 cases.[112]

Of the judicial sales cases where the properties did resell within one year, the ratio of the resale price to the final judgment amount was 81.99% for the 1993 cases and 82.47% for the 1994 cases.[113] Hence, the median results reflect losses upon a resale of the property of between approximately 17% to 18%. By combining the profits and losses for resales by both lenders and third parties and comparing them against the total number of judicial sales cases, we found that profits were made upon resale in 12.4% of the 1993 judicial sales cases and 3.5% of the 1994 judicial sales cases;[114] in 18.0% of the 1993 judicial sales cases and 13.0% of the 1994 judicial sales, the lender or third party incurred a loss upon resale;[115] and in 41.6% of the 1993 and 59.1% of the 1994 judicial sales cases, the property either did not resell within one year or the amount of the profit or loss could not be ascertained.[116]

To understand more clearly who is earning a profit or incurring a loss upon resale of foreclosed property and the amounts of such profits and losses, it is helpful to separate the results between lenders and third party bidders at the foreclosure sale. This analysis reveals that mortgagees usually incurred a loss when they resold property, while third parties usually earned a large profit upon resale.

The mortgagee resold the property within one year of the foreclosure sale for a profit in eleven of the thirty-nine 1993 lender resale cases (28.3%), and the lender incurred a loss 71.8% of the time.[117] In three of these eleven 1993 cases in which the lender resold the property for a "profit,"[118] the profit was less than 10% of the final judgment. As discussed in Part

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unable to sell them all within one year. It is unlikely that these unsold properties were appraised at a value in excess of the debt due and yet were not sold within one year.

112. This fact may indicate that in a number of these cases, the third parties were not in the business of buying and quickly reselling foreclosed property, but were ordinary home purchasers.

113. These numbers are slightly lower than the ratio of resale price to final judgment found in app. A, ¶ 4(d) because the numbers in app. A, ¶ 4(d) included resales that occurred more than one year after the foreclosure sale.

114. *See infra* app. A, ¶ 4(x).

115. *See id.*

116. *See id.*

117. *See infra* app. A, ¶ 4(o).

118. As used herein, the "profit" is the amount by which the resale price exceeded the final judgment amount.

IV, the typical carrying and resale costs can equal 10% of the final judgment amount. Thus, since the lender made a true profit in only eight of the thirty-nine 1993 judicial sales cases that resold within one year, the lender made a true profit upon resale in only 20% of the resale cases. The median amount of this profit was $12,437.35, and the median amount of the 1993 loss was $21,348.38. To give context to the median profit and loss figures, it should be noted that the median size of the mortgage loans, or the initial principal amount of the loan, was $48,600 in 1993 and $49,506 in 1994, and the median final judgment amount was $62,646.77 in 1993 and $61,115.85 in 1994.[119] In summary, the data from the 1993 cases reflects that lenders usually did not make a profit when they were the successful bidder at the judicial sale and resold the property within one year. Occasionally, however, lenders were able to resell for a true profit and, in some instances, for a very large profit.[120]

In the 1993 cases, when a third party was the successful bidder at the foreclosure sale and resold the property approximately one year after the foreclosure sale,[121] the third party made a profit in nine of the twelve 1993 third party resale cases, or 75% of such cases, for a median profit of $25,971.50. The third party bidder resold for a loss in only one of the twelve third party resale cases, or 8.3%, for a loss of $12,750.[122] The level of the profits in these cases, which is calculated by comparing the ratio of the resale price to the bid amount, was very high (ranging from 32% to 326%), with five of the nine cases generating a profit of greater than 100%. While third parties rarely were the successful bidders at the foreclosure sales in the 1993 cases,[123] when they were

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119. These figures are based on the median of the judicial sales cases, not the median of all foreclosure cases filed.

120. Of the eight cases where the lender resold the property for a true profit, the lender made a profit of more than 100% in one case, a profit of approximately 50% in another case and a profit of 37% in a third case. The other profits were just slightly more than 10% greater than the final judgment amount.

121. Two of the cases included in this calculation resold after one year had passed. In one case, the property sold two days beyond the one year period. In the other case, the property sold 76 days after the one year period. These two cases are included because they are close to the one year cut-off point and the number of resales within the precise one year period is small.

122. In two of the 1993 third party resale cases, the amount of the resale price was not available.

123. Only 11.2% of successful bidders in the 1993 sample were third parties. *See infra* app. A, ¶ 4(g).

successful, and resold the properties within one year, they frequently resold the properties for very large profits.

In the 1994 judicial sales cases, only five third parties purchased and then resold the property approximately one year after the sale. Unfortunately, the profit or loss upon resale in these five cases could not be ascertained.[124] With respect to resales by lenders in the 1994 judicial sales cases, the lender made a profit on four of the nineteen properties which were resold by the lender within one year of the foreclosure sale. In two of these cases the lender made a profit of more than 10% above the final judgment amount, and in the other two cases, the profit was less than 10% above the final judgment amount. Thus, of the nineteen cases in which the lender resold the property within one year of the foreclosure sale, the lender made a true profit in only two cases, or 10% of the resales. In one of these two cases the lender made a profit of 379%, and in the other case the lender made a profit of 98%. Thus, while lenders rarely made any true profit upon resale in the 1994 cases, in two relatively rare occurrences the lender reaped a huge profit upon resale.

To summarize the key data regarding the fairness of the foreclosure process in protecting the borrower's equity in the property: (i) in approximately two-thirds of the cases, the borrower was able to avoid the foreclosure sale and protect his or her equity in the property, (ii) in the vast majority of those cases where the property was sold at foreclosure sale, the lender was the successful bidder and resold the property for a loss, but (iii) occasionally, third parties and very few lenders purchased and resold the property for huge profits and (iv) in a very small percentage of the cases, the borrower was sued on a deficiency even when the property resold for a profit.

In short, the data reflects that the foreclosure system typically operates in a manner that protects the borrower's equity in the property. In a very small percentage of the cases, however, the system operates in an unconscionable manner. Conventional wisdom holds that any reforms making the foreclosure sale more commercially reasonable will add to the costs of the process.[125] Since unconscionable results are rare,

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124. One case was exempt from the payment of transfer taxes, one deed was not recorded, and in three cases the records were not complete enough to allow a comparison of the bid to the resale price.

125. *See* Alex M. Johnson, Jr., *Critiquing the Foreclosure Process: An Economic Approach Based on the Paradigmatic Norms of Bankruptcy*, 79 VA. L. REV. 959,

and since on average lenders are reselling the foreclosed property for less than the final judgment amount, it does not seem sensible to require cost-laden reforms.[126] Part IV addresses whether there is a method to make forclosure sales more commercially reasonable without increasing the overall costs.

This study also gathered some basic data relating to the amount of time and costs of the foreclosure process.[127] The lender waited approximately six months after the monetary default to file the foreclosure complaint.[128] After the complaint was filed, approximately four months elapsed between the filing of the complaint and the judgment of foreclosure.[129] An additional four to five months passed between the judgment date and the judicial sale.[130] The median time period between the occurrence of the default and the judicial sale was approximately fifteen months, and the median time period between the filing of the complaint and the judicial sale was approximately nine months.[131]

The total costs of the foreclosure process consisted of accrued interest, advances, costs of the lawsuit, attorney's fees, publication fees and the fee of the sheriff or selling officer from the filing of the complaint through the foreclosure sale. These costs amounted to 19.61% of the final judgment amount in the 1993 sales cases and 18.43% of the final judgment amount in the 1994 sales cases.[132] The two largest

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991–1000 (1993); James Geoffrey Durham, *In Defense of Strict Foreclosure: A Legal and Economic Analysis of Mortgage Foreclosure*, 36 S.C. L. REV. 461, 504–08 (1985).

126. Johnson, *supra* note 125, and Durham, *supra* note 125, each argue, from an economic perspective that focuses on creating an efficient foreclosure process, that the more costly commercially reasonable sale process should not be required. They both argue that such reform would not only harm lenders but also would harm "healthy" borrowers (those who would borrow and *not* default), because the reforms would cause higher interest rates or loan fees overall due to the more costly foreclosure process. In addition, they each argue that these defaulting borrowers are seeking more rights ex post than they bargained and paid for ex ante. *See* Johnson, *supra* note 125, at 962; Durham, *supra* note 125, at 496.

127. The median time periods and costs for both the 1993 and 1994 samples were very close and, therefore, both are reflected in the figures which follow.

128. *See infra* app. B, fig. 15 (comparing the time periods of the foreclosure process for the 1993 and 1994 judicial sales cases).

129. *See id.*

130. *See id.*

131. *See id.*

132. *See infra* app. B, figs. 12, 14 (depicting these costs as a percentage of all costs and as a dollar amount). One can also determine the total costs to the lender from the default by comparing the final judgment amount (the total amount due to the lender) to the "principal amount." As used herein, the "principal amount" is the

components of such costs were accrued interest on the amount due and advances made by the lender for the protection of the property.[133] Of the approximately 19% of the final judgment amount which represents the costs to foreclose, over 7% of such costs accrued during the period from the judgment until the judicial sale.[134] This is especially significant when one considers the other data from this study, which reflects that in the majority of the cases which go to judicial sale, the value of the property does not in fact exceed the debt on the property.[135]

One of the more disappointing findings of this study was the lack of use of the fifteen special features of the Illinois Mortgage Foreclosure Act.[136] In none of the foreclosure sales cases did the borrower or lender make a motion to utilize any of the special features geared towards attracting more third party bidders.[137] The only special feature utilized was the use of a selling officer, instead of the sheriff's office, to sell the property.[138] This feature was not designed to attract more third party bidding, but rather to reduce the costs and the time period required to perform the sale. When the cases which utilized the private selling officer feature were compared to the other foreclosure sales cases, there were no differences in results regarding the timing and costs of the foreclosure process. The fact that the optional special features were not used suggests that any reform of the foreclosure process should not rely on optional features. It is likely that lenders would prefer simply to take over the property as quickly and cheaply as possible and then try to interest a third party in

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amount of the loan still due and owing on the date of the complaint and does not include any accrued interest, advances, attorney's fees, or any other fee which legally may be added to the principal due. When comparing the median final judgment amount to the median principal amount, one arrives at a total cost to the lender of 27.9% of the final judgment amount in the 1993 sample and 26.35% in the 1994 sample (these total costs include accrued interest, attorney's fees, advances, and other fees from the date of default through the foreclosure sale).

133. *See infra* app. B, figs. 12, 14.

134. *See infra* app. B, figs. 13a, 13b. This percentage of costs is even lower than the actual amount because, in calculating the final judgment, the lender's attorney typically did not indicate attorney's fees after the judgment of foreclosure, and instead put all such costs within the judgment amount.

135. This conclusion is derived from two facts: that on resale, the median result is a loss rather than a profit, and that in only a small percent of the judicial sales cases does the lender or third party resell the property within one year at a profit.

136. *See* discussion *supra* Part I.D.

137. *See infra* app. A, ¶ 5(a).

138. *See id.*

buying the property. The few borrowers who fail to protect their equity in the property prior to the foreclosure sale are probably unaware of their right to move for any special provisions to apply to the foreclosure sale. It is also possible that since lender's attorneys charge on average between $800–$850 to handle a foreclosure,[139] clients do not move for any special matters since this would result in additional fees.

This study also collected data to determine the extent to which *BFP v. Resolution Trust Corporation*[140] affected third party bidding at foreclosure sales and the amount bid at foreclosure sales. Before *BFP*, 11.2% of the 1993 judicial sales cases had a third party as the successful bidder, compared to only 9.6% of the 1994 judicial sales cases after *BFP*.[141] The median amount bid for both the 1993 judicial sales cases and the 1994 judicial sales cases was 100% of the final judgment.[142] In addition, the ratio of resale price to amount bid at the judicial sale, the 1993 and 1994 data was similar regarding the ratio of resale price to final judgment, the percentage of cases with a deficiency amount and higher resale price than the judicial bid price, and the percentage of judicial sales with a deficiency amount bid.[143] Thus the *BFP* decision appears not to have had a material impact on the level of third party bidding, the amount bid, or the degree to which lenders or third parties make a low bid and then resell for a profit.

