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The Future of Foreclosure Law in the Wake of the Great Housing Crisis of 2007-2014

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I. INTRODUCTION: THE CRISIS AND RESPONSE

As 2014 came to an end so, perhaps, did the worst foreclosure crisis in U.S. history. On January 15, 2015, RealtyTrac, one of the nation's leading reporters of housing data, declared the foreclosure crisis had ended.[1] Whether its declaration proves true, the aftermath of the crisis will be felt for years to come. During the crisis it is estimated more than five million families lost their homes to foreclosure.[2] Federal, state, and local responses to the crisis changed laws and perceptions regarding foreclosure. Despite these changes, we end the crisis much the way we began—with a nationwide foreclosure system mistrusted and disliked by lenders and consumers alike. This Article examines the responses to the crisis in an effort to determine what worked, what did not, and where foreclosure law should go from here. In the end, it is clear that we need a more uniform system, but one that also prioritizes homeownership, or at least home occupancy.

A. The Crisis

In the early morning hours of September 13, 2008, the financial world shook when it was announced that Lehman Brothers, one of the nation's premier financial institutions, had failed.[3] For many people, this was the

* Clinical Professor at Notre Dame Law School. I would like to thank my faculty for their support and helpful feedback relating to this article, especially Jim Kelly, John Robinson, Margaret Brinig, and Robert Jones.

1. In its 2014 year-end summary of foreclosures, RealtyTrac reports that foreclosure filings were down sixty-one percent from their 2006 peak and that foreclosure is "stabilizing at a historically normal level." REALTYTRAC, *1.1 Million US Properties with Foreclosure Filings in 2014, Down 18 Percent From 2013 to Lowest Level Since 2006, available at*, http://www.realtytrac.com/news/foreclosure-trends/1-1-million-u-s-properties-with-foreclosure-filings-in-2014-down-18-percent-from-2013-to-lowest-level-since-2006/ (last visited April 14, 2015) [Hereinafter Foreclosure Filings].

2. CoreLogic reported in January of 2014 that 4.9 million homes had been lost from 2008 to 2014. The crisis began earlier than 2008 and another year has passed since the report was issued. Therefore, five million is a very conservative estimate of how many homes have been lost. CORELOGIC: NATIONAL FORECLOSURE REPORT, Jan. 14, 2014, *available at* http://www.corelogic.com/research/foreclosure-report/national-foreclosure-report-january-2014.pdf.

3. In the early morning hours of September 13, 2008, I was getting ready to begin a lecture on some changes to regulations relating to credit cards to a roomful of banking attorneys, when I got an email from a colleague in Washington, D.C. telling me an announcement was about to made that Lehman would be allowed to go into bankruptcy. Foolishly, I passed on the news and watched my seminar turn into a room of panic-

psychological beginning of the financial crisis. By September 2008, however, we were already deep into the mortgage foreclosure crisis and, as we would later learn, well into a recession.[4] The causes of the financial crisis are still being debated.[5] Foreclosures generally rise in bad economic times, but this foreclosure crisis was historic. While researchers will likely never agree on a single cause for the duration and depth of the foreclosure crisis, several theories consistently rise to the top: subprime lending, a housing bubble, lax underwriting standards, dropping home prices, credit default swaps, and the deregulation of the lending industry.[6] All of these likely contributed to the problem; but this Article is not concerned with how the crisis started. This Article focuses on the responses to the crisis and what the crisis should teach us about foreclosure policy going forward.

B. The Response

The housing bubble began to burst in early 2007.[7] Federal response to the growing number of foreclosures was slow and ineffective. The HOPENOW program, a voluntary program created by the Bush Administration, was supposed to assist homeowners in modifying their loans to stem the tide of foreclosures.[8] The program is largely regarded as a failure.[9] The loan modifications that were accomplished did little to alleviate the debt burden of homeowners.[10] It is not surprising that large numbers of homeowners re-

stricken, email and tweeting, attorneys. So much for the seminar. For a more critical analysis of the moment, *see* FIN. CRISIS COMM'N: FINAL REPORT OF THE NAT'L COMM'N ON THE CAUSES OF THE FIN. AND ECON. CRISIS IN THE UNITED STATES, 324–43 (2011) [hereinafter Commission Report].

4. The Business Cycle Dating Committee of the National Bureau of Economic Research, the committee charged with identifying business cycles in the United States, marked the official start of the recession as December 2007. NAT'L BUREAU OF ECON. RESEARCH, *Determination of the December 2007 in Econ. Activity*, *available at* http://www.nber.org/cycles/dec2008.html (last visited Apr. 14, 2015).

5. The governmental analysis of the causes and effects of the crisis can be found in the Commission Report, *supra* note 3. There has been no shortage of scholars weighing in. *See generally* Ben Bernanke, THE FEDERAL RESERVE AND THE FINANCIAL CRISIS (Princeton, 2001); Alan Blinder & Andrew W. Lo, RETHINKING THE FINANCIAL CRISIS (Russell Sage Foundation, 2013); Michael Lewis, THE BIG SHORT: INSIDE THE DOOMSDAY MACHINE (Norton 2010); Richard Posner, A FAILURE OF CAPITALISM (Harvard, 2009); Andrew Ross Sorkin, TOO BIG TO FAIL (Penguin 2010).

6. For a concise summary of the Financial Inquiry Commission's conclusions as to the causes of the crisis, *see* Commission Report, *supra* note3, xv–xxviii.

7. Housing prices peaked in 2006 and then began to fall. *See id.* at 215. "[B]y the end of 2009, prices would drop 28% from their peak in 2006." *Id.* at 215.. Securitization of subprime loans dropped from $75 billion in the second quarter of 2007 to $12 billion in the fourth quarter. Mortgage lending would eventually all but halt. *Id.* at 214.

8. *See* Patricia A. McCoy, *Barriers to Foreclosure Prevention During the Financial Crisis*, 55 ARIZ. L. REV. 723, 736 (2013); Alan White, *Rewriting Contracts, Wholesale*: *Data on Voluntary Mortgage Modifications from 2007 and 2008 Remittance Reports*, 36 FORDHAM URB. L. J. 509, 516 (2008); Press Release, HOPENOW, HOPE NOW Alliance Created to Help Distressed Homeowners (Oct. 10, 2007) (available at https://investor.shareholder.com/jpmorganchase/releasedetail.cfm?ReleaseID=269436).

9. *See* Alan M. White, *Deleveraging the American Homeowner: The failure of the Voluntary Mortgage Contract Modifications* 41 CONN. L. REV. 1107 (2009) (providing a comprehensive analysis of all the ways in which the voluntary loan program failed).

10. White, *supra* note 8, at 529. In this study, Professor White found that 23 percent of the modifications did not change the monthly payment and 23 percent actually increased it. *Id.* at 530.

defaulted.[11]

The number of foreclosures continued to grow, ballooning to a historic high of 2,871,891 foreclosure filings in 2010.[12] Congress passed the Emergency Economic Stabilization Act in 2008, which was "intended to, among other things, preserve home ownership and protect home values."[13] This led to the creation of the Obama Administration's Home Affordable Modification Program (HAMP) in 2009.[14] HAMP created a "waterfall" which required participating servicers[15] to follow a specific set of steps in an attempt to modify troubled mortgages in order to reduce monthly payments "to as close to 31 percent of gross income as possible."[16] The program has been more successful in avoiding foreclosures than previous efforts, but is still mired in problems.[17] The modification programs are complicated, requiring substantial confusing paperwork and multiple changes to existing servicer software.[18] Servicers had neither the will[19] nor the capacity to deal with the magnitude of

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11. White, *supra*, note 8, at 519. More than one-half of the loan modifications made in 2008 defaulted within one year. Less than one quarter were current in early 2010. NAT'L CONSUMER LAW CENTER, REBUILDING AMERICA: HOW STATES CAN SAVE MILLIONS OF HOMES THROUGH FORECLOSURE MEDIATION 4 (Feb. 2012) [hereinafter REBUILDING AMERICA].

12. Foreclosure Filings, *supra* note 1.

13. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-288, TROUBLED ASSET RELIEF PROGRAM: TREASURY CONTINUES TO FACE IMPLEMENTATION CHALLENGES AND DATA WEAKNESSES IN ITS MAKING HOME AFFORDABLE PROGRAM, 1 (2011) [hereinafter TARP REPORT].

14. *Home Affordable Modification Program*, FREDDIE MAC, http://www.freddiemac.com/singlefamily/service/mha_modification.html (last visited April 14, 2015). The initial program was just intended to aid borrowers in first-lien, residential properties. Since its inception, it has been expanded to include numerous other programs, including the 2MP (Second Lien Modification Program), a program to identify and modify second mortgages; HAFA (Home Affordable Foreclosure Alternatives Program), a program to assist with deed-in-lieu or short sale transfers; PRA (Principal Reduction Alternative SM), a program to encourage principal write downs, HARP (Home Affordable Refinance Program), a program that allows certain underwater borrowers to refinance; UP (Home Affordable Unemployment Program), a program to offer forbearance if you are unemployed; HHF (Hardest Hit Funds), state-administered programs funded by the federal government to assist borrowers in certain counties hardest hit by foreclosure. The Veteran's Administration, FHA, Fannie Mae, and Freddie Mac all have variations of these programs.

15. Allan S. Glass, *The HAMP Waterfall—Qualifying for a Loan Modification*, L.A. REAL EST. BLOG, http://allanglass.featuredblog.come/?p=123 (last visited Apr. 14, 2015). While HAMP is technically a voluntary program banks, especially those that accepted TARP bail out money were expected, if not specifically required, to sign on.

16. TARP REPORT, *supra* note 13, at 7.

> Servicers must first capitalize accrued interest and certain expenses paid to third parties and add this amount to the loan balance (principal) amount. Next, the interest rate must be reduced in increments of one-eighth of 1 percent until the 31 percent DTI target is reached, but servicers may not reduce interest rates below 2 percent. If the interest rate reduction does not result in a DTI ration of 31 percent, servicers must then extend the maturity and/or amortization period of the loan in 1-month increments up to 40 years. Finally, if the target DTI ratio is still not reached, the servicer must forbear, or defer, principal until the payment is reduced to the 31 percent target. Servicers may also forgive mortgage principal.

Id.

17. *Id.*

18. *Id.* at 20–25.

19. Several studies have been conducted that suggest "the payment structure for servicing may provide incentives for servicers to forego a modification even if modification would serve the lenders' or investors' interests." Vicki Been et al., *Determinants of the Incidence of U.S. Mortgage Loan Modifications*, 37 J. BANKING & FIN. 3951, 3952 (2013); Larry Cordell et al., *The Incentives of Mortgage Servicers: Myths and Realities, Finance and Economics,*, FED. RES. BD. OF WASH. D.C., 18 (2008) *available at* http://www.federalreserve.gov/pubs/feds/2008/200846/200846pap.pdf; Adam Levitin & Tara Twomey, *Mortgage Servicing*, 28 YALE L. ON REG. 1 (2011); Dan Magder, *Mortgage Loan Modifications: Program*

the crisis.[20]

State and local governments, frustrated by the growing number of abandoned properties and the lack of a successful federal intervention, began to take matters into their own hands.[21] Governments and courts created foreclosure modification programs.[22] Although they vary greatly from state-to-state, and even from county-to-county, they all share one common theme. They all require mortgage service providers to meet fact-to-face with homeowners in an effort to facilitate loan modifications.[23]

Additionally, local governments got creative and enacted ordinances in an attempt to stem the growing number of abandoned properties resulting from the crisis.[24] San Bernardino County, California took things one step further when it began exploring how to use eminent domain to buy mortgages on underwater properties and re-write them to avoid foreclosures.[25] Other cities announced their intent to follow suit.[26] This has set off a national debate that is still raging.[27]

Much of the local effort for alternative solutions comes from a frustration with the accelerated pace of foreclosures and the resulting abandoned

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Incentives and Restructuring Design, PETERSON INST. FOR INT'L ECON. (2009); Joseph R Mason, *Mortgage Loan Modification: Promises and Pitfalls* (2007), *available at* http://ssrn.com/abstract=1027470; Diane Thompson, *Why Servicers Foreclosure When They Should Modify and Other Puzzles of Servicer Behavior: Servicer Compensation and its Consequences*, NAT'L CONSUMER LAW CENTER__(2009), https://www.nclc.org/images/pdf/pr-reports/report-servicers-modify.pdf.

20. TARP REPORT, *supra*, note 13, at 11. "Loan loss mitigation is labor intensive and thus raises servicing costs, which in turn make it more likely that a servicer would forego loss mitigation and pursue foreclosure even if the investor would be better off if the foreclosure were avoided." Cordell, *supra* note 19 at 15; Jeffrey P. Hulett, *Loan Modifications and HAMP*, 92 THE RMA J. 14, 16–17 (2010) (categorizing the issues both with the culture of the servicer and implementation of the necessary technology); Neil J. Morse, *News from Loan-Modification Front*, 70 MORTG. BANKING30 (2010) (noting the complexity of the program and frequent changes are beyond the servicers' ability to handle).

21. *See* Frank S. Alexander et al., *Legislative Responses to the Foreclosure Crisis in Nonjudicial Foreclosure States*, 31 REV. BANKING & FIN. L. 34, 1 (2011); Cordell, *supra* note 19; Geoff Walsh, *The Finger in the Dike: State and Local Laws Combat the Foreclosure Tide*, 44 SUFFOLK U.L. REV 139 (2011) (giving a broad overview of various strategies used by state and local governments).

22. *See* REBUILDING AMERICA, *supra* note 11 (explaining the various mediation programs that existed by February 2012 and their relative success rates).

23. *Id.* at 17–20.

24. Mary Ellen Podmolik, *Chicago Loses Court Challenge to Vacant Building Registry*, CHI. TRIB. (Aug. 26, 2013), *available at* http://articles.chicagotribune.com/2013-08-26/business/chi-chicago-vacant-building-registry-20130825_1_fhfa-federal-housing-finance-agency-fannie-mae (reporting on FHFA's challenge to an ordinance that required mortgage holders to register and pay $500 for each abandoned property). The article claims that "[m]ore than 1,000 municipalities around the country" have enacted similar ordinances. *Id.* Another creative, and as of yet unsuccessful, idea was to use eminent domain as a means of taking over the mortgages and making them affordable to avoid foreclosures. *See also Fed. Housing Fin. Agency* v. *City of Chicago*, 962 F. Supp. 2d 1044 (N. Dist. Ill, 2013).

25. Jennifer Medina, *California County Weight Drastic Plan to Aid Homeowners*, N.Y. TIMES (July 14, 2012), *available at* http://www.nytimes.com/2012/07/15/us/a-county-considers-rescue-of-underwater-homes.pdf.

26. Shaila Dewan, *More Cities Consider Using Eminent Domain to Halt Foreclosures*, N.Y. TIMES (Nov. 15, 2013), *available at* http://www.nytimes.com/2013/11/16/business/more-cities-consider-eminent-domain-to-halt-foreclosures.html?_r=0.

