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Articles

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Abstract

This article discusses the impact of the foreclosure crisis on the housing prospects of American families. Foreclosure is governed by state law, which establishes a procedure to enable lenders to recover property from defaulting borrowers through a public sale process. States authorize two different methods, judicial foreclosure, in which the foreclosure process requires a judicial hearing, and power of sale foreclosure, in which a trustee can offer mortgaged property to the highest bidder at a public sale after giving twenty days public notice. Judicial foreclosure is administered by state courts in twenty-three states. The power of sale foreclosure process is administered by loan servicers through trustees in the other twenty-seven states.

Part I reviews the role that homeownership has played in American society and summarizes the history of federal support for homeownership. Part II examines the housing bubble of the early years of the new millennium and the foreclosure crisis that occurred when the bubble burst in 2008. Part II also examines the roles played by residential mortgage servicing companies that collect and distribute mortgage payments, as well as the role of the computerized mortgages tracking system operated by Mortgage Electronic Registration Services Inc. (MERS) as it interacts with the public land recording system as a nominee for lenders. Part III discusses governmental responses to the foreclosure crisis, including the HOPE NOW Alliance, the FHA HOPE for Homeowners (H4H) program established by the Bush administration, along with the Obama administration's Housing Affordable Modification Program (HAMP) and the Home Affordable Foreclosure Alternatives (HAFA) program. Part IV argues that current foreclosure response techniques such as counseling and mediation can be successful if they become automatic parts of the residential mortgage foreclosure process, are coupled with mandatory loss mitigation requirements for lenders along the lines of the National Mortgage Settlement, and have as a resource a financing cushion for qualified defaulting homeowners, such as a "first priority 'seed lien'" recommended by Professor Christopher Peterson of the University of Utah, S.J. Quinney College of Law. Part IV also recommends that greater attention be paid to the value of renting as a means of restoring stability to the overall housing market.

Introduction

> Housing is both a product and a process. . . . Its primary functions are three: to provide (1) comfortable shelter; (2) a proper setting . . . for the day-to-day activities of families and households . . . ; and (3) the locus or location of families and other groups within the larger physical pattern of the locality.– National Commission on Urban Problems (Douglas Commission) (1969)

"We are engaged in hand to hand combat," asserted Linda Ingram, director of foreclosure intervention services at Beyond Housing Inc. in

St. Louis, describing the foreclosure crisis from the street. "Each loan servicer approaches these cases differently, so our focus must be on one family at a time."[1]

For generations, homeownership has been a cherished goal of the American people and a major policy objective of the federal government.[2] During the 1990s and into the early years of the new millennium, the housing sector was one of the strongest parts of the U.S. economy. A federal government-backed homeownership initiative triggered a short-lived optimism that virtually anyone who wished to could own a home.[3] Property values soared, creating a mindset focused on "How much can I borrow?" rather than the wiser question, "How much can I afford to pay back?"[4] By 2004, a record 69 percent of American households owned their own homes.[5] More new single-family homes were built in 2002 than in any year since 1978.[6]

1. Interview with Linda Ingram, Dir., Foreclosure Intervention Servs., Beyond Hous. Inc., St. Louis, Mo. (Nov. 23, 2010).

2. *See, e.g.*, David Streitfeld & Megan Thee-Brenan, *Despite Fears, Owning Home Retains Allure, Poll Shows*, N.Y. TIMES, June 30, 2011, at D1 (reporting that "[n]early nine in ten Americans say homeownership is an important part of the American dream"). For analyses of homeownership questioning the commonly held beliefs in its value, see Kristen D. Adams, *Homeownership: American Dream or Illusion of Empowerment?*, 60 S.C. L. REV. 573 (2009); Stephanie M. Stern, *Reassessing the Citizen Virtues of Homeownership*, 100 COLUM. L. REV. 101 (2011).

3. American Dream Downpayment Act, Pub. L. No. 108-186, §§ 101–02, 117 Stat. 2685 (codified at 42 U.S.C. § 12821 (2003)) (authorizing grants to states and municipalities to enable them to provide downpayment assistance to low-income first-time home buyers, not to exceed the greater of "(i) 6 percent of the purchase price of a single family housing unit; or (ii) $10,000"). Congress first began mandating annual affordable housing goals for the Federal National Mortgage Association (FNMA or Fannie Mae) and the Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac) in 1992. Federal Housing Enterprises Financial Safety and Soundness Act of 1992, Title XIII, Subtitle A, Part 2, Subpart B, Pub. L. No. 102-550, §§ 1331–38, 106 Stat. 3941, 3956–64 (codified at 12 U.S.C. §§ 4561–67) (establishing the goal requirements and requiring HUD to promulgate them and report annually on progress toward meeting those goals).

4. The late Terry McCormack, an engineer and cofounder of McCormack Baron Salazar Inc. (MBS), one of the largest developers of affordable housing in the country, emphasized this question in his analyses of failed 1960s-era nonprofit housing developments as a guest speaker in a housing law seminar I taught in the late 1970s. From those analyses, he and Richard Baron developed the strategy and business model that proved so successful for MBS. *McCormack Baron Salazar Community Development, Urban Revitalization History*, MCCORMACK BARON SALAZAR, http://www.mccormackbaron.com/about/history (last visited Apr. 15, 2012).

5. JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., THE STATE OF THE NATION'S HOUSING 2011, at 17 (2011).

6. JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., THE STATE OF THE NATION'S HOUSING 2003, at 1, 6 (2003).

Annual affordable housing goals for Fannie Mae and Freddie Mac, the government-sponsored enterprises (GSEs) that were the backbone of the secondary mortgage market, were increased from 52 percent to 56 percent of the two agencies' total mortgage portfolios to "meet the then-existing unaddressed needs" of low-income and very low-income families during the 2005–2008 period.[7] To help meet these goals, the two agencies purchased over $400 billion in subprime[8] mortgage-backed securities[9] between 2004 and 2006, a practice that later was deemed "a mistake" by former Department of Housing and Urban Development (HUD) officials.[10] When home values began dropping in 2005 and 2006, many of these borrowers found they were holding loan obligations that were larger than the value of their property, leading to the phenomenon of "being underwater."[11] The deepening recession, triggered by the collapse of the housing bubble and exacerbated by a sharp rise in unemployment in 2008 and 2009, only made matters worse.

Following the housing market collapse, homeownership declined sharply, falling 2.1 percent between 2004 (the peak year) and 2010 to a level 0.5 percent below the rate at the beginning of the decade.[12] At the end of 2010, homeowner households were down 805,000 from 2006, while renters had grown by 3.9 million since 2004.[13] New single-family home construction in 2010 "sank to lows last seen in the midst of World War II."[14]

7. Peter W. Salsich, Jr., *National Affordable Housing Trust Fund Legislation: The Subprime Mortgage Crisis Also Hits Renters*, 16 Geo. J. on Poverty L. & Pol'y 11, 32 (2009) (quoting 12 U.S.C. § 4563 and citing 24 C.F.R. §§ 81.12–.22 (2005)). The term "government-sponsored enterprise" was coined to denote the fact that the two agencies are corporations chartered by the federal government but owned by private investors who hold stock in the entities.

8. Subprime mortgages secure residential loans to borrowers with lower incomes or poor credit ratings, thus having a greater risk of defaulting. Such loans usually feature high interest rates and fees to protect lenders from the greater default risk. *See* Amy Crew Cutts & Robert Van Order, *On the Economics of Subprime Lending* 10 (Freddie Mac, Working Paper No. 04-01, Jan. 2004).

9. Mortgage-backed securities are fractional shares of pools of mortgages that have been accumulated by intermediaries and then sold to investors. Salsich, *supra* note 7, at 28 (citing David Alan Richards, "*Gradable and Tradable*": *The Securitization of Commercial Real Estate Mortgages*, 16 Real Est. L.J. 99, 102 (1987)).

10. Salsich, *supra* note 7, at 32.

11. Bob Tedeschi, *Lifelines for Those "Underwater*," N.Y. Times, July 24, 2009, http://www.nytimes.com/2009/07/26/realestate/26mort.html.

12. Joint Ctr. for Hous. Studies of Harvard Univ., The State of the Nation's Housing 2011, at 17 (2011). "The drop from the peak is the largest posted in annual records dating back to 1960. . . ." *Id*.

13. *Id*.

14. *Id*. at 6. The homeownership rate kept falling in 2011, dropping to 65.9 percent in the second quarter, a percentage not seen since the first quarter of 1998. Carrie Bay, *Homeownership Rate Drops to 13-Year Low*, DSNews.com (Aug. 1, 2011), *retrieved from* http://www.dsnews.com/articles/print-view/homeownership-rate-drops-to-13-year-low-2011-08-01 (citing U.S. Census Bureau News, Residential Vacancies and Homeownership in the Second Quarter 2011, CB11-124 (July 29, 2011)).

Foreclosures spiked in 2008 and kept rising through 2011. The Center for Responsible Lending (CRL) reported in November 2011 that "2.7 million homeowners [had] lost their homes to foreclosure" and another "3.6 million [were] at serious risk of losing their homes."[15]

When the foreclosure volume spiked, both the courts and the servicers were overwhelmed.[16] Allegations of sloppy recordkeeping, negligence, and even fraud proliferated, with so-called robo-signing of thousands of documents by one person becoming the poster child for a deepening scandal.[17] Amid claims that banks short-changed the servicing side of their residential mortgage business,[18] and that the computerized mortgages tracking system operated by Mortgage Electronic Registration Services Inc. (MERS), a northern Virginia-based company, was effectively hiding the identity of mortgage holders so that traditional public land records were not yielding true pictures of residential land titles,[19] attorneys general in all fifty states announced a

15. Debbie Gruenstein Bocian, Wei Li & Carolina Reid, Ctr. for Responsible Lending & Roberto G. Quercia, Ctr. for Cmty. Capital, Lost Ground, 2011: Disparities in Mortgage Lending and Foreclosures 14 (2011), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/lost-ground-2011.html. An earlier report estimated that "between 10 and 13 million foreclosures [may] have occurred by the time the crisis abates." Sara Weed & Sonia Garrison, Ctr. for Responsible Lending, Foreclosure as a Last Resort: States Can Stabilize the Housing Market by Preventing Unnecessary Foreclosures 1 (2010), *available at* http://www.responsiblelending.org/mortgage-lending/policy-legislation/states/foreclosure-as-a-last-resort.html (citing Debbie Gruenstein Bocian, Wei Li & Keith S. Ernst, Ctr. for Responsible Lending, Foreclosures by Race and Ethnicity: The Demographics of a Crisis 3 (2010), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf; Jan Hatzius & Michael A. Marschoun, Goldman Sachs Global ECS Research, Home Prices and Credit Losses: Projections and Policy Options (2009)).

16. *See, e.g.*, Joseph R. Fortunato & Steven B. Bashaw, *The Foreclosure Explosion: How Illinois Courts Are Responding*, 98 Ill. B.J. 380 (2010) ("Courts in the Chicago metro area are drowning in a sea of foreclosures.").

