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## Fixing a Broken System: Reconciling State Foreclosure Law with Economic Realities

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FIXING A BROKEN SYSTEM: RECONCILING  
STATE FORECLOSURE LAW WITH ECONOMIC REALITIES

*Yianni D. Lagos*<sup>1</sup>

INTRODUCTION

The housing crisis ignited a chain reaction of events that resulted in the U.S. economy cascading to the worst contraction since the Great Depression.<sup>2</sup> In response, not only has the Federal Government proposed and implemented various legislation,<sup>3</sup> but the financial industry has also joined in the effort to find a solution.<sup>4</sup> However, large-scale mortgage restructurings already show signs of failing.<sup>5</sup> These results should not be surprising, because

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<sup>2</sup> S&P 500, a measure of the 500 largest U.S. corporations, fell below 700 points on March 2, 2009, the lowest level since 1996. See Google Finance, S&P 500 Index, <http://www.google.com/finance?q=INDEXSP:.INX>.

<sup>3</sup> See Michael Corkery, *Mortgage 'Cram-Downs' Loom as Foreclosures Mount*, WALL ST. J., Dec. 31, 2008, at C1 (allowing bankruptcy judges to cram-down first mortgages); Laura Meckler, *Housing Bailout at \$275 Billion*, WALL ST. J., Feb. 19, 2009, at A1 (providing funds to refinance and modify loans); Nick Timiraos, *Real-Estate Sector Cheers Tax Credit*, WALL ST. J., Feb. 9, 2009, at A4 (giving tax rebates for first-time home buyers).

<sup>4</sup> See Ruth Simon, *Citi to Allow Jobless to Pay Less on Loans*, WALL ST. J., Mar. 3, 2009, at A4 (temporarily reducing mortgage payments for unemployed borrowers); Ruth Simon, *Investors Hit BofA Loan Modification*, WALL ST. J., Nov. 18, 2008, at C1 (engaging in massive restructuring of loans); Meena Thiruvengadam, *Banks Agree to Foreclosure Moratoriums*, WALL ST. J., Feb. 14, 2009, available at <http://online.wsj.com/article/SB123454524404184109.html> (participating in voluntary mortgage moratoriums).

<sup>5</sup> *Loan Modifications Get Reviewed as Borrowers Miss Paying Again: Is Aid Dragging Out the Pain?*, INVESTOR'S BUS. DAILY, Dec. 19, 2008, at A6 (during Q1 and Q2, half of the restructured mortgages were already back in default).

general loan modifications suffer from the problems that created the housing crisis. Namely, mortgage originators did not examine whether the borrower could afford the monthly payments.<sup>6</sup>

The fact that the banking industry largely overlooked what should be the primary consideration before lending—*i.e.*, the ability of the borrower to repay—can be explained by the securitization of loans.<sup>7</sup> David Wiechel,<sup>8</sup> a distinguished practitioner working in the area of foreclosure prevention, explained the complex process of securitization as follows. General Motors Automobile Corporation (“GMAC”) makes loans until it runs out of funds. In order to increase profits, GMAC needs to make more loans. To raise the necessary capital to make more loans, GMAC sells off its existing loans in a securitized package. After consistently engaging in this process, GMAC knows a market exists for its loans. Therefore, GMAC lacks the incentive to examine the ability of the borrower to repay.<sup>9</sup>

The consequences of GMAC, along with the majority of lenders, overlooking such risk led to the

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<sup>6</sup> Letter from Warren Buffett to Shareholders (Feb. 27, 2009), at 11, available at <http://www.berkshirehathaway.com/letters/2008ltr.pdf>.

<sup>7</sup> See generally Richard J. Rosen, *The Role of Securitization in Mortgage Lending*, CHICAGO FED. LETTER, No. 244, Nov. 2007 available at [http://www.chicagofed.org/publications/fedletter/cflnovember2007\\_244.pdf](http://www.chicagofed.org/publications/fedletter/cflnovember2007_244.pdf) (discussing the procedures and major participants in the mortgage securitization process).

<sup>8</sup> Interview with David Wiechel, former Legal Aid Attorney specializing in foreclosure prevention, in Springfield, OH (Jan. 9, 2009).

<sup>9</sup> Evidence of GMAC’s poor loan quality is the recent capital infusion. See Brian Wingfield, *GMAC Gets Bailout Funds: The U.S. Government Commits an Additional \$6 Billion to Rescue Detroit*, FORBES, available at [http://www.forbes.com/2008/12/30/gmac-washington-tarp-markets-equity-cx\\_bw\\_1230markets01.html](http://www.forbes.com/2008/12/30/gmac-washington-tarp-markets-equity-cx_bw_1230markets01.html).

housing crisis.<sup>10</sup> By the end of 2008, home prices had fallen 23.4 percent from their peak.<sup>11</sup> This burst of the housing bubble took the economy with it, as unemployment has increased.<sup>12</sup> Rising unemployment engenders increased foreclosures.<sup>13</sup> In addition to the unemployment problem, falling property values have pushed more homes underwater.<sup>14</sup> Combining the effect of mortgages being underwater with the fact that many borrowers contributed little or nothing in the way of a down payment significantly reduces a borrower's incentive to pay the mortgage.<sup>15</sup> With less incentive to pay, increased foreclosures have followed. Foreclosures hurt not only the individuals losing their homes but also the community as a whole.<sup>16</sup> For example,

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<sup>10</sup> Alexandra Basak Russell, *What Gave Rise to the Global Financial Crisis?* The University of Iowa Center for International Finance and Development (Mar. 2010), available at <http://www.uiowa.edu/ifdebook/ebook2/contents/part5-1.shtml>.

<sup>11</sup> Sudeep Reddy, *Home Prices Declined at Record Pace in October: S&P/Case-Shiller Data Show Return to 2004 Levels as Tight Credit, Consumers' Wariness Weigh on Sector*, WALL ST. J., Dec. 31, 2008, at A2.

<sup>12</sup> See BUREAU OF LABOR STATISTICS, LABOR FORCE STATISTICS FROM CURRENT POPULATION SURVEY, available at [http://data.bls.gov/PDQ/servlet/SurveyOutputServlet?data\\_tool=latest\\_numbers&series\\_id=LNS14000000](http://data.bls.gov/PDQ/servlet/SurveyOutputServlet?data_tool=latest_numbers&series_id=LNS14000000).

<sup>13</sup> Buffett, *supra* note 6, at 11.

<sup>14</sup> "Underwater" refers to home values below what is left due on the mortgage. See John D. Geanakoplos & Susan P. Koniak, *Matters of Principle*, N.Y. TIMES, Mar. 5, 2009, at A31 (chart showing that mortgagors' chance of default increases as the amount owed goes above the value of the home).

<sup>15</sup> See Stephen J. Dubner & Steven D. Levitt, *Payback Time: A Quiet Exchange of Funds Lets a Family Buy a New House and Helps the Seller Get a Good Price. So Why Is It Illegal?*, N.Y. TIMES MAG. (June 10, 2007), available at <http://www.nytimes.com/2007/06/10/magazine/10wwln-freakonomics-t.html> (discussing how many homeowners were able to avoid paying a down payment by using cash-back transactions).

<sup>16</sup> Editorial, *Foreclosures Still Destroying Neighborhoods*, SPRINGFIELD NEWS-SUN, Nov. 30, 2008, at A10.

with this increase in foreclosures, vacancies have been on the rise.<sup>17</sup> Increased vacancies lead to community blight, which affects everyone in the neighborhood through lower housing prices and an increased tax burden.<sup>18</sup>

Despite the devastating effects that foreclosures are inflicting across the country, hope exists for those individuals trying to save their homes. Agnes Spriggs saw her mortgage payments balloon from \$800 to \$2,300.<sup>19</sup> Her first efforts to refinance were thwarted, as she could not work out a partial payment schedule with the lender.<sup>20</sup> However, with diligent effort and advice from a local housing agency, she worked out an agreement with Chase Bank and reduced her monthly payments to \$855.<sup>21</sup> With banks incurring substantial losses when properties are sold at foreclosure auctions and government agencies at all levels providing significant aid, homeowners facing the prospect of foreclosure should not concede to foreclosure sale.<sup>22</sup>

The securitization of loans created another problem that directly affects the adjudication of foreclosures. As explained by David Wiechel,<sup>23</sup> many mortgages lack a lawful mortgagee.<sup>24</sup> During the securitization process,

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<sup>17</sup> See generally Haya El Nasser & Paul Overberg, *No One Home: Record 1 in 9 Housing Units Empty. Vacancies Have Ripple Effect*, USA TODAY, Feb. 13, 2009, at A1 (discussing increases in vacancies throughout the country).

<sup>18</sup> Editorial, *supra* note 16, at A10.

<sup>19</sup> Elaine Morris Roberts, *A Foreclosure Story with a Happy Ending: Help is Available from Agencies, Lawyers and Banks, as Agnes Spriggs' Saga Shows*, SPRINGFIELD NEWS-SUN, Nov. 9, 2008, at D1.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> See Kathleen Pender, *Help is Out There for Homeowners Facing Foreclosure*, THE COLUMBUS DISPATCH, Dec. 14, 2008, at D6.

<sup>23</sup> Interview with David Wiechel, *supra* note 8.

<sup>24</sup> See *In re Foreclosure Cases*, 521 F. Supp. 2d 650, 655 (N.D. Ohio 2007) (the Court made it clear that failure to repeatedly comply with General Order 07-03 will result in immediate dismissal. One

mortgages normally are not transferred directly from the originator to the sponsor of the trust.<sup>25</sup> Instead, the mortgage passes to many intermediate holders, such as an arranger and then a warehouse lender, before finally reaching the sponsor of the trust.<sup>26</sup> The many steps create a trade-off. During each step, the parties can go to the recordation office and endorse the new mortgagee or skip the documentation and forego the expense.

With multiple steps along the way, the expense in filing fees with the recorder's office, as well as paying lawyer's fees, can become material. Hypothetically, if a securitization contains 2,000 loans and costs \$500 to legally change title for each loan, the cost reaches \$1,000,000 for each transaction. This example illustrates why a mortgage company would choose not to assign mortgagees using the proper procedure. Then, when the sponsor of the trust containing a mortgage forecloses on a property, the sponsor lacks a claim, because no legal mortgagee ownership exists.<sup>27</sup> Even if the sponsor records a transfer after the default with the loan originator, the lien is still unenforceable, because all transactions must be recorded properly.<sup>28</sup> An attorney defending a mortgagor

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requirement of General Order 07-03 is that "the named plaintiff is the owner and holder of the note and mortgage.").

<sup>25</sup> See Adam B. Ashcraft & Til Schuermann, *Understanding the Securitization of Subprime Mortgage Credit*, Dec. 17, 2007, at 8, <http://www.ny.frb.org/research/economists/ashcraft/subprime.pdf> (The arranger aggregates mortgages from different loan originators and then sells those packaged mortgages to a warehouse lender, who proceeds to sell the mortgages in securitized form.).

<sup>26</sup> *Id.*

<sup>27</sup> See *In re Foreclosure Cases*, 521 F. Supp. 2d at 653 ("To show standing, then, in a foreclosure action, the plaintiff must show that it is the holder of the note and the mortgage at the time the complaint was filed.").

<sup>28</sup> See, e.g., MICH. COMP. LAWS § 600.3204 (West Supp. 2010) ("If the party foreclosing a mortgage by advertisement is not the original mortgagee, a record chain of title shall exist prior to the date of sale

can prove this flaw by examining the pooling agreement, which is publicly available for all securitizations that would show the sponsor of the trust received the mortgage from another party.<sup>29</sup> Therefore, a significant number of securitized mortgages that make up a large percentage of all mortgages are improper.<sup>30</sup>

Lastly, securitization of mortgages increases the difficulty for borrowers to work out an agreement with lenders for two reasons. First, the party with power to negotiate cannot always be located.<sup>31</sup> Due to the fact that servicing rights to securitized mortgages trade between banks as if they were stocks, the borrower may not know the loan servicer.<sup>32</sup> Second, even if an agreement between the borrower and loan servicer can be reached, the workout agreement must be approved by all the investors.<sup>33</sup>

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under section 3216 evidencing the assignment of the mortgage to the party foreclosing the mortgage.”).

<sup>29</sup> See Pooling and Servicing Agreement, [http://www.sec.gov/Archives/edgar/data/1399057/000088237707001688/d676234\\_ex4-1.htm](http://www.sec.gov/Archives/edgar/data/1399057/000088237707001688/d676234_ex4-1.htm) (example where the originators are listed but the originators are not a party to the transfers taking place in the pooling agreement).

<sup>30</sup> See generally Liz Rappaport & Jon Hilsenrath, *Fed Moves to Free Up Credit for Consumers*, WALL ST. J., Mar. 4, 2009, at A1-A2 (reporting that forty percent of mortgages were securitized before the crisis); Moe Bedard, *The Mers Fifty Million Mortgage Meltdown*, Dec. 30, 2008, <http://loanworkout.org/2008/06/the-mers-fifty-million-mortgage-meltdown/> (one example of a shell corporation that securitized a large number of mortgages and then sold those mortgages to trusts that lack proper identification of ownership).

<sup>31</sup> Roberts, *supra* note 19 (one estimate places the number of people in foreclosure who have never talked with their lender at 60 percent).