27. Raymond H. Brescia & Nicholas M. Martin, *The Price of Crisis: Eminent Domain, Local Governments, and the Value of Underwater Mortgages*, 20 TEMP. POL. & CIV. RTS. L. REV. (forthcoming 2014); Robert Hockett, *Paying Paul and Robbing No One: An Eminent Domain Solution for Underwater Mortgage Debt*, 19 CURRENT ISSUES IN ECON. AND FIN. 1, 2013.

properties, coupled with the slow pace of loan modification. As the programs to encourage loan modification increased, so did allegations of servicer abuse relating to homeowners' failed attempts to obtain loan modification.[28] A pattern of deliberate efforts to thwart loan modification began to emerge. As one former employee said in an affidavit, the "practice is to string homeowners along with no apparent intention of providing the permanent loan modification" promised.[29] Others claim they were instructed to tell customers that their loan modification packets were incomplete, even when it was clear "all the documentation was in" the bank's system.[30] Pressure began to mount on the industry to make changes.

When it seemed that things could not get any worse, the "robo-signing" scandal broke.[31] Two distinct problems became evident. In the rush to securitize loans, it appears that banks failed to get the proper loan endorsements needed to transfer the notes into the securitized trusts.[32] Instead, they were fraudulently recreating documents and having employees forge endorsements.[33] A second, but related, problem arose from the affidavits that banks were submitting to prove the mortgage default and amount due and owing. Employees were signing thousands of affidavits per day, attesting to the accuracy of documents and figures for accounts they had never seen.[34] The big lenders halted foreclosures in all judicial foreclosure states—twenty-three

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28. Hearing on Mortgage Services, House Committee on Financial Services, Subcommittee on Housing and Community Opportunity, 111th Cong. 9–11 (2010) (statement of the Honorable Elizabeth A. Duke, Governor, Federal Reserve System) *available at* http://www.gpo.gov/fdsys/pkg/CHRG-111hhrg63124/pdf/CHRG-111hhrg63124.pdf.

29. Affidavit of Erika Brown at 1, *Kahlo v. Bank of Am., N.A.*, 2:10-cv-00488 JLR, (W.D. Wash. Jun. 7, 2013). In her affidavit, Theresa Terrelonge stated that "Based on what I observed, Bank of America was trying to prevent as many homeowners as possible from obtaining permanent HAMP loan modifications while leading the public and the government to believe that it was making efforts to comply with HAMP." Affidavit of Theresa Terrelonge at 4, *In re Bank of Am.*, 1:10-md-02193-RWZ (D. Mass. Jun. 7, 2013).

30. Affidavit of Recorda Simon at 4, *In re Bank of Am.*, 1:10-md-02193-RWZ (D. Mass. Jun. 7, 2013); In her affidavit, Simone Gordon also indicated that employees were instructed to lie to homeowners, telling them their documents had not been received even when they had. Affidavit of Simone Gordon at 4, *In re Bank of Am.*, 1:10-md-02193-RWZ (D. Mass. Jun. 7, 2013).

31. *See, e.g.*, David H. Carpenter, CONG. RESEARCH SERV., R41491, "ROBO-SIGNING" AND OTHER ALLEGED DOCUMENTATION PROBLEMS IN JUDICIAL AND NONJUDICIAL FORECLOSURE PROCESSES(Nov. 15, 2010); Gretchen Morgenson, *Flawed Paperwork Aggravates a Foreclosure Crisis*, N.Y. TIMES (Oct. 3, 2010) http://www.nytimes.com/2010/10/04/business/04mortgage.html?_r=0.

32. *Foreclosure Documentation Issues Before the H. Comm. on Financial Services Subcommittee on Housing and Community Opportunity* 111th Cong. (2010) (citing the testimony of Elizabeth A. Duke, Governor, Federal Reserve System) http://www.bis.org/review/r101124e.pdf; *see also* Elizabeth Renuart, *Uneasy Intersections: The Right to Foreclosure and the U.C.C.*, 48 WAKE FOREST L. REV.1205, 1208–10 (2013) (explaining the importance of the paperwork in foreclosure).

33. Karen Weise, *Mortgage Fraud Whistle-Blower Lynn Szymoniak Exposed Robosigning's Sins*, BLOOMBERG BUS. (Sept. 12, 2013), *available at* http://www.bloomberg.com/bw/articles/2013-09-12/mortgage-fraud-whistle-blower-lynn-szymoniak-exposed-robosignings-sins (exposing the "Linda Green" robo-signing scandal in Florida).

34. Carpenter, *supra* note 31, at 15. In Maine, pro bono attorney Tom Cox uncovered the robo-signing of affidavits of debt after deposing GMAC employee Jeffrey Stevens. Debra Cassens Weiss, *How 2 Pro Bono Lawyers Uncovered 'Robo-Signer,' Halting Foreclosures in 23 States*, A.B.A. J. (Sept. 23. 2010), *available at* http://www.abajournal.com/news/article/how_2_pro_bono_lawyers_uncovered_robo-signer_halting_foreclosures_in_23_sta/.

at the time.[35] This scandal resulted in a $25 billion settlement between forty-nine of the nation's attorneys general and the five largest mortgage servicers that required specific action be taken to modify mortgage loans in foreclosure.[36]

The responses to the crisis and the resulting problems in the mortgage market were defensive and, as such, implemented in an ad hoc, reactive way across the country. This Article examines the responses to the crisis in an effort to determine what worked, what did not, and where foreclosure law should go from here. It adds to a growing sense that foreclosure law needs to be more uniform, less reactive, and more fair to consumers and communities. Unlike others, however, this Article recommends a move to more, not less, judicial supervision of the foreclosure process.

II. MORTGAGE LAW AND THE CASE FOR UNIFORMITY

A. Foreclosure Law

States are fiercely proprietary about their property law. Like most American law, the law of mortgages first developed in England.[37] Under English law, the lender held title to the property until the mortgage was paid.[38] This is known as the *title* theory of mortgages and is the law in many states, usually those that were formed early in America's development.[39] The competing theory is the *lien* theory which vests ownership with the borrower, subject to defaulting on the mortgage.[40] Two distinct documents are used to create the security interest, a mortgage, or a deed of trust.[41] In states that recognize deeds of trust, ownership is actually vested in a third-party, the trustee, until the mortgage is paid.[42] In the early nineteenth century, American states began to move from the title theory to the lien theory, with New York leading the way in 1828.[43] While there is no consistent pattern, older states tend to follow the title theory, while newer states are more likely to be lien theory states.[44] This was the first step in the move to multiple foreclosure systems.

Under the title theory of mortgages, when a borrower failed to make his payments, the property was automatically transferred to the mortgagee "without

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35. Carpenter, *supra* note 31 at 1.

36. Weise, *supra* note 33. The five servicers are: Chase, Citibank, Wells Fargo, Bank of America, and GMAC. Attorneys General on the Exec. Comm., *Joint State-Federal Mortgage Servicing Settlement FAQ*, *available at* http://www.nationalmortgagesettlement.com/faq (last visited Apr. 14, 2015).

37. Harold C. Vaughan, *Reform of Mortgage Foreclosure Procedure: Possibilities Suggested by* Honeyman v. Jacobs, 88 U. PA. L. REV. 957, 960 (1940).

38. Andra Ghent, *The Historical Origins of America's Mortgage Laws*, RESEARCH INST. FOR HOUS. AM., 1 (Oct. 19, 2012).

39. *Id.*

40. *Id.* at 7.

41. *Id.*

42. *Id.*

43. *Id.* at 15.

44. *Id.* at 16.

the necessity of further legal action."[45] In the early seventeenth century, English mortgage law "underwent a seismic shift with the introduction of the concept of the *equity of redemption*."[46] Courts of equity intervened in situations of default creating the right of redemption and the requirement of a foreclosure sale.[47] Settlers brought this concept to the colonies and early foreclosure procedures in America followed this tradition.[48] Default required a judicial process that allowed homeowners who fell behind to redeem the property after the sale by paying the balance due.[49] The law of foreclosure began to develop as lenders attempted "to foreclose" this right of redemption granted by equity.[50] What originated as a strict foreclosure process soon moved to a judicial process followed by a foreclosure sale.[51] Again, New York led the way.[52]

Lenders reacted to these changes by developing power of sales clauses in their loan documents. A power of sale clause allows the home to be sold if there is a default, without the necessity of court action.[53] Courts were initially reluctant to honor these clauses. Although the U.S. Supreme Court recognized the validity of these clauses in 1827 in *Newman v. Jackson*,[54] it took many years before states began adopting non-judicial foreclosure processes that allowed for due on sale clause foreclosure.[55] The law developed as the country was expanding and new states picked the rules that best suited them. As a result, state foreclosure laws are far from uniform today.

Commentators generally classify foreclosure law as falling into one of two categories: judicial and non-judicial.[56] Judicial states are usually thought of as states where the lender needs to initiate a court action in order to foreclose.[57] Non-judicial, or "power of sale," foreclosure is permitted in thirty states and the District of Columbia.[58] In these states, the document governing the security interest, either a mortgage or deed of trust, gives the lender the authority to sell the property shortly after notice of default is given. Because some states allow

45. Vaughn, *supra* note 37, at 959. This process known as "strict foreclosure" is still used in parts of New England. *Id.* at 960.

46. Ghent, *supra* note 38, at 12.

47. Vaughn, *supra* note 37, at 960.

48. Ghent, *supra* note 38, at 1.

49. *Id.* at 12.

50. *Id.* The early definition of equitable redemption applied to the period after acceleration but before a foreclosure sale. *See id.* This is distinct from the modern, statutory notion of redemption which relates to the period after a sale in which a homebuyer can essentially re-purchase the property for the balance owed. *See id.*

51. *Id.* at 21.

52. Vaughn, *supra* note 37, at 960.

53. John Rao & Geoff Walsh, *Foreclosing A Dream: State Laws Deprive Homeowners of Basic Protections*, NAT'L CONSUMER LAW CTR. 11–12 (2009).

54. 25 U.S. 570 (1827).

55. Ghent, *supra* note 38, at 21.

56. For a summary of the laws of each state and the District of Columbia, *see* JOHN RAO ET AL., FORECLOSURES AND MORTGAGE SERVICING INCLUDING LOAN MODIFICATIONS (5th ed., 2014) [hereinafter FORECLOSURES].

57. *Id.* at 388.

58. *Id.*

for both judicial and non-judicial foreclosure but prefer one over the other, researchers have been confused about which states actually fall into which category.[59]

This confusion has only grown in recent years as states modified their procedures in response to the foreclosure crisis. Maryland is a good example of why it is not always easy to characterize a state's foreclosure laws. Maryland is considered a non-judicial foreclosure state by some sources, and it is considered a judicial foreclosure state by others.[60] It is non-judicial in the sense that you do not need to initiate a court action to begin a foreclosure, though you do have to file a notice, and it is judicial in the sense that, once the property is sold, the sale must be ratified by a court, and an accounting of the sales proceeds given to the prior homeowner.[61]

B. The Federalization of Mortgage Lending

When the laws governing mortgage foreclosure were developing, mortgage lending was largely a local issue. It is a completely different issue now. Things began to change during the Great Depression and exploded in the 1970s.[62] The Federal National Mortgage Association ("Fannie Mae") was created as a response to the Great Depression. It was charged with buying up mortgages insured by the Federal Housing Administration ("FHA") and, after World War II, with buying loans insured by the Veteran's Administration as well.[63] By the late 1960s the number of mortgages owned by Fannie Mae had skyrocketed, creating a large debt issue for the federal government. In response, the federal government decided to make Fannie Mae a publicly traded corporation.[64] Soon afterwards, the Government National Mortgage Association ("Ginnie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") were also created.[65] They are known as the GSEs, government-sponsored entities, because they are a hybrid between private, publicly traded corporation, and public entities, created to acquire government-backed mortgage loans.[66]

In 1970, Ginnie Mae began to securitize its loan portfolio. The other GSEs

59. Kristopher Gerardi, Lauren Lambie-Hanson, & Paul S. Willen, *Do Borrower Rights Improve Outcomes? Evidence from the Foreclosure Process*, 11 (Nat'l Bureau of Econ. Research, Working Paper No. 17666, 2011), *available at* http://www.nber.org/papers/w17666 (last visited Apr. 14, 2015).

60. The National Consumer Law Center identifies Maryland as a "power of sale with court supervision" state. FORECLOSURES, *supra* note 56, at 871. In Maryland, a mortgagee must serve notice of the foreclosure, sell the property, and then a court must ratify the sale. *Id.* at 971–72. This distinguishes Maryland from true judicial foreclosure states, where a formal complaint is filed.

61. *Id.*

62. For a more detailed description of the changing mortgage market, *see* COMMISSION REPORT, *supra* note 3, at 38–51.

63. *Id.* at 38.

64. *Id.*

65. *Id.*

66. *Id.*

soon followed suit.[67] The private market saw the opportunity for profit in the securitization of home loan mortgages. Not only did securitization add lending capacity to financial institutions, it added a profit source for the Wall Street firms that created the securitized pools.[68] At this time the GSEs were restricted in what they could own, and therefore they securitized mostly thirty-year fixed rate mortgages—the standard, less risky, mortgage product.[69] The private securitization market was largely cut off from the prime, thirty-year fixed market and had to look to other, often riskier, loans for its portfolios.[70] Wall Street-driven demand for loans to securitize incentivized mortgage lenders and brokers to originate more, and riskier subprime loans.[71] By 2006, privately securitized mortgage pools had grown to $1.15 trillion, dwarfing Fannie Mae and Freddie Mac.[72] Seventy-one percent were subprime or Alt-A loans.[73]

By the early 2000s, the rules governing loan origination were fairly uniform and mostly federal.[74] The GSEs created standard mortgage documents that resulted in even greater uniformity.[75] Congress passed a series of laws to preempt state mortgage law.[76] What we did not have, and in hindsight what was probably needed, were uniform underwriting standards.[77] In fact, as states desperately tried to rein in the abuses of predatory lending, the federal government consistently intervened to stop them, claiming federal preemption. By preempting state consumer protections, federal agencies—predominately

67. *Id.* at 39.

68. Edmund L. Andrews, *Greenspan concedes error on regulation*, N.Y. TIMES, (Oct. 23, 2008), *available at* http://www.nytimes.com/2008/10/24/business/economy/24panel.html?_r=0 (citing Alan Greenspan as placing the blame for the crisis on Wall Street because the "demand for the securities was so high . . . that Wall Street companies pressured lenders to lower their standards and produce more 'paper.' "). The article goes on to quote Greenspan:"[t]he evidence strongly suggests that without the excess demand from securitizers, subprime mortgage originations (undeniably the original source of the crisis) would have been far smaller and defaults accordingly far lower") *Id.*

69. COMMISSION REPORT, *supra* note 3, at 42. *But see* Todd Zywicki, *The Behavioral Law And Economics Of Fixed-Rate Mortgages (And Other Just-So Stories*), 21 SUP. CT. ECON. REV. 157, 157 (2014). (arguing that the thirty-year fixed mortgage is "[a] major cause of the recent financial crisis").