This study also collected data to determine whether the *BFP* case affected the number of borrowers who would file (or have filed against them) a bankruptcy action after the foreclosure sale to challenge the sale as a fraudulent conveyance. The data collected reflects that the borrower filed or had filed

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139. *See infra* app. B, fig. 14.

140. 511 U.S. 531 (1994).

141. *See infra* app. A, ¶ 4(g).

142. *See infra* app. A, ¶ 4(a).

143. *See infra* app. A, ¶ 4. The percentage of judicial sales cases in which a surplus amount was bid differed significantly between the 1993 and 1994 cases. While no lender in either sample bid a surplus amount, third parties bid a surplus in 14 of the 18 (77.8%) 1993 third party resale cases and did so in only 4 of the 11 (36.4%) 1994 third party resale cases. However, the 1994 percentage figure may be skewed by the fact that the base sample was much smaller in 1994 than in 1993, especially since only one of the 18 bid prices was unavailable in the 1993 cases, while 3 of the 11 bid prices were unavailable in the 1994 cases.

The percentage of deficiency cases where the lender sought a deficiency judgment also differed between the 1993 and 1994 judicial sales cases. In 11 of 39 judicial cases in 1993 with a deficiency (28.2%), the lender sought a deficiency judgment (in 4 of the 39 cases this information was not available). In 4 of the 31 judicial sales cases in 1994 with a deficiency (12.9%), the lender sought a deficiency judgment.

against her a bankruptcy action after the foreclosure sale in only seven of the 1993 judicial sale cases and in only four of the 1994 judicial sales cases. Further, in none of these seven cases did the court files reflect that the borrower or a junior lender challenged the foreclosure sale as a fraudulent conveyance.[144] Although there were nearly twice as many post-foreclosure bankruptcy filings among the 1993 sample than among the 1994 sample, it would not be appropriate to make a sweeping conclusion as to the impact of the *BFP* case on bankruptcy filings based on a statistic encompassing such a small number of cases. Both before and after the *BFP* case, the percentage of cases in which a bankruptcy filing was made after the foreclosure sale was very small.[145] Based on this data, it may be safe to conclude that the *BFP* case may have led to a small reduction in the number of bankruptcy filings. This lower amount might be due to other factors as well. The absence of challenges to foreclosure sales as fraudulent conveyances in any of the 1993 and 1994 cases studied may indicate that the bankruptcy filing was not motivated by a desire to challenge the foreclosure sale as a fraudulent conveyance.

B. Comparing the Results of This Study With the Results in Prior Foreclosure Studies

Among the various empirical studies of foreclosures,[146] the one closest in time and scope to this study was Steven Wechsler's 1979/1980 study of foreclosures in Onondaga County, New York.[147] According to Wechsler's data, mortgagees made profits in half of the resales and suffered losses in the other half, with total losses outweighing total gains and a median loss on resale that was $1,800 greater than the median profit.[148] In this study of foreclosures in Cook County, Illinois in 1993, mortgagees made a profit in approximately 28% of the cases for a median profit of $12,437.35. Mortgagees incurred

144. *See infra* note 210.

145. Post-foreclosure bankruptcy filings occurred in approximately 4% of the 1993 judicial sales cases and in approximately 3% of the 1994 judicial sales cases. *See infra* app. A, ¶ 4(v).

146. *See supra* note 3.

147. *See* Wechsler, *supra* note 3.

148. *See id.* at 882.

a loss on resale in approximately 72% of the 1993 cases for a median loss of $21,348.38. Thus, in both studies, lenders lost more money in the aggregate than they made upon resale. As previously discussed, the losses lenders incur through the foreclosure process may then be passed along to all borrowers in the form of higher loan fees or interest rates.

According to the data collected by Wechsler, in fourteen of the fifteen cases in Onondaga County in which a third party resold the property, the third party did so at a profit, with profits ranging from $7,000 to $23,000.[149] In this study of 1993 foreclosures in Cook County, Illinois, third parties who resold did so at a profit in nine of the twelve resale cases, with a median profit of $25,971.50, and did so at a loss in one of the twelve resale cases, with a loss of $12,750. Thus in both studies, in the vast majority of cases, third parties who resold did so at a large profit.

Another notable similarity between the results of two studies is that in both studies, the mortgagee was the successful bidder at the sale in the vast majority of the cases. In Wechsler's study, the mortgagee was the purchaser in three-quarters of the foreclosure sales,[150] and in this study the mortgagee was the successful bidder in more than 80% of the cases.[151]

These similarities in results reflect a pattern in judicial foreclosure sales, indicating that the results of this study were not an aberration. The results differed in some interesting ways,[152] but these differences do not detract from the basic similarities.

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149. *See id.* at 883.

150. *See id.* at 875.

151. *See infra* app. A, ¶ 4(g).

152. For example, the New York study noted a much higher number of deficiency bids. *See* Wechsler, *supra* note 3, at 877. This difference is probably due to the requirement to pay transfer taxes in a foreclosure sale in New York—which induces lenders to bid less than the final judgment amount even if the lender does not intend to sue the borrower for a deficiency—while there is no such requirement in Illinois. *See* STATE-BY-STATE DIGEST, *supra* note 14, at 157, 405. The results in this study differed in other ways with the results of the Wechsler study, *supra* note 3, and the Aalberts & Bible empirical study of foreclosures in Louisiana, *supra* note 3. First, only a very small number of deficiency judgments were sought in the New York and Louisiana cases. Only one deficiency judgment was sought in the 94 New York cases with a deficiency bid, *see* Wechsler, *supra* note 3, at 878, and a judgment was sought in only 1.9% of the Louisiana foreclosure suits. *See* Aalberts & Bible, *supra* note 3, at 220. This is small compared to the percentage of pursued deficiencies revealed in the Illinois data—the lender pursued a deficiency action in 11 of the 39 deficiency bids in the 1993 sample and 4 of the 31 deficiency bids in the 1994 sample. *See infra* app. A, ¶ 4(o).

It is illuminating to compare the results in this study with the data collected in studies of Illinois foreclosures conducted at different points throughout this century. The data from a 1933 study reflected that it took approximately two years to complete a foreclosure sale, including a twelve month redemption period after the foreclosure sale,[153] while foreclosures in 1993 and 1994 were typically completed in less than nine months.[154] Another significant difference involves the costs of the foreclosure process. In the mortgage foreclosures examined in 1933, legal fees amounted to over 11% of the debt due[155] and the selling officer's fee as a percentage of each mortgage debt was estimated at 6% of that debt.[156] In contrast, in the 1993 and 1994 cases, legal fees typically amounted to only 1.5% of the final judgment amount and the selling officer's fee was less than 0.5%.[157] These changes may reflect improvements in the foreclosure process since the Great Depression.

The system also operates better today than it did in 1964 and 1974, as evidenced by the percentage of borrowers who are able to prevent a foreclosure sale. As previously mentioned, prior to 1987, the statutory right of redemption in Illinois activated after the foreclosure sale rather than before.[158] Foreclosure data from 1964 and 1974 reflected very few situations where the borrower or a junior lender exercised the statutory right of redemption after the foreclosure sale. In 1964, of the 1,343 foreclosure sales in Cook County, only nineteen owners redeemed their property;[159] in 1974, of the 3,015 foreclosure sales in Cook County, only twenty-four borrowers and four judgment creditors redeemed.[160] Similarly, a study of redemptions in Iowa, where the statutory right of redemption also runs after the judicial sale, reflected that borrowers redeemed in only approximately 10% of the cases.[161] Conversely, the data from this study of foreclosures in 1993 and 1994 reflected a very large percentage of cases in which

153. *See* Carey et al., *supra* note 3, at 599.
154. *See infra* app. B, fig. 15.
155. *See* Carey et al., *supra* note 3, at 602, 623.
156. *See id.* at 607.
157. *See infra* app. B, fig. 12.
158. *See supra* note 77 and accompanying text.
159. *See* Jim Blanco & David Crumbaugh, Note, *Foreclosures, Redemptions, and Homeowners*, 1975 U. ILL. L.F. 335, 351.
160. *See id.* at 351–52.
161. *See* Bauer, *Statutory Redemption Reconsidered*, *supra* note 3, at 350–51.

the borrower utilized the time period afforded by the statutory right of redemption prior to the sale to prevent a foreclosure of the property. In light of this data, one may conclude that the decision in Illinois in 1987 to have the statutory redemption period run before the sale rather than after the sale was a wise one.

C. Accounting for Carrying Costs and Resale Costs: Calculating the Mortgagor's True Equity and the Lender's True Profits or Losses Upon Resale

One way to evaluate the fairness of a foreclosure process is to examine whether the resale amounts within one year after the foreclosure sale equal or exceed the mortgagor's equity in the property. The mortgagor's true equity in the property is not the difference between the fair market value of the property and the outstanding balance of the loan on the date of the foreclosure sale. Rather, it is the difference between the fair market value and said outstanding balance plus the costs the lender will incur in reselling the property. Without accounting for these costs, one does not have an accurate picture of whether a lender (or third party bidder) has made a profit or loss upon resale of the property after the foreclosure sale.

The following costs typically arise when a lender takes over property at a foreclosure sale and subsequently attempts to resell the property: (i) broker's commission; (ii) real estate taxes; (iii) property insurance; (iv) inspection and maintenance; (v) attorney's fees to handle the resale; (vi) closing costs for the resale; and (vii) the loss of interest on the final judgment amount for the period from the foreclosure sale until the resale. This study does not attempt to calculate the actual amounts of these costs for different properties; instead, it attempts to provide a general sense of what these costs might be in a "typical" foreclosure case.[162] This topic is raised

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162. In determining the "typical" case regarding the fair market value of the property and the amount of time likely required to resell the property, it is helpful to look at the statistics generated from this study regarding the median resale price and the average time period before resale. The median resale price was $56,750 (in the 1993 cases in this study, approximately one-quarter of the lenders resold within six months and slightly more than one-half of the lenders resold within one year). The low number of resales within these time frames was surprising in light of the

in this Article not only because these costs have an impact on any evaluation of fairness, but also because these costs are relevant to this Article's proposed reform.

It appears that lenders typically hire a broker to advertise and market the property, usually paying a commission of 6% of the sales price.[163] Usually, the banks also pay (i) approximately $750 for property insurance for each property they take over at foreclosure, (ii) $10 each month to inspect the property and (iii) approximately $300 for maintenance of the property prior to resale.[164] According to one source, it appears that attorneys usually charge about $400 to handle a closing and the other closing costs incurred by the seller (title insurance, recording fees, and transfer stamps) typically amount to approximately $600.[165] Based upon a report issued by the Cook County Clerk's office, the average annual real estate taxes in 1995 for property located in Chicago, Illinois, with a fair market value of $75,000, were $1,962.[166]

If we assume an average fair market value for foreclosed property of $75,000[167] and an average of six months to resell the property,[168] and further assume lost interest based on a rate of eight percent per annum for the six month period, this suggests a figure of approximately $10,500 in total carrying and resale costs for a "typical" resale. This amount is 14% of $75,000. Hence, an estimated 14% of the resale price is consumed in resale and carrying costs. Some of the carrying and resale costs are fixed, while others vary depending on the amount of the resale price and other factors. Because some of the costs are fixed, the percentage of transaction costs will increase for properties which resell at lower amounts, as opposed to properties which resell at much higher amounts.

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data in the Wechsler study showing that approximately half of the lenders had resold within six months and almost 80% had resold within one year. *See* Wechsler, *supra* note 3, at 879. When lenders resell the property on which they foreclosed through a voluntary public auction, they can typically complete the resale in approximately two months.