<sup>32</sup> This author was surprised to see that JP Morgan Chase Bank in Columbus, OH, housed a mortgage-servicing trading room where rights to servicing loans were traded as if they were stocks. In an environment where servicing rights can trade daily, a borrower may not know who is servicing his or her loan.

<sup>33</sup> Melissa B. Jacoby, *Home Ownership Risk Beyond A Subprime Crisis: The Role of Delinquency Management*, 76 FORDHAM L. REV.

Because ownership of the cash flows paid from securitized mortgages is separated into multiple tranches, convincing all investors to agree on a workout agreement can be difficult.<sup>34</sup>

Keeping in mind the present environment of securitized mortgages, this note will examine state foreclosure law. Part I will develop the public policy framework for examining state foreclosure law. Part II will introduce a basic economic cost-benefit analysis of general foreclosure laws. Part III will examine different state foreclosure laws and compare those laws to state foreclosure rates. Part IV will examine recent legislation passed by various states. Part V will discuss two scholarly solutions proposed to improve state foreclosure law. Part VI will summarize many of the proposed solutions and present new ideas by looking at foreclosures from the policy perspective favoring foreclosure prevention and increased participation in foreclosure sale by potential homeowners.

## I. POLICY PERSPECTIVE

Foreclosure laws differ from state to state in many respects. Unlike the Uniform Commercial Code (“UCC”), all attempts to unify state law have proven unsuccessful.<sup>35</sup> Many of these differences can be characterized as defaulter-friendly or lender-friendly, as the foreclosure

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2261, 2291 (2008); *see also* Ruth Simon, *Mortgage Investors Call for Changes in Housing Rescue Plan*, WALL ST. J., Mar. 12, 2009, at A3 (despite the severity of the foreclosure crisis, investors cling to their right to reject mortgage modifications).

<sup>34</sup> Jacoby, *supra* note 33, at 2291.

<sup>35</sup> *See* Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act*, 53 DUKE L.J. 1399, 1399 (2004) (explaining the Uniform Nonjudicial Foreclosure Act whose framers attempted to unify state foreclosure law).



debate has centered on the trade-off between protecting homeowners and bank investments.<sup>36</sup> Both seem to be of equal concern in today's economy, with foreclosures occurring at a rapid pace and billions of dollars of government bail-out money flowing to the banking industry.<sup>37</sup> Although the traditional debate may be useful, many scholars have recognized the inadequacies of examining foreclosure from such a narrow perspective.<sup>38</sup>

A general policy approach should be used when examining state foreclosure law, but exactly what policies should be used is a difficult question. Public policy regarding foreclosures involves protecting the defaulting homeowner.<sup>39</sup> Home ownership is a worthy goal in and of itself, and in many instances homeowners will best maintain the property.<sup>40</sup> Yet homeowners should be protected only when their interests coincide with the interests of the community. The community cares about avoiding the dilapidation of properties.<sup>41</sup> When a

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<sup>36</sup> See Brian M. Heaton, *Hoosier Inhospitability: Examining Excessive Foreclosure Rates in Indiana*, 39 IND. L. REV. 87, 92 (2005) (classifying states as either "creditor-friendly" or "lender-friendly"); Karen M. Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit*, 88.1 REV. ECON. & STATISTICS, 177, 177 (2006) (characterizing some states as "defaulter-friendly").

<sup>37</sup> *Show Me the TARP Money*, ProPublica, <http://www.propublica.org/special/show-me-the-tarp-money> (listing 455 institutions that have received TARP funds).

<sup>38</sup> Prentiss Cox, *Foreclosure Reform Amid Mortgage Lending Turmoil: A Public Purpose Approach*, 45 HOUS. L. REV. 683, 723 (promoting the use of a housing policy approach to examine state foreclosure laws); Jacoby, *supra* note 33, at 2263 (emphasizing the importance of mortgage-delinquency management by looking at multiple policy perspectives, but not altogether abandoning the lender-borrower model).

<sup>39</sup> Cox, *supra* note 38, at 723-24.

<sup>40</sup> *Id.* at 727 (properties will be better maintained by a defaulting homeowner than if left vacant).

<sup>41</sup> Home ownership provides many community benefits, but all of the benefits of home ownership assume that the homeowner is not in

defaulting borrower wishes to remain in his home and is willing to pay all he can afford to remain in the home, state laws should increase the chances for homeowners to maintain ownership. However, in many instances, a long period between the initial default and a foreclosure sale can lead to property deterioration. A property owner whose home was just foreclosed lacks the incentive to reinvest in the property. Therefore, the community deteriorates with the property, as the defaulting homeowner's interest no longer coincides with the community's interest of property maintenance.

In addition to home ownership and property maintenance, general policy should be concerned with who purchases the property at a foreclosure sale. Three potential buyers exist for a foreclosed property: an investor, a new resident, or a lender.<sup>42</sup> Public policy favors a new resident. A new resident provides the best source of maintenance for the property, because a new homeowner would likely spend time and money to improve his or her property.<sup>43</sup> Along with property maintenance, home ownership is an important justification underlying a public policy favoring the residential purchaser.<sup>44</sup> Since foreclosed properties are typically purchased at depressed prices, home ownership originating from foreclosure sales would be sustainable home ownership.<sup>45</sup>

Bringing potential homeowners to the foreclosure bidding will also create higher prices at foreclosure sales.

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default. Jacoby, *supra* note 33, at 2277 (listing the community benefits of home ownership).

<sup>42</sup> Cox, *supra* note 38, at 729

<sup>43</sup> See Jacoby, *supra* note 33, at 2277.

<sup>44</sup> *Id.* at 2276-77 (describing three benefits to home ownership: household wealth-building, positive social-psychological states, and neighborhood and community benefits).

<sup>45</sup> "Putting people into homes, though a desirable goal, shouldn't be our country's primary objective. Keeping them in their homes should be the ambition." Buffett, *supra* note 6, at 12.

In times of decreasing real estate value, an investor will only buy a property at below-market prices in order to make a profit from the property, and many lenders lack the expertise to effectively manage real estate.<sup>46</sup> Consequently, a potential homeowner provides the only source of a fair market bid. These increases in foreclosure prices will alleviate the threat of delinquency judgments and may provide equity to the original homeowner.<sup>47</sup>

Most importantly, increased resident bidder participation will speed the recovery of the economy. Many banks are financially and administratively unable to take on more real estate owned (“REO”) because their balance sheets have suffered substantially over the last year and a half.<sup>48</sup> This problem is accelerating as the number of defaulting borrowers increases. Additionally, with the inflow of foreclosures collapsing home prices, the need for foreclosed properties to quickly find their way to homeowners has never been stronger. Thus, business as usual with lenders acquiring the foreclosed properties at uncontested foreclosure auctions may no longer be feasible.

Lastly, banks benefit from the increased foreclosure sale prices. Banks acquiring the foreclosed property take the risk of re-selling at prices below what would have been received at a foreclosure auction and face significant transaction costs associated with the resale of the foreclosed property. For example, WesBanco recently lost substantial sums of money by buying three foreclosed properties and then selling them later at a commercial auction.<sup>49</sup> These properties (which are located at 542 N.

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<sup>46</sup> See *infra* pp. 93-94 (WesBanco selling property at a large loss illustrates their inability to effectively manage real estate).

<sup>47</sup> See Cox, *supra* note 38.

<sup>48</sup> Through the FDIC website ([www.fdic.gov](http://www.fdic.gov)), one can search thousands of banks and view the non-accrual loans on any bank’s balance sheet.

<sup>49</sup> U.S. Department of Housing & Urban Development Settlement Statement on file with the author (hereinafter “Settlement Statement”).

Murray Street, 1741 Kentucky Ave., and 329 Fair Street in Springfield, Ohio) were bought recently from WesBanco at a commercial auction for the gross price of \$18,000.<sup>50</sup> The three properties in question were purchased at the foreclosure auction by WesBanco for \$15,000, \$12,000, and \$20,000 for a loss of \$19,000.<sup>51</sup> In a foreclosure, the lender does not pay cash for the property. Because the Springfield properties mentioned above were purchased above the minimum bid, it is likely that another bidder was willing to pay close to the final bid.<sup>52</sup>

Along with losing money on the resale of the three properties, WesBanco paid significant transaction costs. First, they owed a total of \$1,641.67 in county taxes for the entire year.<sup>53</sup> Second, the broker conducting the auction received a fee of \$6,000.<sup>54</sup> Third, the city charged WesBanco \$125.19 for a delinquent water bill.<sup>55</sup> Finally, WesBanco owed settlement charges of \$72.<sup>56</sup> These transaction costs, combined with the low resale price, resulted in a loss of almost \$30,000 for the three properties.<sup>57</sup> If the three properties had sold to another bidder at the foreclosure sale, WesBanco would have avoided this large loss.

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<sup>50</sup> *Id.*

<sup>51</sup> Springfield Clerk of Courts, [http://64.56.107.134/pa/pages/CRTVCaseSummary.jsp?case\\_id=23073901%20&xsl=](http://64.56.107.134/pa/pages/CRTVCaseSummary.jsp?case_id=23073901%20&xsl=).

<sup>52</sup> *Id.*

<sup>53</sup> Settlement Statement, *supra* note 49.

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> Before the foreclosure crisis, banks were concerned with not writing off losses. This author personally witnessed lenders bidding far above the closest bid to reach the mortgage amount. By bidding the mortgage amount, the bank avoided taking the paper loss. It seems banks have been slow to recognizing the severe economic condition. Banks purchasing foreclosed property below minimum bids is a losing strategy that banks may stop doing in the future.

With lenders, neighborhoods, and economists in agreement, public policy favors a foreclosure policy that creates more potential resident bidders.<sup>58</sup> Thus, foreclosure policy should be focused primarily on homeowners. First, public policy demands protection of the original homeowner. Second, after it is clear that a homeowner does not wish to work out an agreement to remain in the home, public policy should favor laws making it easier for a new homeowner to purchase the property out of foreclosure.

## II. ECONOMIC ANALYSIS OF STATE FORECLOSURE LAW

Foreclosure law is so intertwined with the economy that a solid foundation in the economic issues surrounding foreclosure law is necessary before an in-depth analysis can be undertaken. To understand how foreclosure laws affect the economy, one only needs to drive through one of the thousands of streets that have been decimated by foreclosures. Although this section only begins to examine the many effects of foreclosure laws, understanding the basic economic costs and benefits of foreclosure laws is a necessary starting point.

Foreclosure laws can be broken down into three generic groups. The first group of laws lengthens the foreclosure process.<sup>59</sup> A longer period of time between

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<sup>58</sup> Bankers across the country are concerned about changes in foreclosure law, because they fear the lengthening of the foreclosure process. See Rick Adamczak, *Ohio Bankers Concerned About Possibility of New Foreclosure Laws*, THE DAILY REPORTER (Franklin County), Feb. 3, 2009, at A1. This concern by bankers is warranted, as they fear policy makers will focus exclusively on borrowers' interest. However, by taking into account the whole community, public policy may favor policies that aid lenders, such as shortening the foreclosure process in many situations.

<sup>59</sup> Both judicial foreclosure and notice statutes, discussed in detail in Part III of this note, lengthen the foreclosure process.

default and sale increases the probability that a borrower will avoid foreclosure sales for three reasons. First, a lengthened foreclosure period provides the borrower with the opportunity to engage in negotiations with the lender and to seek alternatives.<sup>60</sup> Given the current state of securitized mortgages, workouts have become increasingly difficult.<sup>61</sup> Not only is it difficult to find the party with authority to negotiate, but mortgage modification takes time, because the parties must reach an agreement that is “commercially reasonable and sustainable.”<sup>62</sup> In essence, the obligation bankers failed to carry out—that is, making sure people had the ability to repay—must be done by the borrower and lender in any workout. Second, a longer foreclosure period increases the costs of foreclosure, making it more likely that lenders will pursue negotiation before initiating foreclosure.<sup>63</sup> By decreasing the cash received from foreclosing on properties, longer foreclosures create an increased incentive for lenders to agree to lower payment terms with the borrower.<sup>64</sup> Third, many individuals lose their homes because of unemployment; more time means an increased chance of finding new employment. With employment, the borrower can resume making mortgage payments and save his home.

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<sup>60</sup> See Jacoby, *supra* note 33, at 2272. One alternative to a foreclosure sale is short selling, where the defaulting borrower sells the property below the amount owed on the mortgage with the lender’s permission. *Id.*

<sup>61</sup> *Id.* at 2291.

<sup>62</sup> Interview with David Wiechel, *supra* note 8.

<sup>63</sup> Cox, *supra* note 38, at 724 (citing Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 VA. L. REV. 489, 496 (1991)).