17. Robo-signing refers to the practice of lenders signing off on foreclosure affidavits in such mass numbers without the specific knowledge and facts of each case that is required before approval of the foreclosure. Andrew Martin, *GMAC Mortgage Expands Review of Its Foreclosures*, N.Y. Times, Oct. 12, 2010, at B9.

18. Eric Dash & Nelson D. Schwartz, *Bankers Ignored Signs of Trouble on Foreclosures*, N.Y. Times, Oct. 14, 2010, at B1; Jim Puzzanghera, *The Mortgage Meltdown; FDIC Chief: Red Flags Were Missed; Bank Regulators Begin Their Own Probe of Problems with Home Seizure Procedures*, L.A. Times, Oct. 26, 2010, at B1 (quoting Sheila Bair, then chair of the Federal Deposit Insurance Corporation, that fees charged by mortgage servicers had declined significantly in recent years, something that should have raised questions about "how servicers were able to achieve such efficiencies without sacrificing quality").

19. For a comprehensive analysis of the role that MERS has been playing in the residential real estate market, see Christopher L. Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System*, 78 U. Cin. L. Rev. 1359 (2010).

joint investigation of foreclosure practices in October 2010. This ultimately led to a $25 billion settlement with five major banks, Ally Financial, Bank of America, Citigroup, JPMorgan Chase, and Wells Fargo, in March 2012.[20]

This article discusses the impact of the foreclosure crisis on the housing prospects of American families and takes a critical look at both current and proposed responses to the foreclosure crisis. The foreclosure crisis reminds us that not all can afford the responsibilities of homeownership at every stage of their lives and that rental housing can and does provide a valuable resource to all income levels. Part I reviews the role that homeownership has played in American society and summarizes the history of federal support for homeownership. Part II examines the housing bubble of the early years of the new millennium and the foreclosure crisis that occurred when the bubble burst in 2008. The roles played by residential mortgage servicing companies that collect and distribute mortgage payments, as well as the role of MERS as it interacts with the public land recording system as a nominee for lenders, also are examined. Part III discusses governmental

20. The final settlement, accepted by forty-nine states (Oklahoma did not participate) and the Obama administration, was announced on February 9, 2012, and filed as five separate consent judgments on March 12 in U.S. district court in Washington, D.C. *See, e.g.*, Consent Judgment, United States v. Bank of Am. Corp., No. 1:12-cv-00361-RMC (D.D.C. Mar. 12, 2012), *available at* http://www.nationalmortgagesettlement.com/about (follow "Bank of America Consent Judgment" hyperlink); Andrew Martin, *All 50 States Start Inquiry into Foreclosures*, N.Y. Times, Oct. 14, 2010, at B1; Nelson D. Schwartz & Shaila Dewan, *Mortgage Plan Gives Homeowners Bulk of the Benefits*, N.Y. Times, Feb. 10, 2012, http://www.nytimes.com/2012/02/10/business/states-negotiate-26-billion-agreement-for-homeowners.html?pagewanted=all; Nick Timiraos, Dan Fitzpatrick & Ruth Simon, *Accord Near on Foreclosure Abuses Deal, Totaling as Much as $26 Billion with Five Banks, Would Settle Federal, State Probes of Lenders*, Wall St. J., Feb. 9, 2012, at C1. The settlement allocates $20 billion for borrower relief activities, including $10 billion for principal reduction for "borrowers who, as of the date of the settlement, owe more on their mortgages than their homes are worth and are either delinquent or at imminent risk of default," and $3 billion toward refinancing efforts for "borrowers who are current on their mortgages but who owe more on their mortgages than their homes are worth." *Fact Sheet: Mortgage Servicing Settlement*, Nat'l Mortgage Settlement, *retrieved from* https://d9klfgibkcquc.cloudfront.net/Mortgage_Servicing_Settlement_Fact_Sheet.pdf (Apr. 15, 2012). States will receive $2.5 billion in direct payments, with the bulk of those funds expected to be used to support foreclosure prevention, antifraud enforcement, legal assistance to homeowners, housing counseling, consumer education, and foreclosure mediation. Amanda Roberts, *Policy Post—How Will States Use Their $2.5 billion?*, @the Horizon (Mar. 14, 2012), http://enterprisecommunity.typepad.com/enterprise/2012/03/policy-post-how-are-states-using-their-25-billion.html (an Enterprise blog about affordable housing and community development). As the settlement talks came to a conclusion, forgery charges were filed against a Missouri firm, Doc X, which allegedly engaged in a massive robo-signing practice. Gretchen Morgenson, *Company Faces Forgery Charges in Mo. Foreclosures*, N.Y. Times, Feb. 7, 2012, at B1. An audit in

responses to the foreclosure crisis, including the HOPE NOW Alliance, the FHA HOPE for Homeowners (H4H) program established by the Bush administration, together with the Obama administration's Housing Affordable Modification Program (HAMP) and the Home Affordable Foreclosure Alternatives (HAFA) program. Part IV argues that current foreclosure response techniques such as counseling and mediation can be successful if they become automatic parts of the residential mortgage foreclosure process; they are coupled with mandatory loss mitigation requirements for lenders; and a cushion for qualified defaulting homeowners, such as the "first priority 'seed lien'" recommended by Professor Christopher Peterson of the University of Utah's S.J. Quinney College of Law, is established. Part IV also recommends that greater attention be paid to the value of renting as a means of restoring stability to the overall housing market.

I. The American Dream

A. Homeownership—Boom and Bust

That old cliché, the American dream home, pictures housing as a brick or frame house, surrounded by green grass, ornamental shrubs, a white picket fence, and nestled among stately elms and oaks along a traffic-free lane. Ownership of one's home long has been a cherished value and symbol of success in America. Generations of American families have pursued the homeownership dream successfully, albeit in a variety of housing styles and sizes. But the collapse of the housing market in 2008 delivered an unsettling wake-up call. Perhaps homeownership was not all that it was said to be.[21]

When the housing bubble burst in 2008, homeownership dreams for millions of Americans evaporated. The stresses produced by a severe economic downturn, a sudden loss of access to credit, and a precipitous drop in residential property values helped ignite a foreclosure firestorm that consumed the dreams of rich and poor alike.[22] Housing had been asked to

San Francisco documented numerous instances of suspicious documentation and failure to follow legal standards. Gretchen Morgenson, *Audit Uncovers Extensive Flaws in Foreclosures*, N.Y. TIMES, Feb. 16, 2012, at A1.

21. "I wanted the white picket fence." Ronnie Cohen & Shannon O'Byrne, *Burning Down the House: Law, Emotion, and the Subprime Mortgage Crisis*, 45 REAL PROP. TR. & EST. L.J. 677, 692 (2011) (quoting Abby Aquirre, *The Wrong Mortgage Derails a Mother's Plans*, N.Y. TIMES, Nov. 9, 2008, at A47 (describing the plight of a single mother who accepted a subprime, adjustable rate mortgage way beyond her means and was left penniless following two subsequent refinancings and a short sale)). Robert Shiller, coauthor of the *Case-Shiller Report*, attributed the housing bubble and its subsequent collapse to "pervasive optimism and complacency." Robert J. Shiller, *The Sickness Beneath the Slump*, N.Y. TIMES, June 12, 2011, at BU6.

22. Linda Ingram, *supra* note 1, in describing her work, included the example of a client in a wealthy suburb of St. Louis who had exhausted virtually all of his savings and retirement funds attempting to save his home that carried a monthly mortgage payment of several thousand dollars.

do too much by all sectors of the market. The resulting collapse left millions of homeowners facing foreclosure, countless others holding mortgages far larger than the market value of the properties to which they were attached, and a new breed of foreclosure counselors across the country striving to save as many families as possible from loss of their homes.[23] Millions of foreclosures helped produce a huge oversupply of houses,[24] as depressed housing prices fell 33 percent from the beginning of the market collapse in 2006 to the first quarter of 2011, a pace greater than the 31 percent drop during the Great Depression.[25] Recovery would take years.[26]

The collapse made clear that several fundamental shifts had taken place during the run-up to the 2008 catastrophe:

- Homeowners had shifted from treating a house as a place of shelter and family activities to treating it as an investment;
- Borrowers had shifted from asking the question, "how much can I afford to pay back?" to asking, "how much will you lend me?";
- Lenders had shifted from considering a home loan as a type of fixed-rate bond (thirty year, fixed rate, level payment, first mortgage loan) to considering it as a type of preferred stock (five year, variable rate, interest-only first or second mortgage loan); and

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23. Lender Processing Services (LPS), a mortgage and real estate data services provider, estimated that approximately 6.4 million mortgages were thirty or more days delinquent or in foreclosure, with approximately 2.2 million of those in foreclosure in April 2011. *LPS "First Look" Mortgage Report: April Month-End Data Shows an Increase in Delinquency Rate and Drop in Foreclosure Inventories*, Lender Processing Services (May 17, 2011), http://www.lpsvcs.com/LPSCorporateInformation/NewsRoom/Pages/20110517a.aspx. Nine months later, the numbers had declined, but only slightly. Carrie Bay, *Overdue Mortgages Number 6,082,000*, DSNews.com (Feb. 21, 2012), http:www.dsnews.com/articles/overdue-mortgages-number-6082000-2012-02-21.

24. Carrie Bay, *Inventory Overhang Means 6.5M New Households Needed*, DSNews.com (June 16, 2011), http://www.dsnews.com/articles/inventory-overhang-means-65m-new-households-needed-2011-06-16.

25. Jeff Cox, *US Housing Crisis Is Now Worse Than Great Depression*, CNBC (June 14, 2011), http://www.cnbc.com/id/43395857. According to the S&P/Case-Shiller Home Price Indices, residential real estate prices peaked in the second quarter of 2006 at 189.93, with 100.00 being the price level in 2000, then dropped precipitously to a level of 125.41 in the first quarter of 2011. *S&P/Case-Shiller Home Price Indices*, Standard & Poor's http://www.standardandpoors.com/indices/sp-case-shiller-home-price-indices/en/us/?indexId=spusa-cashpidff—p-us——(last visited Apr. 15, 2012).

26. One economist, using Census vacancy data and housing occupation trends, believes recovery will require "an average of 1.3 million new household formations per year for the next five years." Bay, *supra* note 24. But household formations dropped sharply during 2007–10 to an annual average of less than one million new households. Joint Ctr. for Hous. Studies of Harvard Univ., The State of the Nation's Housing 2011, at 12 (2011).

- Investors had shifted from considering a residential mortgage as a loan of money to a purchase or sale of a fractional interest in a promise to pay (mortgage-backed securities bought and sold on the secondary and tertiary markets).[27]

The housing market collapse exposed the inherent risks of such shifts and the fact that none of the actors, including consumers (buyers, borrowers, and sellers), lenders, investors, regulators, or servicers, was prepared to respond effectively to the collapse.