163. Telephone Interview with Jim Schulte, Vice President, LaSalle Home Mortgage (July 3, 1996).

164. *Id.*

165. Telephone Interview with Lawrence Stark, attorney in private practice (July 31, 1996).

166. News Release from the Office of the Cook County Clerk (Aug. 6, 1996) (reporting the average Chicago taxpayer's real estate tax bill in 1995).

167. This figure is somewhat higher than the median resale prices in this study.

168. This figure is lower than the data from this study, but closer to the average time needed to complete a commercially reasonable public auction.

This point could be addressed in any legislative proposal that attempts to calculate these costs as a percentage of the sales price.

IV. REFORMING THE FORECLOSURE PROCESS

A. Bifurcating the Foreclosure Process to Promote the Interests of Lenders and Borrowers

The data collected in this study and in other studies[169] suggests that, overall, the judicial foreclosure process in Illinois[170] works adequately to balance both the lender's interest in an efficient loss recovery system and the borrower's interest in protecting her equity in the property. In the vast majority of cases, the borrower protects her equity in the property either by reinstating the loan or by redeeming the property prior to the foreclosure sale. When a property actually goes through a foreclosure sale, the median resale price of the property is less than the final judgment amount (a loss rather than a profit occurs upon resale), suggesting that the borrower had no equity in the property. These two facts suggest that, most of the time, the foreclosure process permits the borrower to protect her equity in the property.

The data also reflects, however, that in a small percentage of cases, lenders and third party scavengers are able to purchase property at foreclosure sales well below its fair market value and then resell the property soon after, reaping large profits.[171] Furthermore, since the data reflects that in the vast majority of cases where the property actually goes to foreclosure sale, the borrower has no equity in the property to protect,[172] the current system is inefficient because it requires cost expenditures with no corresponding benefit to borrowers or lenders.

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169. *See supra* note 3.

170. Unlike a power of sale, the Illinois judicial foreclosure process requires court intervention, and provides for a statutory redemption period before the foreclosure sale rather than after the sale (with a mere 30-day redemption period after the sale in limited circumstances). The judicial foreclosure process in Illinois is similar to the judicial foreclosure processes in many other jurisdictions. *See, e.g.*, STATE-BY-STATE DIGEST, *supra* note 14, at 91 (Delaware), 108 (Florida), 167 (Indiana); *see also supra* Part I.B, I.D.

171. *See supra* note 109 and accompanying text.

172. *See supra* Part III.A.

As a means to retain that which works in the judicial foreclosure system and to replace that which does not, this Article recommends a bifurcated foreclosure system for residential mortgages.[173]

Under the proposed bifurcated foreclosure system, foreclosures would be either judicial strict foreclosures or judicial foreclosures with a required commercially reasonable sale of the property.[174] After 1) the foreclosure is filed and the mortgagor is served, and 2) the expiration of a ninety day period to reinstate the loan, the court will order an appraisal of the value of the mortgaged property that must be completed before the judgment of foreclosure (the borrower would have a four-month period to redeem before the lender could obtain the judgment of foreclosure).[175] If the appraisal reflects a property value which is less than the amount of debt due on the date of the judgment of foreclosure plus a percentage of

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173. This proposal to reform the foreclosure process is limited to residential mortgages for several reasons. First, the data in this study and in other studies which support this proposal is based overwhelmingly on residential foreclosures rather than commercial or agricultural ones. Second, the factors involved in a commercial mortgage loan are more complicated than the factors involved in a residential mortgage loan. Third, the borrower in a commercial mortgage loan is usually more sophisticated than the borrower in a residential loan, and frequently utilizes more protective bankruptcy provisions when faced with a foreclosure action.

174. *Cf.* Durham, *supra* note 125, at 509; Johnson, *supra* note 125, at 963. Durham recommends a bifurcated foreclosure process in which a strict foreclosure would occur if the debt exceeded the appraised fair market value of the property, but a judicial sale would occur if the value of the property exceeded the amount of the debt. *See* Durham, *supra* note 125, at 509. The proposal in this Article is similar to Durham's proposal, with two notable exceptions. First, under Durham's proposal, if the property value exceeded the amount of the debt, there would be an ordinary public foreclosure sale as opposed to the commercially reasonable sale proposed in this Article. *See* Durham, *supra* note 125, at 509. Second, the proposal in this Article requires that the value of the property exceed the amount of the debt by a specified percentage that reflects the anticipated costs to carry and sell the property.

Johnson proposes that upon the commencement of a foreclosure proceeding, a trustee should be appointed to decide if the mortgagor has any equity in the property. *See* Johnson, *supra* note 125, at 963. If there is equity, then the foreclosure action would be stayed and the trustee would have the duty to sell the property through the same methods used in standard retail real estate. If there is no equity in the property, however, Johnson proposes that the foreclosure proceed in the ordinary fashion (i.e., not a strict foreclosure). *See* Johnson, *supra* note 125, at 963. This Article combines the best features of both of these proposals.

175. According to the data in this study, it takes approximately four months from the filing of the complaint to get a judgment. *See infra* app. B, fig. 15. Appraisals typically can be performed in a few days. Even assuming that the appraisal companies are busy, one month is more than sufficient time to complete the appraisal and, therefore, this requirement should not add to the time it takes to obtain a judgment of foreclosure. One month is the period from the expiration of the right of reinstatement until the expiration of the four-month redemption period.

the judgment amount (representing the costs of sale) as set forth in the statute,[176] the property is deeded to the lender on the date of the judgment of foreclosure. This is a judicial strict foreclosure with no public sale. The statute would require the passage of a four-month period from service of summons to the mortgagor[177] before the judgment of foreclosure could occur and would give no discretion to a court to postpone the judgment date without agreement of the borrower and lender.[178] The borrower would have a statutory right of reinstatement which could be exercised within ninety days from service to the borrower. There would be, however, no right of redemption after the judgment of foreclosure.[179]

If, however, the amount of the appraisal exceeds the judgment amount by more than the specified percentage, then the

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176. The percentage set forth in the statute would be based upon studies collecting data on the median costs lenders incur to carry the property, the median time period for carrying property until it can be sold in a commercially reasonable manner, and the median costs of the sale of the property. This Article roughly estimates this percentage at 14% based upon an assumed carrying time of six months and an assumed median resale price of $75,000. *See supra* Part III.C. A more sophisticated analysis should be performed for purposes of any specific legislative enactment rather than the primitive analysis employed in this Article.

177. In Illinois, the median time period for the borrower to exercise the right of redemption was approximately four months in the 1994 sample and nine months for the 1993 sample; the median time it took for the borrower to reinstate the loan for both samples was approximately four months. While one might interpret the 1993 sample's nine-month figure as indicating a need for a redemption period longer than four months, the 1994 data in fact reflects the adequacy of a four month period. In addition, some borrowers who took nine months or more to redeem the property may have been able to move more quickly but did not do so because the statutory redemption period was seven months. Based on the data regarding the median time period for borrowers to redeem the property in the 1993 sample, it appears that lenders will frequently work with borrowers to redeem the property from foreclosure even after the statutory redemption period has expired.

178. Practitioners in Connecticut have complained that completing the strict foreclosure process takes too long, sometimes as long as 18 months. Telephone Interview with Marc Friedman, Partner, Dechert, Price & Rhoads (Aug. 2, 1996). The reason for the delay is that the expiration of the borrower's redemption period is not a firm deadline. Connecticut law gives the court full discretion to set the redemption deadline beyond a twenty day period after the judgment of foreclosure. *See* Metropolitan Life Ins. Co. v. Bassford, 120 Conn. 384 (1935).

179. The Vermont foreclosure statute provides for a six-month right of redemption after the judgment of strict foreclosure which may lead to delay. *See* VT. STAT. ANN. tit. 12, § 4528 (1973). As previously discussed, *see supra* Part III, the data reflects that borrowers take better advantage of a redemption right prior to the foreclosure sale rather than after the sale, and the same may well hold true in a strict foreclosure context (especially one which contains the safeguard of requiring an appraisal reflecting insufficient equity in the property as in this proposal). The Vermont statute does not require an appraisal prior to a strict foreclosure, *see* VT. STAT. ANN. tit. 12, § 4531 (Supp. 1996), and presumably for this reason, it provides for a redemption period after the strict foreclosure.

property must be sold in a manner which is commercially reasonable and designed to produce a selling price close to the fair market value of the property. The borrower would have the same ninety day statutory right of reinstatement and four-month redemption period. There would be no right of redemption after the judgment of foreclosure.

Requiring an appraisal that reflects a value of the property that is in excess of the judgment amount is intended to ensure that the borrower has sufficient equity in the property before the lender must undergo the more expensive and time-consuming commercially reasonable sales process. For example, if it becomes apparent that on average it costs a lender 10% of the judgment amount to pay for both performance of the commercially reasonable sale and the costs incurred in carrying the property from the date of the judgment of foreclosure until the time the property sells, then unless the appraisal reflects a value of the property which exceeds 10% of the judgment amount, the borrower does not have any true equity in the property that would merit the more costly process of a commercially reasonable sale. Prior to reforming the foreclosure process, further data should be gathered to determine the typical amount of these costs when calculated as a percentage of the judgment amount.[180] That figure should be utilized in the statute as the amount by which the appraised value must exceed the judgment amount to require the commercially reasonable sale as opposed to a strict foreclosure.

Lenders would benefit from a reform which bifurcates the foreclosure process since the more expensive and commercially reasonable foreclosure process will only be required when an appraisal reflects that the borrower has sufficient equity in the property to merit such a process and the borrower has failed to reinstate or redeem the loan prior to the judgment of foreclosure. According to the data from this study, this should only occur in a minority of the foreclosure cases filed.[181] When the appraisal reflects that the borrower has no equity in the property,[182] the lender will be able to take title to the property in a more cost-efficient manner.

While requiring an appraisal appears to increase the costs of the foreclosure process, the data collected in this study

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180. *See supra* Part III.C for a discussion of these carrying costs and resale costs.

181. *See supra* Part III.A.

182. The data from this study indicates that this should occur in the majority of cases which go to foreclosure sale. *See supra* Part III.A.

shows that the appraisal should actually operate in a manner that reduces instead of adds costs. Apparently, the typical cost of the appraisal is $200 to $300 and takes a few days.[183] If the appraisal shows that the borrower has insufficient equity in the property, the property will be deeded to the lender on the date of the judgment of foreclosure, thereby reducing the time involved by approximately five months and saving over 5% of the judgment amount in costs. This figure is based upon (i) saving approximately 4% in accrued interest and advances that would otherwise accrue during the period from the judgment until the sale and (ii) saving approximately 1% of the judgment amount which would otherwise be expended in connection with costs to perform the public sale. In addition, allowing the lender to retake the property more quickly when the borrower has no equity in the property may also prevent some deterioration of the property that commonly occurs during the foreclosure process.

Borrowers benefit from this bifurcated process because it requires a commercially reasonable sale, and thus a bid price closer to the fair market value of the property, when the borrower has equity in the mortgaged property and is unable to protect her equity by reinstating the loan or by paying off the loan prior to the foreclosure sale. If the property is worth $100,000 and the debt and sales costs total $90,000, the borrower's true equity in the property is $10,000. Under the proposed process, the property would sell at or very near its market value of $100,000. Because of the commercially reasonable sale, the debt would be satisfied and the borrower would receive the net proceeds from the sale.[184] This means that lenders and third parties will be less likely to reap large profits in the occasional situation where the borrower has

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183. Telephone interview with Ron and Sue Becker, Principals of Becker Associates (July 12 and 18, 1996). The appraisal cost depends on the uniqueness of the house. If there are many unique features to the house then the appraisal cost could increase to as much as $600. *See id.*

184. The statute should require both a process by which the borrower would be notified that she is entitled to this surplus amount and a procedure to collect the surplus. Currently in Illinois, when a surplus is bid, the person conducting the sale must advise all parties to the proceeding. It is not clear whether a borrower who is no longer a party to the proceeding will know about the surplus. Usually, the mortgagee's attorney will include the borrower's name on the list of parties to the proceeding supplied to the person conducting the sale. Telephone Interview with Jeffrey Liss, 1981–87 Vice-Chair of the Illinois State Bar Association Real Estate Law Section's Committee that drafted the 1987 amendments to the Illinois Mortgage Foreclosure Act (July 1996).

significant equity in the property but is unable to reinstate or redeem the loan before the foreclosure sale. Furthermore, since the costs to perform the appraisal are relatively minor,[185] an appraisal should not pose a barrier to the borrower's ability to redeem the property prior to the judgment of foreclosure or prior to the commercially reasonable sale, if applicable.