<sup>64</sup> The average rule of thumb in the banking industry is a 30 percent loss on the mortgage when the mortgagor defaults and the property is foreclosed. Interview with Sandeep Mawalkar, Risk Management JP Morgan Chase in Columbus, OH (Mar. 6, 2009). By increasing those costs further, a lender would be willing to accept low monthly payments for an extended period of time to avoid such large losses. *Id.*

If a borrower can reach a workout agreement with the lender, the benefits include a homeowner not losing her home, a bank minimizing its losses, one less house on the market, and a reduction in the number of vacant homes.<sup>65</sup> Even if a workout agreement cannot be reached, the borrower can still save his home by taking advantage of various statutory protections and can protect the equity in his home by finding a buyer in the market.<sup>66</sup> Thus, the lengthened foreclosure process increases the probability that borrowers will remain in their homes and that borrowers will protect their interest in the property. If the homeowner avoids foreclosure, the benefits extend to all of the parties concerned.<sup>67</sup>

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<sup>65</sup> The benefit to the homeowner of maintaining ownership is obvious, but the other three benefits may need to be clarified. Lender losses are large in a foreclosure sale. First, because a lender is normally the successful bidder at a foreclosure auction, the costs include time and investment to maintain the property. After many foreclosure sales, the property needs significant repairs just to comply with housing codes. Second, transaction costs associated with buying and selling the property can be high. *See supra* Part I (discussing the losses on three properties sold by WesBanco). Third, another benefit is that there is one less house on the market, which may not appear significant. However, given the present saturation of houses for sale, decreasing the inflow of foreclosed houses on the market will lead to a faster recovery in the housing market. Lastly, vacant buildings have destroyed neighborhoods across the country. *See Nasser, supra* note 17.

<sup>66</sup> *See infra* Part III.B (discussing the different forms of redemption rights).

<sup>67</sup> To quantify the benefits of prolonging the foreclosure process, one would multiply the increased probability of a homeowner saving his or her home by the benefits of a homeowner maintaining ownership (individual benefit of maintaining home ownership + neighborhood benefit of reduced chances of a vacant building + community benefit of more homeowners to share the tax burden + lender benefit of reducing losses associated with foreclosure). However, the benefits have not been quantified by empirical studies, which provide an excellent opportunity for economic statisticians to benefit legislatures by engaging in detailed foreclosure research.

However, the benefits of lengthened foreclosure must be weighed against the costs in order to discover the efficient outcome. Although the benefits of a lengthened foreclosure process have not been quantified, there has been substantial research on the costs.<sup>68</sup> The costs that have been measured include the increased expense of the foreclosure process and lower loan amounts for the state as a whole.<sup>69</sup> In addition to these costs, a longer foreclosure period increases the chance for deterioration of the property.<sup>70</sup> Therefore, the costs of a longer foreclosure process include the increased costs to lenders, the reduced access to mortgage lending, and the increased probability of property deterioration.

Unfortunately, weighing the costs with the benefits of a longer foreclosure period is a difficult task. Yet when examining foreclosure laws that lengthen the process, these trade-offs must be at the forefront of the discussion. The efficient foreclosure length occurs when the benefits of a prolonged foreclosure process equal the costs associated with a longer foreclosure process. Given the lack of empirical data, assigning numbers to the benefits and costs would yield unsupported results. However, by looking into different foreclosure laws and their effects, policy makers can strike a fair balance with foreclosure laws.

The second group of foreclosure laws provides the borrower with protection. These “mortgagor protection

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<sup>68</sup> This inability to accurately measure the benefits of lengthened foreclosure may be the cause of a shift to less costly foreclosure procedures. See Donald L. Schwartz, Comment, *Power of Sale Foreclosure After Fuentes*, 40 U. CHI. L. REV. 206, 209 (1972).

<sup>69</sup> *Id.* See generally Terrence M. Clauretie & Thomas Herzog, *The Effect of State Foreclosure Laws on Loan Losses: Evidence from the Mortgage Insurance Industry*, 22 J. MONEY, CREDIT & BANKING 221, 231 (1990) (judicial procedure increases foreclosure costs); Pence, *supra* note 36, at 177 (2006) (defaulter-friendly states have loan sizes that are 3 percent to 7 percent smaller).

<sup>70</sup> See Cox, *supra* note 38, at 726.



laws” provide the borrower with statutory protections beyond that of the mortgage contract.<sup>71</sup> These protections take the form of rights to redeem ownership of the property and shield the borrower from personal liability.<sup>72</sup> Although there are many forms of redemption rights, the economic analysis for each should remain the same. Similar to a lengthened foreclosure process, redemption rights increase the probability that borrowers will be able to remain in their homes. From the previous discussion, the benefits of that outcome are large. However, not all redemption statutes are equal, and the benefits of different types of redemption statutes should be compared based on the marginal benefits and costs associated with each type of redemption statute.<sup>73</sup> The costs associated with redemption rights also depend on the type, but the general type of costs are consistent. Although some debate exists, redemption rights provide a disincentive to bid at foreclosure auctions.<sup>74</sup> In addition, redemption rights could increase the chance of the property deteriorating, because the defaulting homeowner or the new purchaser delays making improvements to the property.<sup>75</sup>

Along with redemption rights, delinquency rights aim to protect the borrower.<sup>76</sup> Delinquency rights take many forms, but the basic idea is protecting the borrower from personal liability. This protection of the borrower provides the emotional benefit of aiding an individual in

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<sup>71</sup> Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 VA. L. REV. 489, 489 (1991).

<sup>72</sup> See *infra* Part III.B & Part III.D.

<sup>73</sup> See *infra* Part III.B.

<sup>74</sup> James B. Hughes, Jr., *Taking Personal Responsibility: A Different View of Mortgage Anti-Deficiency and Redemption Statutes*, 39 ARIZ. L. REV. 117, 134 (1997) (“The mere possibility of redemption discourages bidders at the foreclosure sale because there is no finality attached to the purchase.”).

<sup>75</sup> *Id.* (“[A] potential purchaser would face a disincentive to bid for the property because, for a period, she could not maximize the value of the property by making further investment in it. . . .”).

<sup>76</sup> See *infra* Part III.D.

need; however, no economic justification is available for providing such protection. Conversely, there is a “moral hazard” cost associated with prohibiting deficiency judgments.<sup>77</sup> In addition, due to falling property values across the country, many homeowners have lost all the equity in their homes.<sup>78</sup> With no equity in the home and no concern for a deficiency judgment, a borrower would have no incentive to make her mortgage payments or maintain her property.<sup>79</sup> Thus, the social justification must outweigh the economic costs for delinquency laws to be beneficial.

Finally, the third group of foreclosure laws involves disclosure. Disclosure includes informing both the defaulting borrower during the foreclosure process and potential bidders before the foreclosure sale.<sup>80</sup> More information allows defaulting borrowers to better understand their options.<sup>81</sup> For example, a defaulting homeowner has little hope of maintaining ownership when she does not even communicate with her lender.<sup>82</sup> In addition to aiding borrowers, more disclosure also will improve the foreclosure sale process. Low bidder information negatively impacts participation and sale price

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<sup>77</sup> Schill, *supra* note 71, at 534.

<sup>78</sup> Geanakoplos & Koniak, *supra* note 14.

<sup>79</sup> Schill, *supra* note 71, at 534 (“Once a borrower’s equity evaporates because of falling houses prices or accrued, but unpaid, interests and penalties, he no longer has any incentive to maintain the value of the property securing the loan or protect it from waste if he is insulated from personal liability.”).

<sup>80</sup> See *infra* Part IV.B.1.

<sup>81</sup> A defaulting borrower will be unable to make life-changing decisions without knowing all of the different options. See *Avoiding Foreclosure Toolkit, Doing Business with Freddie Mac*, available at [http://www.freddiemac.com/service/msp/avoid\\_foreclosurekit.html](http://www.freddiemac.com/service/msp/avoid_foreclosurekit.html). The easiest way for states to improve the foreclosure process is through forcing lenders to provide crucial information to defaulting homeowners.

<sup>82</sup> Roberts, *supra* note 19 (One estimate places the number of people in foreclosure who have never talked with their lender at 60 percent.).

at foreclosure auctions.<sup>83</sup> Therefore, any increase in bidder information will improve participation and increase sale prices at foreclosure auctions.<sup>84</sup> Both forms of disclosure increase the chance of home ownership, and the costs of such disclosure are minimal. With such a large benefit at almost no cost, increased disclosure provides a positive economic outcome.

### III. STATE FORECLOSURE LAWS

The differences in state foreclosure laws demonstrate different ideological preferences. Many of these foreclosure laws can be explained under the traditional policy preferences of lender-friendly or defaulter-friendly.<sup>85</sup> Judicial foreclosure, long redemption periods, lengthy mandatory delays before foreclosure sale, and delinquency restrictions can be classified as defaulter-friendly. The other foreclosure laws can be classified as lender-friendly. However, those preferences mistake the real policy concerns regarding foreclosure laws that are discussed above. Thus, when examining foreclosure law, this note examines the effect of foreclosure laws on reducing foreclosure rates (*i.e.*, keeping borrowers in their homes), and the effect of foreclosure laws on the resale of the property (*i.e.*, putting a subsequent homeowner in foreclosed property).

#### A. *Judicial vs. Non-Judicial Foreclosure*

The first major difference in state foreclosure laws is judicial vs. non-judicial foreclosure.<sup>86</sup> A judicial

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<sup>83</sup> Nelson, *supra* note 35, at 1421 (“[I]t is essential that buyers have adequate information about the property being sold if market price is to be achieved.”).

<sup>84</sup> *Id.*

<sup>85</sup> Pence, *supra* note 36, at 177; Heaton, *supra* note 36, at 92.

<sup>86</sup> Clauretje & Herzog, *supra* note 69, at 223.

foreclosure involves the court, while a non-judicial foreclosure, commonly referred to as power of sale, does not involve the court.<sup>87</sup> Since judicial foreclosures typically end in default judgments or with no defense made, the practical consequence of a state having judicial versus non-judicial foreclosures is that judicial foreclosures are generally more costly and take longer to complete.<sup>88</sup> However, characterizing states as either a judicial or non-judicial state can prove difficult. Many state laws that allow non-judicial foreclosure contain rights and incentives that make it more likely for lenders to choose judicial foreclosure over non-judicial foreclosure. For example, South Dakota allows for power by advertisement (non-judicial foreclosure), but gives the borrower the ability to request a foreclosure by action (judicial foreclosure).<sup>89</sup> New York allows for non-judicial foreclosure, but foreclosures are almost exclusively done by civil action (judicial foreclosure).<sup>90</sup> Past studies have ignored these intricacies, but in order to discover any correlation between foreclosure rates and judicial versus non-judicial foreclosure, these unique laws must be categorized in their own group.<sup>91</sup> Therefore, states that permit non-judicial

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<sup>87</sup> Heaton, *supra* note 36, at 91 (“Judicial foreclosure entails court adjudication of a lender-mortgagee initiated foreclosure action. In contrast, non-judicial foreclosure gives the mortgagee the power to sell the mortgaged property to the general public, without court supervision, by placing advertisements.”)

<sup>88</sup> A judicial foreclosure proceeding can last just twenty seconds with only two questions posed by the judge: “Are you current on your mortgage and are you living in the home.” Michael Corkery, *A Florida Court’s ‘Rocket Docket’ Blasts Through Foreclosure Cases: 2 Questions, 15 Seconds, 45 Days to Get Out; ‘What’s to Talk About?’ Says a Judge*, WALL ST. J., Feb. 18, 2009, at A1.

<sup>89</sup> S.D. CODIFIED LAWS § 21-48-9 (1993).

<sup>90</sup> RML-SRNE NY § 2:19.

<sup>91</sup> Failing to properly identify all states can lead to unsupported assumptions. By only taking into account a handful of states, Heaton

foreclosure but maintain significant exceptions that cause many foreclosures to be performed through the judicial process are classified as mixed foreclosure states.

With mixed foreclosure as a classification, twenty-nine states are classified as non-judicial foreclosure states.<sup>92</sup> Eleven states are judicial foreclosure states.<sup>93</sup> Nine states are not classified as either a judicial or a non-judicial foreclosure state; thus, those states are classified as mixed foreclosure states.<sup>94</sup> Lastly, Vermont is the only state that generally allows strict foreclosures.<sup>95</sup>

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came to the conclusion that non-judicial foreclosures lowered foreclosure rates. Heaton, *supra* note 36, at 97.

<sup>92</sup> Residential Mortgage Lending: State Regulation Database updated January 2009: Alabama: RML-SRSE AL § 2:19; Alaska: RML-SRW AK § 2:19; Arkansas: RML-SRSCN AR § 2:19; Arizona: RML-SRSCN AZ § 2:19; California: RML-SRW CA § 2:19; Colorado: RML-SRSCN CO § 2:19; Georgia: RML-SRSE GA § 2:19; Hawaii: RML-SRW HI § 2:19; Idaho: RML-SRW ID § 2:19; Maryland: RML-SRATL MD § 2:19; Massachusetts: RML-SRNE MA § 2:19; Michigan: RML-SRNCN MI § 2:19; Minnesota: RML-SRNCN MN § 2:19; Mississippi: RML-SRSE MS § 2:19; Missouri: RML-SRSCN MO § 2:19; Montana: RML-SRW MT § 2:19; Nevada: RML-SRW NV § 2:19; New Hampshire: RML-SRNE NH § 2:19; North Carolina: RML-SRSE NC § 2:19; Oregon: RML-SRW OR § 2:19; Rhode Island: RML-SRNE RI § 2:19; South Carolina: RML-SRSE SC § 2:19; Tennessee: RML-SRSE TN § 2:19; Texas: RML-SRSCN TX § 2:19; Utah: RML-SRW UT § 2:19; Virginia: RML-SRATL VA § 2:19; Washington: RML-SRW WA § 2:19; West Virginia: RML-SRSE WV § 2:19; Wyoming: RML-SRW WY § 2:19..