B. Federal Support for Homeownership: A Brief History

During the first half of the twentieth century, ownership and rental of housing was split about fifty-fifty among American households. The pent up demand created by returning GIs after World War II, coupled with strong encouragement of homeownership by government authorities, led to a surge in single-family housing construction and sale from the late 1940s into the 1970s. From 1945 to 1975, homeownership increased by about 50 percent so that about two-thirds of American households owned their own homes in 1975.[28] During the last quarter of the twentieth century, homeownership continued to increase but at a much slower rate so that by 2000, slightly more than 67 percent of households owned their own homes.[29]

The provision of housing for American households traditionally has been considered the province of the private sector[30] and for a long time was carried out by a particularly localized industry. However, beginning in the 1930s as a response to the Great Depression, Congress began a continuing focus on housing as a social and economic force of national significance. Landmark legislation was enacted over a five-year period in the 1930s that created the mortgage insurance program administered by the Federal Housing Administration (FHA);[31] the secondary mortgage market

27. For trenchant analyses of the housing meltdown, see Michael Lewis, The Big Short: Inside the Doomsday Machine (2010); Gretchen Morgenson & Joshua Rosner, Reckless Endangerment: How Outsized Ambition, Greed, and Corruption Led to Economic Armageddon (2011).

28. George Sternlieb & Robert Burchell, Multifamily Housing Demand: 1975–2000, at 2–3 (GPO 1978).

29. Joint Ctr. for Hous. Studies of Harvard Univ., The State of the Nation's Housing 2010, at 18, fig.18 (2010); Heather K. Way, *Informal Homeownership in the United States and the Law*, 29 St. Louis U. Pub. L. Rev. 113, 126 (2009) (citing U.S. Census Bureau, Current Population Survey/Housing Vacancy Survey tbl.14 (2008), http://www.census.gov/hhes/www/housing/hvs/qtr208/q208tab5.html).

30. This short discussion of federal housing programs is drawn from Peter W. Salsich, Jr., *A Decent Home for Every American: Can the 1949 Goal Be Met?*, 71 N.C. L. Rev., 1619, 1621–22 (1993); and *Toward a Policy of Heterogeneity: Overcoming a Long History of Socioeconomic Segregation in Housing*, 42 Wake Forest L. Rev. 459, 478 (2007). Permission to use is gratefully acknowledged.

31. National Housing Act of 1934, Pub. L. No. 73-479, 48 Stat. 1246 (codified as amended at 12 U.S.C. §§ 1701–50 (2006)).

programs administered by the Federal National Mortgage Administration (Fannie Mae);[32] and the low-rent housing program administered by the Public Housing Administration (PHA), a subdivision of the Housing and Home Finance Agency (HHFA), later HUD.[33]

After the Second World War, dramatic changes in demand occasioned by returning veterans, the baby boom, and the explosive growth of the suburbs changed the emphasis on housing from multifamily and townhouse units in cities to tracts of single- family housing in the suburbs. This was accomplished in large part through the assistance of the mortgage insurance program administered by the FHA; the loan guarantee program administered by the Veterans Administration;[34] the rural loan and guarantee programs of the Farmers Home Administration (FmHA);[35] and the secondary mortgage market programs of Fannie Mae, buttressed by the Government National Mortgage Agency (Ginnie Mae) in 1968[36] and the Federal Home Loan Mortgage Corporation (Freddie Mac) in 1970.[37]

The key tradeoff, which changed the face of residential mortgage finance, was the federal requirement that participating lenders offer fully amortizing loans with level monthly payments, fixed interest rates, and low down payments.[38] Lenders were willing to comply with these conditions because of the confidence generated by the mortgage insurance and guarantee programs and the creation of the secondary market to purchase the loans.[39]

But while the government's mortgage loan insurance and guarantee programs made home loans affordable for millions of Americans, decisions by government agencies administering the programs made it extremely difficult for nonwhites to take advantage of these programs, particularly in the suburbs developed after World War II.[40] For example, the FHA, in its administration of the mortgage insurance program, used a neighborhood rating system devised by the short-lived Home Owners' Loan Corporation

32. National Housing Act Amendments of 1938, Pub. L. No. 75-424, 52 Stat. 23, 23, 24 (codified as amended at 12 U.S.C. § 1716 (2006)).

33. United States Housing Act of 1937, 42 U.S.C. § 1437 (2006).

34. Servicemen's Readjustment Act of 1944, Title III, Pub. L. No. 78-346, 58 Stat. 284, 291 (codified as amended at 38 U.S.C. §§ 3701–08 (2006)).

35. Bankhead-Jones Farm Tenant Act of 1937, Pub. L. No. 75-210, 50 Stat. 522 (codified as amended at 7 U.S.C. §§ 1922–2009ee (2006)).

36. Housing and Urban Development Act of 1968, Title VIII, Pub. L. No. 90-448, 82 Stat. 476, 536 (codified as amended at 12 U.S.C. §§ 1716b–17 (2006)).

37. Federal Home Loan Mortgage Corporation Act of 1970, Title III, Pub. L. No. 91-351, 84 Stat. 451 (codified as amended at 12 U.S.C. §§ 1451–59 (2006)).

38. President's Comm'n on Urban Housing, A Decent Home 55 (1968).

39. *Id*. at 55–56.

40. Adam Gordon, *The Creation of Homeownership: How New Deal Changes in Banking Regulation Simultaneously Made Homeownership Accessible to Whites and Out of Reach for Blacks*, 115 Yale L.J. 186, 213 (2005).

(HOLC) to establish criteria for insuring loans based on the notion that neighborhood stability required "that properties . . . continue to be occupied by the same social and racial classes."[41] This, coupled with the FHA's sanction of racially restrictive covenants, effectively denied nonwhites the opportunity to purchase homes in the newly developing suburbs that featured single-family protective Euclidean zoning.[42] The combination of Commerce Department–marketed single-family zoning and FHA-influenced home mortgage practices tilted single-family homeownership strongly toward whites and away from nonwhites, something that would not necessarily have happened without these governmental actions.[43]

II. Housing Collapse

A. Home Prices and Sizes Escalate

In the closing decades of the twentieth century, single-family home size and cost increased substantially, then ballooned in the first years of the twenty-first century. In 2000, the median size of a new home was 2,000 square feet, and it cost approximately $200,000. Mortgages peaked in 2003 at a record 13.6 million totaling $3.7 trillion, and Wall Street's issuance of mortgage-backed securities also peaked that year at $463 billion.[44] By 2004, the Census Bureau reported that the median price had increased by 31 percent to $262,000.[45] As a result, "many [homeowners] rushed to refinance their mortgages, extracting some of the bounty to buy a vacation home, go on a cruise, remodel the kitchen, or send the kids to college."[46]

41. *Id*. at 207–08 (citing Kenneth T. Jackson, Crabgrass Frontier: The Suburbanization of the United States 208 (1985)).

42. The term Euclidean zoning comes from the Supreme Court decision upholding the comprehensive zoning technique that separates single-family detached housing from other forms of permissible land use against constitutional challenge. Village of Euclid v. Ambler Realty Co., 272 U.S. 365 (1926).

43. Gordon makes the points that the HOLC did not use its rating index as a major factor when it refinanced previously defaulted home loans in the early years of the Great Depression and that housing segregation was not a serious problem for blacks in the early years of the twentieth century. Gordon, *supra* note 40, at 207–08. The term "redlining," which became so controversial in the 1960s and 1970s, *see, e.g.*, Jean Pogge, *Reinvestment in Chicago Neighborhoods: A Twenty-Year Struggle*, *in* From Redlining to Reinvestment: Community Responses to Urban Disinvestment 133 (Gregory D. Squires ed., 1992), was based on the fact that HOLC's color-coded neighborhood rating maps used the color red to identify the neighborhoods that had been given the lowest quality rating of "D," including predominantly black neighborhoods. Gordon, *supra* note 40, at 207.

44. Morgenson & Rosner, *supra* note 27, at 272; *Median and Average Sales Prices of New Homes Sold in United States*, U.S. Census Bureau, 10, http://www.census.gov/construction/nrs/pdf/uspricemon.pdf (last updated Mar. 23, 2012).

45. *Median and Average Sales Prices of New Homes Sold in United States*, *supra* note 44, at 11.

46. Morgenson & Rosner, *supra* note 27, at 219.

As average home sizes increased, extremely large new homes of 3,000 square feet or more almost doubled.[47] The housing bubble was fueled by steadily rising property values, which enabled middle- and upper-income households to obtain larger loans in order to buy larger homes, including the so-called McMansions that dotted the landscape of suburbia in increasing numbers.[48] When home values began dropping in 2007, many of these borrowers found they were holding loan obligations that were larger than the value of their property, leading to the phenomenon of "being underwater."[49]

But despite the overall strength of the housing sector during the boom years, some disturbing trends were present. While more than 70 percent of white households owned their own homes in 1999, less than 50 percent of minority families did. An even larger gap existed between homeownership rates for lower-income households and higher-income households.[50] The Joint Center for Housing Studies reported that after ten years of substantial gains in homeownership rates for low-income households, homeownership rates for that cohort "fell almost twice as much as those for higher-income households on a percentage-point basis" from 2005–2009.[51] An increasing number of full-time workers, not to mention unemployed or part-time workers, could not afford to purchase a home. Fully employed people making minimum wage could not afford rental housing without substantial governmental assistance. Homelessness remained a serious problem for individuals and families, even those with jobs.

47. Jack L. Nasar, Jennifer S. Evans-Cowley & Vicente Mantero, *McMansions: The Extent and Regulation of Super-Sized Houses*, 12 J. Urb. Design 339, 340 (2007).

48. The term "McMansion" was coined to dramatize the substantial increase in the size of many American homes, particularly new homes that were built "in existing smaller house neighborhoods and on greenfield plats." *Id*. McMansions became the culmination of a long period of house-size growth "from an average of 983 square feet in the 1950s up to 2,300 square feet in the 2000s, despite declining household sizes." Kaid Benfield, *Have Americans Given Up on McMansions?*, Atlantic Cities (Feb. 9, 2012), http://www.theatlanticcities.com/housing/2012/02/have-americans-given-mcmansions/1184/.

49. Both median and average prices peaked in March 2007 at $262,600 and $329,400, respectively. *Median and Average Sales Prices of New Homes Sold in United States*, *supra* note 44, at 11. A loan is said to "be underwater" when its "market value [is] less than its book value. . . . Loans sink because . . . [among other reasons,] the loan collateral is worth less than the loan principal. . . ." *Barron's Banking Dictionary: Underwater Loan Definition*, Answers.com, http://answers.com/topic/underwater-loan, *retrieved* Apr. 15, 2012.