This Article leaves open the issue of recovering a deficiency under the bifurcated foreclosure process for residential loans, mainly because the bifurcated process should on its own work to protect the borrower's equity in the property, making an anti-deficiency action unnecessary. However, some states enact anti-deficiency legislation for other reasons, such as preventing a double loss to the borrower when property values decline generally. The accomplishment of these and other goals are beyond the scope of this Article.

Two basic assumptions must be correct for this bifurcated system to benefit both borrowers and lenders. The first assumption is that a fair and accurate appraisal of the property can be made. By having the court order the appraisal rather than the lender's or borrower's counsel, and by requiring that a licensed residential real estate appraiser follow specific guidelines in preparing the appraisal, a fair and accurate appraisal should result. Such guidelines include making the appraisal a "blind" appraisal, where the appraiser is not given a goal number and is instructed to appraise the fair market value[186] of the property, instead of the value as affected by the

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185. Appraisal costs are less than the combined typical current sales costs for the selling officer and costs to advertise the sale.

186. Market value is defined as:

> the highest price in terms of money which a property will bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each selling prudently, knowledgeably and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby: (1) buyer and seller are typically motivated; (2) both parties are well informed or well advised, and each using what he considers his own best interest; (3) a reasonable time is allowed for exposure in the open market; (4) payment is made in cash or equivalent; (5) financing, if any, is on terms generally available in the community at the specified date and typical for the property type in its locale; (6) the price represents a normal consideration for the property sold unaffected by special financing amounts and/or terms, services, fees, costs, or credits incurred in the transaction.

FNMA-FHLMC, Attachment Form on Real Estate Appraisal Terminology (1975).

foreclosure process.[187] The accuracy of the appraisal will be reduced, however, if the borrower does not allow the appraiser to gain access to the interior of the house. Some sort of deterrent should be established to prevent borrowers from denying appraisers access to the premises (such as allowing the appraiser to presume that the interior is in poor condition) or, the statute should provide for the sheriff's office to assist the appraiser in gaining access to the inside of the house.

The second basic assumption upon which this proposal rests is that general procedures can be established that would provide sales to third parties at the fair market value of the property. Thus, the lender would be paid in full at the sale and would not incur any further costs through marketing and selling the property after the foreclosure sale. The sale could take two possible forms, with the lender having the right to elect between the two. In one form, a broker would be hired to market and advertise the sale in the conventional manner. The buyer would have the opportunity to inspect the property, receive a title commitment, and obtain financing to purchase the property. This procedure would clearly lead to higher costs than the current foreclosure sale process, but should also lead to a sale price at fair market value, especially if the house is vacant (i.e., if the statute requires the borrower to vacate possession shortly after the judgment of foreclosure and to clean up prior to an open house).

A second approach to providing for a commercially reasonable sale would be to conduct a public auction of the property. The auction would have to use procedures similar to those successfully used by independent auction firms to produce sale prices above, at, or close to the appraised fair market value or list price.[188] There are a number of differences between typical foreclosure sales and foreclosure sales handled by independent auction firms. First, independent auction firms advertise and market a large group of homes together and spend much more money on marketing and advertising,

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187. Other potential guidelines include the Uniform Residential Appraisal Report form required by FNMA-FHLMC, and the requirements for appraisals contained in the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (codified as amended in scattered sections of 12 U.S.C.) (FIRREA).

188. According to data on sales conducted for Resolution Trust Company by David Kaufman & Company, the sale price of thirty homes averaged 85% of their appraised value. Telephone Interview with David Kaufman, principal of David Kaufman & Company (July 1996).

around $700 to $1,000 per house.[189] The firms strive to obtain a critical mass of houses (at least twenty to fifty) from many neighborhoods to maximize public interest and to get a large attendance at the public sale. There is a thirty to forty-five day period to show the house. Prospective buyers can inspect both the property and a form real estate contract. The property is sold "as is." The bidder must put down at least 1 to 2% of the purchase price in order to bid and the successful bidder has thirty days after the public sale to pay the remaining portion of the price; if she fails to pay the balance she will lose her deposit. Brokers are invited to participate in the process and earn a fee if they attract a successful bidder. The auctioneer is licensed (trained in the art of calling for bids), and can stimulate the level of bidding. The independent auction firm typically charges a commission of between 5 to 6% to market, advertise, show, and sell a group of twenty to fifty homes. Similar standards could be developed and enacted for the new foreclosure sale procedure to achieve a commercially reasonable sale and yield higher bids.

Offering lenders a choice between at least two methods of foreclosure sale (either a conventional broker sale or an independent auction-style public sale) is desirable as a means of stimulating competition among providers of this service, in order to keep costs down and sales up. The reduced charge of the sheriff's office shows the impact of the 1987 reforms allowing competition. Furthermore, the Illinois experience demonstrates that the commercially reasonable sales process should be required by law, rather than by a measure for which the lender or borrower may choose to petition.[190]

One problem may still arise in obtaining a fair market bid using either of these two commercially reasonable sales methods. If the borrower retains title and possession of the property between the judgment of foreclosure and the sale, the borrower may bar access to the premises and may commit acts of waste on the property. Although this would be irrational (since the commercially reasonable sale is a means to protect the borrower's equity in the property and to reduce any deficiency) it is conceivable that not all borrowers would view the forced sale of their houses as a process with which they should cooperate. For this reason, the borrower should be

189. *See id.*

190. *See supra* note 137 and accompanying text.

required to vacate the house within a short period after the judgment of foreclosure.

B. Comparing the Bifurcated Reform Proposal to Other Reform Proposals

Lenders seeking reform of the foreclosure process typically desire a non-judicial power of sale because it is often performed more quickly and cheaply than a judicial foreclosure. As previously discussed, those who wish to protect the interests of borrowers typically seek reforms which make the sale more commercially reasonable.

While a power of sale can be structured to be quick and cheap, taking only two to four months, the fact that this process allows foreclosure on someone's home without court enforcement of contract rights makes it appear unfair. The potential for abuse is particularly high because a court is not involved.[191] The power of sale process is unfair because the burden of proof shifts to the borrower, who must bring a court action to enjoin the sale and show that the lender is not entitled to the power of sale.[192] Furthermore, there is no reason to believe that a power of sale, which does not require a commercially reasonable sale, will prevent occasions in which the lender or a third party is able to resell the property for a large profit. If it were possible to reduce the time and costs involved in the process while still protecting the borrower's equity in the property, this would be preferable to the more draconian power of sale that would lead to inequitable results in a small percentage of cases.

On the other hand, the data from this study suggests that the borrower seldom has any real equity in property which goes to foreclosure sale. In cases where the debtor has no real equity in the property, it would be inefficient to require the more expensive and time consuming commercially reasonable

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191. It is interesting to note that the borrower did not raise a defense to the foreclosure suit in any of the 1994 cases and raised a defense in only two of the 1993 cases examined in this empirical study. *See infra* app. A, ¶ 5(e). In each of these cases, the default was a monetary default rather than a non-monetary default.

192. *Cf.* BLACK'S LAW DICTIONARY 1172 (6th ed. 1990) (describing a contractual right of the mortgagee to sell mortgaged property without a court order).

sale process.[193] In such cases, requiring a redemption period of four months and a strict foreclosure with no right of redemption thereafter is fairer and more efficient than the typical nine month process needed to perform a judicial foreclosure sale. The savings which can be achieved by permitting a shorter and less expensive strict foreclosure in those cases will then permit the added expense of requiring a commercially reasonable sale in the less frequently occurring cases in which the debtor has real equity in the property but is unable to reinstate or redeem the loan.

CONCLUSION

This Article has followed the advice of Justice Holmes to "look the facts in the face"[194] in its assessment of how well or how poorly the foreclosure system operates and in proposing reforms. This empirical study has confirmed some assumptions and disproved others regarding the fairness and efficiency of the judicial foreclosure sale process. The data from this study reflects a foreclosure system that typically operates to protect the borrower's equity in the property. According to this study, the borrower is able to avoid the foreclosure sale and protect her equity in the property in approximately two-thirds of the foreclosure cases filed. In the vast majority of foreclosure sales, the lender is the successful bidder and resells the property for a loss. Occasionally third parties and

193. Theoretically, if a foreclosure sale is commercially reasonable, the lender will always achieve the fair market value of the property through that process. In that case, the lender could rely on the foreclosure sale, rather than subsequently being forced to resell the house, in order to get the best price possible for the property. Hence, the lender should always be willing to submit to a commercially reasonable sale, whether or not the debtor has real equity in the property.

This argument relies too much on the unknown effects of the statutory creation of a commercially reasonable sale process. If empirical data indicates that, under this proposal, the commercially reasonable sale process indeed typically leads to sales at prices equal to or better than those that lenders could achieve if unconfined by statutory requirements, then lenders could elect to avail themselves of the commercially reasonable sale process created by statute.

Competition leads to better results for the consumer of the service. *See infra* note 215 (discussing the drop in sheriff's fees to perform sales after the introduction of private selling officers). For this reason, this Article recommends that statutory provisions requiring that the foreclosure sale be conducted in a commercially reasonable manner only apply when the debtor has real equity in the property.

194. Holmes, *supra* note 5, at xxxii.

more rarely lenders purchase at the foreclosure sale and resell the property for huge profits. Finally, in a very small percentage of the cases, the borrower is sued on a deficiency even when the property resells for a profit.

The facts uncovered in this study reflect the possibility of improving the foreclosure process. The conventional view is that one cannot simultaneously pursue the goals of fairness and efficiency by creating a foreclosure process that both allows the borrower to protect his equity in the mortgaged property and reduces the costs of the process to lenders and non-defaulting borrowers. The data from this study reveals that this conventional wisdom may be incorrect. It is possible to devise a new foreclosure process that can simultaneously achieve both goals.

Under the bifurcated foreclosure system proposed in this Article, if the fair market value of the property does not exceed the final judgment amount plus anticipated carrying and resale costs, then the lender may elect a judicial strict foreclosure in which the borrower has a ninety day period to reinstate the loan and a four-month period to redeem the property before the judgment of foreclosure and judicial decree naming the lender as the new owner of the property (i.e., no public sale of the property occurs). If, however, an appraisal indicates that the fair market value of the property exceeds the final judgment amount plus the anticipated carrying and resale costs, then the lender must proceed under a judicial foreclosure with a commercially reasonable sale of the property. The savings reaped by lenders due to the shorter and less costly strict foreclosure process[195] will more than offset the additional expense of an appraisal which will only be ordered after the ninety day reinstatement period expires. In addition, those few borrowers who have true equity in the property but are unable to reinstate the loan or redeem the property are protected by a required commercially reasonable sale that should produce a sale price at or close to the fair market value of the property.