<sup>93</sup> Residential Mortgage Lending: State Regulation Database updated January 2009: Connecticut: RML-SRNE CT § 2:19; Delaware: RML-SRATL DE § 2:19; Florida: RML-SRSE FL § 2:19; Illinois: RML-SRNCN IL § 2:19; Indiana: RML-SRNCN IN § 2:19; Kansas: RML-SRSCN KS § 2:19; Kentucky: RML-SRSE KY § 2:19; Louisiana: RML-SRSCN LA § 2:19; Ohio: RML-SRNCN OH § 2:19; Pennsylvania: RML-SRATL PA § 2:19; Wisconsin: RML-SRNCN WI § 2:19.

<sup>94</sup> Residential Mortgage Lending: State Regulation Database updated January 2009: Iowa: RML-SRNCN IA § 2:19; Maine: RML-SRNE ME § 2:19; Nebraska: RML-SRNCN NE § 2:19; New Jersey: RML-SRATL NJ § 2:19; New Mexico: RML-SRSCN NM § 2:19; New

By classifying foreclosure laws into two clear groups of judicial versus non-judicial foreclosure states, comparisons can be made between the effects of these laws on foreclosure rates. As discussed earlier, one of the arguments in favor of lengthening the foreclosure process is to deter lenders from initiating foreclosures.<sup>96</sup> However, a regression analysis shows almost no evidence that the longer judicial foreclosure process decreases the foreclosure rate.<sup>97</sup> When comparing the effects of judicial

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York: RML-SRNE NY § 2:19; North Dakota: RML-SRNCN ND § 2:19; Oklahoma: RML-SRSCN OK § 2:19; South Dakota: RML-SRNCN SD § 2:19.

<sup>95</sup> Residential Mortgage Lending: State Regulation Database updated January 2009; Vermont: RML-SRNE VT § 2:19. Strict foreclosure allows the lender to directly take possession of the property through the foreclosure process. James Geoffrey Durham, *In Defense of Strict Foreclosure: A Legal and Economic Analysis*, 36 S. C. L. REV. 461, 472 (1984□1985). Although historically foreclosures first used this process, strict foreclosure is rarely used today. *Id.* at 472□73. However, contract law allows lenders to gain direct possession of the property through a deal made with the borrower. John D. Hastie, *Conveyances in lieu of Foreclosure*, C516 ALI-ABA 263 (1990).

<sup>96</sup> See *supra* at Part I.

<sup>97</sup> Author applied regression analysis to data of foreclosure rates per household for all fifty states during the last three years. RealtyTrac Staff, *Foreclosure Activity Increases 81 percent in 2008*, RealtyTrac, available at

<http://www.realtytrac.com/content/press-releases/foreclosure-activity-increases-81-percent-in-2008-4551>; RealtyTrac, *U.S. Foreclosure Activity Increases 75 Percent in 2007*, RealtyTrac, available at

<http://www.realtytrac.com/content/press-releases/us-foreclosure-activity-increases-75-percent-in-2007-3604>; RealtyTrac, *More than 1.2 Million Foreclosure Filings Reported in 2006*, RealtyTrac, available at

<http://www.realtytrac.com/content/press-releases/more-than-12-million-foreclosure-filings-reported-in-2006-2234>. This author then compared those rates to whether the state was a judicial or non-judicial foreclosure through use of a dummy variable. A dummy variable just uses 1 or 0 to denote whether a state is a certain type of foreclosure state. To test the validity of the regression model, this author compared unemployment rates with foreclosure rates. Press Release, U.S. Bureau of Labor Statistics, *Civilian Labor Force and Unemployment by State*

versus non-judicial foreclosure on foreclosure rates for each state during the last three years, the regression model yields a correlation coefficient of less than negative 0.00066,<sup>98</sup> which means that the effect of judicial foreclosures on foreclosure rates is negligible.<sup>99</sup> Although regression analysis did not indicate any significant correlation between judicial foreclosures and foreclosure rates, judicial foreclosures may increase a borrower's ability to avoid a foreclosure sale.<sup>100</sup> Unfortunately, little data are available for rates of foreclosure workouts, but the increased opportunity for negotiations in judicial foreclosures makes it likely that judicial foreclosures

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*and Selected Area, Seasonally Adjusted* (2008), available at [http://www.bls.gov/news.release/archives/laus\\_01272009.pdf](http://www.bls.gov/news.release/archives/laus_01272009.pdf); Press Release, U.S. Bureau of Labor Statistics, *Civilian Labor Force and Unemployment by State and Selected Area, Seasonally Adjusted* (2008), available at

[http://www.bls.gov/news.release/archives/laus\\_01182008.pdf](http://www.bls.gov/news.release/archives/laus_01182008.pdf). The results showed with over 99 percent confidence that unemployment rates affect foreclosure rates. In fact, for each 1 percent increase in unemployment, foreclosure rates on average increase almost 0.25 percent. With this evidence of the accuracy of the regression model, the model could be used to test whether judicial foreclosures really decrease foreclosure rates.

<sup>98</sup> A coefficient of negative 0.00066 shows that states with judicial foreclosure compared with a non-judicial foreclosure have 0.00066 percent lower foreclosure rates.

<sup>99</sup> Given the simplicity of this regression model, no firm conclusion on whether judicial foreclosures actually decrease foreclosure rates can be reached. However, by looking at foreclosure rates for each state during the last three years, which translated into 150 samples, one would expect to see more evidence of judicial foreclosures decreasing foreclosure rates if such a relationship existed.

<sup>100</sup> Debra Pogrud Stark, *Foreclosing on the American Dream: An Evaluation of State and Federal Foreclosure Laws*, 51 OKLA. L. REV. 229, 242-43 (1998) (Empirical studies showed that in Illinois two-thirds of borrowers were able to prevent foreclosure sale by using reinstatement rights, redemption rights, workout, or bankruptcy).

positively influence foreclosure workout rates after the foreclosure process begins.<sup>101</sup>

In addition, the regression model showed almost no evidence that mixed foreclosures caused lower foreclosure rates than pure non-judicial foreclosures.<sup>102</sup> Although the results do not provide evidence that mixed foreclosure states are preferred over pure non-judicial states, some mixed foreclosure states provide interesting solutions that benefit from the use of both judicial and non-judicial foreclosure. A law that allows for a power of sale foreclosure to occur, unless a homeowner requests a judicial foreclosure, could lower foreclosure rates.<sup>103</sup> When a borrower files with the court requesting judicial foreclosure, the borrower signals his or her desire to stay in the home. This signal ensures that the borrower is interested in remaining in her home, either through negotiation or prolonging the foreclosure process. With this knowledge, a lender is more likely to be willing to go through the expense of a loan workout.<sup>104</sup>

### B. *Redemption Rights*

Another divergence among state foreclosure laws involves redemption rights. Redemption rights provide the borrower with an opportunity to save his property from foreclosure.<sup>105</sup> Redemption rights may be classified into

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<sup>101</sup> *Id.*

<sup>102</sup> The regression model showed that mixed foreclosures compared with judicial foreclosures showed a negative coefficient of 0.003 percent, which means that a state having a mixed foreclosure state instead of a pure non-judicial state causes foreclosure rates to decrease by 0.003 percent.

<sup>103</sup> OKLA. STAT. ANN. tit. 46, § 43 (West 1986); S.D. CODIFIED LAWS § 21-48-9 (1993).

<sup>104</sup> Expenses that occur during a loan workout include the time to negotiate and the costs of reinitiating the foreclosure process if the borrower falls back into default. See *Loan Modifications Get Reviewed*, *supra* note 5, at A6.

<sup>105</sup> Heaton, *supra* note 36, at 92.



three separate rights. One form of redemption right (hereinafter referred to as “cure”) provides the borrower with the ability to save her property from foreclosure by paying all past missed payments, plus interest and expenses, but not including any accelerated payments.<sup>106</sup> Another form of redemption right (hereinafter referred to as “equitable redemption”) allows recovery of the borrower’s property by paying the full amount of the judgment (*i.e.*, the total amount outstanding on the mortgage) or the total amount of past due payments plus acceleration.<sup>107</sup> The last

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<sup>106</sup> See, *e.g.*, WASH. REV. CODE § 61.24.090 (2008). “(1) At any time prior to the eleventh day before the date set by the trustee for the sale in the recorded notice of sale, or in the event the trustee continues the sale pursuant to RCW 61.24.040(6), at any time prior to the eleventh day before the actual sale, the borrower, grantor, any guarantor, any beneficiary under a subordinate deed of trust, or any person having a subordinate lien or encumbrance of record on the trust property or any part thereof, shall be entitled to cause a discontinuance of the sale proceedings by curing the default or defaults set forth in the notice, which in the case of a default by failure to pay, shall be by paying to the trustee: (a) The entire amount then due under the terms of the deed of trust and the obligation secured thereby, *other than such portion of the principal as would not then be due had no default occurred*, and (b) The expenses actually incurred by the trustee enforcing the terms of the note and deed of trust, including a reasonable trustee’s fee, together with the trustee’s reasonable attorney’s fees, together with costs of recording the notice of discontinuance of notice of trustee’s sale.” *Id.* (emphasis added)

<sup>107</sup> See, *e.g.*, FLA STAT. § 45.0315 (West 2006). “At any time before the later of the filing of a certificate of sale by the clerk of the court or time specified in the judgment, order, or decree of foreclosure, the mortgagor or the holder of any subordinate interest may cure the mortgagor’s indebtedness and prevent a foreclosure sale by paying the amount of moneys specified in the judgment, order, or decree of foreclosure, or if no judgment, order, or decree of foreclosure has been rendered, by tendering the performance due under the security agreement, *including any amounts due because of the exercise of a right to accelerate*, plus the reasonable expenses of proceeding to foreclosure incurred to the time of tender, including reasonable attorney’s fees. . . .” *Id.* (emphasis added).

form of redemption right (hereinafter referred to as “post-sale redemption”) provides the borrower with the right to recover the property after the foreclosure sale.<sup>108</sup> In many states, this post-sale redemption right permits the borrower to remain on the property<sup>109</sup> and can last from ten days to two years.<sup>110</sup> With these classifications in mind, one can compare the benefits of cure rights to those of equitable redemption, and the benefits of equitable redemption to those of post-sale redemption.

The primary difference between cure redemption and equitable redemption is that equitable redemption imposes more costs on the borrower in order to recover his or her property. Despite this burden, some states allow redemption only by paying the full amount of the judgment or paying late payments plus acceleration.<sup>111</sup> By forcing the borrower to pay the full amount of the mortgage instead of simply curing the past unpaid payments, these states significantly decrease the chances for a borrower to avert foreclosure sale.<sup>112</sup> This clearly detrimental policy to the homeowner finds no justification from any policy perspective. The lender is not substantially disadvantaged from allowing cure rights,<sup>113</sup> and the quality of the property will not suffer from giving a borrower the right to cure instead of the right of equitable redemption. In fact, a borrower will more likely take care of the property until the foreclosure sale if there is a greater chance that she will be able to remove her property from the foreclosure process. Hence, cure rights should be preferred over equitable redemption.

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<sup>108</sup> See, e.g., TENN. CODE ANN. § 66-8-101 (2004) (“Real estate sold for debt shall be redeemable at any time within two (2) years after such sale.”).

<sup>109</sup> Cox, *supra* note 38, at 702.

<sup>110</sup> *Id.*

<sup>111</sup> See, e.g., FLA STAT. § 45.0315 (2006).

<sup>112</sup> Cox, *supra* note 38, at 732.

<sup>113</sup> *Id.*

The difference between equitable redemption and post-sale redemption rights is that equitable redemption applies only to pre-foreclosure.<sup>114</sup> The benefits associated with post-sale redemption rights include giving the borrower another chance at saving his or her home and increasing the cost of foreclosure, which might decrease foreclosure rates.<sup>115</sup> However, there is evidence that very few borrowers take advantage of post-sale redemption rights.<sup>116</sup> In addition, a regression analysis study compared nine states offering lengthy post-sale redemption rights of over six months with all other states; this study showed that long redemption rights decreased foreclosure rates only slightly.<sup>117</sup> Conversely, the possible negative effects of redemption rights include lower foreclosure sale prices and the inability of potential homeowners to bid on the property.<sup>118</sup> A potential homeowner would be unlikely to bid on a home with the knowledge that he or she could not inhabit the home for an extended period of time or that the home could be taken from the purchaser for up to two years after the purchase.<sup>119</sup> The successful bidder would be reluctant to invest in the property until the redemption

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<sup>114</sup> Post-sale redemption rights are only available through statute. Hughes, *supra* note 74, at 129-130.

<sup>115</sup> Hughes, *supra* note 74, at 133.

<sup>116</sup> *Id.* at 135.

<sup>117</sup> Residential Mortgage Lending: State Regulation Manual Database updated January 2009: Alabama: RML-SRSE AL § 2:19; Iowa: RML-SRNCN IA § 2:19; Kansas: RML-SRSCN KS § 2:19; Michigan: RML-SRNCN MI § 2:19; Minnesota: RML-SRNCN MN § 2:19; Missouri: RML-SRSCN MO § 2:19; New Mexico: RML-SRSCN NM § 2:19; Tennessee: RML-SRSE TN § 2:19; Vermont: RML-SRNCN VT § 2:19. Similar to the regression model used to analyze judicial for non-judicial foreclosure, this author used dummy variables. When comparing long-redemption states to all other states, the results yield a negative coefficient of 0.0026, which indicates that long-redemption states have a lower foreclosure rate on average by 0.0026 percent.

<sup>118</sup> Hughes, *supra* note 74, at 134.