70. While the vast majority of commentators point to the explosion of subprime lending and securitization as a leading cause of the foreclosure crisis, at least one well-known scholar disagrees. Zyqicki, *supra* note 69, at 157.

71. Andrews, *supra* note 68.

72. COMMISSION REPORT, *supra* note 3, at 102.

73. *Id.*

74. Real Estate Settlement Procedures Act (RESPA), 12 U.S.C. § 2609 and the Truth in Lending Act (TILA), 15U.S.C. § 1604 set out the requirements for loan origination disclosures.

75. Grant S. Nelson, *Confronting the Mortgage Meltdown: A Brief for the Federalization of State Mortgage Foreclosure Law*,1, 19 (2009), *available at* http://ssrn.com/abstract=1558492.

76. *Id.* at 21–22. The Depository Institutions Deregulation and Monetary Control Act, 12 U.S.C. § 1735 f-7 (preempting state usury law), Garn-St. Germain Depository Institutions Act of 1982 (assuring enforceability of due-on-sale clauses that states were attempting to over-rule), and the Alternative Mortgage Transactions Parity Act of 1982 (allowing alternative forms of mortgage loan) are all examples of federal legislation meant to preempt state law). *Id.*

77. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 set out minimum requirements for what Congress defined as a "qualified mortgage." Lenders who meet these underwriting standards are given certain safe harbor protections. C.F.R. § 1026.43 (colloquially referred to as "Reg. Z"); *see also* CONSUMER FIN. BUREAU, *Basic Guidelines for lenders: What is a Qualified Mortgage?*, *available at* http://files.consumerfinance.gov/f/201310_cfpb_qm-guide-for-lenders.pdf (explaining the rules for a qualified mortgage).

the Office of the Comptroller of Currency—"weakened lending restrictions for national banks and their subsidiaries by substituting binding state consumer protection laws with the less stringent federal regulatory structure."[78]

Securitization created yet another significant change in the mortgage market: the growth of the loan servicing industry. When securitized trusts are created, an entity is often designated as the servicer to act on behalf of the trust to collect payments and initiate foreclosure in case of default. While the volume of loans to be serviced was rising, the number of servicers was shrinking. In 2007, "[t]he largest five firms accounted for 46 percent of the residential mortgage market."[79] Eighty-eight percent of the subprime market is serviced by only sixteen firms.[80] Servicers are, therefore, servicing loans on a national basis. Like loan originating, loan servicing is governed by numerous federal regulations.[81]

The federal regulations for loan servicing bleed into the law of loan foreclosure. While the actual process for foreclosure is governed by the law of the state where the property is located, how a servicer moves from default to foreclosure is subject to federal regulation.[82] For example, servicers must give a specific notice of the default and inform the borrower of the right to contact the servicer to seek loss mitigation options.[83] In most states, they may also have to give additional notices under state law.[84] The servicer then must follow certain procedures and deadlines to process a loss mitigation application.[85] The timing of the foreclosure filing is now uniform. Recent federal regulation prohibits the initiation of state procedures to initiate a foreclosure until the loan is at least 120 days delinquent.[86] It is easy to see how difficult it is for servicers whose loan pools come from all over the country to navigate all these various procedures.

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78. Lei Ding et al., *The Impact of Federal Preemption of State Antipredatory Lending Laws on the Foreclosure Crisis*, 31 J. POL'Y ANALYSIS & MGMT. 367, 385 (2012). The Dodd-Frank Wall Street Reform and Consumer Protection Act attempts to prevent a repeat of this by limiting the ability of the regulating agencies to preempt more protective state laws. *Id.*.

79. Cordell, *supra* note 19, at 13.

80. *Id.*

81. Real Estate Settlement Procedures Act (RESPA), 12 U.S.C. § 2609, expanded by the Cranston-Gonzalez National Affordable Housing Act, Pub. L. No. 101-625, 104 Stat. 4079 (1990) (codified as 12 U.S.C. § 2605); Regulation X (the implementing regulations for RESPA), 12 C.F.R. pt. 1024; the Truth in Lending Act (TILA), 15 U.S.C. § 1604; Regulation Z, 12 C.F.R. part. 1026 (implementing regulations for TILA). For a more comprehensive discussion of the federal mortgage servicing rules, *see* FORECLOSURES, *supra* note 56, at 53–142.

82. The rules do not all apply to all mortgage loans. For example, some only apply to mortgages on a borrower's primary residence. 12 U.S.C. § 1024.30(c)(2). For the purposes of this discussion, however, those distinctions are not relevant.

83. Reg. X, 12 C.F.R. § 1024.39(b). It is interesting and significant, that the rules specify requirements of loss mitigation procedures. No specific form of loss mitigation is mandated by the rules. In fact, a lender would be in compliance if it contacted a homeowner to tell him that no loss mitigation options are available.

84. FORECLOSURES, *supra* note 56, at App. F, 963–85.

85. Reg. X, 12 C.F.R.§ 1024.41 (a)–(j).

86. *Id.* § 1024.41 (f)(1).

C. Prior Attempts at Uniformity

There have been multiple attempts to create a uniform mortgage foreclosure law.[87] The Uniform Law Commission has attempted four times to create a uniform act for mortgage foreclosure,[88] and a fifth effort is underway.[89] None of the previous attempts at Uniform Acts have been successful.[90] President Nixon attempted to create a uniform foreclosure law with the Federal Mortgage Foreclosure Act in 1973; but that too failed.[91] The 1994 Single Family Mortgage Foreclosure Act, 12 U.S.C. §§ 3751–3758, permits Housing and Urban Development ("HUD") to foreclose on residential homes non-judicially, even in judicial foreclosure states. Yet, the Act is never used and HUD continues to follow the law of the state where the property is located.[92]

Numerous scholars and commentators have called for uniform foreclosure laws.[93] After so much failure, why would anyone want to broach the subject again? There are several reasons. First, the vast majority of prior attempts called for uniform, non-judicial foreclosure. I do not. In addition, this crisis has presented an opportunity to compare the reasons for and against judicial foreclosure and the weight of the evidence supports judicial foreclosure as the best option going forward.

III. THE CASE FOR NON-JUDICIAL FORECLOSURE

The case for non-judicial foreclosure is relatively simple and consistent: it is cheaper for the lender.[94] In the sense that these costs are usually passed on

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87. Nelson, *supra* note 75.

88. The four attempts are: 1927, Uniform Real Estate Mortgage Act; 1940, Model Power of Sale Foreclosure Act; 1985 Uniform Land Security Act; and 2002 Uniform Nonjudicial Foreclosure Act. *Id.* at 15–16. No state chose to adopt any of the model acts. *Id.*

89. *See* Letter from The American Bankers Association to Mr. William Breetz, Chairman, Uniform Law Commission Drafting Committee on a Home Foreclosure Procedures Act Connecticut Urban Legal Initiative, Inc. University of Connecticut School of Law (Dec. 12, 2014) (on file with author). The Commission is currently working on attempt number five, the Home Foreclosure Procedures Act, which unlike previous attempts does not chose non-judicial foreclosure over judicial foreclosure. *Id.* at 2. Instead, it attempts to allow both to continue. *See id.* The process seems destined for failure as well. In December 2014, the American Bankers Association wrote a letter to the chair of the committee stating that "no banker and no state bankers association has told ABA that they want this bill." *Id.* at 7. It then goes on to say that the American Bankers Association prefers state-by-state attempts at reform. *See id.*

90. *Id.*; Nelson, *supra* note 75, at 15–16.

91. Nelson, *supra* note 75, at 20.

92. *Id.* at 22.

93. *See* Aaron Byrkit, *Reforming Foreclosure Disposition: A Tool for Tempering the Financial Meltdown*, 63 CONSUMER FIN. L. REV. 275 (2009) (endorsing the Uniform Nonjudicial Foreclosure Act); David M. Madway & Daniel D. Pearlman, *Mortgage Forms and Foreclosure Practices: Time For Reform*, 9 REAL PROP. PROB. & TR. J. 560 (1974) (advocating for the Federal Mortgage Foreclosure Act); Basil H. Mattingly, *The Shift From Power to Process: A Functional Approach to Foreclosure Law*, 80 MARQ. L. REV. 77 (1996) (calling for an approach that combines elements of non-judicial and strict foreclosure); Nelson, *supra* note 75; Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act*, 53 DUKE L.J. 1399 (2004) (endorsing the Uniform Nonjudicial Foreclosure Act); Vaughan, *supra* note 37 (calling for a return to strict foreclosure).

94. *See* Karen Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit*, 88 REV. ECON. & STAT. 177, 177 (2003); Cem Demiroglu, Evan Dudley & Christopher James, *State Foreclosure Laws and the Incidents of Mortgage Default*, 57 J.L. & ECON. 280, 228 (citing Citibank data, he claimed foreclosure costs

to the homeowner, if you simply look at the process costs, judicial foreclosure is more expensive than non-judicial foreclosure. It is logical to prefer the cheaper over the more expensive; but we have all heard the adage "you get what you pay for." While a simpler and cheaper process for the lenders may sound compelling, it is only part of the story. The proper comparison is not between the cost of non-judicial versus judicial foreclosure. The proper comparison should be between the cost of foreclosing or not foreclosing on a home.

A. The Effect on Housing Prices

Besides claiming non-judicial foreclosure is cheaper for lenders, the industry also claims that it is cheaper for prospective home borrowers. Here is where the story becomes much more complex. Numerous studies have tried to determine whether judicial foreclosure really adds costs for both borrowers and lenders. Karen Pence conducted one such study. Pence studied home loans originating in 1994 and 1995 in counties bordering state lines, where one county was in a judicial foreclosure state and one was in a non-judicial foreclosure state.[95] She looked at approved mortgage applications in an attempt to ascertain if state law affects a consumer's ability to obtain a mortgage.[96] She estimated that "loan sizes are 3% to 7% smaller in states that require judicial foreclosure processes."[97] This has led to industry claims that judicial foreclosure harms home buyers by limiting the size of available mortgages. Pence's explanation of her results is important and rarely acknowledged. She explained that in judicial foreclosure states:

> borrowers may pay more for their mortgages, purchase smaller houses, or have difficulty becoming homeowners. But borrowers are not necessarily worse off; they may value the insurance provided by the laws. Homeownership might even increase if judicial requirements help borrowers remain in their homes.[98]

There are several other important things to remember about the Pence study. It was done using data from 1994 and 1995, hardly a time of stress for the housing markets. It was pre-subprime boom and also before the explosion in securitization. Frankly, it was a completely different housing market.

More recently, Mian, Sui, and Trebbi examined a sample of foreclosures

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average "$3,112 in judicial review states versus $2,269 in states without judicial review"). Numerous studies over the years have documented that lenders' costs are higher in judicial states. *See* Brian Ciochette, *Loss Characteristics of Commercial Mortgage Foreclosures*, 14 REAL EST. FIN. 53 (1997); Anthony Pennington-Cross, *Subprime & Prime Mortgages: Loss Distributions* (OFHEO, Working Paper No. 03–1, 2004), *available at* http://www.fhfa.gov/PolicyProgramsResearch/Research/PaperDocuments/2003-05_WorkingPaper_03-1_N508.pdf.

95. Pence, *supra* note 94, at 179.

96. *Id.* at 177. She controlled for a number of factors that might affect her results, such as the census characteristics of the residents, property tax, and age of housing stock. *Id.* at 179.

97. Pence, *supra* note 94, at 180. There are two versions of this study available. In the first, published online in 2003, she found a four-to-six percent increase. *Id.* at 177. Because her conclusions were slightly different in each, and because the later version appeared in a peer-reviewed journal, I am relying on the later version of the study.

98. Pence, *supra* note 94, at 182.

from 2006 to 2010 to determine whether the difference between judicial and non-judicial foreclosure laws affected housing prices.[99] They found that lenders were "*twice* as likely to foreclose" on a home in a non-judicial state, despite the fact that default rates in non-judicial and judicial states were nearly identical.[100] Their study documented that the increased rate of foreclosure was responsible for "20 to 30% of the decline in house prices" from 2007 to 2009.[101] Non-judicial foreclosure is directly contributing to the devaluing of the housing market. More interestingly, they specifically addressed the results of Pence's study and found that "during the 1990s there [was] some evidence of higher credit supply to states with no judicial foreclosure requirement. But by the late 1990s into the 2000s, there [was] no evidence that lenders [were] willing to lend higher amounts in states with no judicial foreclosure requirement."[102]

B. The Effect on Interest Rates

Another common reason cited in support of non-judicial foreclosure is that, because it is less costly for the lender, the interest rates charged to customers are correspondingly reduced. Despite a very aggressive search, I could find only one study to support this claim.[103] The applicability of this study is suspect, however, because it is more than twenty years old and was examining the interest rate differentials in regions in a period when "15 to 20 % of all residential mortgages" were being sold by their originator.[104] In 2013, that number was approximately 59 percent.[105] The pooling of the mortgages may reduce the cost of default on any one mortgage, making it less necessary to price the mortgages based on whether there is judicial foreclosure.[106]

A more recent study found "no evidence that judicial foreclosure requirements lead to higher mortgage interest rate quotes."[107] In fact, it found that judicial states actually "exhibit marginally lower effective mortgage rate quotes than similar products" in judicial states.[108] While they did find that lenders charged a bit less in states that allowed deficiency judgments than states that do not, the difference only translated into an additional ten dollars per

99. Atif Mian, Amir Sui, & Francesco Trebbi, *Foreclosures, House Prices, and the Real Economy* (2014), *available at,* http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=1001&context=housing_law_and_policy.

100. *Id.* at 2 (emphasis in original).

101. *Id.* at 4. For further discussion of the effects of foreclosure on housing prices, *see infra pp. 28–30.*

102. *Id.* at 26–27.

103. Mark Meader, *The Effects of Mortgage Law on Home Mortgage Rates*, 34 J. ECON. & BUS. 143, 146 (1982) (finding that judicial foreclosure added 11.09 basis points to a 1000 basis point rate).

104. *Id.* at 144.

105. The Role of the Secondary Market in Mortgage Financing, Bipartisan Policy Center, 2 http://bipartisanpolicy.org/wp-content/uploads/sites/default/files/SecondaryMarket-final.pdf.

106. David M. Harrison & Michael J. Seiler, *The Paradox of Judicial Foreclosure: Collateral Value Uncertainty and Mortgage Rates*, J. REAL EST. FIN. ECON. 1, 33 (2014), *available at* http://ssrn.com/abstract+2234639. The study used loan data from 26,892 applicants from 2011 in both judicial and non-judicial states.

107. *Id.* at 28.

108. *Id.* at 25.

month per mortgage.[109] In fact, the evidence suggested that lenders are aware of the costs of judicial foreclosure so they reacted to these externalities by securitizing "a higher fraction of new loans originated in judicial foreclosure" states, thereby avoiding the risk.[110] Therefore, there really is no strong empirical evidence that judicial foreclosure increases interest rates for borrowers in any significant way. As the market has become more uniform, lenders appear to be eliminating any rate differences between judicial and non-judicial states through securitization.[111]

C. The Cost of Delay

The final argument against judicial foreclosure is that it simply takes too long and, by virtue of that delay, harms lenders, borrowers, and communities. Numerous studies have documented the fact that judicial foreclosure takes longer than non-judicial foreclosure.[112] The trick is to determine the actual harm and then craft a remedy to address that harm without causing other, different harms. It is not so obvious that the only solution to a foreclosure crisis is a more rapid foreclosure process.