By creating a foreclosure process that will benefit lenders, non-defaulting borrowers, and defaulting borrowers, this proposal for reform represents the true hypothetical ex ante bargain that borrowers and lenders make. The normative

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195. According to the data collected in this study, such savings should equal approximately 5% of the final judgment amount.

basis for this proposal is founded on the premises that the foreclosure process should operate in as efficient a manner as possible, and that a defaulting borrower should have a realistic opportunity to prevent a forfeiture of his or her equity in the mortgaged property. Congress enacted a federal power of sale process 1) for multifamily residential mortgages held by the Department of Housing and Urban Development (HUD)[196] and 2) for one to four family residential mortgages held by HUD[197] and was considering a federal power of sale process for all mortgage loans held by a federal agency (which could also affect commercial mortgages).[198] The power of sale processes under these laws should reduce the costs of the foreclosure process compared to a typical judicial foreclosure process like that in Illinois, but this power of sale unnecessarily sacrifices the goal of providing the borrower with a meaningful opportunity to prevent a forfeiture of her equity and, by requiring a foreclosure sale, even when the borrower has no equity in the property, the process is inefficient as well. This Article thus recommends that Congress and state legislatures consider meeting the goal of reducing the costs of the foreclosure process for residential mortgages through the proposed bifurcated foreclosure process, since this reform should not only achieve cost savings, but should also operate in a manner that is fairer to borrowers who have defaulted in paying their mortgage loans.

196. *See* Multifamily Mortgage Foreclosure Act of 1981, 12 U.S.C. § 3704 (1994).

197. *See* Single Family Mortgage Foreclosure Act of 1994, 12 U.S.C. §§ 3751, 3754 (1994).

198. *See* 142 CONG. REC. S2127 (daily ed. Mar. 14, 1996) (proposal by Sen. Bond).

APPENDIX A

The following is a summary of key data generated in this study of Cook County, Illinois:

¶ 1. *General Characteristics of the Data Sample*:[199]

a) Type of lenders:
See infra app. B, fig. 1.

b) Percent residential properties:
(93) 159/161, 98.8%
(94) 107/115, 93.0%[200]

c) Percent commercial properties:[201]
(93) 2/161, 1.2%
(94) 7/115, 5.2%
See also infra app. B, fig. 2.

¶ 2. *Timing and Costs to Foreclose*:[202]

a) Timing:
See *infra* app. B, fig. 15, for a summary of the time periods.

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199. A reference to "(93)" denotes the median results from the sample of foreclosures filed in the Chancery Court of Cook County, Illinois, in July 1993; a reference to "(94)" denotes the median results from the sample of foreclosures filed in the Chancery Court of Cook County, Illinois, in July 1994. With the exception of statistics specially tabulated for the cases that were dismissed, the statistics were run only on the judicial sales cases (hence a denominator of 161 for the 1993 cases that went to judicial sale and a denominator of 115 for the 1994 cases that went to judicial sale).

200. Of the 115 cases that went to sale in 1994, one was for the sale of vacant land.

201. Included within the designation "commercial properties" are properties combining an apartment and a store.

202. Uniform data could not be collected for each case. In some cases, the final judgment, or the break down of the various costs, was not available because the "report of sale" was missing from the chancery file. In other cases, the principal amount or information regarding the accrued interest was not available because the lender did not itemize the outstanding amount he was owed. Because uniform information was not available for all cases reaching a judicial sale, the software used to calculate the various statistics skipped over the cases that did not have the required information and consequently did not consider these cases in the calculations.

Due to the variations in the available information for each case, negligible variations exist in the summation of (i) the ratios of the various costs to the final judgment, and of (ii) the cost ratios during the periods from complaint until judgment and from judgment until judicial sale. Consequently, the totals of the various costs and the principal amounts do not equal one hundred percent of the final judgment. The calculated ratios or median amounts, however, are an accurate reflection of the information that was available and collected for the cases.

b) Costs:
See *infra* app. B, fig. 12, for the percent of costs relative to final judgment;
See *infra* app. B, fig. 13a, for a comparison of costs to final judgment (from default until judgment);
See *infra* app. B, fig. 13b, for a comparison of costs to final judgment (from judgment until judicial sale); and
See *infra* app. B, figs. 14, 14a, and 14b for a comparison of costs by dollars.

¶ 3. *Data of the Cases in Which the Borrower Avoided a Non-Consensual Foreclosure Sale*:
a) Percent of cases dismissed:[203]
(93) 287/448, 64%
(94) 307/422, 73%
See infra app. B, fig. 3–9.[204]
b) Percent of consent foreclosures:[205]
(93) 6/44, 1.3%
(94) 1/422, 0.2%
c) Time period after the complaint that the right of reinstatement was exercised:
(93) 139 days
(94) 112 days

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203. Some of these cases were dismissed because the mortgagor filed for bankruptcy, staying the foreclosure proceeding. These cases were automatically stayed at the time of data collection. Some automatic stays may have been lifted after data collection was complete, and some cases may have subsequently proceeded to the judicial sale. This study classifies these foreclosure cases as dismissed because they were dismissed in fact, and because the borrower has the opportunity under bankruptcy law to protect any equity he or she has in the mortgaged property.

204. In reviewing figures 5 and 6, one may wonder why the number of redemption cases does not include cases in the categories listed as "sold by defendant" or "refinance," both of which are examples of a mortgagor's redemption right. These cases are categorized separately because the court file lacked information indicating the cases in which a defendant refinanced or sold the property. When the court file did not reflect a foreclosure sale, this study investigated other sources to determine that a refinance or sale had occurred.

205. Under the Illinois Mortgage Foreclosure Act, once the foreclosure action has commenced, the mortgagor and mortgagee can agree to a "consent foreclosure," whereby the mortgagor expressly consents in writing to the entry of a judgment without the right of reinstatement or redemption and the mortgagee consents and agrees to waive the right to a deficiency judgment. *See* 735 ILL. COMP. STAT. 5/15-1601(c) (West 1994).

d) Time period after the complaint that the right of redemption was exercised:
(93) 291 days
(94) 120 days

¶ 4. *Data Relating to Bidding at the Foreclosure Sale, Deficiencies, and the Resale of the Property*:

a) Ratio of bid amount to outstanding debt at the date of the judicial sale:
(93) 100%
(94) 100%

b) Ratio of final judgment to the original mortgage amount:
(93) 122.25%
(94) 121%

c) Ratio of resale price[206] to bid at the judicial sale:
(93) 102.49%
(94) 103.65%

d) Ratio of resale price to final judgment:
(93) 85.13%
(94) 83.98%

e) Percent of all judicial sales cases in which a deficiency amount was bid and the property resold for a higher price than the judicial bid:
(93) 10/161, 6.21%
(94) 8/115, 6.95%

f) Ratio of cases with deficiency amount and higher resale price than the judicial bid price to all cases with a deficiency amount bid:
(93) 10/39, 25.6%
(94) 8/31 25.8%

206. As previously mentioned, the data relating to resale prices could not be calculated for those resales which were exempt from the payment of transfer taxes. Loans insured by HUD and the Veteran's Administration comprised 64 of the 1993 judicial sales cases and 16 of the 1994 judicial sales cases. Thus, these exempt resale cases, and any other resale cases in which we could not ascertain the level of profit or loss upon resale, were excluded from the calculation of profits or losses upon resale.

g) Winning bidder:

	1993		1994	
% foreclosing lender	136/161	84.4%	102/115	88.7%
% third party	18/161	11.2%	11/115	9.6%
% defendant	1/161	0.6%	0/115	0.0%
% subsequent lienholder	6/161	3.7%	1/115	0.9%

See also infra app. B, figs. 10, 11.

h) Percent of sales confirmed:
(93) 161/161, 100%
(94) 115/115, 100%

i) Percent of sales with deficiency amount bid:
(93) 39/161, 24.2%[207]
(94) 31/115, 27.0%[208]

j) Percent of deficiency amounts bid by foreclosing lender:
(93) 36/39, 92.3%
(94) 28/31, 90.3%

k) Percent of deficiency amounts bid by third party:
(93) 3/39, 7.7%
(94) 3/31 9.7%

l) Percent of sales with surplus:
(93) 19/161, 11.8%[209]
(94) 5/115, 4.3%

m) Percent surpluses bid by foreclosing lender:
(93) 0/19, 0%
(94) 0/5, 0%

n) Percent surpluses bid by third party:
(93) 14/19, 73.7% (4/19 junior lienholder, 1/19 defendant)
(94) 4/5, 80.0% (1/5 junior lienholder)

o) Percent of deficiency bid cases where the lender sought deficiency judgment within one year:
(93) 11/39, 28.2%
(94) 4/31, 12.9%

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207. In 12 of the 161 sales in 1993, we could not ascertain the amount bid at the judicial sale.

208. In 27 of the 115 sales in 1994, we could not ascertain the amount bid at the judicial sale.

209. *See supra* note 207.

p) Percent of all judicial sales cases where the lender sought a deficiency judgment within one year:
(93) 11/161, 6.83%
(94) 4/115, 3.48%

q) Percent of judicially sold properties that were resold (by the mortgagee, third party or junior lienholder) within six months:
(93) 41/161, 25.5%
(94) 32/115, 27.8%

r) Percent of judicially sold properties that were resold (by the mortgagee, third party or junior lienholder) within one year:
(93) 94/161, 58.4%
(94) 42/115, 36.5%

s) Percent of cases where the foreclosing party (mortgagee only) has not sold the property after six months:
(93) 100/136, 73.5%
(94) 74/102, 72.5%

t) Percent of cases where the foreclosing party (mortgagee only) has not sold the property after one year:
(93) 58/136, 72.5%
(94) 64/102, 62.5%

u) Percent of borrowers in cases which went to foreclosure sale who file or have filed against them a bankruptcy prior to the foreclosure sale:
(93) 60/161, 37.27%
(94) 35/115, 30.43%

v) Percent of borrowers who file or have filed against them a bankruptcy action after the foreclosure sale (up to one year after the foreclosure sale):
(93) 7/161, 4.35%
(94) 4/115, 3.48%

w) Percent of borrowers who file or have filed against them a bankruptcy action after the foreclosure sale (up to one year after the foreclosure sale) where the foreclosure sale is challenged as a fraudulent conveyance:[210]

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210. Although a review of the bankruptcy court files disclosed no claims that the foreclosure sales were fraudulent conveyances, in one of the 1993 cases and in two

(93) 0/67, 0%
(94) 0/39, 0%
See *infra* app. B, fig. 16, for additional information on judicial sales cases where the mortgagor filed a bankruptcy action prior to or within one year of the judicial sale.

x) Percent of all judicial sales cases where the lender made a profit upon a resale of the property[211] (i.e. the resale price exceeded the final judgment amount) or a third party bidder made a profit upon a resale (i.e. the resale price exceeded the amount bid):
(93) 20/161, 12.4%
(94) 4/115, 3.5%[212]

y) Percent of all judicial sales cases where the lender or a third party bidder made a loss upon resale:
(93) 29/161, 18.0%
(94) 15/115, 13.0%[213]

z) Percent of all judicial sales cases where the property did not resell within one year or the resale price was not ascertainable:
(93) 67/161, 41.6%
(94) 68/115, 59.1%[214]

¶ 5. *Data on Miscellaneous Matters*:

a) Percent of cases that use special features other than appointment of selling officer:
(93) 0/111, 0%
(94) 0/115, 0%

b) Percent of cases where a selling officer was appointed:
(93) 105/161, 65.2%
(94) 77/115, 67.0%

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of the 1994 cases the files were being processed for delivery to a warehouse and therefore were not available for review.

211. The percentages in subparagraph (x) are based upon resales that occurred within one year of the foreclosure sale.

212. In the 1994 resale cases, there were eleven third party bidders. In six of these cases the purchaser did not resell, in two of these cases the resales were exempt from the payment of transfer taxes, and in three of these cases the information needed to calculate profit or loss was unavailable.

213. *See supra* note 212.