<sup>119</sup> Nelson & Whitman, *supra* note 35, at 1439.

period ceased.<sup>120</sup> Despite the high cost associated with a long redemption period, long redemption periods only marginally affect the foreclosure rate compared to other states.<sup>121</sup> Therefore, the benefit of slightly higher prospects for home retention seems inadequate to compensate for the costs associated with long post-sale redemption periods.

### C. Notice and Delay Statutes

State foreclosure laws also differ with respect to notice and delay requirements. These requirements take many different forms and provide borrowers with different protections. As one example of a longer time delay, Maryland forces the lender to wait the later of ninety days after default or forty-five days after notice of intent to foreclose before initiating an action to foreclose.<sup>122</sup> Washington requires that a foreclosure under power of sale take place only after 190 days from default.<sup>123</sup> In addition to a long notice period, Washington requires the lender to provide information to borrowers of their options while in foreclosure.<sup>124</sup> If a lender pursues foreclosure by power of sale in Vermont, there exists a seven-month protection period from service of the complaint; however, the period is shortened with evidence of waste of property.<sup>125</sup> Examples of states with shorter time restraints include Texas, which requires notice of only twenty-one days before the sale of the property,<sup>126</sup> and New Hampshire, which requires notice to be sent to the mortgagor twenty-five days before the sale.<sup>127</sup>

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<sup>120</sup> *Id.*

<sup>121</sup> Clauretie & Herzog, *supra* note 69, at 231.

<sup>122</sup> MD. CODE ANN., REAL PROP. § 7-105.1 (LexisNexis 2010).

<sup>123</sup> WASH. REV. CODE § 61.24.040 (2008).

<sup>124</sup> *Id.*

<sup>125</sup> VT. STAT. ANN. tit. 12, § 4531a (2002).

<sup>126</sup> TEX. PROP. CODE ANN. § 51.002 (West 2007).

<sup>127</sup> N.H. REV. STAT. ANN. § 479:25 (2001).

Finding the point where benefits of an increased delay equal the costs of increased delay is an inexact calculation as every homeowner is different. As a means to better differentiate between homeowners, Pennsylvania increases the notice period for homeowners most likely to benefit. Pennsylvania gives borrowers the right to meet with the lender by providing a sixty-day stay on the foreclosure proceedings.<sup>128</sup> By requiring the borrower to request the meeting, the court only imposes the sixty-day stay when the borrower is genuinely interested in working out the loan. Once the borrower signals his or her interest in retaining the home, the sixty-day stay gives the borrower additional time to negotiate a workout.

Pennsylvania's solution reflects the same goals of the states that allow both judicial and non-judicial foreclosure.<sup>129</sup> By forcing the borrower to act to receive certain protections, these laws separate those homeowners interested in saving their home from those not willing to put forth the effort. As discussed earlier, borrowers are not equal.<sup>130</sup> Therefore, any law that separates borrowers allows state legislatures to set up efficient laws by providing different foreclosure delays. Although this note does not try to calculate the optimal level of foreclosure delay that state legislatures should seek,<sup>131</sup> bifurcating the foreclosure process makes choosing foreclosure periods much easier on legislators.

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<sup>128</sup> Residential Mortgage Lending: State Regulation Database updated January 2009, RML-SRATL PA § 2:19.

<sup>129</sup> See sources cited *supra* note 103. By allowing for accelerated foreclosures, unless the borrower complies with a simple requirement, these states streamline the foreclosure process for those not interested in maintaining ownership.

<sup>130</sup> See *supra* Part I (pointing out that the borrower's interest may not coincide with the community's interests).

<sup>131</sup> This is an important question worthy of in-depth research on the empirical benefits and costs of delaying foreclosures.

*D. Deficiency Judgments*

Finally, state foreclosure laws diverge with respect to prohibiting or limiting deficiency judgments. Deficiency judgments occur when the foreclosure sale fails to cover the amount owed on the mortgage.<sup>132</sup> Many states allow for the full amount of deficiency judgments.<sup>133</sup> Other states restrict deficiency judgments to when judicial foreclosure is used,<sup>134</sup> while other states restrict deficiency judgments to the difference between the price sold and the fair market value of the property.<sup>135</sup> A few states completely forbid deficiency judgments when dealing with residential property.<sup>136</sup> These different deficiency judgment limitations do not affect lender incentives to foreclosure or lender losses, because lenders typically do not collect deficiency judgments in the states that do allow them.<sup>137</sup>

Although deficiency judgments may not deter or encourage lenders from foreclosing, deficiency judgments create a perverse incentive to borrowers.<sup>138</sup> As previously discussed, anti-deficiency judgment laws encourage homeowners to walk away from their homes when property

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<sup>132</sup> Cox, *supra* note 38, at 703.

<sup>133</sup> See *Fed. Land Bank of Wichita v. Cummings*, 735 P.2d 1110 (Kan. Ct. App. 1987) (ruling that a creditor cannot be denied a deficiency judgment if the sale is confirmed).

<sup>134</sup> OR. REV. STAT. § 86.990 (2009)

<sup>135</sup> UTAH CODE ANN. § 57-1-32 (2010) (“The court may not render judgment for more than the amount by which the amount of the indebtedness with interest, costs, and expenses of sale, including trustee’s and attorney’s fees, exceeds the fair market value of the property as of the date of the sale.”).

<sup>136</sup> Residential Mortgage Lending: State Regulation Database, RML-SRW CA § 2:19 (California).

<sup>137</sup> Cox, *supra* note 38, at 703. It seems self-evident that a borrower who cannot afford to pay a monthly mortgage payment would also be judgment proof with regards to a lender collecting on the outstanding amount of a deficiency judgment.

<sup>138</sup> See *supra* note 76 and accompanying text.

values drop below mortgage amounts.<sup>139</sup> Along with enticing homeowners to default, anti-deficiency laws take away an important bargaining chip that could be used by lenders. For example, the prospect of a deficiency judgment could persuade a defaulting borrower to turn over ownership of the property to the lender.<sup>140</sup> Even the supposed benefit of protecting the borrower by prohibiting deficiency judgments lacks merit, as lenders rarely pursue deficiencies.<sup>141</sup> Thus, no rationale exists for prohibiting deficiency judgments, while allowing deficiency judgments provides multiple benefits.

#### IV. RECENT FORECLOSURE LAW CHANGES

Given the severity of the housing crisis, state legislatures have begun to reform state foreclosure law. These reforms fall into two separate categories. First, some states have enacted mortgage moratoriums and other foreclosure delays for a specified period.<sup>142</sup> Second, other states have enacted foreclosure statutes changing substantive aspects of foreclosure law.<sup>143</sup>

##### A. *Mortgage Moratoriums and Foreclosure Delays*

A mortgage moratorium delays all foreclosures for a specified period. This delay can be the result of two different types of laws. One type of law consists of a true mortgage moratorium, where a state government prohibits

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<sup>139</sup> See Geanakoplos & Koniak, *supra* note 14 and accompanying text.

<sup>140</sup> Other uses of the prospect of deficiency judgments as bargaining tools are discussed later. See *infra* Part VI.

<sup>141</sup> See Cox, *supra* note 38, at 703.

<sup>142</sup> REAL PROP. ACTS. § 1304 (McKinney 2009); COLO. REV. STAT. § 38-38-108(1)(a) (2010); MD. CODE ANN., REAL PROP. § 7-105.1 (LexisNexis 2010).

<sup>143</sup> CAL. CIV. CODE § 2923.5(a)(1) (2010); GA. CODE ANN. § 44-14-162.2 (2010); N.Y. REAL PROP. ACTS. § 1304 (McKinney 2009); 2007 OH H.B. 138.

foreclosure proceedings from commencing for a certain period.<sup>144</sup> No state has undertaken this option, but some are considering it.<sup>145</sup> The other type delay is when a state government increases the length of time to complete the foreclosure process. The technical effect of lengthening the foreclosure process is a delay of all foreclosures. Many states have chosen this option.

1. *State Law Enactments of Foreclosure Delays*

One state that recently increased the length of the foreclosure process is New York. The New York legislature recently passed a statute stating that foreclosure proceedings cannot commence until ninety days after notice is given to the borrower.<sup>146</sup> Since the enactment of this statute in August, New York has seen a significant reduction in the number of foreclosures. From October to November 2008, foreclosures in New York decreased 31 percent, and foreclosures were down 55 percent for the year.<sup>147</sup> This large decrease is not surprising as many foreclosure proceedings could not be commenced due to the enactment of the statute. Given the temporary effect of the statute, there is a high likelihood that foreclosures will increase in the coming months.<sup>148</sup>

Another state that has lengthened the foreclosure process is Colorado. In order to lengthen the foreclosure

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<sup>144</sup> New York legislators are considering passing a one-year mortgage moratorium. *New York State Legislature to Discuss 1-Year Foreclosure Moratorium*, BANK FORECLOSURES SALES (Mar. 5, 2008), <http://www.bankforeclosuresale.com/wp/article-0305156.html>.

<sup>145</sup> *Id.*

<sup>146</sup> N.Y. REAL PROP. ACTS. § 1304 (McKinney 2009).

<sup>147</sup> RealtyTrac, *Foreclosure Activity Decreases 7 Percent in November*, REALTYTRAC (Dec. 11, 2008), <http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=5543&acct=64847>.

<sup>148</sup> However, the New York statute's purpose goes beyond just creating a mortgage moratorium, as the law permanently delays the foreclosure process. *See supra* Part III.c.



process, Colorado increased the cure period before the foreclosure sale and eliminated the right to redeem after the sale.<sup>149</sup> Before this legislative change, the right to cure lasted between forty-five to sixty days.<sup>150</sup> However, the new statute specifically requires 110 to 125 days between notice and sale.<sup>151</sup> This statute increases the cure time from 110 to 125 days, because the borrower has up until the day before the sale to redeem the property.<sup>152</sup> This trade-off increases the borrower's chances to recover the property by curing, while also giving cleaner title to the buyer of the foreclosed property.<sup>153</sup> The change may have caused a decrease in foreclosures. The bill became effective on July 1, 2007, and from November 2007 to November 2008, Colorado saw a seventeen percent decrease in foreclosures.<sup>154</sup>

Maryland's approach to fixing the foreclosure issue is similar to Colorado's approach. Maryland recently passed an emergency bill to increase the length of the foreclosure process.<sup>155</sup> Maryland increased the length of time after default before a sale can be made to the later of ninety days after the default or forty-five days after notice of intent to foreclose.<sup>156</sup> Because borrowers maintain the

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<sup>149</sup> COLO. REV. STAT. § 38-38-108(1)(a) (2010).

<sup>150</sup> COLO. REV. STAT. § 38-38-103(1)(a)(II) (2007), *amended by* 2007 Colo. Sess. Laws p. 1832.

<sup>151</sup> COLO. REV. STAT. § 38-38-108(1)(a) (2010).

<sup>152</sup> COLO. REV. STAT. § 38-38-108(1)(a) (2010) (giving the borrower until noon on the day before the sale to cure the mortgage).

<sup>153</sup> The successful bidder at foreclosure auctions no longer needs to worry about losing ownership through use of a post-sale redemption right. *See Hughes, supra* note 74, at 134.

<sup>154</sup> *Foreclosure Activity Decreases 7 Percent in November*, RealtyTrac, available at <http://www.realtytrac.com/content/press-releases/foreclosure-activity-decreases-7-percent-in-november-4478>.

<sup>155</sup> Emergency Bill: Environmental Matters/Judicial Proceedings, Md. H.B. 365.

<sup>156</sup> MD. CODE ANN., REAL PROP. § 7-105.1 (LexisNexis 2010).

right to cure until one day before the sale, increasing the length of time before a foreclosure sale increases the time to cure.<sup>157</sup> As discussed before, this increase in time could increase the number of borrowers who eventually cure the mortgage and maintain possession of their home.<sup>158</sup> However, Maryland's foreclosure rate has increased year to date as of November 2008.

## 2. *Policy Analysis of Foreclosure Delays*

A true mortgage moratorium and the effects of creating delays of foreclosure law create both negative and positive consequences. The positive consequences include allowing more time for the borrower to explore alternatives to foreclosure and reduce losses to lenders as more borrowers are able to negotiate mortgage loan modifications.<sup>159</sup> The negative consequences include exacerbating the losses in the banking industry, slowing the recapitalization of the banking system, and delaying the correction of the housing market.<sup>160</sup> The problems of the banking industry should not be underestimated, but the possible effects to the housing market show a particular cause for concern. As emphasized in a congressional research report, "evidence from the Great Depression suggests that states that enacted moratoriums provided relief to some homeowners but saw higher costs of credit and fewer loans compared with states that did not."<sup>161</sup> This environment creates a trade-off of temporarily keeping borrowers in their home with the hope that those borrowers can work out a permanent solution versus making it more

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<sup>157</sup> *Id.*

<sup>158</sup> See *supra* note 107 and accompanying text.

<sup>159</sup> Edward Vincent Murphy, CRS Report for Congress, *Economic Analysis of a Mortgage Foreclosure Moratorium*, updated September 12, 2008, available at <http://fpc.state.gov/documents/organization/110095.pdf>.