50. Millennial Hous. Comm'n, Meeting Our Nation's Housing Challenges 21 (2002).

51. Joint Ctr. for Hous. Studies of Harvard Univ., The State of the Nation's Housing 2010, at 17 (2010).

Why did this escalation in home size and price and the subsequent collapse of the housing market occur? Researchers generally agree that no single cause can be identified, and one team has identified at least thirteen factors:

> corrupt mortgage lenders; fraudulent brokers; lax credit evaluations by underwriters; naïve borrowers; dishonest borrowers . . . ; under-regulated financial institutions; "teaser" and variable interest rates; compliant appraisers; unrealistic rating agencies; conflicts of interest attaching to how credit rating agencies are paid; securitization of mortgage debt; "Wild West investor/risk takers"; . . . historically low interest rates. . . . [and] a contagious optimism accompanying real estate price increases."[52]

Predatory lending practices were prevalent.

> One former mortgage broker in Los Angeles said that . . . branches [of a mortgage lender] in upscale neighborhoods like Beverly Hills and Santa Monica had to slash their mortgage rates to be competitive with rival banks. But in areas that were predominantly minority, [the lender's] rates were far higher because company executives knew borrowers in these neighborhoods had few, if any, alternatives.[53]

Another possible motivating force might be found in the traditional relationship between home buyer/borrower and banker, a relationship that was founded more on moral grounds stemming from the promises that are exchanged by the parties to a residential mortgage transaction than on market-motivated grounds.[54] Suppose, for example, that a bank loan officer was approached by two persons, each seeking a loan of $400,000, one to purchase a home and the other to purchase equipment and pay bills of a startup business. Might the bank be more likely to grant a loan of that size to a person seeking a home than to a small business owner on the assumption that the person seeking a home would be less likely to act strategically?[55] Is there a different notion of responsibility, a different assumption underlying the bargain with a prospective homeowner: the bank assumes the individual home purchaser would not walk away from the payment obligation? Built into the home mortgage is an implicit guarantee on the part of the residential mortgagor to act morally rather than market rationally: to refuse to engage in strategic action (economic breach) but to treat

52. Cohen & O'Byrne, *supra* note 21, at 682–83 (footnotes omitted).

53. Morgenson & Rosner, *supra* note 27, at 191.

54. I am indebted to my colleagues Eric Miller and Brendan Roediger for this suggestion.

55. Acting strategically in this context refers to the practice of strategic default: "walking away from an underwater home even though the owner could afford to pay the mortgage." Nicholas Carroll, *Shifting the Focus from "Strategic Default" to "Prudent Walkaway*," HuffPost Bus. (Mar. 24, 2011), http://www.huffingtonpost.com/nicholas-carroll/shifting-the-focus-from-s_b_838843.html.

the mortgage as a promise (moral act) rather than as a business deal (market act).[56]

That relationship changed with the advent of mortgage securitization and the computerization of loan transactions.

> The face of banking had changed; regulators and lenders now spoke of caveat emptor, let the borrower beware, when it came to lending practices. Why should bankers have to consider which mortgage product was really the best for the customer? It was better to let bankers innovate, creating a variety of products from which borrowers could choose.[57]

If the residential mortgagor does act strategically and breaches the promises contained in the note and mortgage for economically rational reasons,[58] the lender becomes angry. By walking away, the defaulting borrower threatens to transform the assumptions of responsibility underlying residential mortgage lending that differentiates it from commercial mortgage lending.[59] To discourage strategic defaults, the lender vigorously pursues foreclosure, even when the economically rational action may be acceptance of a short sale or deed-in-lieu of foreclosure because the net present value (NPV) of a short sale or deed-in-lieu is greater than that of a foreclosure.[60]

A variation of the theme of moral engagement as the foundation of residential mortgage transactions is the argument that homeownership decisions are highly emotional, but contract law "tends to ignore all emotion or punish it."[61] Under this view, the housing bubble was fueled by emotion, driving

56. From a telephone survey of 1,000 adults, the legal information website, FindLaw.com, reported that 60 percent of those surveyed believe that it is "never OK" to simply stop paying one's mortgage note; 34 percent believe it is allowable to "walk away" from the mortgage "if they aren't able to make the monthly payments"; and only 3 percent believe "strategic default" is acceptable at any time. Heather Hill Cernoch, *Survey: 60% of Americans Frown on Mortgage Abandonment*, DSNEWS.COM (Apr. 6, 2011), http://www.dsnews.com/articles/survey-60-of-americans-frown-on-mortgage-abandonment-2011-04-06.

57. MORGENSON & ROSNER, *supra* note 27, at 284.

58. Carroll, *supra* note 55.

59. Of course, it does not necessarily follow that a bank will approach the two differently. *See, e.g.*, Jay Goltz, *What Some Banks Don't Want You to Know*, N.Y. TIMES, June 29, 2011, http://boss.blogs.nytimes.com/2011/06/29/what-some-banks-dont-want-you-to-know/ (noting that an officer in a mid-sized Chicago-area bank includes a character assessment of small business owners as a factor in evaluating loan applications).

60. The National Mortgage Settlement requires mortgage servicers to "offer and facilitate loan modifications for borrowers rather than initiate foreclosure when such loan modifications . . . are net present value (NPV) positive and meet other . . . requirements." Consent Judgment, *supra* note 20, at A-16.

61. Cohen & O'Byrne, *supra* note 21, at 697 (arguing that modern contract law disregards emotion because in the nineteenth century, when modern contract law developed, emotion "was associated directly with widespread hysteria, a disease typically attributed to women and understood as resulting from a failure to keep one's emotions under control").

many people to purchase larger homes than they needed and to borrow more than they could afford to pay back. The resulting foreclosure crisis was caused, in significant part, by "the common law's harsh response to emotion."[62]

B. Residential Mortgage Crisis

In an earlier article,[63] I discussed briefly three changes in traditional residential mortgage practice that played crucial roles in the occurrence and severity of the residential mortgage crisis: (1) extensive use of adjustable rate mortgages and other alternative mortgage instruments,[64] (2) development of mortgage securitization as an investment vehicle,[65] and (3) growth of the subprime mortgage market, largely made up of persons with low or nonexistent credit ratings, along with the phenomenon of predatory lending.[66] To this list should be added two more factors: reliance on third-party servicers to manage the collection and distribution of mortgage payments, and problems in the foreclosure process, caused in no small part by MERS, the mortgage electronic registration system.

1. Role of Mortgage Servicers

The mortgage servicing industry plays a crucial, but often misunderstood, role in residential mortgage finance. The detailed work of "transaction

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62. *Id*. Cohen and O'Byrne argue that contract law's allocation of risk equally to both parties did not work in the subprime residential mortgage market.

> Everything untoward on the mortgage landscape, it seems, slipped by entirely and egregiously undetected. As a result, and contrary to what the risk allocation model anticipated, only the mortgagor—and those who purchased structured finance products backed by that mortgage—actually bore the risk of borrower emotion. The lender exited long before.
>
> Contract law's focus on autonomy, contract enforcement, and abstraction and its concomitant tendency to see through the steely eyes of the imaged reasonable man also generated myopia in the regulators—yet another cause of the subprime crisis.

Id. at 718–19.

63. Salsich, *supra* note 7, at 11, 19–35.

64. *Id*. at 25 (citing Stephen Cowen & Susan E. Foley, *New Trends in Residential Mortgage Finance*, 13 REAL PROP. PROB. & TR. J. 1075 (1978); Stanley L. Iezman, *Alternative Mortgage Instruments: Their Effect on Residential Financing*, 10 REAL EST. L.J. 3 (1981); Douglas W. Kmiec, *Shared Appreciation Mortgages: A Step Toward Making Housing a Bad Investment*, 10 REAL EST. L.J. 302 (1982); Helen Jean Walleser, *Balancing the Interest: The Changing Complexion of Home Mortgage Financing in America*, 31 DRAKE L. REV. 1 (1981)).

65. *Id*. at 27–30. Mortgage securitization also is discussed in Robin Malloy, *The Secondary Mortgage Market—A Catalyst for Change in Real Estate Transactions*, 39 SW. L.J. 991, 1003–10 (1986); and Michael Schill, *The Impact of the Capital Markets on Real Estate Law and Practice*, 32 J. MARSHALL L. REV. 269, 269–79 (1999).

66. Salsich, *supra* note 7, at 30–32. *See generally* Allen Fishbein & Harold Bunce, *Subprime Market Growth and Predatory Lending: Housing Policy in the New Millennium, in* HOUSING POLICY IN THE NEW MILLENNIUM 273 (Susan M. Watcher & R. Leo Penne eds., 2001), *available at* http://www.huduser.org/Publications/pdf/brd/13Fishbein.pdf.

processing," mailing monthly bills, collecting monthly payments, remitting property taxes and insurance premiums, as well as "administration of defaulted loans,"[67] traditionally was done by the lender that made the loan and kept that loan in its portfolio. But as more loans were sold through the secondary market and mortgage financing shifted from a localized business to a national and even international business, a separate industry of mortgage servicing arose. Mortgage brokers and other financial institutions increasingly took on the servicing responsibilities in return for generous fees and little risk.[68]

Mortgage servicers interact with both home buyer/borrowers and investors in mortgage-backed securities in ways that resemble the principal-agency relationship but are not formally recognized as such. While borrowers and investors may think of servicers as their agents, servicers function more like independent contractors. Adam Levitin and Tara Twomey note that "[t]he business model and economics of servicing remain largely unexplored."

> The economics of the servicing industry often discourage the restructuring of defaulted mortgage loans, even when it would be value-maximizing for mortgage investors. . . . Servicers have little incentive to invest in the resources for hands-on loss mitigation, much less sufficient capacity for peak volumes. The combination of business lines means servicers are ill-prepared to perform their loss mitigation function in a way that maximizes value for mortgage investors. Although housing markets are cyclical, servicers find it more profitable to automate everything across the cycle than to invest in countercyclical hands-on loss mitigation when the market is up in preparation for when the market falls.[69]

Servicers are compensated on a fee-for-service basis over the life of the loan, an arrangement that creates a different set of incentives from those of investors that are compensated based on the value of their investment. Levitin and Twomey argue that the servicer compensation format results in "a moral hazard because the servicer does not bear the same costs of its loss mitigation decisions as do investors."[70] Their interests diverge, with the result that foreclosure decisions may be made with little or no consideration of investors' interests, not to mention those of the defaulting borrowers and the communities in which they live.

2. Problems with the Foreclosure Process

Foreclosure is governed by state law, which establishes a procedure to enable lenders to recover property from defaulting borrowers through a public sale process. Two different methods are utilized: judicial foreclo-

67. Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 Yale J. on Reg. 1, 4 (2011).

68. *Id*. at 11.

69. *Id*. at 4–5.