In their study, Cordell, Geng, Goodman, and Yang, attempted to set out the specific lender costs caused by a delayed foreclosure process.[113] They examined three costs: property taxes that the lender must continue to pay; homeowner's insurance that the lender must continue to pay; and the cost of excess depreciation, based on the assumption that homeowners in foreclosure do not maintain their property.[114] What is both interesting and puzzling about this study is they chose a period of time deliberately because it included two forced foreclosure moratoria: the first was instituted by Freddie Mac and Fannie Mae and the second was caused by the "robo-signing" scandal.[115] They also examined the effects of the introduction of HAMP in 2009 and the Attorneys General Settlement of 2012.[116] Frankly, this was a very anomalous time period.

They found that foreclosure took an average of six months longer in judicial states, a period slightly longer than previous studies.[117] Considering

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109. *Id* at 2.

110. *Id* at 33.

111. *See also* Terrence M. Clauretie, *The Impact of Interstate Foreclosure Cost Differences and the Value of Mortgages on Default Rates*, 15 AREUEA J. 152 (1987) (giving more evidence that the cost of foreclosing is not being reflected in mortgage rates). *But see* Milonas Kristoffer, *The Effect of Foreclosure Laws on Securitization: Evidence from U.S.* 4 (2014), *available at* https://www.eurofidai.org/.Milonas 2014.pdf (finding evidence that loans are less likely to be privately securitized in judicial states).

112. *See* Terrence M. Clauretie, *State Foreclosure Laws, Risk Shifting, & the PMI Industry*, 56 J. OF RISK & INS. 544 (1989) (finding that judicial foreclosure took five months longer than nonjudicial foreclosure); Terrence M. Clauretie & Thomas Herzog, *The Effect of State Foreclosure Laws on Loan Losses: Evidence from the Mortgage Insurance Industry*, 22 J. OF MONEY, CREDIT & BANKING 221 (1990) (same).

113. Larry Cordell et al., FED. RESERVE BANK OF PHILA., *The Cost of Delay* (2013).

114. *Id.* at 13.

115. *See generally id.*; *see also id.* at 27.

116. *See generally id.*

117. *Id.* at 7.

that the "robo-signing" moratoria was effective only in judicial foreclosure states it is surprising that the differential was not larger. What is disappointing about this study is that Cordell and his colleagues then jumped to the conclusion that longer foreclosure periods would "get passed on to ALL homeowners, in the form of higher rates on their new mortgages" with absolutely no data to support that conclusion.[118]

Their statement appears to be a response to the Federal Finance Housing Agency's (FHFA) announcement of December 9, 2013 that it would be charging an increased fee to loans in states where "foreclosure carrying costs are more than two standard deviations greater than the national average."[119] The increased timelines in order to complete a foreclosure in certain states motivated the rule. While the decision was unfortunate and even misguided, it hardly applies to *all* homeowners.

The delineated states—New Jersey, New York, and Florida—are very good examples of why complaints about the length of the foreclosure process should not be taken at face value.[120] At last count, these three states have the three longest average timelines to complete a foreclosure—1098, 939 and 925 days, respectively. They also have the three highest numbers of zombie mortgages according to a recently released report by RealtyTrac.[121] A "zombie" mortgage is a foreclosure in which the homeowner abandoned the home believing it was lost in foreclosure, but the lender never completed the foreclosure or took possession of the property.[122] The two statistics are intrinsically linked. Abandoned foreclosures caused by lender inaction are artificially inflating the foreclosure timelines.

There are many possible explanations for the increased numbers of "zombie" mortgage in these three states. In a previous paper, I documented four subsets of zombie loans found in judicial foreclosure states: (1) the foreclosure was commenced and then dismissed unresolved (no cure and no sale), (2) the foreclosure was commenced and simply abandoned with no further action, (3) a foreclosure judgment was entered, but no sale occurred, and (4) a judgment was entered, no sale occurred and the judgment was later

118. *Id.* at 14.

119. *FHFA Takes Further Steps to Advance Conservatorship Strategic Plan by Announcing an Increase in Guarantee Fees*, FED. HOUS. FIN. AGENCY (Dec. 9, 2013), http://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Takes-Further-Steps-to-Advance-Conservatorship-Strategic-Plan-by-Announcing-an-Increase-in-Guarantee-Fees.aspx. The affected states are New York, New Jersey, Connecticut, and Florida. *Id.*

120. *One in Four U.S. Foreclosures are "Zombies" Vacated By Homeowner, Not Yet Repossessed by Foreclosing Lender,* REALTYTRAC, (Feb. 5, 2015) http://www.realtytrac.com/news/foreclosure-trends/zombie-foreclosures-q1-2015/.

121. *U.S. Foreclosure Decreases 2 Percent in June to Lowest Level Since July 2006, Before Housing Bubble Burst*, REALTYTRAC (July 2014), http://www.realtytrac.com/content/foreclosure-market-report/june-and-midyear-2014-us-foreclosure-market-report-8111.

122. Judith Fox, *The Foreclosure Echo: How Abandoned Foreclosures are Re-entering the Market through Debt Buyers*, 26 LOY. CONSUMER L. REV. 25, 31 (2013).

vacated by the lender.[123] Lenders appear to abandon foreclosures for a variety of reasons. Several studies have attempted to show that homeowners may be more likely to default if they owe more on the home than it is worth.[124] In her study of abandoned properties in Newark, New Jersey, Professor Linda Fisher found that 37 percent of the properties had been abandoned by both the homeowner and the lender, suggesting that home value may have contributed to the abandonment.[125] Some properties may not be worth the cost of the foreclosure; but if that were the only cause of the long timelines it hardly makes sense for the industry to complain.

A closer look at what has happened in New Jersey, however, suggests other reasons for the delays. Daren Bloomquist of RealtyTrac claims the foreclosure backlog in New Jersey is due to "litigation, legislation and mitigation."[126] The backlog is largely a result of abandoned foreclosures and lender misconduct in the foreclosure process.[127] In 2010, Chief Justice Rabner, concerned about reports of shoddy paperwork being filed in New Jersey courts, helped enact a court rule that mandates attorneys who file foreclosure complaints to communicate with their client to determine that the information in the filed documents is accurate and based on an actual inspection of the record.[128] It is true that the rule caused foreclosure filings to fall from 58,445 in 2010 to 11,037 in 2011.[129] However, this is hardly the fault of the judicial system. What it proves—if it proves anything—is that in New Jersey, prior to 2010, lenders were filing foreclosures based on inaccurate documentation. The

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123. *Id.* at 31–43.

124. Demiroglu, *supra* note 94, at 228 (finding that negative equity may increase the likelihood of default).

125. Linda E. Fisher, *Shadowed by the Shadow Inventory: A Newark, New Jersey, Case Study of Stalled Foreclosures and Their Consequences*, 4 U.C. IRVINE L. REV. 1265, 1277–78 (2014).

126. Joe Light, *Foreclosure Backlog Slows Housing Recovery in Some States*, WALL ST. J., Nov. 14, 2014, available at http://www.wsj.com/articles/foreclosure-backlog-slows-recovery-in-some-states-141598909; Fisher, *supra* note 125 (looking at a New Jersey-specific study of the issue).

127. Joe Tyrell, *New Foreclosure Procedures Put to Test as Number of Cases Climbs in New Jersey*, NJSPOTLIGHT (Feb. 4, 2015), *available at* http://www.njspotlight.com/stories/15/02/02/new-foreclosure-procedures-put-to-test-as-number-of-cases-climbs-in-nj/.

128. *See* N.J. SUP. CT. R. 4:64-1. Foreclosure Complaint, Uncontested Judgment Other Than In Rem Tax Foreclosure:

(a)Title Search; Certifications.

> (1) Prior to filing an action to foreclose a mortgage, a condominium lien, or a tax lien to which R. 4:64-7 does not apply, the plaintiff shall receive and review a title search of the public record for the purpose of identifying any lienholder or other persons and entities with an interest in the property that is subject to foreclosure and shall annex to the complaint a certification of compliance with the title search requirements of this rule.
>
> (2) In all residential foreclosure actions, plaintiff's attorney shall annex to the complaint a certification of diligent inquiry:
>
> > (A) that the attorney has communicated with an employee or employees of the plaintiff who (i) personally reviewed the documents being submitted and (ii) confirmed their accuracy; and
> >
> > (B) the name(s), title(s) and responsibilities in those titles of the plaintiff's employee(s) with whom the attorney communicated pursuant to paragraph (2)(A) of this rule.
>
> (3) Plaintiff's attorney shall also annex to the complaint a certification, executed by the attorney, attesting that the complaint and all documents annexed thereto comport with the requirements of R. 1:4-8(a).

129. Tyrell, *supra* note 127.

lenders were unable to produce accurate documentation when required and, as a result, stopped filing foreclosure actions. The fact that a lender is unable to meet its burden to honestly and accurately document its right to foreclosure is not the same as judicial-driven delay.[130]

Mortgage Electronic Registration Systems ("MERS") was a contributing factor in the paperwork problems across the country, but this was especially true in in Florida.[131] MERS was created by the industry (largely the GSEs) to ease the transfer of paper in the buying and selling of mortgages.[132] Unfortunately, MERS did not operate in the manner intended and numerous paperwork problems resulted.[133] Studies of Florida foreclosures show that involvement by MERS made it more likely the loan would end up as a "zombie" loan.[134] In addition, a substantial number of foreclosures in Florida were handled by the Stern Law Office. This law firm handled the bulk of the GSEs' filings in the state.[135] Unfortunately for everyone, these foreclosures were handled by fraudulently recreating documents and the robo-signing of affidavits.[136] The firm eventually closed and Mr. Stern was disbarred; but not until hundreds of thousands of foreclosure cases had been mishandled.[137] This at least suggests that the long foreclosure timelines and high rate of "zombie" loans in Florida are partially related to the industry's failure to properly handle its paperwork. It is ironic that the GSEs have raised the cost of home ownership in Florida because of the delays in foreclosure, many of which are the direct result of the system they created and the lawyer they hired to administer it.[138]

The situation in New York is similar. In 2010, New York's Chief Judge Lippman ordered all foreclosure attorneys to certify that their paperwork was accurate.[139] In New York City alone, this caused 4450 foreclosure cases to be stalled.[140] It is likely that many of these foreclosures have joined the list as

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130. For a discussion of what lenders need to establish in order to foreclose, see Renaurt, *supra* note 32.

131. Alan M. White, *Losing the Paper-Mortgage Assignments, Note Transfers and Consumer Protection*, 24 LOY. CONSUMER L. REV. 468, 486 (2012) [hereinafter White, *Losing the Paper*]; *see also* COMMISSION REPORT, *supra* note 3, at 407; Christopher L. Peterson, *Two Faces: Demystifying the Mortgager Electronic Registration System's Land Title Theory*, 53 WM. & MARY L. REV. 111 (2011).

132. White, *Losing the Paper*, *supra* note 131, at 486 (2012); David H. Carpenter, Cong. Research Serv., R41491, "Robo-Signing" and Other Alleged Documentation Problems in Judicial and Nonjudicial Foreclosure Processes (2010) at 6–7.

133. COMMISSION REPORT, *supra* note 3, at 407.

134. White, *Losing the Paper*, *supra* note 131, at 486.

135. Todd Ruger, *Top Florida Foreclosure Lawyer Shuts Down Firm*, HERALD TRIB. (Mar. 7, 2011), *available at* http://www.heraldtribune.com/article/20110307/WIRE/110309587.

136. *Id.*

137. Kimberly Miller, *Florida Supreme Court Disbars Foreclosure King David J. Stern*, PALM BEACH POST (Jan, 9, 2014), *available at* http://www.mypalmbeachpost.com/news/business/real-estate/fla-supreme-court-disbars-foreclosure-king-david-j/nchLs/.

138. *See id.*

139. David B. Caruso & Alan Zibel, *New York Judge Orders Foreclosure Lawyers Held Accountable for Accuracy of Paperwork*, HUFFINGTON POST (December 20, 2010) http://www.huffingtonpost.com/2010/10/20/new-york-judge-orders-for_n_770798.html.

140. Robert Gearty, *Dubious signatures, missing, inaccurate paperwork halt 4,450 city foreclosures*, N.Y. DAILY NEWS (Oct. 24, 2010), *available at* http://www.nydailynews.com/new-york/dubious-signatures-missing-inaccurate-paperwork-halt-4-450-city-foreclosures-article-1.187597.

"zombie" loans.

The delays the industry wants to blame on judicial procedure are really the result of lender malfeasance. Eliminating the need for a plaintiff to prove its case should never be the basis for accelerating the foreclosure process. With no other compelling rationale, the lending industry's argument in support of faster foreclosure devolves into an argument that, because it is too burdensome to prove the right to foreclose, states should not require it. It is also an acknowledgement that in states that make foreclosing parties produce valid paperwork, foreclosure takes longer. The length of time for the foreclosure to be completed is the price we pay for due process. It is a price worth paying.

D. The Role of Bankruptcy

Bankruptcy proceedings are another reason that reported foreclosure timelines can be deceiving. In non-judicial states, homeowners appear to use bankruptcy proceedings as a substitute for state judicial process.[141] Homeowners facing foreclosure usually file for bankruptcy relief under either Chapter 7 or Chapter 13 of the bankruptcy code.[142] Either will temporarily stay the foreclosure proceeding, but a Chapter 13 is often preferable for a homeowner wishing to maintain possession of the home.[143] A Chapter 13 bankruptcy provides a mechanism to cure the default over the life of the bankruptcy plan.[144] In their study, White and Reid found that bankruptcy protection is more useful in preventing foreclosures in non-judicial states.[145] This makes sense in that a bankruptcy proceeding may provide some of the oversight that a non-judicial procedure lacks. However, White and Reid ultimately concluded that during the recent crisis, bankruptcy acted more as a delay than a cure to the foreclosure.[146] Mortgage modification was more successful than bankruptcy in curing default.[147] While non-judicial foreclosure appears more efficient, it may simply be pushing homeowners into bankruptcy, a less efficient and more time consuming process.

IV. THE COSTS OF FORECLOSURE

Before moving into the reasons that support judicial foreclosure, it is important to evaluate the very concept of "foreclosure" as something to be

141. *See* Alan M. White & Carolina Reid, *Saving Homes? Bankruptcy and Loan Modification in the Foreclosure Crisis*, 65 FLORIDA L. REV. 1713 (2013); Demiroglu, *supra* note 94, at 231.

142. White & Reid, *supra* note 141, at 1717.

143. 11 U.S.C. § 362(a)(2012).