<sup>160</sup> *Id.*

<sup>161</sup> *Id.*

difficult for new potential homeowners to buy a house. By making access to credit more difficult, states could slow the recovery of the housing market. Therefore, enacting a mortgage moratorium requires careful consideration before implementing.<sup>162</sup>

Similar to the mortgage moratorium, the effects of permanently lengthening the foreclosure process creates benefits and costs. The benefits associated with a longer foreclosure process are increased time for a mortgagor to negotiate with the lender or to seek other alternatives, while the costs include increased mortgage costs and dilapidation of property.<sup>163</sup> This trade-off occurs often in the foreclosure process, but the decision of the Colorado legislature seems particularly well thought out.<sup>164</sup> Colorado traded post-sale redemption rights for a longer cure period before foreclosure sale.<sup>165</sup> This statute created an environment where the borrower's opportunity to maintain ownership is increased, while simultaneously making it easier for a potential homeowner to buy the foreclosed property. Curing the missed payments is easier for a homeowner than paying the full cost of the foreclosure sale.<sup>166</sup> Therefore, by giving the homeowner the opportunity to cure the mortgage instead of post-sale redemption, the Colorado legislature increased the chance of a borrower being able to save her home.<sup>167</sup>

Moreover, eliminating post-sale redemption rights promotes increased bidder participation. The discouraging

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<sup>162</sup> This note does not argue for or against a mortgage moratorium. However, as the economy worsens, many states may become increasingly interested in a mortgage moratorium to stop the foreclosure problem. Before any legislature considers this option, research should be done on the effect on the banking industry and the economy as a whole.

<sup>163</sup> See *supra* Part II.

<sup>164</sup> See generally COLO. REV. STAT. § 38-38-108(1)(a) (2010).

<sup>165</sup> See *id.*

<sup>166</sup> See *supra* note 107 and accompanying text.

<sup>167</sup> See *id.*

effects of post-sale redemption rights on a potential homeowner bidding are greater than the effects of increasing the time between default and foreclosure sale. For example, a potential homeowner will be reluctant to bid on a house to live in when there is a chance that the home could be taken away from him in the next six months. With regard to a longer cure period, the only detriment to a potential homeowner bidding would be the dilapidation of the property, but that problem is just as prevalent with post-sale redemption rights where the original borrower remains in possession.<sup>168</sup> Even without the original borrower living in the home, it seems logical that a potential homeowner will be more reluctant to buy a house when the house could be taken away.<sup>169</sup>

### *B. Substantive Changes to State Foreclosure Laws*

In an effort to curb the effects of the foreclosure crisis, state legislatures have also made substantive changes to foreclosure laws. States have passed legislation that aims to improve the knowledge of the defaulting borrower and provide the borrower with a chance to confront the lender, ensure proper mortgage title, increase bidder information, and improve post-foreclosure sale use of the property. Even though changes to foreclosure law were implemented with good intentions, some of these changes have created perverse incentives.

#### *1. Improving Borrower Knowledge*

In addition to the ninety days provision discussed earlier, the New York legislature passed numerous provisions to aid borrowers and to help prevent future

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<sup>168</sup> See Hughes, *supra* note 74, at 134.

<sup>169</sup> Post-sale redemption rights also discourage the new owner from investing in the home until the post-sale redemption period has passed. *Id.*

foreclosures.<sup>170</sup> For example, a notice of foreclosure to a defaulting borrower requires specific language giving the homeowner a list of options, including telephone numbers that borrowers can call for further assistance.<sup>171</sup> By increasing the length of time for initiating foreclosures to ninety days and by ensuring that mortgagors know all of their options, the New York legislature created a legal landscape more conducive for borrowers to retain ownership. In addition, the statute created preventative measures requiring no negative amortization and a good faith showing that the mortgagor has the ability to repay.<sup>172</sup> The goal of this provision is to ensure that borrowers will not lose their homes by regulating the making of the mortgage.

Similar to the New York law mandating disclosure of options, a new California law requires lenders to illuminate the borrower's options. The law requires the lender to make contact with the borrower thirty days before filing a default notice in order to explore possible options for avoiding foreclosure, including the right to request a subsequent meeting with the lender that can be by telephone.<sup>173</sup> The statute's goal is to put the borrower and lender in contact. By giving the borrower the power to set up a subsequent meeting, the law gives the homeowner, who has the most to lose in this situation, the opportunity to force a meeting with the lender. Since meeting the lender precedes any negotiations, it is critical for the borrower to have that opportunity.

New York and California are not alone in revamping state foreclosure law. The Ohio General Assembly recently passed a foreclosure bill with three

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<sup>170</sup> N.Y. REAL PROP. ACTS. § 1304 (McKinney 2009).

<sup>171</sup> *See id.*

<sup>172</sup> *See id.*

<sup>173</sup> CAL. CIV. CODE § 2923.5(a)(1) (2010).

provisions affecting pre-foreclosure sale.<sup>174</sup> First, the bill provides Ohio courts with the power to require the mortgagor and mortgagee to appear in person and to participate in mediation.<sup>175</sup> Given the fact that many borrowers do not know who owns their mortgage, this requirement gives borrowers a chance to explain their situation and possibly save their homes through a workout program.<sup>176</sup> A similar statute was recently passed in Georgia that requires that the borrower be notified of the name and contact information of the individual who has full authority to negotiate and modify the loan at issue.<sup>177</sup> These statutory changes are in direct response to the mortgage securitization problem, which makes it difficult to know who really owns the mortgage and who has the power to modify the mortgage.<sup>178</sup>

## 2. *Mortgage Title Requirements*

Along with the mediation provision, the Ohio legislature passed a bill requiring that a judicial report be prepared and issued by a title insurance company that

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<sup>174</sup> See generally 2007 OH H.B. 138.

<sup>175</sup> OHIO REV. CODE ANN. § 2323.06 (2010). “In an action for the foreclosure of a mortgage, the court may at any stage in the action require the mortgagor and the mortgagee to participate in mediation as the court considers appropriate and may include a stipulation that requires the mortgagor and the mortgagee to appear at the mediation *in person*.” *Id.* (emphasis added). Forcing the actual mortgagee to meet with the borrower ensures that a person with the power to negotiate is present. Many defaulting homeowners may never speak to an individual that has the authority to alter the mortgage, which greatly decreases the borrower’s chances of avoiding foreclosure sale. Roberts, *supra* note 19.

<sup>176</sup> See *supra* note 31 and accompanying text.

<sup>177</sup> GA. CODE ANN. § 44-14-162.2 (2010) (requiring the notice to “include the name, address, and telephone number of the individual or entity who shall have full authority to negotiate, amend, and modify all terms of the mortgage with the debtor”).

<sup>178</sup> See *supra* Introduction.

contains detailed information on the property, the owner, and any lien holders.<sup>179</sup> The effect of this provision is to weed out all lenders without proper identification of their lien. As stated in the introduction of this note, many securitized mortgages lack proper title. Without proper title, foreclosures cannot be executed due to this provision. Not surprisingly, Ohio is not the only state to pass this type of statute. Georgia recently passed a statute that requires foreclosures to be conducted by the holder of the mortgage on public record.<sup>180</sup> Although a statute requiring proof of title to a mortgage seems trivial, it is necessary that states stress the need for proper recordation, given the improper recording of many asset-backed securities.<sup>181</sup>

### 3. *Increased Bidder Information*

The Ohio legislature did not limit its focus to problems caused only by the securitization of mortgages. The new Ohio foreclosure statute gives the officer who makes the foreclosure sale the option of holding an open house for the foreclosed property if abandoned.<sup>182</sup> This statute grants the officer in charge of foreclosure sales the opportunity to significantly increase the bidding at foreclosure sales.<sup>183</sup> One of the major reasons why properties are not sold at market value in foreclosure auctions is lack of information.<sup>184</sup> Lack of information makes it extremely risky for a one-time bidder to buy at a foreclosure auction, because a person trying to buy a house

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<sup>179</sup> OHIO REV. CODE ANN. § 2329.191 (2008).

<sup>180</sup> GA. CODE ANN. § 44-14-161(b) (2010).

<sup>181</sup> See *supra* Introduction.

<sup>182</sup> OHIO REV. CODE ANN. § 2329.272 (2010).

<sup>183</sup> See Nelson, *supra* note 35, at 1422 (discussing the inadequacies of the present auction-based foreclosure sale procedure).

<sup>184</sup> See *supra* note 81 and accompanying text.

for the first time typically cannot afford to buy a lemon.<sup>185</sup> However, a repeat player such as a bank or investor can afford to buy multiple houses at foreclosure auctions, despite knowing that one or two of them may bring a negative return. Therefore, increasing information by allowing all potential bidders to inspect the house increases the chances that a bidder who wants to live in the house will bid, which in turn increases the price paid at a foreclosure auction.

#### 4. *Post-Foreclosure Sale Reforms*

Not surprisingly, given the significant foreclosure problem facing the state, California's legislature made changes affecting foreclosed properties after a sale. California passed a law authorizing civil fines of \$1,000 per day for failing to maintain a property with fourteen days notice required to comply with the violation.<sup>186</sup> This law helps to alleviate the problem of deteriorating vacant properties.<sup>187</sup> However, the law also provides a disincentive to buying foreclosed real estate, because the fine of \$1,000 per day can add up quickly. Also, the fourteen-day notice seems to be an insufficient amount of time for a homeowner to fix substantial problems with a recently bought home that could have been vacant for a long period of time.<sup>188</sup>

Through the same law, California gave tenants sixty days after the foreclosure sale to vacate a property.<sup>189</sup> Immediate possession provides the successful bidder with

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<sup>185</sup> Lemon commonly refers to used cars. This author uses the term to apply to a property that needs significant repairs or needs to be torn down.

<sup>186</sup> CAL. CIV. CODE § 2923.3(a)(1) (2008).

<sup>187</sup> See Cox, *supra* note 38, at 727 (discussing the problem of vacant properties).

<sup>188</sup> Some activities, such as house painting, cannot be done during winter months in many states.

<sup>189</sup> CAL. CIV. CODE § 2923.3(2) (2008).



significant benefits. Such benefits include the assurance that the property will not further deteriorate, the ability to move into the house quickly, and the opportunity to make improvements. However, because this law increases the amount of time it takes for a purchaser at a foreclosure auction to gain possession of the property, the law further dissuades bidders at foreclosure auction.

California was not alone in passing laws associated with foreclosed property post-sale. Ohio passed a law that requires the officer who conducted the sale, normally the sheriff, to record the deed conveying title to the property.<sup>190</sup> This requirement helps to prevent the deterioration of abandoned property, because many lenders or investors who buy foreclosed property may not record their deed in order to avoid city laws requiring the property to be maintained. Dilapidated housing lowers the value of all houses in a neighborhood and creates safety concerns for the community.<sup>191</sup> However, many city code violations are served on the new owners of the property the day after a foreclosed property is bought.<sup>192</sup> The city waiting to enforce housing-code violations until after the foreclosure sale places a large cost on an individual wishing to purchase a foreclosed property. Thus, a city must weight the benefits of holding people accountable with the costs of stringent requirements.

##### *5. Policy Analysis of Recent Substantive Changes to Foreclosure Law*

When examining the recent changes to foreclosure law through the lens of promoting home ownership, one discovers that many of the changes to foreclosure laws are beneficial and long overdue. Improving the knowledge of

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<sup>190</sup> OHIO REV. CODE. ANN. § 2323.66 (2008).

<sup>191</sup> See Cox, *supra* note 38, at 727.

<sup>192</sup> This author has personally seen housing code officials writing down the names of successful bidders at a foreclosure auction.

borrowers by making sure that they are privy to the alternatives to foreclosure provides important benefits. First, it protects the mortgagor from scams targeting defaulting borrowers who lack knowledge.<sup>193</sup> Second, it ensures that the mortgagor knows her options to protect equity in her home.<sup>194</sup> Third, and most importantly, the buyer knows of the opportunities to engage in negotiations with the mortgagee in order to find a way to maintain ownership.<sup>195</sup> Many laws go a step further by giving the borrower the right to a meeting with the lender, which increases the likelihood of a workout.<sup>196</sup> The appealing characteristic of disclosure statutes is the lack of a negative trade-off. The only cost associated with disclosure is the time it takes the lender to educate the borrower.<sup>197</sup>

Another enacted disclosure statute focuses on educating bidders instead of the homeowner. Many scholars have attempted to explain why foreclosure sales are below market prices.<sup>198</sup> One logical explanation for the low foreclosure price is the lack of information.<sup>199</sup> Allowing potential bidders the opportunity to view the property through an open-house helps to resolve this problem.<sup>200</sup> A potential homeowner would never buy a home on the market without walking through the home, and in the foreclosure auction, that is exactly what a potential bidder needs to do. Therefore, any law that increases the

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<sup>193</sup> See Mortgage Foreclosure Rescue Scams, <http://www.fraudguides.com/mortgage-foreclosure-rescue-scam.asp>.

<sup>194</sup> See Jacoby *supra* note 33, at 2272.

<sup>195</sup> A recent study released by the Federal Home Loan Mortgage Corporation found that “57 percent of the nation’s late-paying borrowers do not know their lenders may offer alternatives to help them avoid foreclosure.” CAL. CIV. CODE § 2923.5 note (e) (2010).

<sup>196</sup> CAL. CIV. CODE § 2923.5(a)(2) (2010).

<sup>197</sup> Educating the borrower should be the type of activity lenders already engage in, but, unfortunately, that is not the case. *Id.*

<sup>198</sup> Nelson, *supra* note 35, at 1422.

<sup>199</sup> *Id.*

<sup>200</sup> OHIO REV. CODE ANN. § 2329.27.2 (2010).

information of potential bidders will encourage increased participation at foreclosure auctions.