70. *Id*. at 5.

sure,[71] in which the foreclosure process requires a judicial hearing to authorize a public sale of the mortgaged property, and power of sale foreclosure,[72] in which a mortgagor or a trustee can offer mortgaged property to the highest bidder at a public sale after giving twenty days public notice.[73] Judicial foreclosure is administered by state courts in twenty-three states. The power of sale foreclosure process is administered by loan servicers through trustees in the other twenty-seven states.[74]

a. Impact of MERS

MERS was created as an electronic registration system by a group of lenders, servicers, and government agencies, including Fannie Mae, Freddie Mac, the FHA, and the Veterans Administration, in the aftermath of the 1993 savings and loan crisis. In what amounts to a short course, the Supreme Court of Minnesota described MERS as follows:

> MERS does not originate, lend, service, or invest in home mortgage loans. Instead, MERS acts as the nominal mortgagee for the loans owned by its members. The MERS system is designed to allow its members, which include originators, lenders, servicers, and investors, to assign home mortgage loans without having to record each transfer in the local land recording offices where the real estate securing the mortgage is located. MERS members pay subscriber fees to register on the MERS system, as well as other fees on each loan registered and each transaction conducted.
>
> . . . .
>
> Traditionally, each mortgage loan transfer on the primary and secondary market included an assignment of the security instrument that could be recorded in the local land recording office where the real estate securing the mortgage loan is located. According to MERS, multiple assignments of the security instrument commonly caused confusion, delays, and chain-of-title problems. In an effort to streamline the assignment process, MERS essentially privatized part of the mortgage recording system. Participants in the mortgage industry can subscribe as members on the MERS system. A loan held by a member is registered in the MERS database. Once registered, MERS serves as the mortgagee of record for all loans in its system. More specifically, MERS is the nominal mortgagee for the lender and any successors and assigns. When the security instrument is recorded, the local land records list MERS as the mortgagee.

71. *See, e.g.*, 735 ILL. COMP. STAT. 5/15-1501 *et seq*.

72. *See, e.g.*, MO. REV. STAT. §§ 443.290–.410.

73. RealtyTrac®, the California-based organization that keeps track of real estate transactions, including foreclosures, organizes its reports of documents filed in foreclosure actions into three categories: Default—Notice of Default (NOD) and Lis Pendens (LIS); Auction—Notice of Trustee Sale (NTS) and Notice of Foreclosure Sale (NFS); and Real Estate Owned, or REO properties (that have been foreclosed upon and repurchased by a bank). *See Foreclosure Overview and Foreclosure Process*, REALTYTRAC®, http://www.realtytrac.com/foreclosure/overview.html (last visited Apr. 15, 2012).

74. For a discussion of the two methods of foreclosure, see GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW §§ 7.11–.30 (5th ed. 2007).

The benefit of naming MERS as the nominal mortgagee of record is that when the member transfers an interest in a mortgage loan to another MERS member, MERS privately tracks the assignment within its system but remains the mortgagee of record. According to MERS, this system "saves lenders time and money, and reduces paperwork, by eliminating the need to prepare and record assignments when trading loans."

There is limited information in the record on the language used for transfers of loans within the MERS system. Publicly available documents, namely pooling and servicing agreements filed with the Securities and Exchange Commission, suggest that when loans are transferred between MERS members, an assignment of the promissory note is executed but an assignment of the security instrument is not—although the original security instrument is physically delivered along with the promissory note.

A side effect of the MERS system is that a transfer of an interest in a mortgage loan between two MERS members is unknown to those outside the MERS system. If, on the other hand, a MERS member transfers an interest in a mortgage loan to a non-MERS member, MERS no longer acts as the mortgagee of record and an assignment of the security instrument to the non-MERS member is drafted, executed, and typically recorded in the local land recording office.

When documentation is necessary, such as for an assignment to a non-MERS member, MERS does not draft or execute the paperwork on behalf of its members. Rather, MERS instructs its members to have someone on their own staff become a certified MERS officer with authority to sign on behalf of MERS. This procedure allows the member that owns the indebtedness to assign or foreclose the mortgage loan in the name of MERS, eliminating the need to either work through a third party or to execute an assignment of the security instrument from MERS back to the member.[75]

Professor Gerald Korngold has described benefits associated with MERS as follows:

> MERS facilitates an efficient secondary market in mortgages by allowing the easy transfer of beneficial rights. After the initial recording in the local clerk's office, subsequent transactions can be done quickly at a low cost from a central location utilizing modern technology without the need for local recording of paper assignment documents. Such a process facilitates the flow of global capital, bringing investment funds into areas without local mortgage financing. Potential homeowners, as well as those seeking the most favorable rates, can benefit from MERS.[76]

By May 2007, MERS had become the recorder of choice with sixty million loans recorded in its name, which amounted to "[s]ixty percent of all new mortgage originations . . . and more than half of the nation's existing residential loans."[77]

75. Jackson v. Mortg. Elec. Registration Sys., Inc., 770 N.W.2d 487, 490–91 (Minn. 2009) (footnote omitted).

76. Gerald Korngold, *Legal and Policy Choices in the Aftermath of the Subprime and Mortgage Financing Crisis*, 60 S.C. L. Rev. 727, 742 (2009).

77. Peterson, *supra* note 19, at 1373.

As the foreclosure crisis was beginning to unfold in 2006, former Chief Judge Judith Kaye of the New York Court of Appeals, in a call for legislative review of the "incongruity between the needs of the modern electronic secondary mortgage market and our venerable real property laws regulating the market," captured both the benefits and concerns triggered by MERS.[78]

> The benefits of the system to MERS members are not insubstantial. Through use of MERS as nominee, lenders are relieved of the costs of recording each mortgage assignment with the County Clerk, instead paying minimal yearly membership fees to MERS. Transfers of mortgage instruments are faster, allowing for efficient trading in the secondary mortgage market; a mortgage changes hands at least five times on average.
>
> Although creating efficiencies for its members, there is little evidence that the MERS system provides equivalent benefits to home buyers and borrower—and, in fact, some evidence that it may create substantial disadvantages. While MERS necessarily opted for a system that tracks both the beneficial owner of the loan and the servicer of the loan, its 800 number and website allow a borrower to access information regarding only his or her loan servicer, not the underlying lender. The lack of disclosure may create substantial difficulty when a homeowner wishes to negotiate the terms of his or her mortgage or enforce a legal right against the mortgagee and is unable to learn the mortgagee's identity. Public records will no longer contain this information as, if it achieves the success it envisions, the MERS system will render the public record useless by masking beneficial ownership of mortgages and eliminating records of assignments altogether. Not only will this information deficit detract from the amount of public data accessible for research and monitoring of industry trends, but it may also function, perhaps unintentionally, to insulate a noteholder from liability, mask lender error and hide predatory lending practices. The county clerks, of course, are concerned about the depletion of their revenues—allegedly over one million dollars a year in Suffolk County alone.[79]

Judge Kaye admitted that "we do not know . . . the extent to which these concerns will be realized" but deemed it "prudent" to call to the attention of the legislature "a disparity between the relevant statute . . . and the burgeoning modern-day electronic mortgage industry."[80]

Confusion resulting from MERS's role in the foreclosure process has raised a host of questions. Michael Powell and Gretchen Morgenson, writing in the *New York Times*, summarize the MERS questions as follows:

> How can MERS claim title to those mortgages, and foreclose on homeowners, when it has not invested a dollar in a single loan? And, more fundamentally: Given the evidence that many banks have cut corners and made foreclosure mistakes, does anyone know who owns what or owes what to whom anymore?[81]

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78. MERSCORP, Inc. v. Romaine, 861 N.E.2d 81, 86, 88–89 (N.Y. 2006) (Kaye, C.J., dissenting in part).

79. *Id*. at 88–89.

80. *Id*. at 89.

81. Michael Powell & Gretchen Morgenson, *MERS? It May Have Swallowed Your Loan*, N.Y. Times (Mar. 6, 2011), at BU1.

More technical, legal questions include: Should servicers have to prove they have standing to bring foreclosure actions by presenting the original note?[82] Does the robo-signing scandal indicate a lack of due process for homeowners or an abuse of the judicial process?[83] On whom should the burden of proof be—the homeowner to establish that the lender is not entitled to foreclose, or the lender to establish that it is entitled to foreclose?[84]

b. Judicial Responses to Foreclosure Challenges

Courts have been brought into the fray and generally have responded by strictly construing state mortgage law. For example, the Supreme Judicial Court of Massachusetts, in *U.S. Bank National Association v. Ibanez* (and a companion case, *Wells Fargo Bank v. LaRace*),[85] held that U.S. Bank and Wells Fargo Bank, acting as trustees for assignees who held mortgages, failed to establish that they held the applicable mortgages when they foreclosed and thus "failed to demonstrate that they acquired fee simple title to these properties by purchasing them at the foreclosure sale."[86]

Examining the Massachusetts statutory power of sale requirements and "[r]ecognizing the substantial power that the statutory scheme affords to a mortgage holder," the court reiterated "the familiar rule that 'one who sells under a power [of sale] must follow strictly its terms.'" Failure to do so renders a sale "wholly void."[87] The court stressed that authority to exercise the statutory power of sale is limited to holders of the mortgages or assignees of those mortgages "at the time of the notice of sale and the subsequent foreclosure sale."[88]

U.S. Bank and Wells Fargo Bank, as trustees of mortgage-backed securities made up of pools of mortgages, were at the end of a long trail of assignments.[89] For example, the record owner of the Ibanez mortgage was Option

82. Gretchen Morgenson, *Don't Just Tell Us. Show Us*, N.Y. Times (Nov. 28, 2010), at BU1 (reporting that the U.S. Trustee Program in the Justice Department has sought to challenge banks' efforts to foreclose through removal of automatic stays in bankruptcy proceedings by arguing that the banks did not have standing to seek automatic stays because they had not proved that they were the holders, or agents of the holders, of the notes involved in the foreclosures).

83. *Id*.

84. When the question is framed in this manner, one is reminded of the successful movement in the 1970s to shift the effective burden of proof from tenant to landlord on the question of responsibility for the condition of the demised premises. *See, e.g.*, Javins v. First Nat'l Realty Corp., 428 F.2d 1071 (D.C. Cir. 1970).

85. 941 N.E.2d 40 (Mass. 2011).

86. *Id*. at 55.

87. *Id*. at 50 (alteration in original).

88. *Id*. at 51.