214. The information was unavailable in five cases.

c) Percent of cases sold by the sheriff:
(93) 56/161, 34.8%
(94) 38/115, 33.0%
d) Percent of cases that are monetary defaults:
(93) 161/161, 100%
(94) 115/115, 100%
e) Percent of cases in which the borrower raised a defense:
(93) 2/161, 1.2%
(94) 0/115, 0%
f) Percent of strict foreclosures:
(93) 0/61, 0%
(94) 0/15, 0%

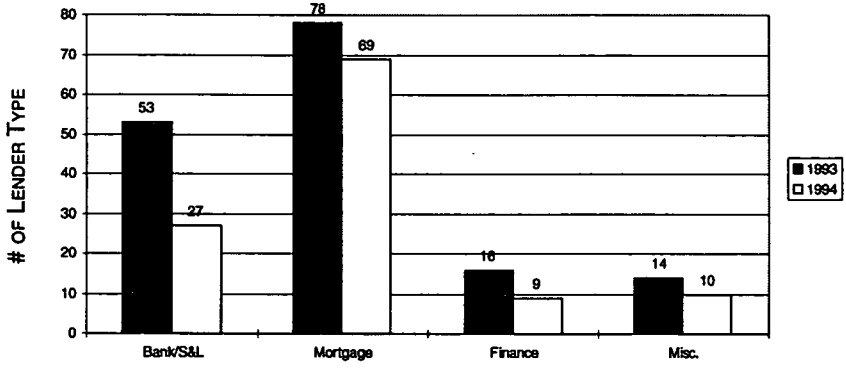
¶ 6. *Comparisons of Results Utilizing a Specific Factor as the Distinguishing Feature*:[215]
Commercial properties v. residential properties:
See infra app. A, fig. 17.

215. Data summarized here includes a comparison of the July 1993 foreclosures with the July 1994 foreclosures, as do most of the graphs in appendix B. A comparison of cases in which a selling officer was appointed to cases in which the sheriff's office was utilized illustrates that the costs of conducting the judicial sale were not affected and that the amount of time required to conduct the sale did not differ. It should be noted, however, that prior to 1987, the sheriff's office typically charged $750 to conduct a foreclosure sale. The sheriff's office has since lowered its rate to compete with the private companies who charge $250. Since the 1993 sample had only two cases and the 1994 sample had no cases where the borrower raised a defense, a comparison based on this feature could not be made.

APPENDIX B

FIGURE 1

SUMMARY OF TYPE OF JUDICIAL SALE LENDER

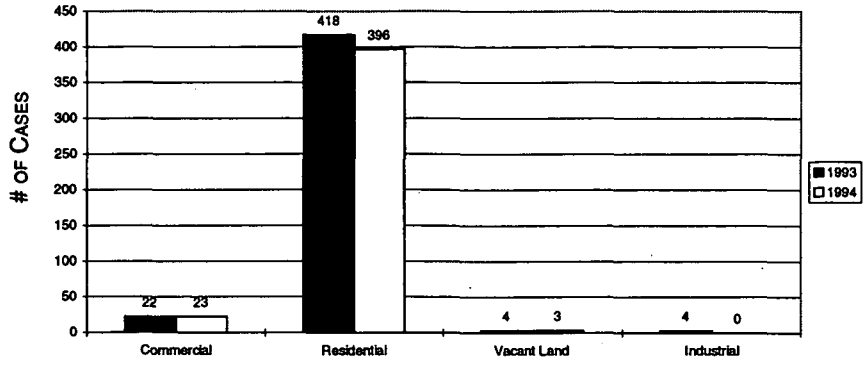


TYPE OF LENDER

	1993	1994
Bank/S&L	53	27
Mortgage	78	69
Finance	16	9
Misc.	14	10
Total	161	115

FIGURE 2

PROPERTY TYPES OF ALL CASES

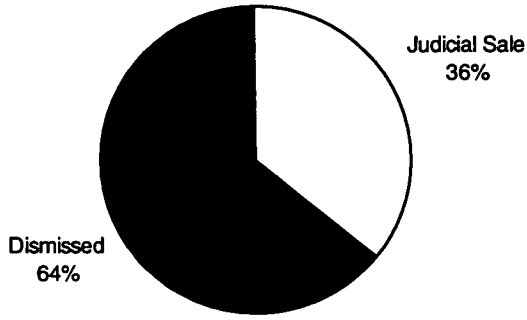


TYPE OF PROPERTY

	1993	1994
Commercial	22	23
Residential	418	396
Vacant Land	4	3
Industrial	4	0
Total	448	422

FIGURE 3A

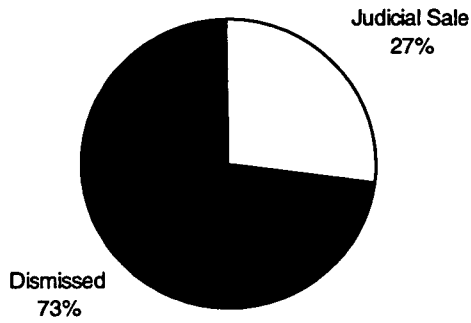
1993 JUDICIAL SALE TO DISMISSED CASES COMPARISON



	1993
Judicial Sale	161
Dismissed	287
Total	448

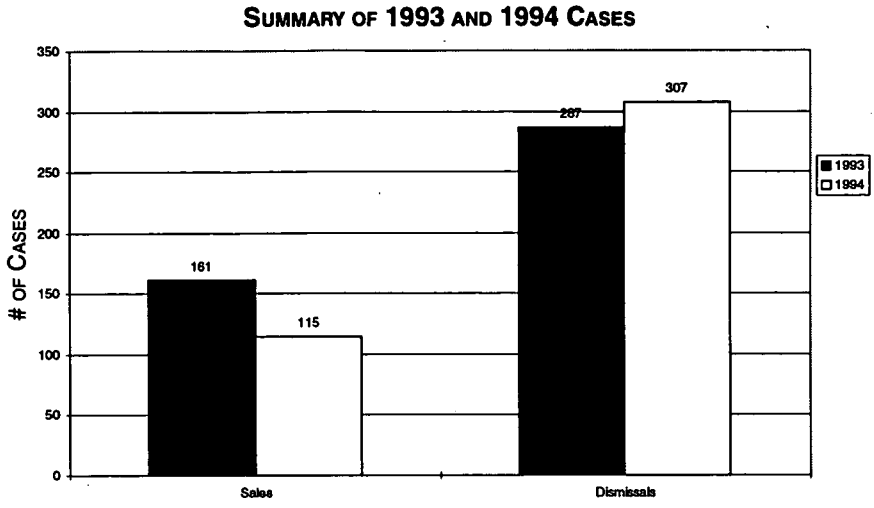
FIGURE 3B

1994 JUDICIAL SALE TO DISMISSED CASES COMPARISON



	1994
Judicial Sale	115
Dismissed	307
Total	422

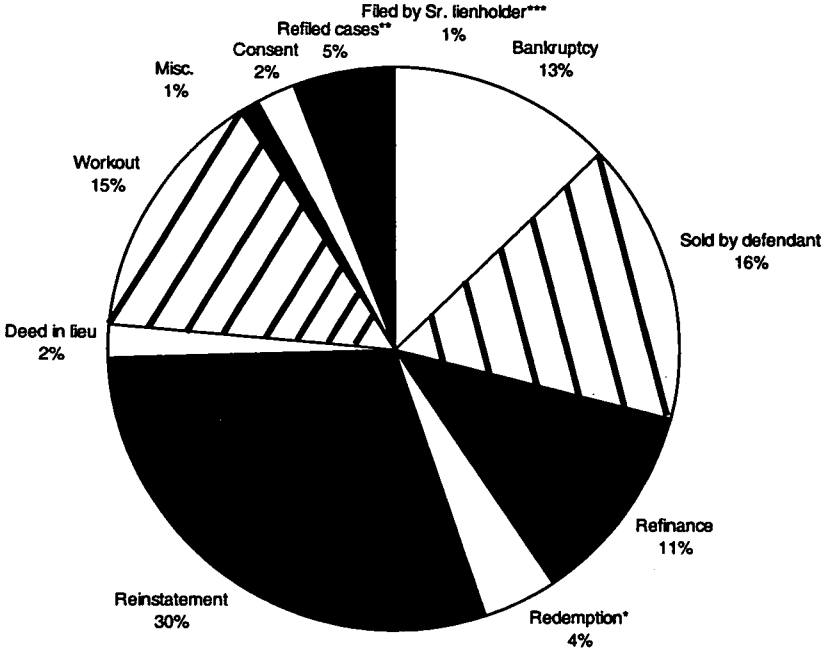
FIGURE 4



	1993	1994
Sales	161	115
Dismissals	287	307
Total	448	422

FIGURE 5

1993 DISMISSED CASES



	1993
Bankruptcy	37
Sold by defendant	46
Refinance	33
Redemption*	12
Reinstatement	86
Deed in lieu	5
Workout	42
Misc.	3
Consent	6
Refiled cases**	15
Filed by Sr. lienholder***	2
Total	287

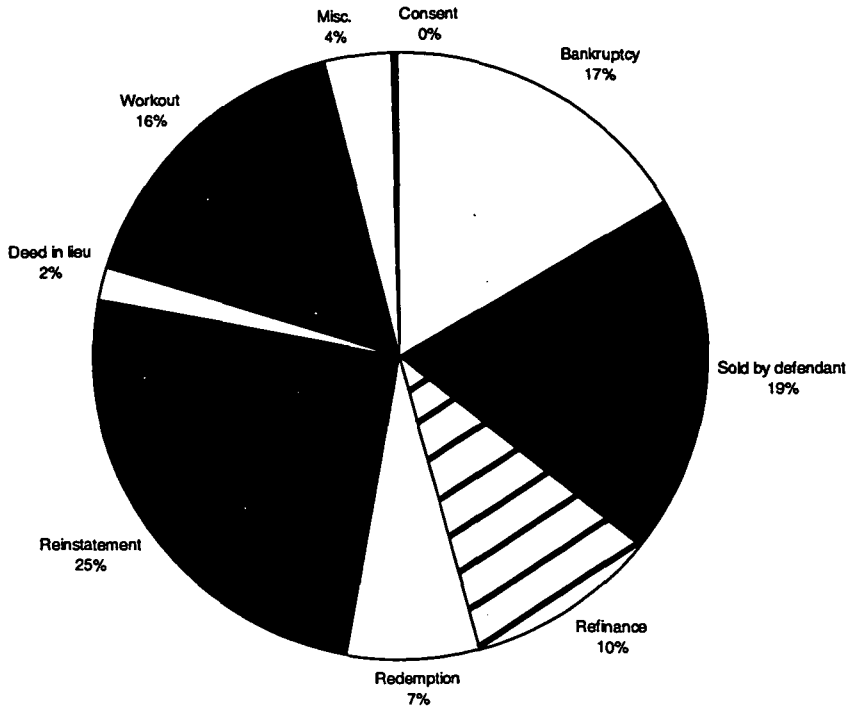
* Mortgagee's motion to dismiss based on mortgagor's exercise of the right of redemption.

** Mortgagee refiled complaint for foreclosure several months later, reflecting an earlier dismissal of the case.

*** Complaint for foreclosure was filed by Senior lienholder, reflecting a dismissal of the foreclosure case by the junior lienholder.