Along with disclosure statutes, states have passed laws explicitly requiring proper foreclosure recording.<sup>201</sup> These laws present a difficult problem. Because many mortgages were improperly recorded, many mortgages could be held invalid.<sup>202</sup> Although this outcome keeps many borrowers in their homes, it comes at costs to the financial industry. Given the fragile state of the financial sector, invalidating a significant number of mortgages would have detrimental effects on any state's economy.<sup>203</sup> Hence, giving the borrower a windfall by voiding his mortgage does not appear to lead to the most efficient outcome. Instead, states should promote mortgage modification where the lender still earns returns and the borrower maintains possession.

The last type of foreclosure law modification affects the foreclosed property after the sale. These laws aim at making the buyer of the foreclosed property responsible for the condition of the property.<sup>204</sup> Although the law does not promote home ownership, these laws benefit the community by forcing buyers to maintain the property.<sup>205</sup>

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<sup>201</sup> GA. CODE ANN. § 44-14-160 (2010).

<sup>202</sup> See *In re Foreclosure Cases*, 521 F. Supp. 2d 650, 655 (S.D. Ohio 2008).

<sup>203</sup> Since securitized mortgages made up 40 percent of all mortgages held before the crisis, prohibiting a large part of securitized mortgages would collapse a state's banking industry. See Rappaport, *supra* note 30.

<sup>204</sup> CAL. CIV. CODE § 2929.3(a)(1) (2010).

<sup>205</sup> Although one would expect a purchaser at a foreclosure auction to invest in the property, financial institutions lack the ability to efficiently maintain the property. Since financial institutions will not maintain the property, avoiding liability for the property becomes necessary. See *New Laws Provide Protections for Tenants of Foreclosed Properties*, Legal Services NYC, available at <http://www.legalservicesnyc.org/index.php?option=content&task=view&id=452>.

However, the laws create a disincentive to purchase properties at foreclosure auction because of the uncertainty surrounding local building inspector's decisions regarding property conditions. Despite this drawback, property owners should be held accountable for the condition of their property, but state law must be fair by giving buyers of foreclosed properties time to bring the property up to code.<sup>206</sup>

#### V. SCHOLARLY REFORMS TO STATE FORECLOSURE LAW

Many suggestions have been presented on how to improve state foreclosure law. Hence, an in-depth analysis of all of the scholarly reforms would be overwhelming. Nevertheless, two scholarly articles presented particularly astute observations and recommendations that are worth examining before one can formulate any recommendations. One legal scholar, Prentiss Cox, recommended two reforms to state foreclosure law when examining the law from the housing policy perspective.<sup>207</sup> Furthermore, Grant Nelson and Dale Whitman have argued for implementing the Uniform Nonjudicial Foreclosure Act.<sup>208</sup>

##### A. *Prentiss Cox*

The two recommendations made by Prentiss Cox include separating the foreclosure process and increasing

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<sup>206</sup> For example, many old houses economically cannot be brought up to current code, and requiring successful bidders to do so will lead to vacant buildings. See Mary Kane, *Lenders, Services Fight Anti-Blight and Property Laws*, The Washington Independent (Aug. 2009), available at

<http://washingtonindependent.com/57132/lenders-services-fight-anti-blight-and-property-laws>.

<sup>207</sup> Cox, *supra* note 38, at 727.

<sup>208</sup> Nelson, *supra* note 35, at 1399.

the notice requirements to homeowners.<sup>209</sup> The foreclosure process generally treats property owned by homeowners and property owned by investors as the same.<sup>210</sup> However, the two property owners act in distinct ways. Cox argues that defaulting investors are in a worse position than any potential buyer to achieve public benefits; therefore, they should not be given preferential treatment.<sup>211</sup> Conversely, the defaulting homeowner should be given every opportunity to retain ownership.<sup>212</sup> Those opportunities include delaying the foreclosure process and creating reinstatement (cure) rights until the foreclosure sale.<sup>213</sup> Although the research is limited, Cox cites a study that discovered evidence that a longer foreclosure process promotes homeowner retention.<sup>214</sup> In addition, Cox argues for the benefits of reinstatement rights by explaining how paying the arrearage due is easier than paying the whole mortgage amount.<sup>215</sup>

Along with the benefits of promoting homeowner retention of foreclosed property, Cox refutes the costs associated with longer foreclosures.<sup>216</sup> However, his complete dismissal of the costs seems unsupported. Cox first dismisses a study that found that higher foreclosure costs decrease loan amounts.<sup>217</sup> Cox dismisses this study

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<sup>209</sup> Cox, *supra* note 38, at 727.

<sup>210</sup> In the present crisis, most of the foreclosure aid has excluded investor owned properties. Kathleen Doler, *Investors Fight Foreclosure on Their Own*, INVESTOR'S BUS. DAILY, Dec. 5, 2008, at A6.

<sup>211</sup> Cox, *supra* note 38, at 729. It appears that policy makers agree that investor-owned real estate does not provide public benefits. *Id.*

<sup>212</sup> Cox, *supra* note 38, at 730.

<sup>213</sup> *Id.* at 730-32.

<sup>214</sup> See Stark, *supra* note 100, at 242-43.

<sup>215</sup> Cox, *supra* note 38, at 732.

<sup>216</sup> *Id.* at 735-38.

<sup>217</sup> Pence, *supra* note 36, at 177 (finding that defaulter-friendly states have loan amounts that are 3 percent to 7 percent smaller).

by arguing that lenders will become more careful.<sup>218</sup> However, more careful lenders mean less credit for potential homeowners. Cox then rejects the waste concern caused by a lack of incentive for defaulting homeowners to maintain the property.<sup>219</sup> However, waste frequently occurs in the case of foreclosed properties.<sup>220</sup> By emphasizing the importance of these costs, one can weigh the benefits and costs associated with longer foreclosure periods to discover the most efficient solution.<sup>221</sup>

Cox's second suggestion is to provide better notice to homeowners disclosing all of their options before solicitation by individuals seeking to benefit from the defaulting homeowners predicament.<sup>222</sup> From an earlier analysis, the benefits of disclosure outweigh the costs of providing that notice.<sup>223</sup> Furthermore, the use of plain language, as Cox suggests, ensures that the homeowner understands his options.<sup>224</sup> Cox also appropriately suggests that providing a plain language notice before publication of the foreclosure protects the borrowers from solicitors seeking to take advantage of them.<sup>225</sup> Thus, notice requirements that provide plain language to the borrower are necessary in order for the homeowner to make an informed decision.

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<sup>218</sup> Cox, *supra* note 38, at 736.

<sup>219</sup> *Id.* at 737.

<sup>220</sup> The kitchen sink, bath tub, furnace motor, and copper pipes were removed from the Murray Street property, mentioned in Part I, after the tenant was evicted for non-payment of rent.

<sup>221</sup> *See supra* Part II.

<sup>222</sup> *See* Mortgage Foreclosure Rescue Scams, *supra* note 193 (listing all the different types of foreclosure scams).

<sup>223</sup> *See supra* Part II.

<sup>224</sup> Cox, *supra* note 38, at 740.

<sup>225</sup> *Id.*

B. *Grant Nelson and Dale Whiteman*

Although the Uniform Nonjudicial Foreclosure Act (“UNFA”) failed to gain large-scale support, the Act provides many useful suggestions on how to improve state foreclosure law. The most novel and beneficial aspects of the Act involve improving the auction sale process and providing additional alternatives to foreclosed property disposal.<sup>226</sup>

The first part of the UNFA focuses on improving the auction sale process.<sup>227</sup> The central theme in improving the current system is improving bidder information. Bidder information is improved by having access to title information and general property information,<sup>228</sup> and inspecting the collateral.<sup>229</sup> The UNFA requires the lender to provide title evidence to each bidder who requests it.<sup>230</sup> The UNFA also authorizes lenders to make additional information available to bidders, while exculpating lenders from any liability for false information.<sup>231</sup> These provisions aim at putting information, which is already available to lenders, in the hands of bidders as well. Lastly, the UNFA tries to strike a compromise between allowing potential bidders to view the premises and “lien theory.”<sup>232</sup> It does so by protecting a residential debtor from deficiency

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<sup>226</sup> Nelson, *supra* note 35, at 1430.

<sup>227</sup> *Id.*

<sup>228</sup> *Id.* at 1434 (general property information includes “appraisals, environmental assessments, surveys, engineering studies, [and] inspection reports”).

<sup>229</sup> *Id.* at 1435.

<sup>230</sup> UNIFORM NONJUDICIAL FORECLOSURE ACT § 302(a) (2002). The act even requires the person conducting the auction to have copies of the title evidence at the sale. § 303(c)(7). Since lenders already possess information on the mortgaged property, forcing them to provide that information comes is a low burden. Nelson, *supra* note 35, at 1434.

<sup>231</sup> UNIFORM NONJUDICIAL FORECLOSURE ACT § 302(b)-(c).

<sup>232</sup> Nelson, *supra* note 35, at 1435 (“lien theory” states that the property belongs to the debtor until the foreclosure sale).

judgments if he acts in “good faith.”<sup>233</sup> One of the components of good faith requires the debtor to allow bidders reasonable access to the property.<sup>234</sup> There can be no substitute for inspecting the premises, and any way in which a state legislature can provide that option to potential bidders will increase the chances of a potential homeowner bidding at the auction.

Along with increasing the amount of disclosure in the auction sale, the UNFA eliminates the post-foreclosure statutory right of redemption.<sup>235</sup> This post-foreclosure right affects the finality of the foreclosure sale.<sup>236</sup> By ensuring that the successful bidder at the auction will in fact own the property, the law promotes the participation of bidders who desire to inhabit the residence.

Along with improving the auction sale, the UNFA proposes two alternatives to property disposal. First, the UNFA allows foreclosure by negotiated sale.<sup>237</sup> Foreclosure by negotiated sale allows the lender to sell the property through the open market.<sup>238</sup> However, the borrower is empowered to reject any proposed sale.<sup>239</sup> According to Nelson, lenders would use a negotiated sale to reduce transaction costs.<sup>240</sup> Although avoiding transaction costs does provide a benefit, it seems unlikely that a lender would engage in the process of selling the property when

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<sup>233</sup> *Id.* at 1437.

<sup>234</sup> *Id.*

<sup>235</sup> UNIFORM NONJUDICIAL FORECLOSURE ACT § 209 (cutting off all forms of redemption rights after the foreclosure sale has been completed).

<sup>236</sup> *See supra* note 114 (discussing the negative effects of post-foreclosure sale redemption rights).

<sup>237</sup> Nelson, *supra* note 35, at 1440-42 (discussing the different elements of the rules regulating negotiated sale in the UNFA).

<sup>238</sup> UNIFORM NONJUDICIAL FORECLOSURE ACT § 403.

<sup>239</sup> UNIFORM NONJUDICIAL FORECLOSURE ACT § 404.

<sup>240</sup> Transaction costs are reduced by “complet[ing] the process of property disposition in a single step, rather than the two-step procedure usually employed now.” Nelson, *supra* note 35, at 1442.



that effort could so easily be wasted by the objection of the borrower.<sup>241</sup>

Second, the Act allows for foreclosure by appraisal.<sup>242</sup> Foreclosure by appraisal allows the lender to give the borrower an appraisal of the property and offer a proposed amount for the property in order to take title.<sup>243</sup> This law allows the lender to streamline the process by taking possession quickly. In many instances, it would be profitable for the lender to pay the borrower to get immediate possession to the premises. For example, if a homeowner plans to simply delay the foreclosure sale in order to get free rent, the property will deteriorate in value. It is likely that the lender will acquire the property at foreclosure sale, and since the lender is incapable of repairing the property efficiently, the lender will be forced to sell the property at a large discount to an investor. This discount is the price that the bank is willing to offer the borrower to get immediate possession. Although this law does not directly promote home ownership, the law allows lenders to preserve the quality of the house, thereby making it easier for a potential homeowner to purchase the property.<sup>244</sup>

## VI. BENEFICIAL STATE FORECLOSURE LAW REFORMS

With a solid understanding of the different elements of state foreclosure law, recent changes in state foreclosure law, and scholarly perspectives of foreclosure law, one can

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<sup>241</sup> Given the present state of the housing industry, negotiated sales would not be feasible. There is simply too much housing inventory on the market.

<sup>242</sup> Nelson, *supra* note 35, at 1444.

<sup>243</sup> *Id.*

<sup>244</sup> Although this law does not show up in statute, contract law allows two parties to make such an agreement through use of a “deed in lieu.” Ron Lieber, *Thoughts on Walking Away from Your Home Loan*, N.Y. TIMES, Mar. 14, 2009, at B1.

begin to piece together the most beneficial aspects of each. To determine which laws are beneficial, this article gives preference to the goals of promoting homeownership before and after the foreclosure sale. With all this in mind, foreclosure reforms are necessary with two basic changes. First, foreclosure law should not treat everyone equally. Second, foreclosure law must be structured in such a way to bring potential resident bidders into foreclosure auctions.