89. For example, the chain of title provided by the court for the Ibanez mortgage is: "Rose Mortgage, Inc. (originator), Option One Mortgage Corporation (record holder), Lehman Brothers Bank, FSB, Lehman Brothers Holdings Inc. (seller), Structured Asset Securities Corporation (depositor), U.S. Bank National Association, as

One Mortgage Corp., the first assignee in the U.S. Bank chain of title. U.S. Bank claimed its assignment occurred pursuant to a trust agreement dated December 1, 2006, the effective date of the mortgage. That trust agreement was not recorded, and a 273-page private placement memorandum containing an "unsigned offer of mortgage-backed securities to potential investors," which was recorded, did not list the Ibanez mortgage as part of the mortgage pool governed by the trust agreement.[90] The court concluded that because Option One was the mortgage holder of record at the time of the foreclosure, U.S. Bank did not have the authority to foreclose the mortgage, nor did it have the authority to purchase the property at the foreclosure sale.[91]

In New York, while the Court of Appeals held in 2006 that county clerks were statutorily required to record and index mortgages, assignments of mortgages, and discharges that named MERS as the lender's nominee or mortgagee of record,[92] it left open the question whether MERS or its assignee has standing to bring foreclosure actions.[93] Five years later, a New York appellate court in *Bank of New York v. Silverberg* held that an assignee from MERS lacked standing to begin foreclosure proceedings.[94] Noting that MERS "was listed in the underlying mortgage instruments as a nominee and mortgagee for the purpose of recording, but was never the actual holder or assignee of the underlying notes,"[95] the court concluded that the purported assignment by MERS was "a nullity" because MERS never acquired title to or possession of the underlying notes.[96] In so holding, the court cited a long line of cases emphasizing that a mortgage "is merely security for a debt . . . and cannot exist independently of the debt."[97]

The court acknowledged that its decision may have a serious impact on the mortgage industry, but asserted that "the law must not yield to expediency and the convenience of lending institutions. Proper procedures must be followed to ensure the reliability of the claim of ownership, to secure the dependable transfer of property, and to assure the enforcement of the rules that govern real property."[98]

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trustee for the Structured Asset Securities Corporation Mortgage Pass-Through Certificates, Series 2006-Z." Rose Mortgage, Inc., the original lender, began the chain by executing an assignment in blank, which was later stamped with Option One Mortgage Corporation's name and recorded on June 7, 2006, approximately six months after the loan was made. The mortgage pool that was converted into the Series 2006-Z Pass-Through Certificates contained over 1,200 mortgages. *Id*. at 46.

90. *Id*. at 46–47.

91. *Id*. at 52.

92. MERSCORP, Inc. v. Romaine, 861 N.E.2d 81, 86, 88–89 (N.Y. 2006).

93. *Id*. at 100 (Ciparick, J., concurring).

94. 926 N.Y.S.2d 532 (App. Div. 2011).

95. *Id*. at 533.

96. *Id*. at 539.

97. *Id*. at 537 (quoting FGB Realty Advisors v. Parisi, 696 N.Y.S.2d 207 (App. Div. 1999)).

98. *Id*. at 539.

The court distinguished an earlier case holding that MERS had foreclosure power[99] by noting that in the earlier case, "the lender had transferred and tendered the promissory note to MERS before the commencement of the foreclosure action."[100]

A federal judge in Oregon invalidated a nonjudicial foreclosure as "wrongful" because Bank of America and MERS, both defendants in the case, "failed to record all assignments of the trust deed" in violation of the Oregon Trust Deed Act.[101] The court acknowledged that the plaintiffs had not made any payments on the note for eighteen months, but concluded

> that failure does not permit defendants to violate Oregon law regulating non-judicial foreclosure. The Oregon Trust Deed Act "represents a well-coordinated statutory scheme to protect grantors from the unauthorized foreclosure and wrongful sale of property, while at the same time providing creditors with a quick and efficient remedy against a defaulting grantor." In part due to the legislature's desire "to protect the grantor against the unauthorized loss of its property," a party conducting a non-judicial foreclosure must demonstrate strict compliance with the Act.[102]

Noting that document review by Bank of America and MERS officials "appear[ed] rushed," and that several instances of unrecorded transfers of the trust deed's beneficial interest appeared in the MERS internal record-keeping system, the court questioned the "appropriateness and validity of foreclosure by advertisement and sale outside of any judicial proceeding" in cases involving MERS because "the MERS system creates confusion as to who has the authority to do what with the trust deed."[103]

Not all the court decisions have gone against MERS. In Minnesota, MERS survived a class action challenge to its use of the state's foreclosure by advertisement (nonjudicial foreclosure) statute.[104] An amendment to the Minnesota Recording Act, dubbed the "MERS statute" because it was enacted in 2004 in response to "questions raised about the MERS system," authorized nominees to record assignments and powers of attorney to foreclose.[105] Plaintiffs challenged MERS's power to foreclose by advertisement, alleging that MERS had not complied with that statute[106] because it had "not recorded and given notice of the promissory note assignments between its

99. Mortg. Elec. Registration Sys., Inc. v. Coakley, 838 N.Y.S.2d 622 (App. Div. 2007).

100. *Silverberg*, 926 N.Y.S.2d at 674.

101. Hooker v. Nw. Tr. Servs., Inc., Civ. No. 10-3111-PA, 2011 U.S. Dist. LEXIS 57005 (D. Or. May 25, 2011) (applying Or. Rev. Stat. § 86.735(1)).

102. *Id*. at *9 (citation omitted).

103. *Id*. at *17.

104. Jackson v. Mortg. Elec. Registration Sys., Inc., 770 N.W.2d 487, 490–91 (Minn. 2009).

105. *Id*. (quoting Act of Apr. 6, 2004, ch. 153, § 2, 2004 Minn. Laws 76, 76–77 (codified at Minn. Stat § 507.413 (2008))).

106. Minn. Stat. §§ 580.02, .04.

members."[107] Applying the language of the statute, in particular the clause "debt then remaining *secured by such mortgage*," the court concluded that the statutory recording requirement applied only to the mortgage, which was held by MERS as nominee for the lender and its assigns, and not to the underlying promissory note, which was transferred freely among MERS members.[108]

The Supreme Court of Michigan, reversing a decision of the court of appeals that MERS, as mortgagee, could not institute foreclosure by advertisement under Michigan's nonjudicial foreclosure statute,[109] held that MERS was entitled to foreclose because it held "an interest in the indebtedness."[110]

> The rule is well-settled that . . . the mortgagee has a lien on the land to secure the debt. It has never been necessary that the mortgage should be given directly to the beneficiaries. The security is always made in trust to secure obligations, and the trust and the beneficial interest need not be in the same hands. . . . The choice of a mortgagee is a matter of convenience. . . . [I]n cases in which the mortgagee had transferred a beneficial interest, but retained record title, this Court has unanimously held that "[o]nly the record holder of the mortgage has the power to foreclose; the validity of the foreclosure is not affected by any unrecorded assignment of interest held for security."[111]

The court construed the statutory term "interest in the indebtedness" as evidencing an "intent to include mortgagees of record among the parties entitled to foreclose by advertisement."[112]

In California, courts have refused to entertain lawsuits questioning the authority of MERS to institute nonjudicial foreclosure proceedings,[113] or that MERS is not a proper beneficiary of a deed of trust.[114] Calling it a "legal loophole," the California Court of Appeal refused to entertain the argument that MERS did not have the authority to initiate foreclosure proceedings because it was not the holder of the note.

> [T]he deed of trust in this case specifically states: "Borrower understands and agrees that MERS holds only legal title to the interests granted by Borrower in this Security Instrument, but, if necessary to comply with law or custom, MERS (as nominee for Lender and Lender's successors and assigns)

107. *Jackson*, 770 N.W.2d at 495.

108. *Id*. at 496.

109. MICH. COMP. LAWS §§ 600.3201 *et seq*.

110. Residential Funding Co. v. Saurman, 805 N.W.2d 183, 183 (Mich. 2011).

111. *Id*. at 183–84 (second alteration in original) (citations omitted) (quoting Arnold v. DMR Fin., 532 N.W.2d 852 (Mich. 1995)).

112. *Id*. at 184 (construing MICH. COMP. LAWS § 600.3204(1)(d)).

113. Gomes v. Countrywide Home Loans, Inc., 121 Cal. Rptr. 3d 819, 824 (Ct. App. 2011) (noting that "nowhere does the [California nonjudicial foreclosure] statute provide for a judicial action to determine whether the person initiating the foreclosure process is indeed authorized, and we see no ground for implying such an action").

114. Ferguson v. Avelo Mortg., LLC, 126 Cal. Rptr. 3d 586 (Ct. App. 2011).

has the right: to exercise any or all of those interests, including, but not limited to, the right to foreclose and sell the Property; and to take any action required of Lender including, but not limited to, releasing and canceling this Security Instrument."[115]

In concluding that California does not require a person bringing a nonjudicial foreclosure proceeding to possess the underlying note, the court cited three federal district court opinions to that effect.[116]

III. Governmental Support for Voluntary Programmatic Responses

States, Congress, and the Bush and Obama administrations have struggled to develop appropriate responses to the huge volume of foreclosures. But achieving success with a program that would "rescue the needy but not the reckless or greedy" has proved to be very difficult.[117]

A. HOPE NOW Alliance

The first organized federal government response was the HOPE NOW Alliance, a Bush administration initiative launched in October 2007.[118] In testimony before the House Subcommittee on Housing and Community Opportunity, Executive Director Faith Schwartz described the Alliance as a "broad-based voluntary collaboration between lenders, HUD-approved housing counselors, investors, mortgage market participants and trade associations . . . [including] 34 servicer members which account for over ninety percent of the subprime market and nearly seventy percent of the prime market."[119]

115. *Id*. at 593.

116. *Id*. at 594 (citing Jensen v. Quality Loan Serv. Corp., 702 F. Supp. 2d 1183, 1189 (E.D. Cal. 2010); Odinma v. Aurora Loan Servs., No. C-09-4674 EDL, 2010 U.S. Dist. LEXIS 28347, at *13 (N.D. Cal. Mar. 23, 2010); Morgera v. Countrywide Home Loans, Inc., No. 2:09-cv-01476-MCE-GGH, 2010 U.S. Dist. LEXIS 2037, at *21 (E.D. Cal. Jan. 11, 2010)).

117. Salsich, *supra* note 7, at 11 n.2, citing David M. Herszenhorn & Vikas Bajaj, *The Tricky Task of Offering Aid to Homeowners*, N.Y. Times, Apr. 6, 2008, at A1, A17. One study concluded that "[a]s much as 70 percent of recent early payment defaults had fraudulent misrepresentations on their original loan applications." Tyler Cowen, *So We Thought, But Then Again . . .*, N.Y. Times, Jan. 13, 2008, at BU6 (discussing a study of more than three million loans between 1997 and 2006). *See also* Occupancy Fraud and the Impact on the Mortgage Industry (2008) by BasePoint Analytics, a lender consulting firm. The opening of Senate debate on a Banking Committee compromise bill, discussed *infra*, was met with the threat of a presidential veto. Lori Montgomery, *Veto Threatened for Housing Bill: White House Objects to Funding Plan for FHA Program*, Wash. Post, June 20, 2008, at D2.

118. Press Release, HOPE NOW Alliance Created to Help Distressed Homeowners (Oct. 10, 2007), www.HOPENOW.com (last visited Dec. 23, 2010).

119. *Examining the Making Home Affordable Plan, Hearing Before the H. Subcomm.on Housing and Community Opportunity of the Comm. on Fin. Services*, Mar. 19, 2009. at 1 (statement of Statement of Faith Schwartz, Executive Director, HOPE NOW Alliance).