144. White & Reid, *supra* note 141, at 1717–18. Since the beginning of the crisis, advocates have been calling for changes in the Bankruptcy Code that would allow the Trustee to modify mortgage terms in a Chapter 13 bankruptcy. For more on this debate, see Adam J. Levitin, *Resolving the Foreclosure Crisis: Modification of Mortgages in Bankruptcy*, 2009 WIS. L. REV. 571 (2009).

145. White & Reid, *supra* note 141, at 1715.

146. *Id.* at 1736.

147. *Id.*

avoided. There is a growing consensus that foreclosures cause harm. As President Obama stated in 2009, by investing:

> in foreclosure-prevention today, we will save ourselves the costs of foreclosure tomorrow - costs borne not just by families with troubled loans, but by their neighbors and communities and our economy as a whole.[148]

The debate is whether "harm" is a necessary evil to a vital housing market. No one argues that lenders should never be able to foreclose on a loan. The question is whether policy should favor the foreclosure, as it has for the last several decades, or whether it should favor homeowners, as advocates have been claiming since the onset of this crisis.

A. Costs to the Lenders and Investors

As stated previously, lenders complain that foreclosure costs are too high, especially for judicial foreclosure.[149] Freddie Mac estimated those costs to be $58,759 per loan.[150] The extent to which these losses are borne by the lender, the investor, or an insurer depends on a number of factors.[151] Professor White studied records of 32,190 foreclosure sales involving securitized loans and estimates investors "lost approximately $4.72 billion" or approximately "$146,716" per home.[152] While it is logical to claim that lenders also want to avoid foreclosure, that is not what is happening in the real world.

In the real world it is neither the lender nor the investor who is in primary contact with the borrower. It is the servicer. Servicers do not have the same financial incentives to avoid foreclosure that lenders and banks have.[153] They have to hire and train staff and improve technology; but these are additional costs for which they are not compensated.[154] Most of the loans were in securitized trust governed by Pooling and Servicing Agreements ("PSAs"). While most PSAs allow for loan modification, the decisions required a certain amount of discretion that the servicers were reluctant to exercise.[155] In the end, many loans that could have been saved went into foreclosure.

B. Foreclosure's Effects on Property Values

The cost of an avoidable foreclosure is not just borne by the parties to the transaction. Numerous studies have documented that foreclosures depress

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148. *Obama Foreclosure Speech: Housing Plan (FULL TEXT)*, HUFFINGTON POST (Mar. 21, 2009), http://www.huffingtonpost.com/2009/02/18/obama-foreclosure-speech_n_167889.html.

149. Darryl E. Getter, Cong. Research Serv., RL34232, Understanding Mortgage foreclosure: Recent Events, the Process, and Costs (2007), *available at* http://assets.opencrs.com/rpts/RL34232_20071105.pdf.

150. *Id.* at 11.

151. For the industry perspective, *see* MORTG. BANKERS ASSOC., *Lenders' Cost of Foreclosure* (May 28, 2008), http://dcwintonlaw.com/wp-content/uploads/2010/06/Lenders-Cost-of-Foreclosure.pdf.

152. Justin Wagner, *Assisting Distresses Homeowners to Avoid Foreclosures: An Advocate's Role in an Evolving Judicial and Policy Environment*, 17 GEO. J. ON POVERTY L. & POL'Y 423, 434 (2010).

153. Cordell, *supra* note 19, at 2.

154. *Id.* at 15–16.

155. *Id*. at 21–22.

surrounding housing prices as well.[156] The results are consistent for studies done before and after the mortgage crisis that began in 2006.[157] As stated earlier, at least one very recent study found that the size of the price decline is larger in non-judicial foreclosure states than judicial foreclosure states because homes are more likely to be foreclosed in non-judicial states.[158] The specifics about the size of the decline, as well as about the geographic and temporal impacts of the decline, differ slightly from study to study, but the overall conclusion is consistent: the value of properties located near a foreclosure will decrease due to that foreclosure.[159] An example of how substantial this impact can be in a neighborhood is well-illustrated in a 2011 study of Sacramento, California by Robert Wassmer.[160]

Wassmer studied the extent of the price depreciation in the selling of non-real estate owned homes caused by the presence of real estate owned homes.[161] As with other studies, he found that the magnitude of the impact decreased as one moves further from the home.[162] The decrease in value "averaged $48,827 per home."[163] This is a shockingly high number, but he acknowledged that the magnitude of a price decline this size may be found in only a few other similar urban areas.[164] That, however, does not diminish the fact that in eighteen months he estimated that the City of Sacramento lost $1.1 billion in property

156. *See* Elliot Anenberg & Edward Kung, *Estimates of the Size and Source of Price Declines Due to Nearby Foreclosures*, 104 AM. ECON. REV. 247 (2014) (finding a 1.5 percent drop in home prices for each foreclosure listed within 0.1 miles); Charles Calomiris, Stanley D. Longhofer, & William Miles, *The Foreclosure-House Nexus: Lessons from the 2007-2008 Housing Turmoil*, NAT. BUREAU OF ECON. RES., at 25 (2008), *available at* www.nber.org/papers/w14294 (finding foreclosure has a "small effect . . . on house prices . . . [and] conservatively (over-)estimate that the national average price decline for houses from the 2007:Q2 peak to 2009:Q4 will be roughly 5.5 percent"). They then go on to conclude that "a reasonable estimate of the future path of U.S. housing market prices is that they will remain essentially flat, on average, for the next two years, notwithstanding the large predicted increase in foreclosures." *Id.*; John Y. Campbell, Stefano Giglio, & Parag Pathak, *Forced Sales and Housing* Prices, 101 AM. ECON. REV. 2108, 2124 (2011) (finding considerable evidence that "foreclosures within 0.25 mile, and particularly within 0.1 mile, lower the price at which a house can be sold."); John Harding, Eric Rosenblatt & Vincent W. Yao, *The Contagion Effect of Foreclosed Properties*, 66 J. OF URBAN ECON. 164, 165 (2009) (confirming that nearby foreclosed properties have "significant negative contagion effects over and above the local trend in house prices"); Daniel Hartley, *The Effect of Foreclosures on Nearby Housing Prices: Supply or Dis-Amenty?*, 49 REG'L SCI. & URB. ECON. 108 (2014) (finding that nearby foreclosures depress housing prices by 1.3 percent); Dan Immergluck & G. Smith, *The External Costs of Foreclosures on Neighborhood Property Values*, 17 HOUS. POL'Y DEBATE 57 (2006) (stating that foreclosure within 1/8 of a mile reduces the value of neighboring houses by 1.1 percent); Mian, Sui, & Trebbi, *supra* note 99; Anthony Pennington-Crosse, *The Value of Foreclosed Property*, FED. RESERVE BANK OF ST. LOUIS (2004) (discussing a study done before the crisis documenting that prices decline in homes near a foreclosure, decreasing as you move away from the sale both in time and distance).

157. At least one study raised the possibility that the effects of this price depression may be larger because of the number of foreclosures. Calomiris, *supra* note 159, at 14. They took this into account in their model, but could neither prove nor disprove it. At the same time, their predictions of only small housing price drops as a result of the crisis proved to be widely inaccurate.

158. Mian, Sui, & Trebbi, *supra* note 99, at 28.

159. *See supra* note 156.

160. Robert W. Wassmer, *The Recent Pervasive External Effects of Residential Home Foreclosure*, 21 HOUS. POL'Y DEBATE 247 (2011).

161. *See generally id*. An REO ("real estate owned") is a term that refers to a property, post foreclosure sale that has been purchased by the lender.

162. *Id.* at 260.

163. *Id.*

164. *Id.*. at 261.

sales value.[165] This was not just a loss to the individuals, it was a huge loss to the local property tax base.[166] Such a huge loss of revenue must certainly be followed by a reduction in municipal services. Consequently, everyone in Sacramento suffered as a result of the foreclosure crisis.

There are several theories as to why foreclosures depress neighboring house prices. First, it could be a supply problem. When an unusually large number of properties become available because of foreclosure, supply and demand theories operate to lower the price of neighboring properties.[167] A second possibility is that foreclosed properties, because they typically sell for less than non-foreclosure properties, depress the appraisal values of neighboring, comparable properties used by appraisers.[168] Finally, houses in foreclosure are likely to be under-maintained, which could "send a negative signal to potential buyers about the quality of life and social control in the neighborhood."[169] All of these probably interact in some way to create these results. The last of these theories has led to a number of studies on the effects of foreclosures on neighborhoods.

C. The Contagion Effect

The contagion effect is the name given to the fact that one foreclosure in a neighborhood affects all the neighboring properties the way a virus might affect a room full of school children. As stated earlier, it is fairly well established that foreclosures depress the value of other homes in the neighborhood.[170] Properties that do make it to sheriff sale tend to sell for less than properties that sell in normal conditions.[171] There are several theories for why this may be. It has been suggested that one reason foreclosed properties sell for a reduced price is that homeowners fail to maintain homes in foreclosure.[172] It is also true that there is a small pool of buyers in a foreclosure auction and those buyers come in with a different set of expectations about price.[173] These buyers are more often investors who intend to resell the

165. *Id* at 260.

166. *Id.* at 261. Wassmer also points out that, because of Proposition 13, the community has no ability to raise property rates to make up this difference. *Id.*

167. *Id.* at 252; *see also* Hartley, *supra* note 156, at 116 (discussing that his findings that could be explained by over-supply); Mian, Sui, & Trebbi, *supra* note 99, at 30 (finding "foreclosure-induced increase in supply" depresses neighboring house prices).

168. Wassmer, *supra* note 160, at 252. The Uniform Standards of Professional Appraisal Practice do not require this, but has said, in response to questions, "[t]here are many appraisal assignments where, in order to achieve credible results, it is necessary to use 'distress' (e.g., REO or Short Sales) properties as comparable sales." *ASB Issues June 2011 USPAP Q&A*, APPRAISAL NEWS (June 15, 2011), http://appraisal-news.com/2011/06/asb-issues-june-2011-uspap-qa/.

169. Wassmer, *supra* note 160, at 252.

170. *See supra* note 156.

171. John Y. Campbell, Stefano Giglio & Parag Pathak, *Forced Sales and House Prices*, 101 AM. ECON. REV. 2108, 2129 (2011) (finding that homes sold in foreclosure sold at a 27 percent discount).

172. *See* Anenberg, *supra* note 156, at 2550 (finding that in high-density neighborhoods the lack of maintenance of homes in foreclosure contributes to lower property values).

173. John P. Harding, Eric Rosenblatt, & Vincent W. Yao, *The Foreclosure discount: Myth or reality?*,

property, as opposed to prospective homeowners who intend to occupy the property after the sale. This difference creates an expectation in the buyer that he should be able to purchase the property at a discount.[174] Often, the only buyer at the auction is the lender.[175] One study found that when the lender buys and then resells a foreclosed home, it sells the home at a loss between 72 percent and 90 percent of the time.[176]

The contagion effect is not only felt in housing costs. Mian, Sui, and Trebbi found that as housing prices drop, so does overall residential investment.[177] There is little incentive to build in areas with shrinking home values. Their results were more pronounced in non-judicial states because, as mentioned earlier, non-judicial states had more foreclosures relative to their default rates.[178] Interestingly, their evidence suggests that it is not only housing-related consumer spending that suffers as a result of foreclosed properties in the neighborhood; other consumer spending also falls.[179] For example, they found that auto sales from 2008 to 2010 "were 5 to 10% lower in non-judicial versus judicial states."[180] Their study suggests that foreclosures have far-reaching effects on the economy in general and not just on local housing prices.[181]

Foreclosures have also been blamed for other societal ills. The results are mixed as to whether the contagion effect of decreasing housing prices also increases crime in an area. One theory is that the physical disorder caused by foreclosure affects the social order and that as social order decreases, crime increases.[182] Several previous studies had suggested that vacant buildings cause a decrease in civil behavior and, as a result, an increase in crime.[183] The question is whether foreclosures or vacant buildings are the problem. Most studies have found that increased foreclosures do not necessarily correspond to a rising level of crime.[184] To the extent that foreclosures cause vacant buildings and vacant buildings increase crime, there is clearly some connection between foreclosure increases and increases in crime. This relationship, however, is still not well understood.

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71 J. OF URB. ECON. 204, 206 (2012).

174. *Id.* at 205.

175. Debra Pogrund Stark, *Facing the Facts: An Empirical Study of Fairness and Efficiency of Foreclosures and a Proposal for Reform*, 30 U. MICH. J.L. REFORM 639, 663 (1997).

176. *Id.* at 663–64.

177. Mian, Sui, & Trebbi, *supra* note 99, at 22.

178. *Id.* at 2.

179. *Id.*

180. *Id.* at 22.

181. *Id.* at 30.

182. Roderick W. Jones & William Alex Pridemore, *The Foreclosure Crisis and Crime: Is Housing-Mortgage Stress Associated with Violent and Property Crime in U.S. Metropolitan Areas?*, 93 SOC. SCI. Q.672, 673 (2012).

183. *See* William Spelman, *Abandoned Buildings: Magnets for Crime*, 21 J. OF CRIM. JUST. 481 (1993); James Q. Wilson & George L. Kelling, *Broken Windows: The Police and Neighborhood Safety*, 27 ATLANTIC MONTHLY 29 (1982).

184. Jones, *supra* note 182, at 674, 683.

Research is just beginning to emerge on other negative implications of foreclosure. A recent study by Jason Houle looked at whether "living in high foreclosure localities is associated with residents' mental health."[185] Several previous studies had shown an association between foreclosure and worsening mental health.[186] As Houle pointed out, this foreclosure crisis hit hardest in disadvantaged communities. These same communities were already dealing with a number of social inequities and are now experiencing a disproportionate number of mental health issues as a result of the current foreclosure crisis.[187] The lost tax revenue caused by the foreclosure crisis has exacerbated the problem because it has also resulted in cuts to programs that could provide needed services in these communities. In my own small foreclosure defense practice, we have seen numerous people experiencing depression—and one suicide—because of their mortgage foreclosures.[188] These costs cannot be quantified.

V. THE CASE FOR LOAN MODIFICATION

The case for the harm of foreclosure is certainly made. But that does not translate into an argument for judicial foreclosure unless judicial foreclosure can somehow prevent foreclosure. Simply moving to judicial foreclosure will not end foreclosure, nor should it. However, there is at least some evidence that it will decrease the number of foreclosures.[189] Research suggests that living in a judicial foreclosure state increases the likelihood of receiving a loan modification.[190] Other studies have shown borrowers in states with a slow foreclosure process are more likely to cure their default.[191]

Loss mitigation is clearly an important part of any ongoing foreclosure policy. It is now required by federal law for most loans.[192] Researchers have

185. Jason N. Holue, *Mental Health in the Foreclosure Crisis*, 118 SOC. SCI. & MED. 1 (2014).

186. *Id.* at 2 (citing D. E. Alley et al., *Mortgage Delinquency and Changes in Access to Health Resources and Depressive Symptoms in Nationally Representative Cohort of Americans Older Than 50 Years*, 101 AM J. PUB. HEALTH 2293 (2011); J. Currie and E. Tekin, *Is There a Link Between Foreclosure and Health?* (2014), *available at* http://www.princeton.edu/~jcurrie/publications/Foreclosure_Health_Jan_2014.pdf; K. A. McLaughlin et al., *Home Foreclosure and Risk of Psychiatric Morbidity During the Recent Financial Crisis,* 42 PSYCHOL. MED. 1441 (2012); T. L. Osypuk, *The Consequences of Foreclosure for Depressive Symptomatology*, 22 ANN. EPIDEMIOL. 379 (2012)).