*A. Foreclosures under the Dual System of Judicial and Non-Judicial Foreclosures*

The basic state foreclosure law debate of judicial versus non-judicial foreclosure shows that there are benefits to both systems. Thus, a system that allows for both would be the most effective.<sup>245</sup> Power of sale foreclosure should proceed unless the borrower complies with a simple requirement, such as filing a request for a judicial foreclosure with the clerk of courts. By mandating that the lender provide the borrower sufficient notice of his right to a judicial foreclosure and by making it easy for the borrower to make such a request, the legislature can ensure that judicial foreclosures will take place whenever the homeowner has the slightest interest in maintaining ownership. This small requirement for the homeowner to receive a judicial foreclosure would easily distinguish those interested in maintaining their homes from those who do not, because those interested in maintaining ownership would be willing to comply with the requirement.<sup>246</sup> Conversely, those with no interest in maintaining ownership deserve no special treatment, and the foreclosure

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<sup>245</sup> OKLA. STAT. ANN. tit. 46, § 43 (West 1986); S.D. CODIFIED LAWS § 21-48-9 (1993).

<sup>246</sup> A requirement such as a filing with the court or a letter to the mortgagee would be performed by anyone slightly interested in saving his home.

process should proceed under power of sale.<sup>247</sup> In addition, investors would be unlikely to comply with the provision.<sup>248</sup> A defaulting investor lacks the incentive to save the property and would not go through the expense of fighting the foreclosure in court.

Although there are many options for implementing a law that requires the borrower to request a judicial foreclosure, some details of how such a law would look could be beneficial. First, the law must provide clear notice of the requirements to receive a judicial foreclosure. The law should require the lender to provide the borrower with the form to file with the clerk of the court. Along with making the requirements simple, the notice should provide for a sufficient length of time. The borrower should be given at least one month to follow the steps necessary to get a judicial foreclosure.<sup>249</sup> In addition to notice of the judicial foreclosure, notice should be provided detailing all of the borrower's options.<sup>250</sup> After that period, the law bifurcates into the requirements of judicial foreclosure and non-judicial foreclosure.

If the borrower does not fulfill the requirement to receive a judicial foreclosure, a non-judicial foreclosure shall proceed. Non-judicial foreclosure should still allow the borrower the opportunity to work out or redeem the

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<sup>247</sup> Under the economic analysis presented in Part II, the costs of a borrower not interested in maintaining ownership far exceed the costs. The probability of deterioration of the property is high while the probability of the homeowner avoiding foreclosure is almost zero. Therefore, public policy favors quickly moving on from one homeowner to another homeowner with more incentive to invest time and money into the property.

<sup>248</sup> See Cox, *supra* note 38, at 729.

<sup>249</sup> Picking an exact length of time is difficult, but legislatures should ensure that the borrower has at least enough time to comply with the requirement. For example, if the foreclosed party was a truck driver that travels across country, he may not receive the notice until many weeks after it is sent.

<sup>250</sup> See Cox, *supra* note 38, at 740.

mortgage; however, that period should be limited to curb property waste. A period of one to two months seems sufficient.<sup>251</sup> This period should be further accelerated in the case of a vacant or dilapidated building with the decision of what constitutes vacant or dilapidated being made by the code enforcement official or equivalent office.<sup>252</sup> Then, publication of the foreclosure sale should take place for a period of two to four weeks with the sale taking place after that period. A period of two to four weeks provides sufficient notice to potential bidders.

If the borrower does comply with the requirement, judicial foreclosure shall proceed. Going through the judicial process provides much of the time delay necessary for the borrower to explore his options, but any law must provide the borrower the opportunity to meet with the lender. Given the difficulty of locating the individual with the ability to modify the mortgage, mediation needs to be encouraged or even required between the borrower and lender.<sup>253</sup> Either the judge or the borrower should have the ability to require a meeting with a party capable of modifying the mortgage.<sup>254</sup> When such a meeting is requested, an immediate stay of foreclosure proceedings should last until the meeting takes place.<sup>255</sup> With mediation and the delay caused by judicial process, the borrower will be given ample opportunity to find a way to remain in her home. However, as in non-judicial foreclosure, a ruling by

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<sup>251</sup> Again, picking an exact time is difficult; however, the period should be relatively short because the chance for property deterioration is high and the chance for avoiding foreclosure is low for a borrower not willing to request a judicial foreclosure.

<sup>252</sup> The costs of such assessment should be paid by the lender to ensure that any claim of property deterioration or vacancy is legitimate.

<sup>253</sup> OHIO REV. CODE ANN. § 2326.06 (LexisNexis 2008).

<sup>254</sup> CAL. CIV. CODE § 2923.5 (West 2008) (giving the borrower the ability to request a meeting); OHIO REV. CODE ANN. § 2326.06 (LexisNexis 2008) (giving the judge the ability to require mediation).

<sup>255</sup> See Residential Mortgage Lending, *supra* note 128.

a housing official declaring the building vacant or dilapidated should accelerate the process in judicial foreclosure.

In addition, the type of redemption right authorized should be a cure right up until the foreclosure sale, which provides the borrower with the greatest likelihood of redemption.<sup>256</sup> The cure rights should consist of all past due payments, any court fees, and attorney's fees.<sup>257</sup> However, attorney's fees should be limited to an amount, such as \$500, to avoid any excessive expenses.<sup>258</sup>

The benefits of this divergent treatment come from the economic analysis provided at the beginning of this article.<sup>259</sup> If a homeowner desires to stay in her home, the increased likelihood that the homeowner will in fact stave off foreclosure sale coupled with the benefits of a homeowner maintaining possession lends support to giving the homeowner significant time to explore her options.<sup>260</sup> On the other hand, if a homeowner does not desire to go through the steps necessary to save her home, the decreased likelihood that the homeowner will avoid foreclosure combined with the benefits of home ownership are outweighed by the increased likelihood that the property will not be maintained combined with the costs associated with the waste and deterioration of the property.<sup>261</sup> Since the costs associated with a longer foreclosure period are

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<sup>256</sup> See *supra* Part III.B.

<sup>257</sup> See, e.g., WASH. REV. CODE § 61.24.090 (2008) (example of a foreclosure statute that allows for the right to cure the mortgage without any acceleration of the amount due on the mortgage).

<sup>258</sup> Since attorney fees are only recoverable when the mortgagor reinstates, lenders have the incentive to disproportionately allocate attorney fees to foreclosures that are reinstated. See Keith Arnold, *Attorney Fees Can be Included in Costs of Mortgage Reinstatement*, THE DAILY REPORTER (Franklin County, Ohio) Feb. 5, 2009, at A1.

<sup>259</sup> See *supra* Part II.

<sup>260</sup> See *id.*

<sup>261</sup> See *id.*

higher with this group of homeowner,<sup>262</sup> these homeowners should be given a shorter foreclosure period.

*B. Increased Potential Homeowner Participation at Foreclosure Auctions*

In order to entice a greater number of potential residents into the foreclosure bidding process, four things are necessary. First, the potential homeowner must be given a chance to examine the premises. Without actually walking through the home, a potential resident will be reluctant to bid at a foreclosure auction. Second, a potential homeowner must be assured that if he or she is the successful bidder that there are no disputes over the ownership. Disputes over ownership would be caused by faulty title or redemption rights granted to the original borrower. Third, possession of the property must be obtained quickly. Quick possession allows the successful bidder to move into his or her new home and prevents waste that is likely to occur from a former homeowner who just lost ownership through the foreclosure process. Fourth, there must be some assurance that the successful bidder will not be immediately charged with multiple violations from the code enforcement office. Although a new homeowner will likely buy the property with the intention of improving the property, a home that just went through the foreclosure process may take time to improve.<sup>263</sup> Hence, someone buying a property out of foreclosure needs to be given ample time to improve the premises.

With these qualifications to bringing potential residents to the foreclosure bidding process, state legislatures must change many aspects of foreclosure law. There are two options to increasing access to the home for

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<sup>262</sup> *Id.*

<sup>263</sup> Some improvements, such as painting, cannot take place during some months of the year.

potential bidders. First, state legislatures can abolish the whole foreclosure idea of “lien theory.”<sup>264</sup> Although such a change may be unfair to the borrower, the state could enact a law in such a way as to protect the borrower and allow for potential bidders to inspect the home.<sup>265</sup> For example, legislation could be enacted to still preserve the borrower’s ownership of the property until a week before the sale, and then require the borrower to vacate the premises to allow for an open house of the property the day before the auction. If a state legislature still finds those terms unfair, the law could allow the borrower to trade the right to possess the home before foreclosure sale for an extended period, thereby giving the borrower an increased chance of avoiding foreclosure while also providing potential resident bidders the much needed access to the property before the auction.

This scenario creates a state of limbo as to who owns the property and who is responsible for the property during the days between forcing the borrower to vacate and the foreclosure sale. Although this question creates a legal theory problem, the practical implication of this limbo period is nonexistent. In the present law, the defaulting borrower cannot be held accountable for the property because the loans are uncollectable. For example, when there is a housing code violation, the code enforcement officials will wait to cite the new owner, knowing that the defaulting borrower will not comply and has no reason to comply with the housing code. So for all practical purposes, the property is already in a state of limbo with no one responsible for maintaining the property.

The second way a state legislature can allow potential bidders to view the foreclosed house is by finding ways to work within the present legal system. The UNFA suggests allowing borrowers to exchange avoiding liability

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<sup>264</sup> Nelson, *supra* note 35, at 1435.

<sup>265</sup> *Id.*

through a deficiency judgment for showing the property in foreclosure.<sup>266</sup> For this law to have any effect, deficiency judgments must be allowed against homeowners.<sup>267</sup> However, because deficiency judgments are rarely pursued,<sup>268</sup> this exchange may not incentivize borrowers to let potential bidders inspect their home. Another way to improve bidder access to the home is by allowing a county official to hold an open house for all vacant buildings.<sup>269</sup> Although this law does increase bidder access to a few homes, the majority of homes that are not vacated before the foreclosure sale will still not be viewed by potential bidders. Both these suggestions will increase bidder access to the foreclosed home, but neither will allow potential bidders full access to all foreclosed homes.

In addition to improving access to the home for potential bidders, state foreclosure law needs to ensure that when buying at foreclosure auction the successful bidder receives marketable title. The UNFA suggests that evidence of title should be provided by the lender.<sup>270</sup> Yet, the law allows for evidence of an attorney's opinion.<sup>271</sup> This note suggests requiring the lender to provide title insurance at the lender's expense. Forcing all potential bidders to pay for title insurance, given the fact that many foreclosure sales are cancelled a few days before the sale, is wasteful. Therefore, placing the burden on the lender greatly reduces overall costs. With this title insurance, all doubts about marketable title would be laid to rest before the bidding takes place.

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<sup>266</sup> *Id.* at 1437.

<sup>267</sup> *See supra* Part III.D.

<sup>268</sup> Jason Opland, *Short Sale/Foreclosure Deficiency Judgments – Do Banks Really Sue Homeowners?*, RealTown, available at <http://www.realtown.com/jasonopland/blog/short-sale-foreclosure-deficiency-judgments-do-thebanks-really-sue-homeowners>.

<sup>269</sup> OHIO REV. CODE ANN. § 2329.272 (LexisNexis 2008).

<sup>270</sup> Nelson, *supra* note 35, at 1433.

<sup>271</sup> *Id.*



Along with marketable title, potential homeowners need assurance that the property will not be taken away from them through the use of post-foreclosure statutory redemption. As discussed earlier, the post-sale redemption rights provide no real benefit to the borrower and could be a substantial deterrent for a potential homeowner at the foreclosure sale.<sup>272</sup> Hence, post-foreclosure redemption rights must be abolished to lure potential residents into the bidding process.

Lastly, state foreclosure law needs to be more accommodating to a successful bidder's situation by providing for fast possession and giving the new buyer a moratorium of the housing code violations. When the property is vacant, there should be no delay in giving the successful bidder possession. When the property is not vacant, the law should provide for quick eviction of the homeowner, tenant, or trespasser. Although this may seem harsh, the homeowner, tenant, or trespasser is likely to have had free rent for a long period of time. On the other hand, the successful bidder will want to gain possession of the property and take measures to maintain and improve the premises. To that end of improving the premises, a successful bidder must be given time. Laws that penalize purchasers at foreclosure auction do not take into account the time necessary to make improvements.<sup>273</sup> Therefore, a moratorium of at least three months from building code violations should be provided.

## VII. CONCLUSION

The inefficiencies of state foreclosure procedures have been hidden by the success of the banking industry

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<sup>272</sup> See *supra* Part III.B.

<sup>273</sup> As previously discussed, laws that require the property to be fixed within a couple of weeks, in some instances, cannot be achieved. See *supra* Part VI.B.

throughout the last half century. Because foreclosure rates have historically been a small percentage of total assets, lenders were happy to get possession of properties through uncontested foreclosure auctions. Lenders then sold those properties on the open market for a gain or slight loss. However, the present crisis has illuminated the problems of state foreclosure law. Simply put, lenders can no longer afford to take control of more foreclosed properties. Not only are lenders losing money, but housing values cannot be cured until foreclosed properties work their way into the hands of homeowners. Therefore, foreclosure reforms must be made.

These reforms must focus on improving the foreclosure process through the lens of promoting home ownership. This note suggests modifying the foreclosure process in ways that increase bidder participation and the passage of new laws that incorporate the best aspects of both judicial and non-judicial foreclosure. Together, these changes first will help prevent foreclosure sales, and second, streamline the process of getting new homeowners to buy foreclosed properties. The recommendations presented only begin to scratch the surface of possible changes to state foreclosure law, and it is this author's hope that legal scholars will begin to examine state foreclosure laws with the overall economic environment in mind.