According to Schwartz, the Alliance offers counseling services to "borrowers who may have or expect to have difficulty making their mortgage payments" and, where appropriate, helps negotiate loan modifications and other workout solutions.[120] The Alliance maintains a national hotline (889.995.HOPE) and a website (www.hopenow.com) to enable borrowers to connect with counselors and mortgage servicers. Other services include organizing local programs where borrowers can talk in person with nonprofit counselors; serving as a clearinghouse for servicers developing "best practices in servicing"; coordinating information-sharing among government agencies, the GSEs, and servicers "as they develop policies to apply to loan modification efforts"; serving as "a contact and facilitator" for counseling agencies and servicers; and collecting and publishing "data on actual loan workouts and modifications."[121]

The HOPE NOW Alliance provides crucial counseling, mediation, and data collection services that are integral to any effective foreclosure response program. But the success of such efforts depends heavily on the willingness of servicers to participate, something that many servicers initially were reluctant to do. While advocates and counselors have been able to achieve loan modifications in individual situations, the size of the problem threatens to dwarf those successes. In January 2010, for example, success in achieving 150,000 loan modifications that month[122] was qualified by the fact that almost 4 million mortgages were at least sixty days delinquent.[123] An attorney for borrowers dealing with mortgage delinquencies and foreclosures captured the enormity of the problem: "I've gotten resolutions for clients in individual cases, but I'm just a flea on the tail of an elephant."[124]

HOPE NOW reports slow but steady progress in the five years since its inception. For example, over one million homeowners received loan modifications in 2011, which exceeded the approximately 843,000 foreclosure sales completed that year.[125] Albeit impressive, those figures still paled in comparison with the 2.8 million mortgages that were reported to be at least sixty days delinquent in December 2011.[126]

120. *Id*.

121. *Id*.

122. Press Release, HOPE NOW Alliance (Mar. 17, 2010), *available from* http://www.hopenow.com/press/files/Data%20release_03_17_10.pdf (last visited Dec. 1, 2010).

123. Press Release, HOPE NOW Alliance (May 10. 2010), *available from* http://www.hopenow.com/press/files/1QDataRelease_05_10_10.pdf (last visited Mar. 27, 2012).

124. Morgenson, *supra* note 82, quoting Howard D. Rothbloom, an Atlanta attorney who represents homeowners in bankruptcy proceedings.

125. Press Release, HOPE NOW Alliance (Feb. 7, 2012), *available from* http://www.hopenow.com/Press/files/HN2011Fulldata_FIN . . . (last visited Mar. 27, 2012).

126. *Id*.

The $25 billion that Bank of America and the four other banks committed to pay in settlement of foreclosure misconduct claims[127] is a significant amount, but it will not resolve all cases.[128] Of perhaps greater long term importance is the banks' agreement to implement "comprehensive reform of mortgage servicing practices."[129] Among practices to be implemented are requirements that "affidavits, sworn statements and Declarations . . . [be] based on . . . review and personal knowledge [as well as] competent and reliable evidence";[130] procedures be implemented "to ensure accuracy and timely updating" of accounts;[131] regular reviews be conducted of "a statistically valid sample" of affidavits, sworn statements, notices of default, etc., to ensure accuracy and compliance with prevailing law and the settlement agreement;[132] servicers notify "potentially eligible borrowers" of loss mitigation options and "offer and facilitate" loan modifications rather than foreclosure when loan modifications "are net present value (NPV) positive."[133] Moreover, borrowers who have submitted complete loan modification applications cannot be referred to foreclosure while those applications are pending;[134] an "easily accessible and reliable single point of contact (SPOC)" shall be established for each borrower potentially eligible for loan modification consideration and will be identified "promptly" to borrowers who request loss mitigation assistance;[135] servicers must reach out to "all potentially eligible delinquent borrowers (other than those in bankruptcy)" to inform them of loss mitigation options,"[136] including establishing "an online portal . . . where borrowers can check, at no cost, the status of their

127. Nat'l Mortgage Settlement, *Fact Sheet, supra* note 20.

128. For example, one analysis of the principal reduction portion of the agreement, the largest portion of the settlement in dollar amounts, estimates that only 5 percent of underwater mortgagors will obtain relief, in part because of strict eligibility conditions. Suzy Khimm, *Only 5% of Underwater Loans Might Get Settlement's Principal Reductions, Report Says*, Wash. Post, Mar. 2, 2012, http://www.washingtonpost.com/blogs/ezra-klein/post/only-5percent-. . . (citing Brookings Institution study).

129. Nat'l Mortgage Settlement, Executive Summary of Multstate/Federal Settlement of Foreclosure Misconduct Claims, *retrieved from* http://www.nationalmortgagesettlement.com/states (Mar. 24, 2012).

130. United States v. Bank of America Corp., Case 1:12-cv-00361-RMC, at Exh. A, Settlement Term Sheet, 4. Loss Mitigation, I.A.3. (Mar. 12, 2012) (consent judgment), *retrieved from* http://www.nationalmortgagesettlement.com/about-the-settlement (Mar. 24, 2012).

131. *Id*. at I.B.1.

132. *Id*. at I.E.1.

133. *Id*. at IV.A.1; IV.A.2.

134. *Id*. at IV.B.1.

135. *Id*. at IV.C.1; IV.C.2.

136. *Id*. at IV.D.1.

first lien loan modifications."[137] Loss mitigation staffing and systems must be adequate in number, training, and experience and must not be compensated in a manner that "encourage[s] foreclosure over loss mitigation alternatives."[138]

B. HOPE for Homeowners (H4H)

A new FHA program launched in 2008 to insure mortgages issued to refinance existing single-family mortgages of owner-occupiers in danger of losing their homes to foreclosure became the centerpiece of early legislative foreclosure relief efforts. Enacted as a temporary program by the Housing and Economic Recovery Act of 2008 (HERA) in July 2008,[139] the HOPE for Homeowners (H4H) program was open to borrowers who had entered into their loans on or before December 31, 2007, and had a mortgage debt-to-income ratio greater than 35 percent as of March 1, 2008.[140] The program took effect October 1, 2008, and ended on September 30, 2011.[141] Eligible borrowers had to certify that they owned no other residence and had not intentionally defaulted on the existing mortgage or falsified information to obtain the mortgage.[142] Refinancing loans were restricted to thirty-year, fixed-rate notes and mortgages[143] and originally were limited to 90 percent of the "current appraised value" of the property.[144] However, the 90 percent limitation later was modified as noted below.[145] Counseling for homeowners and renters was emphasized and grants to states and local governments authorized.[146] In addition, state housing finance agencies received a temporary increase in housing bond issue authority to enable them to refinance "qualified subprime" loans, defined as "adjustable rate single-family residential mortgage loan[s] made after December 31, 2001, and before January 1, 2008, that the bond issuer determines would be reasonably likely to cause financial hardship to the borrower if not refinanced."[147]

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137. *Id*. at IV.E.1.

138. *Id*. at IV.H.1; IV.H.3; IV.H.5.

139. Housing and Economic Recovery Act of 2008 (HERA), Pub. L. No. 110-289, 122 Stat. 2654 (effective July 30, 2008, codified in scattered sections of 12 U.S.C. §§ 4501–4520).

140. *Id*. §§ 1401–1404 (HOPE for Homeowners Act of 2008, adding new § 257 to Title II of the National Housing Act, 12 U.S.C. § 1715z-23).

141. 12 U.S.C. § 1715z-23(r).

142. HERA § 1402(a).

143. *Id*.

144. *Id*.

145. *Infra* notes 150–51 and accompanying text.

146. HERA §§ 2401–02.

147. *Id*. § 3021 (amending § 143(k) of the Internal Revenue Code of 1986 by adding new paragraph (12)).

All types of existing single-family, one-to-four unit, primary residence loans were eligible for refinancing with H4H FHA-insured loans, including ones with interest only or negative amortization features.[148] The nationwide maximum mortgage amount for an H4H loan ranged from $550,440 (one unit) to $1,058,574 (four units). FHA guidelines, including the requirement for an appraisal by an FHA-approved appraiser, had to be followed. Interest rates were negotiable as long as they were "commensurate with those offered for similar loan types."[149]

Lender participation was voluntary and few lenders expressed interest when the program was implemented. A major cause for lender concern was the requirement that lenders agree to reduce outstanding principal balances on all existing loans so that the H4H refinancing loan would be within allowable loan-to-value (LTV) ratios. Permissible LTV ratios later were increased from 90 percent to 105 percent for borrowers current on existing mortgages; 96.5 percent for delinquent borrowers with payment-to-income (PTI) and debt-to-income (DTI) ratios of 30 percent or lower and 42 percent or lower, respectively; and 90 percent for delinquent borrowers with PTI and DTI ratios as high as 38 and 50 percent, respectively, and for current borrowers with credit scores below 500.[150] Lenders were required to agree to "accept any loss from writing down the principal to the required LTV ratio." They were also required to extinguish all outstanding loans and forgive all advances for tax and insurance as well as expenses associated with foreclosure filings and preservation of property.[151]

The voluntary nature of the program on the part of both borrowers and lenders, the perception that the requirements for refinancing were overly restrictive, and the severity of the recession produced relatively few participants. The Obama administration threw its weight behind its Home Affordable Modification Program, discussed *infra*, and allowed the H4H program to expire on its sunset date of September 30, 2011.[152]

148. HUD Mortgagee Letter 2009-43 (Oct. 20, 2009), *retrieved from* www.hud.gov/offices/adm/hudclips/letters/mortgagee/index.cfm (Oct. 26, 2010) (explaining amendments to the H4H program in the Emergency Economic Stabilization Act, amending 12 U.S.C. § 1715z-23(e)(1)(B) and the Helping Families Save Their Homes Act of 2009, adding 12 U.S.C. § 1715z-23(x); Comptroller of the Currency, Community Developments Fact Sheet, FHA HOPE for Homeowners Program, *retrieved from* http://www.occ.gov/static/community-affairs/fact-sheets/FHA_HOPE_for_Homeowners_Program.FS.pdf (Oct. 26, 2010).

149. *Id.*

150. *Id.*

151. HOPE for Homeowners Act, *supra* note 139, § 257(e)(4); Community Developments Fact Sheet, FHA HOPE for Homeowners Program, *supra* note 148, at 4.

152. HUD Mortgagee Letter 11-20, Termination of the HOPE for Homeowners (H4H) Program (June 10, 2011), *retrieved from* portal.hud.gov/hudportal/document/huddoc?id=11-20ml.pdf (Mar. 28, 2012).