187. Houle, *supra* note 185, at 6.

188. I run the Economic Justice Clinic at the Notre Dame Law School. We represent clients in collection actions, primarily foreclosure. In addition, I act as a facilitator between lenders and homeowners for the Indiana Supreme Court in an attempt to negotiate loan modifications. In these two capacities, I have interacted with hundreds of homeowners since the crisis began.

189. Mian, Sui, & Trebbi, *supra* note 99, at 10 (finding that "[t]he 13 states with the highest foreclosure to delinquent account ratios all allow non-judicial foreclosure). It is possible, however, that this differential will be irrelevant if all states have the same system. It is not possible to know if foreclosures will decrease in non-judicial states or rise in judicial ones.

190. J. Michael Collins, Ken Lam, & Christopher E Herbert, *State Mortgage Foreclosure Policies and Lender Interventions: Impacts on Borrower Behavior in Default*, 30 J. POLICY ANALYSIS & MGMT. 216, 226 (2011).

191. *Id.* at 219.

192. Reg. X., C.F.R. § 1024.41(a)–(j).

begun to look at loan modifications in the context of the crisis. This research documents the reverse incentives of loan servicing. We know that loan modification is also more likely if the loan is held by the original lender.[193] This is consistent with the understanding that lenders lose money in foreclosure. Securitized loans are less likely to be modified, but GSE-securitized loans are more likely to be modified.[194] Both of these statistics lend credibility to the argument that servicers are still claiming servicer restrictions, even though we know such restrictions do not exist.[195] Recent research has also documented that servicers strategically "lost" paperwork on low risk borrowers in an effort to steer them away from HAMP modifications into more expensive proprietary modifications.[196]

The Consumer Financial Protection Bureau ("CFPB") recently enacted regulations requiring a servicer to reach out to homeowners within fifteen days of a second missed payment.[197] The rules do not require any specific loss mitigation options, just that loss mitigation be attempted.[198] The U.S. Department of the Treasury currently monitors and reports on the status of loan modifications through its Making Homes Affordable Program. This program is scheduled to end soon, and the future of loan modifications once it expires is uncertain.[199]

A recent study by J. Michael Collins and Carly Urban suggests that simply by continuing its monitoring, the Treasury could improve the incidence of loan modifications.[200] The study looks at the situation in Maryland, arguably a non-judicial foreclosure state. In 2008 Maryland began requiring state-level loan servicers to report monthly on their efforts to assist homeowners.[201] No specific results were required, nor were there any sanctions for noncompliance.[202] Nonetheless, the study showed that the servicers behaved differently for homeowners in Maryland than for similar homeowners in neighboring states without the rule.[203] The only difference between the states was that, in Maryland, someone was monitoring the loss mitigation process. It

193. Been, *supra* note 19, at 3961.

194. *Id.*

195. McCoy, *supra* note 8, at 761–62.

196. John A. Karikari, *Why Homeowners' Documentation Went Missing Under the Home Affordable Mortgage Program (HAMP)?: An Analysis of Strategic Behavior of Homeowners and Services*, 22 J. HOUS. ECON. 146, 154 (2013).

197. Reg. X., 12 C.F.R. § 1024.41. The lender cannot initiate foreclosure, however, until the homeowner is 120 days delinquent and any loan modification process is complete.

198. *Id.*

199. As of the writing of this article, the HAMP program has been extended to December 31, 2015. *Obama Administration Extends Deadline for Making Homes Affordable Program*, May 30, 2013, *available at* http://www.makinghomeaffordable.gov/about-mha/latest-news/Pages/Obama-Administration-Extends-Deadline-for-Making-Home-Affordable-Program.aspx.

200. J. Michael Collins & Carly Urban, *The Dark Side of Sunshine: Regulatory Oversight and Status Quo Bias*, 107 J. ECON. BEHAVIOR & ORG. 470 (2014).

201. *Id.* at 471.

202. *Id.*

203. *Id* at 485.

is possible, therefore, that the very fact that the CFPB will continue monitoring compliance with the loss mitigation process may motivate lenders to make substantive decisions as well. It is even more important, however, that state programs continue their supervision.[204]

During the foreclosure crisis, many states enacted foreclosure mediation programs.[205] These programs have been wildly successful.[206] Unfortunately for homeowners, the Mortgage Bankers Association has been aggressively seeking to end these programs, often with inaccurate information about the pre-emptive effect of the CFPB regulations.[207] The loss mitigation regulations are not pre-empted by the Dodd-Frank legislation; nor, frankly, are the processes in state mediation programs duplicative of the process required by the regulations.[208] Unfortunately, many of the same issues that have plagued loss mitigation are still prevalent in the system. The CFPB is able to monitor on a systematic, but not a case by case, basis. The state-based programs can assist on an individual loan level, assuring that all measures have been taken to prevent the foreclosure, if possible. As the Maryland study documents, this loan level scrutiny is essential to ensure good outcomes for homeowners.

The future of loan modification is still unclear. Two arguments are most commonly made by opponents of loan modification. The first is that they simply do not work. The claim is that loan modifications have high default rates and do not prevent the ultimate foreclosure.[209] The second is that the very idea of a loan modification will create moral hazard in the marketplace.[210]

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204. *See* REBUILDING AMERICA, *supra* note 11, at 12–20 (providing additional rationale for state monitoring).

205. *Id.* (providing an overview of state programs).

206. *Id.* at 21.

207. As of the writing of this document, the Mortgage Bankers Association has successfully lobbied to end mortgage mediation in Michigan (on the grounds of pre-emption) and in Connecticut (on the grounds of cost savings). Efforts are underway in Oregon, Maine and Indiana.

208. BUREAU OF CONSUMER FINANCIAL PROTECTION AGENCY, 12 C.F.R. Parts 1024 and 1026 [Docket No. CFPB-2013-0010] RIN 3170-AA37 Amendments to the 2013 Mortgage Rules under the Real Estate Settlement Procedure Act (Regulation X) and the Truth in Lending Act (Regulation Z), Bureau of Consumer Financial Protection. ACTION: Final rule; official interpretations.

> Because the Bureau continued to receive questions on this issue, the Bureau believed it was appropriate to propose commentary to clarify the scope of proposed § 1024.5(c) and expressly address concerns about field preemption. Consistent with the preamble to the 2013 RESPA Servicing Final Rule, proposed comment 5(c)(1)-1 stated that State laws that are in conflict with the requirements of RESPA or Regulation X may be preempted by RESPA and Regulation X. Proposed comment 5(c)(1)-1 stated further that nothing in RESPA or Regulation X, including the provisions in subpart C with respect to mortgage servicers or mortgage servicing, should be construed to preempt the entire field of regulation of the covered practices. This proposed addition to the commentary was meant to clarify that RESPA and Regulation X do not effectuate field preemption of States' regulation of mortgage servicers or mortgage servicing. The comment also made clear that RESPA and Regulation X do not preempt State laws that give greater protection to consumers than do these federal laws.

Id.

209. *See, e.g.*, Gerardi, *supra* note 59.

210. *See* Rojhat Berdan Avsar, *Foreclosure Crisis and Innovative Policy Responses: A Constructive Critique*, 48 J. ECON. ISSUES.155, 158 (2014).

A. The Failures of Loan Modification

The more pervasive of the two arguments is that loan modifications simply do not work. The problem with that conclusion is that it is based largely on data from the very beginning of the crisis when loan modifications were not really loan modifications.[211] The loan modifications given at the beginning of the crisis most often increased a borrower's payments.[212] Lenders often demanded upfront fees and onerous waivers of future consumer rights.[213] A bad loan modification is worse than no modification, but the fact that servicers were only offering bad modifications is not an argument against all modifications.

Things changed, albeit gradually, with the introduction of the HAMP program in 2009.[214] The program is running more efficiently and with better outcomes. The most recent HAMP program performance report shows an increase in permanent loan modifications and improved re-default rates.[215] Some problems with HAMP remain.[216] The paperwork is confusing and repetitive; and the program guidelines are complex and ever changing.[217] Servicers are still rejecting applications for very minor issues.[218] Accounting rules and the presence of second lienholders hamper the process.[219] Silly policy decisions still prevent homeowners and lenders from making the best decisions. For example, a homeowner cannot explore more than one loss mitigation option at any one time. He must choose to either sell the home or apply for a loan modification. If he takes the time to sell the home, he loses the opportunity to apply for a loan modification. If he applies for a loan modification and does not qualify, he has wasted months in which he may have sold the property.

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211. Gerardi, *supra* note 59 (looking at data from 2005–2010).

212. White, *supra* note 8, at 529.

213. *At the Crossroads: Lessons From the Home Affordable Modification Program (HAMP)*, NAT'L CONSUMER LAW CTR., at 14 (Jan. 2013) [hereinafter CROSSROADS].

214. *Id.* at 18.

215. MAKING HOME AFFORDABLE, PROGRAM PERFORMANCE REPORT THROUGH THE THIRD QUARTER OF 2014, *available at* http://www.treasury.gov/initiatives/financial-stability/reports/Documents/3Q%20MHA%20Report%20Final.pdf; *see also*, Amy Crew Cutts & William A. Merrill, *Intervention in Mortgage Defaults: Policies and Practices to Prevent Home Loss and Lower Costs*, FREDDIE MAC WORKING PAPER #08-01, at 15 (Mar. 2008) (claiming an 80 percent five-year success rate for Freddie Mac loan modifications).

216. McCoy, *supra* note 8, at 752–70.

217. RECLAIMING THE RULES: SOLUTIONS FOR MORTGAGE SERVICING, A REPORT OF THE CALIFORNIA MONITOR, 7–11 (Sept. 30, 2014), *available at* https://oag.ca.gov/sites/all/files/agweb/pdfs/mortgage_settlement/06-report-reclaiming-the-rules.pdf

218. In my experience facilitating hundreds of settlement conferences between lenders and homeowners from 2011 to the present, there are several, silly issues that reappear on a consistent basis. (1) Improper completion of the RMA, the standard form needed to apply for a HAMP loan modification. It has a section at the end of the application that asks for race, ethnicity, and gender. Many people check off their ethnicity or race, but not both, thinking one takes care of the other. The result is an "incomplete application," with no explanation about what is incomplete. (2) Improperly completed 4506T form, the form sent to the IRS to verify income. Applicants must ask for the tax returns for 12/31/2014, not December 31, 2014 or the year 2014 or any other variation. Any variation causes an "incomplete application;" and (3) completion of the wrong form (RMA instead of the FHA Form 70) because the homeowner completed what the servicer gave to him to complete, but it was wrong. This too results in an "incomplete application."

219. McCoy, *supra* note 8, at 765–68.

In addition to claiming that loan modifications do not work, lenders also claim that they add needless time to the foreclosure process. They simply delay the inevitable. Again, the evidence does not support the claim. The State Justice Institute did a comprehensive study of Connecticut's mortgage foreclosure mediation program.[220] It found that foreclosure cases for eligible borrowers who participated in mediation took an average of thirty-five percent longer to resolve than those that did not participate in mediation.[221] However, they also noted that the delays in the process were most often attributed to the lenders, not the homeowners.[222] "[P]laintiffs (or their attorneys) were more likely to be unprepared, to file a continuance, to engage in conduct inconsistent with the objectives of the mediation program, not to possess the ability to mediate, or not to make an appearance."[223]

This is consistent with my experience as a facilitator for the Indiana Mortgage Foreclosure Trial Court Assistance Program.[224] Since 2011, I have acted as a facilitator for hundreds of settlement conferences between homeowners and lenders. The delays in the process are nearly always caused by the servicers. The problems range from very serious issues such as refusing to participate in the conference to the less serious, and more common, problem of asking for the same documents multiple times, despite having them in their possession. A review of a random sample of cases from Allen County, Indiana revealed that the average time to resolve facilitated cases was essentially the same as for non-facilitated cases.[225] Most of the delays in the cases occurred after the facilitation process had ended. It can take months for the lender to proceed with the foreclosure if there is no settlement and dismiss the case when there is a settlement.[226] As with the faulty paperwork, the lenders are using a delay they have created to argue for the elimination of borrower protections and speedier process.

B. Moral Hazard

A second argument against loan modification is that it will create "moral

220. Gloria Jean Gong & Carl Brinton, *Connecticut Judicial Branch Mortgage Foreclosure Mediation program Evaluation*, STATE JUST. INST. (Oct. 2014), *available at* http://www.jud.ct.gov/statistics/fmp/sji_eval.pdf.

221. *Id.* at 29–30.

222. *See id.* at 30.

223. *Id.*

224. For an overview of the program, see Division of State Court Administration, *Mortgage Trial Court Assistance Project*, at https://secure.in.gov/judiciary/admin/2416.htm.

225. The average time to complete a cases was 267.9 days for facilitated cases versus 297.6 days for cases not facilitated. In Bartholomew County, a county with many fewer foreclosures, there was a 30 percent increase in time to complete a facilitated case, which was roughly equivalent to the three month trial period. This is consistent with the results from Connecticut. Data is on file with the author.

226. Some of the delay in dismissing after a settlement may be attributed to the trial modification process mentioned previously. The lender will usually not dismiss until all three trial payments have been made and the permanent loan modification is in place. Even if everything goes perfectly—and it never does—this takes four months. Looking at just the time from filing to completion, this adds at least 120 days, even though the homeowner is making payments throughout that time period.

hazard."[227] Moral hazard can be described "as *carelessness* encouraged by implicit guarantees (e.g. bailouts)."[228] The concern is that if the government assists a homeowner who perhaps purchased a home he could not afford or signed a loan document without understanding the terms, it will encourage others to act in a similarly careless manner in the future. The industry has been trying to present a case for wide-spread strategic default for years.[229] Despite these efforts, there is no indication that strategic default was a significant player in the recent foreclosure crisis.[230]

There are a number of problems with these studies. First, researchers typically look at loan-level data and try to guess who has strategically defaulted and who has not.[231] Many of these data sets are problematic. For instance, LPS, a commonly used data set, does not indicate loan modification at all, so some researchers try to guess by determining when the loan became current.[232] The problem with this approach is twofold: (1) as they acknowledge, "approximately 4 percent" of the delinquent loans simply disappear, whether because they are transferred or other reasons,[233] and (2) there has been a persistent problem in the industry of not "booking" loan modifications.[234]

In order to understand the problem, a homeowner must first understand the process for qualifying for a loan modification. The servicer examines the paperwork and determines whether the homeowner qualifies for the loan modification, but there is an initial trial period to be sure the owner can sustain the payments. During this trial period, which usually lasts between three-to-

227. McCoy, *supra* note 8, at 762–63. The HAMP program specifically thought to deal with the moral hazard problem by introducing the NPV, net present value test. CROSSROADS, *supra* note 213, at 16. The calculations allowed servicers to calculate whether the lender would benefit more financially from a modification or a foreclosure. *Id.* If foreclosure was more profitable, the lender was not required to offer a loan modification. *Id.*

228. Avsar, *supra* note 210, at 163.

229. There are essentially two reasons you would default on your mortgage: (1) you can no longer afford to make the payments because of some event like an illness or loss of income, or (2) you are simply unwilling to make the payments, according to the industry, "because the home's value has declined to a level far below the outstanding balance on the loan." Michael J. Seiler, Vicky L. Seiler, Mark A Lane, & David M. Harrison, *Fear, Shame and Guilt: Economic and Behavioral Motivations for Strategic Default*, 40 REAL EST. ECON. S199, S199 (2012). For further discussion of strategic default, see Fox, *supra* note 122, at 26–29.