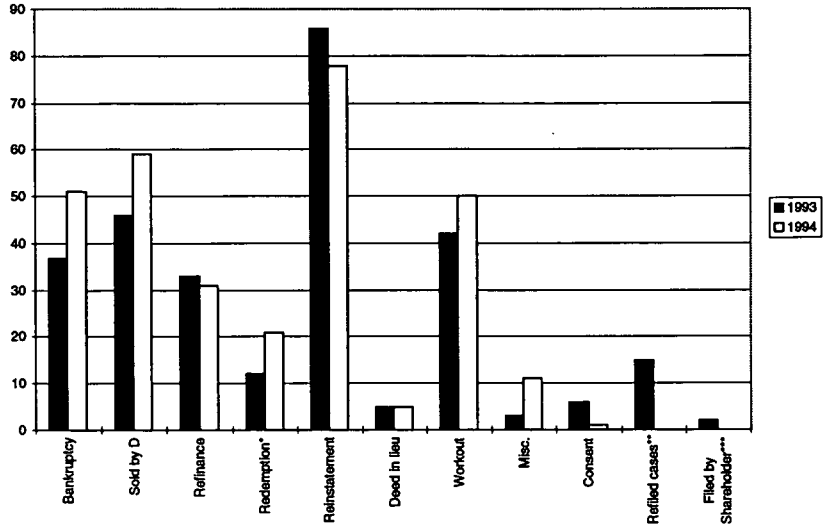
FIGURE 6

1994 DISMISSED CASES



	1994
Bankruptcy	51
Sold by defendant	59
Refinance	31
Redemption	21
Reinstatement	78
Deed in lieu	5
Workout	50
Misc.	11
Consent	1
Total	307

FIGURE 7



TYPE OF CASE

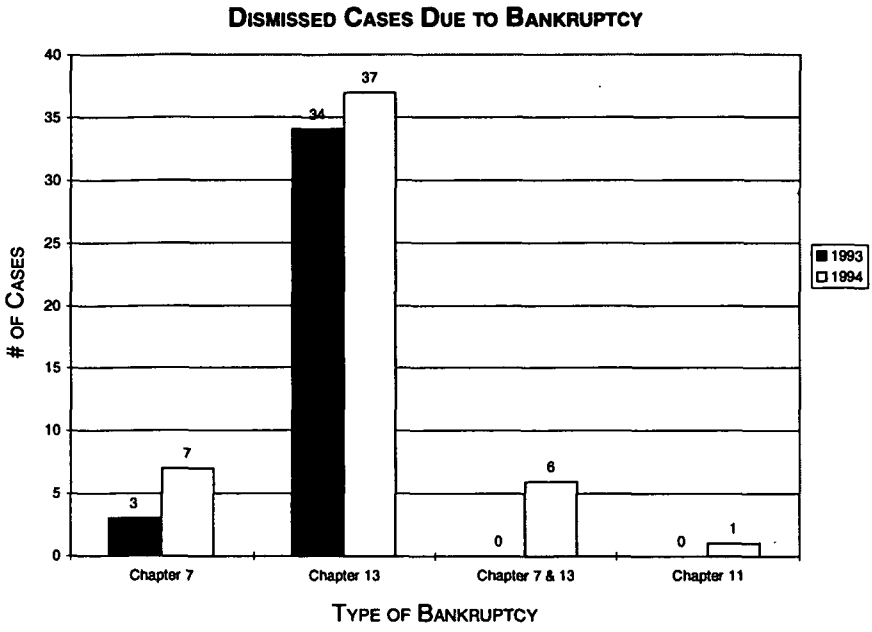
	1993	1994
Bankruptcy	37	51
Sold by D	46	59
Refinance	33	31
Redemption*	12	21
Reinstatement	86	78
Deed in lieu	5	5
Workout	42	50
Misc.	3	11
Consent	6	1
Refiled cases**	15	0
Filed by Shareholder***	2	0
Total	287	307

* See Figure A-5

** See Figure A-5

*** See Figure A-5

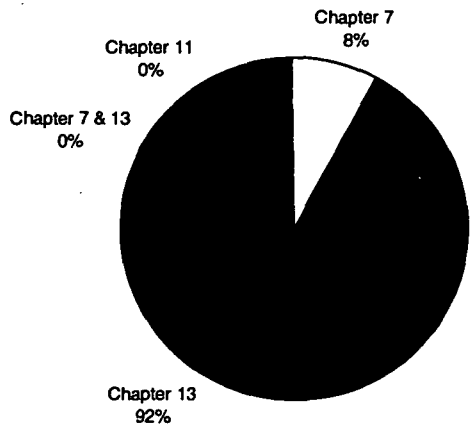
FIGURE 8



	1993	1994
Chapter 7	3	7
Chapter 13	34	37
Chapter 7 & 13	0	6
Chapter 11	0	1
Total	37	51

FIGURE 9A

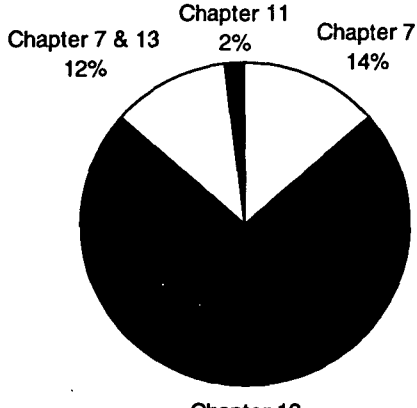
1993 DISMISSED DUE TO BANKRUPTCY



	1993
Chapter 7	3
Chapter 13	34
Chapter 7 & 13	0
Chapter 11	0
Total	37

FIGURE 9B

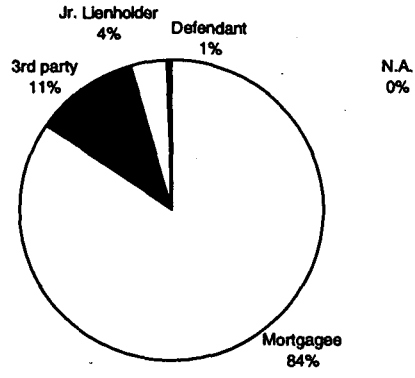
1994 DISMISSED DUE TO BANKRUPTCY



	1994
Chapter 7	7
Chapter 13	37
Chapter 7 & 13	6
Chapter 11	1
Total	51

FIGURE 10A

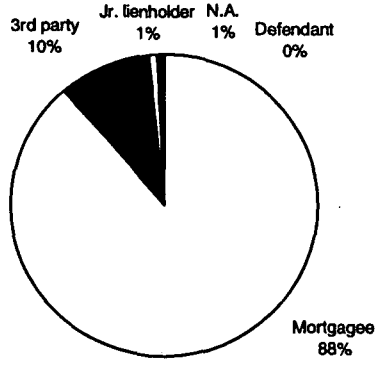
1993 JUDICIAL SALE HIGH BIDDERS



	1993
Mortgagee	136
3rd party	18
Jr. lienholder	6
Defendant	1
N.A.	0
Total	161

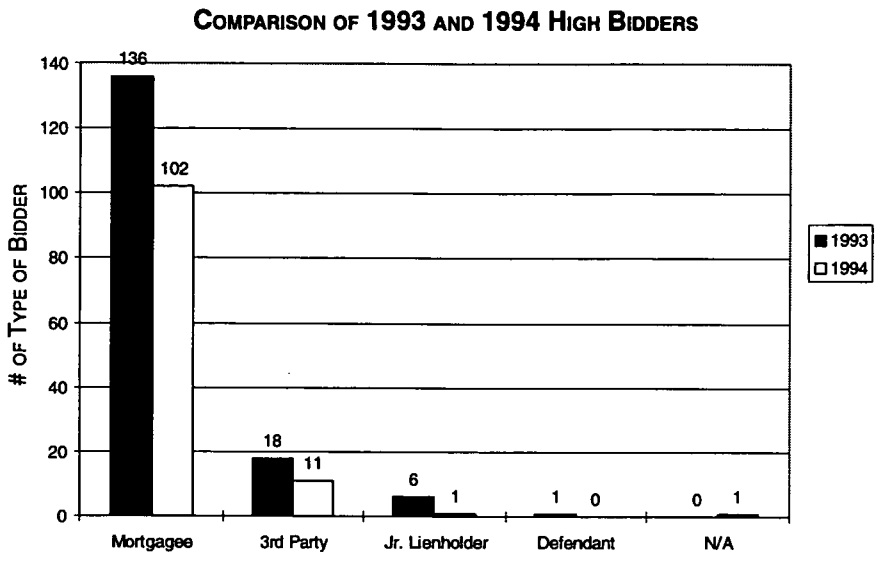
FIGURE 10B

1994 JUDICIAL SALE HIGH BIDDERS



	1994
Mortgagee	102
3rd party	11
Jr. lienholder	1
Defendant	0
N.A.	1
Total	115

FIGURE 11

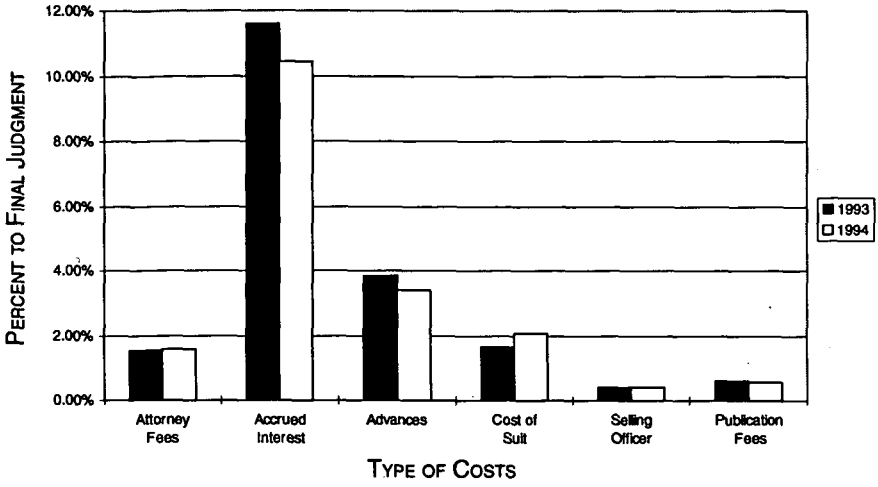


TYPE OF BIDDER

	1993	1994
Mortgagee	136	102
3rd party	18	11
Jr. lienholder	6	1
Defendant	1	0
N.a.	0	1
Total	161	115

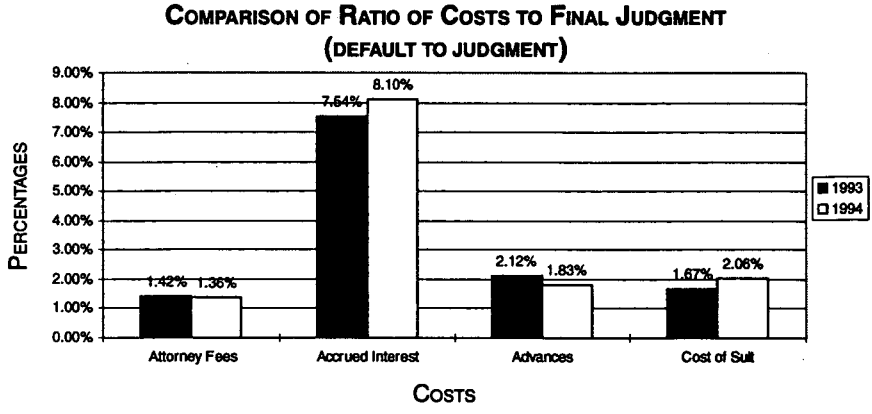
FIGURE 12

PERCENT OF COSTS RELATIVE TO FINAL JUDGEMENT*



	1993	1994
Attorney Fees	1.52%	1.56%
Accrued Interest	11.59%	10.44%
Advances	3.85%	3.41%
Cost of Suit	1.66%	2.05%
Selling Officer	0.40%	0.40%
Publication Fees	0.59%	0.57%