230. Foote, Gerardi, Gotte, & Willen, *Reducing Foreclosures: No Easy Answers*, 24 NBER MACROECONOMICS ANNUAL 89, 115 (2009), *available at* jstor.org/stable/a0.10861648289; *see also,* Michael Hiltzik, *Inflated Threat of Strategic Default,* L.A. TIMES (Feb. 26, 2012), *available at* http://articles.latimes.com/2012/feb/24/business/la-fi-hiltzik-20120224; Richard DeKaser, *"Strategic Defaults" less Common than Thought*, WASH. POST (Aug. 7, 2010), http://www.washingtonpost.com/wp-dyn/content/article/2010/08/05/AR2010080507381.html.

231. Seiler, *supra* note 229, at 231.

232. *See* Gerardi, *supra* note 59, at 25–26.

233. *Id.* at 26.

234. *See* Karikari, *supra* note 199; Jacob Adelman, *Bank of America, JPMorgan Chase: Object of Mortgage Lawsuit,* CHRISTIAN SCI. MONITOR (Nov. 8, 2010), *available at* http://www.csmonitor.com/Business/Latest-News-Wires/2010/1108/Bank-of-America-JPMorgan-Chase-object-of-mortgage-lawsuits (reporting on lawsuits filed alleging failure of banks to honor loan modifications); David Dayen, *Banks Find Appalling New Way to Cheat Homeowners*, SALON (Sept. 24, 2013), *available at* http://www.salon.com/2013/09/24/banks_find_appalling_new_way_to_cheat_homeowners_partner/ (documenting failure to honor loan modifications, especially when servicing is transferred); *In re* JPMorgan Chase Mortgage Modification Litigation, 18 F. Supp. 3d 62, 62 (D. Mass 2014) (final approval of the settlement that was reached on Nov. 26, 2013 with relief to homeowners whose loan modifications were not honored).

five months, the homeowner makes the new mortgage payment, but the homeowner is still considered to be in default. The loan is not brought current. Mega-data would show that this loan is still in default, even though it is in loan modification repayment.[235] After the trial period the loan modification is supposed to become permanent. Only then will it appear as if the loan is current. Regrettably, loan servicers are notoriously slow in turning the trial modifications into permanent modifications on the books.[236] Frustrated homeowners are told to "just keep making the payments" while the computer catches up. The problem becomes worse for some owners when the loan mysteriously disappears when being transferred to a new servicer in the midst of a loan modification.[237] Multiple lawsuits that have been filed have gotten caught up in this trap. In December 2013, the CFPB announced a multi-billion dollar enforcement action against Ocwen, partially related to this issue.[238] Similar litigation with JPMorgan Chase was settled earlier.[239] Others are pending. All of this points to the unreliability of loan-level data to determine if loan modifications were offered, accepted, or honored. The data is simply not accurate.

A second problem lies in the assumptions made on the way to the conclusions. One example of a commonly cited study was done by Experian, the credit reporting company.[240] Its conclusion that a significant number of people strategically defaulted during the crisis rests on the assumption that a homeowner who is current on some of his credit, but not on his mortgage could afford to pay the mortgage and, therefore, has strategically defaulted on the mortgage.[241] The absurdity of that conclusion is obvious to anyone who has worked with actual borrowers during this crisis. When a homeowner does not have enough money to pay all of the bills, it is reasonable that he will decide to pay what he can. Many such borrowers logically choose to pay the car loan because they need a car to buy groceries, to go to work, or to look for employment. A borrower's decision to pay his car loan and not his mortgage loan because he cannot afford to pay both is not the same as strategically deciding to stop paying the mortgage. It is impossible to know a borrower's real financial situation simply by looking at a credit report. The estimates of

235. Brent T. White, *Take This House and Shove it: The Emotional Drivers of Strategic Default*, ARIZ. LEGAL STUDIES, at 32 (May 2010).

236. *See* Paul Kiel, *Homeowners Say Banks Not Following Rules for Loan Modifications*, PROPUBLICA (Jan. 14, 2010), *available at* http://www.propublica.org/article/homeowners-say-banks-not-following-rules-for-loan-modifications.

237. *See supra* note 234.

238. *Explainer: What the Multi-Billion Dollar Ocwen Enforcement Action Means for You*, CONSUMER FIN. PROT. BUREAU (Dec. 13, 2013), *available at* http://www.consumerfinance.gov/blog/explainer-what-the-multi-billion-dollar-ocwen-enforcement-action-means-for-you/.

239. Kiel, *supra* note 234; *JPMorgan Chase Mortgage Modification Litigation*, 18 F. Supp. 3d at 62.

240. *Strategic Default in Mortgages: Q2 2011 Update*, EXPERIAN-OLIVER WYMAN MARKET INTELLIGENCE REPORTS, *available at* http://www.experian.com/assets/decision-analytics/reports/oliver-wyman-strategic-default-2011.pdf.

241. *Id.* at 4.

strategic default based on such a review overestimate the number of people who strategically defaulted on their mortgage.

Despite the difficulties in doing these studies, several researchers have tried to establish why and if people strategically default on their mortgage loans.[242] Some useful themes have emerged from those studies. Some homeowners defaulted because it was the only way to get assistance.[243] Studies show that frustrated borrowers are more likely to strategically default on their mortgage.[244] Some borrowers were angered that help was available for big banks and for people who bought a house they cannot afford, but not for them, this seems to be the strategic default tipping point..[245] Homeowners who have a mortgage that exceeds the value of the house and then suffer some additional shock such as illness, divorce, or job loss are also more likely to default.[246] But, whether these defaults are strategic is hard to determine. The only emerging consensus from the research is that most people are reluctant to default on their mortgage.[247]

In the end, we know that large numbers of people defaulted on their mortgage during this crisis, whether for economic or strategic reasons. The real question that we should be asking is why was society so reluctant to assist homeowners when it was so quick to assist their lenders. One of the reasons seems to be the perception that the government is going to "bail out homeowners who made unwise decisions."[248] The willingness of people to offer governmental assistance to homeowners in foreclosure seems to be tied to the perception of "worthiness"[249] or "deservingness."[250]

Researchers have determined that one important aspect of the "deservingness" concept is the sense in which the person in need appears to lack control over the "cause of the disadvantage."[251] People are less willing to assist a person in harm's way if they perceive that the person needing assistance caused or contributed to his own harm.[252] People react with anger if they

242. *See, e.g.*, Brent T. White, *supra* note 235.

243. *Id.* at 24.

244. *Id.*; *see also* Seiler, *supra* note 229, at S221.

245. Brent T. White, *supra* note 235, at 36–40.

246. Neil Bhutta, Jane Djjo, & Hui Shan, *The Depth of Negative Equity and Mortgage Default Decisions*, DIV. OF RES. STATISTICS & MONETARY AFFAIRS FED. RES. BD. FIN. & ECON. at 3 (Discussion Series, Paper No 2010-34, 2010), *available at* http://www.federalreserve.gov/pubs/feds/2010/201035/201035pap.pdf.

247. Seiler, *supra* note 229, at S200–01.

248. Eric Posner & Luigi Zingales, *A Loan Modification Approach to the Housing Crisis*, 11 AM. ECON. REV. 575, 590 (2009), *available at* http://faculty.chicagobooth.edu/luigi.zingales/papers/research/a_loan_modification_approach_aler.pdf.

249. Several models have been proposed to determine "worth." Three useful models, proposed by Boltanski and Theveno, are "*equality* (civic worth), *purchasing power* (market worth), and *competence* (industrial worth)."Avsar, *supra* note 210, at 159. So, "[f]or instance, a given number of computers could either be allocated to everyone equally [equality], or be given to those who desire them the most [market], or could make the most efficient use of them [competence.]." *Id.*

250. Mark J. Brandt, *Onset and Offset Deservingness: The Case of Home Foreclosures*, 34 POL. PSYCHOL. 221 (2013).

251. *Id.* at 221.

252. Seiler, *supra* note 229, at S222.

perceive the person seeking assistance is somehow responsible for the circumstance (i.e. home foreclosure) and sympathy if they perceive the result as beyond the homeowner's control.[253]

As Seiler points out, the foreclosure crisis has presented an interesting opportunity to study the idea of deservingness. The rhetoric surrounding the crisis has been pervasive. Part of that pervasive rhetoric claims that, by allowing some people to modify their mortgage loans, it encourages others to "strategically default" in order to also get assistance. The myth or reality of "strategic default" is irrelevant to the analysis.

Figure 1 illustrates Seiler's examples of how different perceptions of "deserving" and "undeserving" homeowners can drive the willingness or unwillingness to assist a homeowner in foreclosure.[254] Political leanings can also influence a person's perceptions about deservingness. Research has shown, for example, that "people who endorse conservatism prefer firm answers and search for less information."[255] As a result, they are more likely to make a deservingness decision based on "onset" and not "offset" determinants.[256] While the underlying values and norms people used to determine deservingness may differ by political leanings, the process appears to be the same.[257] The research done by Seiler confirms that people of all political leanings are willing to assist homeowners in foreclosure if they are perceived to be both offset and onset "deserving."[258]

	DESERVING ASSISTANCE	UNDESERVING ASSISTANCE
ONSET	Deceived into taking out an unaffordable loan by unscrupulous loan officer[259]	Took out an unaffordable mortgage[260]
OFFSET	Lost income because of company downsizing[261]	Stopped making payments because the house is worth more than they owe or to get loan modification[262]

What this research suggests is that the rhetoric of the crisis is significant.[263] How the events are framed will influence how readily people

253. *See id.* at S223.
254. *See id.*
255. Brandt, *supra* note 250 at 233.
256. *See id.* at 224.
257. *See id.* at 222.
258. *See id.* at 232. The onset/offset determiners try to show point in time decisions. So an onset decision is one made before the event, like the decision to take out a mortgage. An offset determinate is one that happens afterwards—for example, my house was worth more than the loan when I took out the loan. *Id.* at 222–23.
259. *Id.* at 223.
260. *Id*.
261. *Id.*
262. *Id.*
263. The onset/offset determiners try to show point in time decisions. So an onset decision is one you made before the event, like the decision to take out a mortgage. On offset determinate is one that happens

support government intervention.[264] One of the problems with early efforts to garner support for loan modification was the rhetoric. The early loan modifications were targeted to, and created for, people with variable loans scheduled to re-set with higher payments. The public perceived these as programs to assist people who purchased homes they could not afford. However, as the economic situation changed and the main driver of foreclosure became unemployment, the perception—and support—changed. Researchers began to perceive a growing sense of frustration, even anger that the government was willing to "bail out 'greedy' Wall Street firms (but not most homeowners.)"[265] Willingness to assist homeowners seemed to increase as they were seen as less deserving of blame than their lenders.

This research is important because it tells us that, in order to have a successful policy change, we must be able to articulate both the onset and offset deservingness of those who will benefit. It also suggests that foreclosure law must be seen as protecting those homeowners in situations where they have little or no control over the adverse condition that led to foreclosure.

VI. THE CASE FOR A POLICY FAVORING HOMEOWNERSHIP

An honest evaluation of the current body of research reveals one significant fact: foreclosure is expensive for all of us. Clearly, then, we need a housing process that minimizes the number of foreclosures and maximizes the number of homeowners who are able to remain in their homes. This does not mean that all defaulting homeowners should remain in their homes. The difficult decision is how to craft foreclosure law so as not to incentivize homeowners to default and servicers to foreclose.

The most fundamental reason to favor a judicial process for foreclosure is due process. It is well established law that foreclosure by power of sale does not violate the constitutional protection of due process because the power is derived from contract and not from state action.[266] However, this should not diminish the argument that homeowners should have at least as much due process protection in protecting their most significant asset, their home, as a tenant would have in protecting his tenancy. Currently, in non-judicial states, there is more due process protection in an eviction proceeding than a

afterwards (like my house was worth more than the loan when I took out the loan). *Id.*

264. Avsar, *supra* note 210, at 159–60.

265. Seiler, *supra* note 229, at S201.

266. *See, e.g.*, Apao v. Bank of N.Y., 324 F.3d 1091 (9th Cir. 2003); Roberts v. Cameron-Brown Co., 556 F.2d. 356 (5th Cir. 1977); Northrip v. Fed. Nat'l Mortg. Ass'n, 527 F.2d 23 (6th Cir. 1975); Bullock v. Resolution Trust Corp., 918 F. Supp. 1001 (S.D. Miss, 1995); Brantley v. U.S. Bank, N.A, 2013 WL 5429624 (N.D. Ga. Sept. 30, 2013); Drake v. Citimortgage, Inc., 2011 WL 1396774 (E.D. Tenn. Apr 13, 2011); Williams v. Cheyenne Crossing Residential Ass'n, Inc., 2010 WL 5287509 (E.D. Tex. Dec. 17, 2010); Leininger v. Merchs. & Farmers Bank,
Macon , 481 So. 2d 1086 (Miss. 1986); Garfinkle v. Superior Court, 578 P.2d 925 (Cal. 1978); Citimortgage v. Drake, 410 S.W.3d 797 (Tenn. Ct. App. 2013), appeal denied (Aug. 14, 2013).

foreclosure.[267] This is absurd. However, this has been the state of the law for many years and state legislators are apparently unconcerned with the absurdity. Other arguments must be made.

One of the peculiar aspects of non-judicial foreclosure is that the entire process is in the control of one party, the lender. On its face it appears that a third-party trustee is organizing and holding the sale, but that third-party is rarely, if ever, neutral.[268] The deed of trust often allows the bank to appoint a successor trustee in case of default. That successor trustee is often a lawyer or trust company hired by the bank.[269] The system is fraught with conflicts of interest. It is designed to favor foreclosure over home ownership.

The evidence clearly shows that foreclosures harm everyone, not just the person who is losing his or her home. It is costly to the lender.[270] It is costly to the neighborhood where other homeowners can expect their property values to drop.[271] It is costly to the community in increased blight.[272] It is in everyone's economic interest to prevent foreclosure. Foreclosure happens more often in non-judicial foreclosure states, despite the default rates.[273] Homeowners are more likely to get a loan modification and less likely to suffer a foreclosure in judicial foreclosure states.[274] All the data favors a judicial foreclosure process.

The last few years have shown us what can, and does, go wrong in a system with no checks and balances. It has also shown us what can work to stem the tide of unnecessary foreclosures. We will never have one uniform foreclosure system in America. The state property laws are too well ingrained in the culture of each state. However, as federal law encroaches on the area, we can have uniformity in some key aspects of the process. Uniformity is something the industry has been requesting for years, so they should be able to support a move toward uniform procedures.[275] The lesson of this crisis is that we need uniformity in three key areas: (1) establishing the right to foreclose; (2) loss mitigation and (3) preventing "zombie" mortgages.

267. Rao, *supra* note 53, at 11–12. This is not to endorse the proceedings in eviction hearings. All of the due process rights really depend on the homeowner or tenant's ability to obtain counsel. This is a problem in both judicial and non-judicial states. *See* John Pollock, Lassiter *Notwithstanding: The Right to Counsel in Foreclosure Actions*, 43 CLEARINGHOUSE REV.: J. OF POVERTY LAW & POLICY 448 (2010).

268. John Campbell, *Can We Trust Trustees? Proposals for Reducing Wrongful Foreclosures*, 63CATH. U. L. REV. . 103, 129–30 (2013).

269. *Id.* at 130, 133; *see also* discussion of *Holm v. Wells Fargo*, *infra* Part VI.(A).

270. *See* Costs to Lenders and Investors *supra* Part 27–28.

271. *See* Foreclosure's Effects on Property Values, *supra* Part IV(B).

272. *See* Contagion Effect, *supra* Part IV.(C).

273. Mian, Sui, & Trebbi, *supra* note 99, at 2.

274. Collins, *supra* note 190, at 226.

275. Just one example of this can be found in the industry's support for yet another attempt to draft a Uniform Residential Foreclosure Act, a process which began in 2012 and continues today. Memorandum from John A. Sebert, ULC Executive Director, on Report on Stakeholders Meeting Held Jan. 13, 2012 (May 4, 2012), *available at* http://www.uniformlaws.org/shared/docs/mortgage%20foreclosure/2012may4_RREMFPP_Stakeholders%20Meeting%20Report.pdf.

A. Proposal One: All Foreclosing Parties Should be Required, by Sworn Affidavit and Documentary Evidence, to Certify Their Standing to Foreclose to a Court of Law Before Initiating a Foreclosure

As explained above, states use a variety of theories—lien or title—and a variety of instruments—mortgage or deed of trust—to establish a mortgage. The process to terminate that mortgage in foreclosure varies not only between judicial and non-judicial, but as to what documentation the lender needs to produce in order to have the right to foreclose. Currently most of the loans secured by mortgages are promissory documents.[276] Generally, in order to foreclose on a promissory note the lender needs to establish that it is the "person entitled to enforce the note" (PETE) under the Uniform Commercial Code.[277] Whether a lender also needs proof of the mortgage assignments varies by state.[278] Prior attempts at uniformity have failed because they tried to unify these differing requirements. Unifying what needs to be produced in order to establish the right to foreclose is not necessary. What is necessary, however, is that the requirement be uniform. Every lender in every state should be required to establish its standing to foreclose before it brings the process to a neutral third-party. The trustee on a deed of trust is not a neutral party.[279]

In non-judicial states, the servicers have easily been able to proceed with foreclosures with no proof of the right to do so.[280] The practice continues to this date. As recently as January of 2015, two different judges in two states found that Wells Fargo was proceeding with foreclosures without proof of standing.[281] This first occurred in Missouri.[282] Wells Fargo, through the trustee, the law firm of Kozeny & McCubbin,[283] foreclosed on the homeowner despite receiving funds from the homeowners that were supposed to bring the note current.[284] The court found that "[t]he undisputed facts are neither Wells Fargo . . had the right to enforce the note rendering the foreclosure sale

276. The specifics of non-promissory notes and electronic notes are beyond the scope of this article. Suffice it to say that an argument to unify the foreclosure process would have to include these documents as well. Promissory notes predominate, so my examples focus on promissory notes.

277. *See* Renaurt, *supra* note 32; *Application of the Uniform Commercial Code to Selected Issues Relating to Mort. Notes*, REPORT OF THE PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE (Nov. 14, 2011), *available at* www.uniformlaws.org/Shared/. . ./PEBUCC/PEB_Report_111411.pdf.

278. *See* Elizabeth Renaurt, *Property Title Trouble in Non-Judicial Foreclosure States: The Ibanez Time Bomb?* 4 WM. & MARY BUS. L. REV. 111 (2013).

279. Trustees really cannot be considered neutral and, therefore, would not be the proper party to meet this requirement. *See* Campbell *supra* note 262, at 129–30.

280. *Id.* at 112–15 (discussing instances of wrongful foreclosure in non-judicial states).

281. Catherine Curan, *NY Federal Judge Slams Wells Fargo for Forged Mortgage Docs*, N.Y. POST (Jan. 31, 2015), *available at* http://nypost.com/2015/01/31/ny-federal-judge-slams-wells-fargo-for-forged-mortgage-docs/; Gretchen Morgenson, *Two Judges Who Get It About* Banks, N.Y. TIMES (Jan. 31, 2015), *available at* http://www.nytimes.com/2015/02/01/business/01gret.html.

282. Holm v. Wells Fargo Home Mortgage Inc., No. 08 CN-CV00944 (Mo. Cir. Ct. Jan. 26, 2015). It should be noted that Wells Fargo has indicated its intention to file an appeal in this matter.

283. This illustrates the due process problems of the trustee. Here Kozney & McCubbin, the allegedly neutral Trustee on the deed of trust were also the lawyers for Wells Fargo. *Id.* at 2.

284. *Id.* at 6.

void."[285] This dispute lasted six years and cost Wells Fargo $295,912.30 in actual damages and $2,959,123 in punitive damages.[286] This could have been avoided with a simple requirement that the foreclosure party be required to prove its right to foreclose before proceeding to a foreclosure sale.

In a similar case in the bankruptcy court situated in the Southern District of New York found that Wells Fargo was forging documents to prove the right to foreclose.[287] Cynthia Carrsow-Franklin, the homeowner in this case, had a home in Texas, a non-judicial state that relies on deeds of trust.[288] Wells Fargo presented a proof of claim that included documents the judge concluded were forged.[289] In his order, Judge Drain found that the endorsement filed in the case "does show a general willingness and practice on Wells Fargo's part to create documentary evidence, after-the-fact, when enforcing its claims, WHICH IS EXTRAORDINARY."[290]

These are just two examples of why the loan servicing industry continues to require scrutiny. While it is clear that a uniform judicial foreclosure procedure would be preferable, the industry lobby is strong and it is probably not possible to win that fight. It may be possible, however, to create a pseudo-judicial procedure. At a minimum, the procedure should require that a certification be filed and examined by a neutral third party before any foreclosure can be initiated, and that homeowners have a meaningful process by which to contest an erroneous filing. Parties filing such a certification should be held to a standard of reasonable investigation such as that expressed by Federal Rule of Civil Procedure 11.[291] A uniform process requiring proof of standing prior to any foreclosure would eliminate some of the delays in foreclosure and restore confidence in a system gone amok.[292]

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285. *Id.* at 3.

286. *Id.* at 8.

287. Curan, *supra* note 275; Morgenson, *supra* note 275.

288. *In re* Carrsow-Franklin, 524 B.R. 33, 37 (Bankr. S.D.N.Y. 2015). It should be noted that Wells Fargo has filed a notice of appeal in this matter.

289. *Id.* at 19.

290. *Id.* at 17–18 (emphasis in original).

291. Subsection (b) of the rule states as follows:

> REPRESENTATIONS TO THE COURT. By presenting to the court a pleading, written motion, or other paper—whether by signing, filing, submitting, or later advocating it—an attorney or unrepresented party certifies that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable
> under the circumstances:
>
> > (1) it is not being presented for any improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of litigation;
> > (2) the claims, defenses, and other legal contentions are warranted by existing law or by a nonfrivolous argument for extending, modifying, or reversing existing law or for establishing new law;
> > (3) the factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery; and
> > (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on belief or a lack of information.

FED. R. CIV. P. 11(b).

292. *See e.g.*, Renaurt, *supra* note 32 (providing examples of some of the other issues that faulty

B. Proposal Two: Foreclosing Parties Must Certify That All Loss Mitigation Processes Have Been Completed Prior to Initiating Foreclosure

It is true that federal law now requires an effort at loss mitigation prior to proceeding with a foreclosure. It is also true that these regulations have been in effect for more than a year and many of the same problems persist.[293] As Collins and Urban demonstrated, the act of monitoring the loss mitigation activity of the servicer may produce better results.[294] However, states with mediation programs report that cases are still proceeding to foreclosure when another option is possible.[295] Numerous studies have documented that loan modification is a better economic solution for the lenders. Fewer foreclosures is an economic win for the community.

We have learned that homeowners in judicial foreclosure states are more likely to receive a loan modification.[296] That, in and of itself, should be enough to prefer judicial foreclosure. In the alternative, however, states should require lenders and their servicers to prove that all of the federally mandated loss mitigation procedures have been complied with before a foreclosure can be initiated. For all the reasons stated previously, this proof needs to be submitted to a neutral third party. Our judicial system is the best equipped third party.

In addition, FHFA should strive to develop uniform standards for loan modification that focus on those homeowners whose homes can be saved.[297] This should include programs for defaults resulting from lost or reduced employment as we saw in the last crisis; but it should also address the common financial stresses associated with medical crisis and divorce. A loss mitigation program that focuses on borrowers who had no control over the causes of their financial difficulties is less likely to create the moral hazard the industry so fears.

C. Proposal Three: A Lender Who Initiates, and Then Abandons a Foreclosure Process Should be Deemed to Have Abandoned the Security Instrument

Finally, we face the problem of banks who abandon their foreclosure. Zombie loans are a significant problem, but not the focus of this paper.[298]

documentation causes).

293. As a facilitator, I have not seen a significant difference in servicer behavior since the rules have been in effect. The files are still not being processed quickly. The paperwork is still becoming lost and multiple requests for the same information still occur.

294. *See* Collins, *supra* note 200.

295. *See* Gong, *supra* note 220, at 24 (finding that sixty-eight percent of the people who entered their program avoided foreclosure).

296. Collins, *supra* note 190, at 219.

297. The Federal Housing Finance Agency oversees Freddie Mac, Fannie Mae, and the Federal Home Loan Bank. FED. HOUS. FIN. AGENCY, http://www.fhfa.gov/ (last visited Apr. 18, 2015).

298. *See* Linda Allen, Stavros Peristiani, & Yi Tang, *Bank Delays in the Resolution of Delinquent Mortgages: The Problem of Limbo Loans*, FORTHCOMING J. OF REAL EST. RESEARCH (Dec. 2013), *available at*

Zombie mortgages artificially inflate the timelines for foreclosure and clog the judicial system.[299] Lenders can reasonably consider the economics of taking possession of a home. They should not, however, be making that decision after they have completed the foreclosure process, dumping the abandoned property on the community.[300] If a lender files a foreclosure and then abandons it, the security instrument should be deemed abandoned as well.

Some states have attempted to accomplish this through abandoned property statutes.[301] A more uniform process would be easier for servicers to comply with across state borders and would better protect homeowners and communities. This crisis saw a huge rise in abandoned properties caused by bank walkaways and zombie mortgages.[302] It is clear from the crisis we have just experienced that sometimes "not foreclosing" can also create problems. Abandoned properties cannot re-enter the market because of liens that almost always exceed the value of the property and have been abandoned by the industry. Stripping those liens will allow those homes to re-enter the marketplace, even if that re-entry is at a discount.

VII. CONCLUSION

Uniform judicial foreclosure is clearly the preferable method of foreclosure. Political realities also make it unlikely to ever occur. The lessons learned from the recent crisis demonstrate the need for a more uniform system that includes more oversight of the lending community. The public has lost faith in both the lending community and the government that is seen to support it. At a bare minimum, we need a foreclosure system that requires lenders to certify proof of standing to a neutral third party before foreclosure is initiated.

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http://pages.jh.edu/jrer/papers/pdf/forth/accepted/Bank%20Delays%20in%20the%20Resolution%20of%20Delinquent%20Mortgages.pdf; Michael Schramm, April Hirsh, Dikwakar Vanapalli, Daniel J. Van Fro, Krist Moine Nelson, & Claudia Colton, *Stalling the Foreclosure Process: The Complexity Behind Bank Walkaways*, CTR. ON URB. POVERTY AND CMTY. DEV., MANDEL SCH. OF APPLIED SOC. SCI. (Feb. 2011), *available at* http://blog.case.edu/mass/2011/02/07/CUPCD_2011_02_07Stalling%20the%20foreclosure%20process-%20th20%complexity%20behind%20bank%20walkaway.pdf.; Kate Buitrago, *Deciphering Blight: Vacant Building Data Collection in the Chicago Six County Region*, WOODSTOCK INST. (June 2013), *available at* http://www.woodstockinst.org/sites/default/files/attachments/decipheringblight_buitrago_june2013.pdf.

299. For a discussion of Florida, New Jersey and New York s*ee infra* Part III.(C).

300. *See, e.g.*, Michelle Conlin, Special Report: *The Latest Foreclosure Horror: The Zombie Title*, REUTERS (Jan. 10, 2013), http://www.reuters.com/article/2013/01/10/us-usa-foreclosures-zombies-idUSBRE9090G920130110; Sandra Livingston, *Bank 'Walkaways From Foreclosed Homes a Growing, Troubling Trend*, THE PLAIN DEALER (July 18, 2009), *available at* http://www.cleveland.com/news/index.ssf/2009/07/bank_walkaways_from_foreclosed.html; Mary Ellen Podmolik, *More Banks Walking Away From Homes, Adding to the Housing Crisis*, CHI. TRIB. (Jan. 13, 2011), *available at* http://articles.chicagotribune.com/2011-01-13/news/ct-biz-0113-walkaway—20110113_1_foreclosure-process-foreclosure-filing-servicers; Susan Saulny, *Banks Starting to Walk Away on Foreclosure*, N.Y. TIMES, (Mar. 30, 2009), A20, *available at* http://www.nytimes.com/2009/03/30/us/30walkaway.html?.

301. *See, e.g.*, WISC. STAT. ANN. § 845.102(1) (2012) The Wisconsin Supreme Court holding allows the court to sell a foreclosed and abandoned property over the bank's objection. Bank of N.Y. Mellon v. Carson, No. 2013AP544, 2015 WL 651968, at *1, (Wis. Feb. 17, 2015).

302. *See* sources cited *supra* note 283.

The lender should be incentivized to put as much effort into not foreclosing as it does into foreclosing. As part of this process, proof of compliance with loss mitigation efforts should be required before any foreclosure is initiated. Finally, if the previous two conditions are met and foreclosure is still the only option, the lender should be required to move through the process quickly and completely. Abandoning a foreclosure should result in an abandoned security instrument. These small changes to the current system will begin to rebuild the trust so badly lost in the last crisis. More importantly, it may help prevent, or at least mitigate, the next housing crisis.