FIGURE 13A

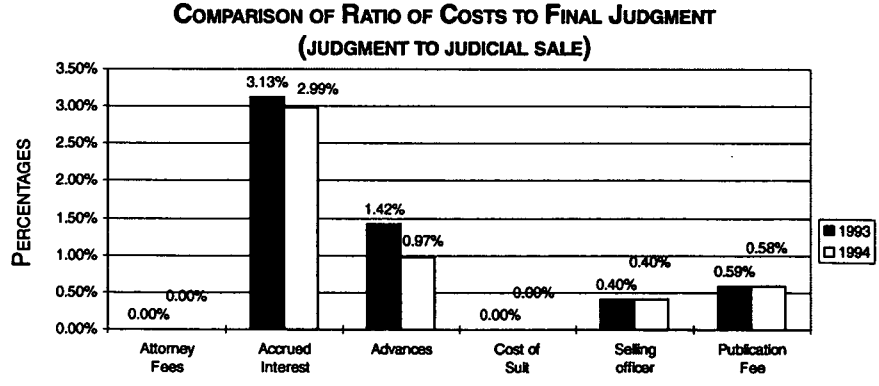


Costs up to Judgment*

	1993	1994
Attorney Fees	1.42%	1.36%
Accrued Interest	7.54%	8.10%
Advances	2.12%	1.83%
Cost of Suit	1.67%	2.06%
Total	12.75%	13.35%

*See Figure 12

FIGURE 13B

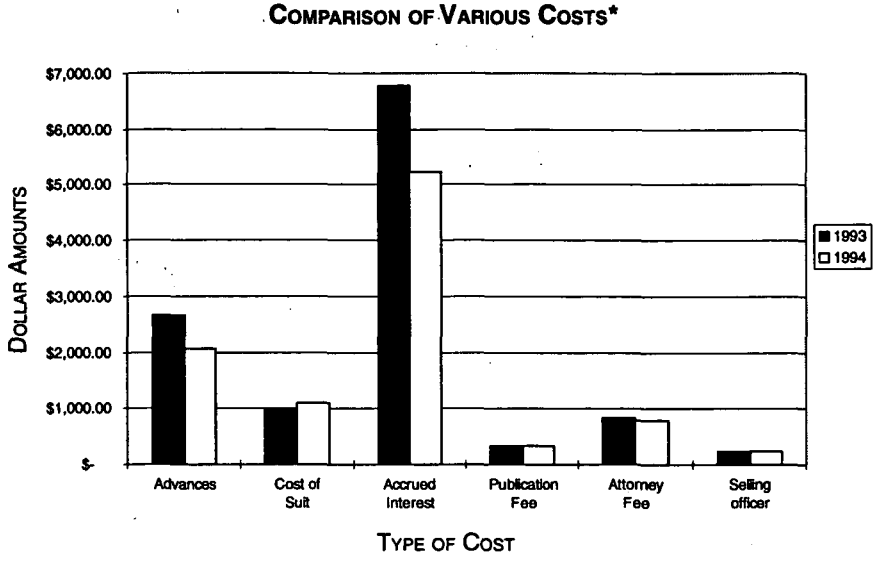


Costs Judgment to Judicial Sale*

	1993	1994
Attorney Fees	0.00%	0.00%
Accrued Interest	3.13%	2.99%
Advances	1.42%	0.97%
Cost of Suit	0.00%	0.00%
Selling officer	0.40%	0.40%
Publication Fee	0.59%	0.58%
Total	5.54%	4.94%

*See Figure 12

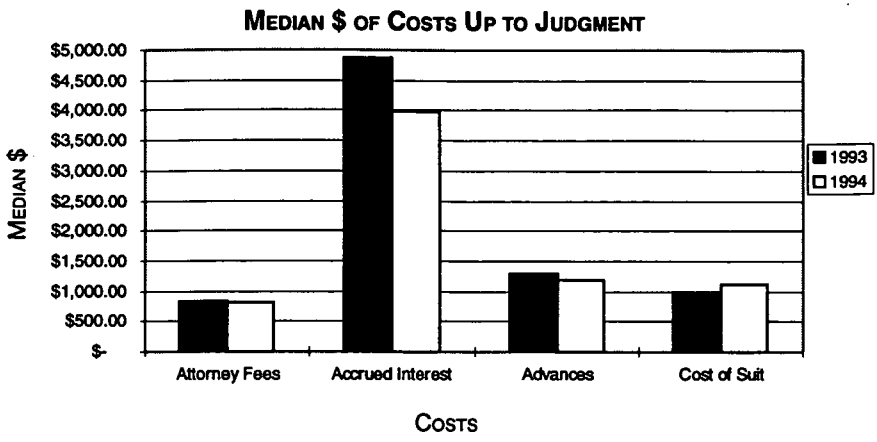
FIGURE 14



	1993	1994
Advances	$ 2,658.29	$ 2,067.01
Cost of Suit	$ 994.25	$ 1,106.98
Accrued Interest	$ 6,786.76	$ 5,215.41
Publication Fee	$ 328.00	$ 328.00
Attorney Fee	$ 850.00	$ 800.00
Selling officer	$ 250.00	$ 250.00

* These amounts do not equal the summation of the amounts in Fig. 14a and Fig. 14b because we did not have the same data for all the cases, thus resulting in minor discrepencies. See footnote 73 of the article.

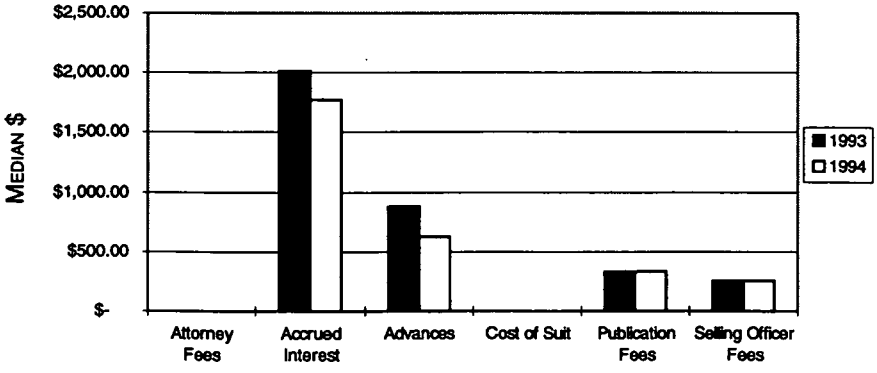
FIGURE 14A



Median $ Costs Up to Judgment*

	1993	1994
Attorney Fees	$ 850.00	$ 800.00
Accrued Interest	$ 4,861.61	$ 3,989.58
Advances	$ 1,299.86	$ 1,199.16
Cost of Suit	$ 994.25	$ 1,106.04

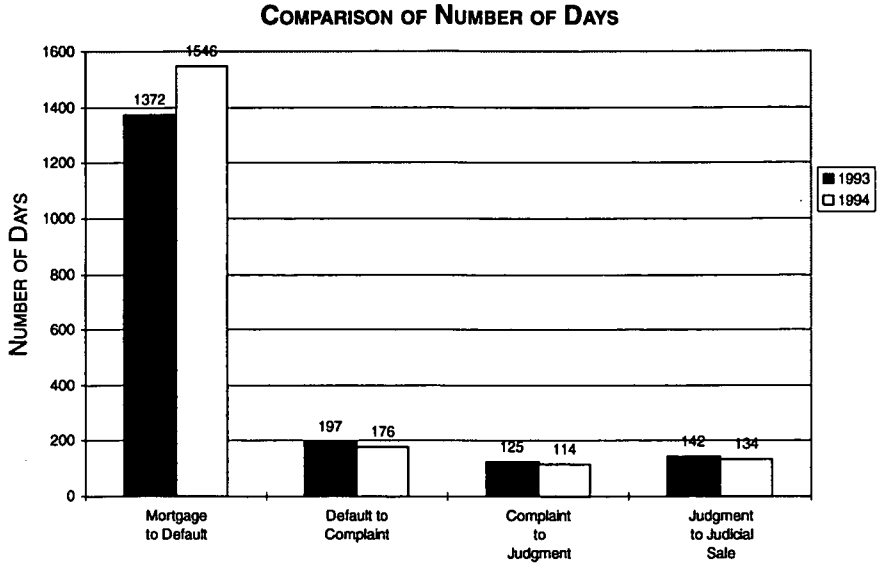
FIGURE 14B



Median $ Judgment to Judicial Sale*

	1993	1994
Attorney Fees	$ -	$ -
Accrued Interest	$ 2,013.18	$ 1,771.96
Advances	$ 874.24	$ 619.70
Cost of Suit	$ -	$ -
Publication Fees	$ 328.00	$ 328.00
Selling Officer Fees	$ 250.00	$ 250.00

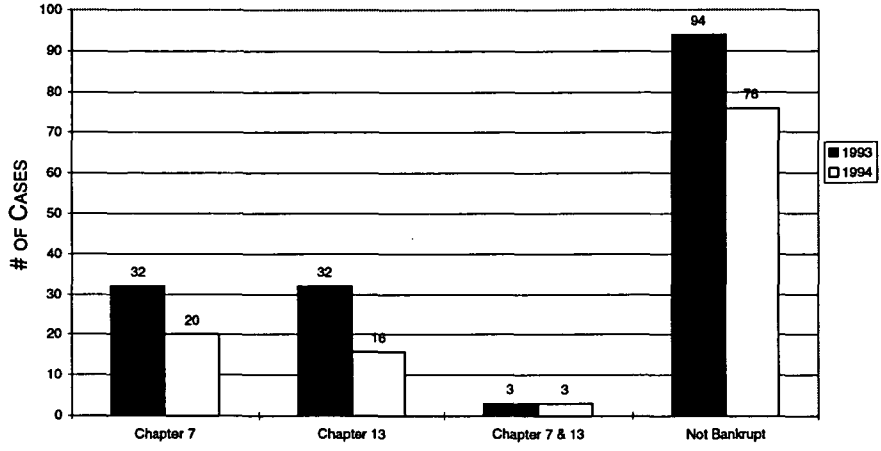
FIGURE 15



	1993	1994
Mortgage to Default	1372	1546
Default to Complaint	197	176
Complaint to Judgment	125	114
Judgment to Judicial Sale	142	134

FIGURE 16

JUDICIAL SALES CASES
(DEFENDANT FILED BANKRUPTCY PRIOR TO JUDICIAL SALE OR WTHIN ONE YEAR OF JUDICIAL SALE)

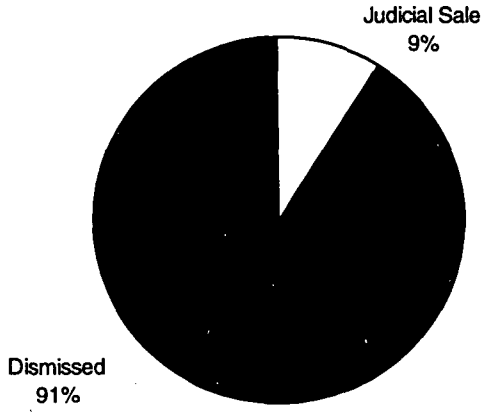


TYPE OF BANKRUPTCY

	1993	1994
Chapter 7	32	20
Chapter 13	32	16
Chapter 7 & 13	3	3
Not Bankrupt	94	76
Total	161	115

FIGURE 17A

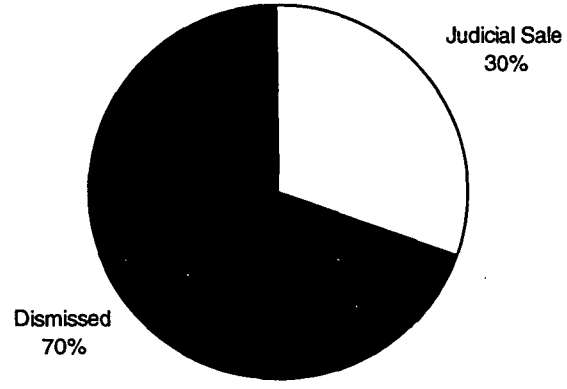
1993 COMMERCIAL PROPERTY CASES



	1993
Judicial Sale	2
Dismissed	20

FIGURE 17B

1994 COMMERCIAL PROPERTY CASES



	1994
Judicial Sale	7
Dismissed	16