C. Housing Affordable Modification Program (HAMP)

On February 18, 2009, the Obama administration announced its Homeowner Affordability and Stability Plan,[153] the third attempt by the federal government to come to grips with the foreclosure crisis. Now known as the Making Home Affordable (MHA) program, it became "an umbrella program for the administration's homeowner assistance and foreclosure prevention efforts," with an allocation of $45.6 billion from the Troubled Asset Relief Program (TARP).[154] The Treasury Department-sponsored Home Affordable Modification Program (HAMP) is the administration's flagship housing support program.[155] HAMP is a voluntary program "designed to help financially struggling homeowners avoid foreclosure by modifying loans to a level that is affordable for borrowers now and sustainable over the long term."[156]

HAMP's major initiative provides incentives to servicers and investors to encourage modifications of first lien mortgages for eligible homeowners "currently in default or at imminent risk of default."[157] The Treasury

153. SIGTARP: Office of the Inspector General for the Troubled Asset Relief Program, Quarterly Report to Congress 55 (Jan. 26, 2012), citing President Barack Obama, Remarks by the President on the Home Mortgage Crisis (Feb. 18, 2009), *retrieved from* http://www.sigtarp.gov/reports.shtml (Mar. 30, 2012) [hereinafter SIGTARP Report (Jan. 2012)].

154. *Id*.

155. *Id*. at 60. Unless extended, HAMP is scheduled to terminate December 31, 2013. MHA, Supplemental Directive 12-02, Making Home Affordable Program–MHA Extension and Expansion 2 (Mar. 9, 2012) (announcing extension of MHA "and all of its component programs through December 31, 2013"), *retrieved from* https://www.hmpadmin.com/portal/programs/hamp.jsp (Mar. 31, 2012).

156. Home Affordable Modification Program: Overview, *retrieved from* https://www.hmpadmin.com/portal/programs/hamp.jsp (Mar. 31, 2012).

157. SIGTARP Report (Jan. 2012), *supra* note 153. In addition to its first-lien mortgage program, HAMP includes three smaller subprograms: (1) Home Price Decline Protection (HPDP), TARP-funded investor incentives to offset home price declines; (2) Principal Reduction Alternatives (PRA), TARP-funded investor incentives to encourage the use of principal reduction in loan modifications, and (3) Home Affordable Unemployment Program (UP), which assists unemployed homeowners through temporary forbearance of all or a portion of their mortgage payments. *Id*. at 55–56.

Other related programs include (1) Home Affordable Foreclosure Alternatives (HAFA), discussed *infra*, which provides incentives to servicers and borrowers to pursue short sales and deed-in-lieu of foreclosures where HAMP modifications are not successful; (2) Second Lien Modification Program (2MP), which provides incentives to servicers to enable second liens to be modified along with corresponding first liens; (3) HAMP-like loan modification programs within the FHA, Veterans Administration, and the Department of Agriculture; (4) FHA Short Refinance program to encourage refinancing of non-FHA-insured underwater mortgage loans into FHA-insured loans with lower principle balances; (5) Treasury/FHA Second Lien program (FHA2LP) providing incentives to servicers and investors to reduce or extinguish second liens on FHA-refinanced loans; and (6) Housing Finance Agency Hardest Hit Fund (HHF), a TARP-funded foreclosure prevention program operated

Department originally paid participating servicers $1,000 for each permanent modification completed under HAMP, and an additional $500 if the borrower was current but at imminent risk of default before enrolling in HAMP's first phase, i.e., a trial modification.[158] In October 2011, the incentive payment was changed to a sliding scale ranging from $1,600 for loans no more than 120 days delinquent, $1,200 for loans between 120 days and 210 days delinquent, and $400 for loans more than 210 days delinquent. The $500 current borrower fee also was dropped.[159] Servicers also can earn $1,000 per year for three years, or one-half of the reduction in the borrower's monthly payment (the so-called pay-for-success fee) for any borrowers receiving a reduction of 6 percent or more in monthly mortgage payments through HAMP "if the borrower remains in good standing (defined as less than three full monthly payments delinquent)." Likewise, successful HAMP-assisted borrowers can earn an annual "pay for performance" principal balance reduction payment calculated in the same manner.[160] In addition to its voluntary nature, HAMP is quite complicated. HUD and Treasury officials administering the program have modified the guidelines on numerous occasions during the first months, provoking criticism from servicers and advocates for borrowers.[161]

To participate, borrowers must establish hardship, such as income reduction or loss, death or serious illness in the family, increase in mortgage payments, increase in medical or other expenses, lack of cash reserves, or overextension of credit.[162] Eligible borrowers who are current on their mort-

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by housing finance agencies in states hardest hit by the recession and foreclosure crisis. Eighteen states and the District of Columbia have been approved for HHF assistance. *Id*.

158. SIGTARP Report (Jan. 2012), *supra* note 153, at 62.

159. *Id*.

160. *Id*., citing Treasury Dept., Supplemental Directive 11-06, Making Home Affordable Program–Updates to Servicer Incentives (July 7, 2011), www.hmpadmin.com/portal/programs/docs/hamp_servicer/sd1106.pdf (last visited Jan. 6, 2012).

161. John W. Schoen, *Flaws Plague Foreclosure Relief Program*, msnbc.com (Jan. 26, 2010), http://www.msnbc.com/id/35062033/ns/business-mortgage_mess/ (last visited Oct. 19, 2010) (reporting that the Mortgage Bankers Association had tracked nine new HAMP program requirement releases and more than ninety clarifications for new or revised forms, reporting changes, and policies issued between April 2009 and January 2010). A revised handbook for servicers for the MHA stable of programs, including HAMP, identifies thirty-eight supplemental directives released in the twenty-eight months between April 2009 and September 2011. U.S. Treasury, Making Home Affordable Program Handbook for Servicers of Non-GSE Mortgages, Version 3.4, at 15–17 (Dec. 15, 2011), *retrieved from* https://hmpadmin.com/portal/programs/hamp.jsp (Mar. 31, 2012).

162. Handbook for Servicers, *supra* note 161, at 66–67; Fannie Mae Servicing Guide, Announcement 09-05R, Reissuance of the Introduction of the Home Affordable Modification Program, HomeSaver Forbearance™, and New Workout Hierarchy 4 (Apr. 21, 2009), *retrieved from* http://www.efanniemae.com/sf/mha/mhamod/# (Oct. 25, 2010).

gages or less than thirty days delinquent must satisfy an "imminent default screen," meaning they must have a debt coverage ratio of less than 1.20 and cash reserves of less than three times their first mortgage payment.[163] All HAMP-eligible loans must be evaluated with a net present value (NPV) test[164] to determine whether a lender's return from a new loan would be more, or less, valuable than the return from taking the old loan through foreclosure.[165] The NPV test initially was quite controversial because lenders can deny loan modifications if borrowers fail the test, but Treasury did not make available the data that goes into those determinations to borrowers and their representatives.[166] Section 1482 of the Dodd-Frank Act added a mandate that Treasury require servicers to make available to borrowers whose mortgage modification applications have been denied "all borrower-related and mortgage-related input data used in any net present value (NPV) analyses" at the time of denial.[167]

HAMP uses a debt-to-income ratio of 31 percent as a standard of affordability. Participating servicers are required to use what is termed a "standard modification waterfall," i.e., a series of proposed modification steps in a prescribed order, to reduce a borrower's monthly mortgage payment ratio to the 31 percent level. Capitalization of accrued interest and escrow advances to third parties is the first step, followed by interest reduction, in increments of .125 percent "to get as close as possible" to the 31 percent target, with an interest rate floor of 2.0 percent. If interest reduction does not achieve the 31 percent goal, the loan term should be extended by up to forty years. If necessary, servicers must offer forbearance, but not forgiveness, of principal, structured as a balloon payment that becomes due upon "transfer of the property, payoff of the interest bearing UPB, or at maturity of the mortgage loan."[168] Foreclosure counselors report that servicers rarely if ever get to the fourth step of principal deferral because they conclude that if a modification that reduces the interest rate to 2 percent and extends the term to forty years does not achieve the 31 percent debt-to-income ratio, the loan simply is not affordable and further attempts at loan modification are unrealistic.[169]

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163. Fannie Mae Servicing Guide, *supra* note 162, at 5–6. The debt coverage ratio is "the borrower's monthly disposable net income divided by the borrower's current monthly principal and interest payment on the first mortgage." *Id*. at 5.

164. *Id*. at 6–7.

165. Schoen, *supra* note 161.

166. *Id.*, arguing that "[b]ecause Treasury has kept the formula a secret, homeowners who have been rejected for modifications can't check the lender's math to correct possible mistakes about the borrower's income, home value, credit score or other critical pieces of data."

167. Dodd-Frank Wall Street Reform and Consumer Protection Act § 1482, Pub. L. No. 111-203, 124 Stat. 1376, 2203 (July 21, 2010); Handbook for Servicers, *supra* note 161, at 58–61.

168. Handbook for Servicers, *supra* note 161, at 78–80.

169. Ingram, *supra* note 1.

The HAMP process involves three steps: application and determination of eligibility, trial period plan,[170] and permanent modification. Servicers must use "reasonable efforts" to inform delinquent borrowers of the HAMP program and give them an opportunity to apply. Borrowers seeking HAMP modification of their mortgages must first establish eligibility by providing detailed financial and hardship information. Servicers are encouraged to suspend foreclosure sales while borrowers' applications are evaluated. During the trial payment period, a loan modification plan created by applying the "standard modification waterfall" described earlier is implemented. Borrowers must make all payments due under the loan modification plan. If borrowers successfully complete the trial period plan, they may receive a permanent modification "as long as the servicer has received . . . all other required documentation from the borrower, including a fully executed Modification Agreement."[171] Permanent loan modification terms "remain fixed for at least five years. After five years, the loan's interest rate. . . . can rise incrementally by up to 1 percent per year" until it reaches the interest rate for 30-year fixed-rate loans that was in effect on the date the modification became effective.[172]

Despite the fanfare accompanying HAMP's announcement, the program got off to a very slow start. Many borrowers had difficulty producing accurate records verifying their income and expenses. The trial payment period proved to be insurmountable for large numbers of participants.[173] By August 2010, eighteen months after HAMP was announced, 1.3 million trial modifications had been started, but only about 450,000 had successfully moved to permanent modifications (more than 468,000 permanent modifications were started, but 19,000 already had been cancelled). Over 660,000 trial modifications had been cancelled and another 202,000 trials remained active, with about 95,000 of those classified as "aged" trials, i.e., extended to six months or more from the original expectation of three to four months. Paperwork problems, missed payments, and primary housing expenses of less than 31 percent of income headed the lists of reasons for cancellation. Borrowers who were successful in obtaining permanent loan modifications enjoyed median savings of $515.49 per month ($1,428.56 before and $839.21 after modification). All permanent modifications included

170. The trial period lasts for three months ("or longer if necessary to comply with applicable contractual obligations."). Handbook for Servicers, *supra* note 161, at 89.

171. *Id*. at 93–94.

172. SIGTARP Report (Jan. 2012), *supra* note 153, at 61–62.

173. A major criticism was that borrowers initially were accepted into the trial period on the basis of verbal statements. Many could not make even the modified payments because their verbal statements did not comport with the reality of their situations. Trial period eligibility standards later were changed to require written evidence that applicants meet the criteria for entering the trial period phase. Ingram, *supra* note 1.

interest rate reductions; 56.7 percent added extensions to loan terms, and 29.5 percent also provided for principal forbearance.[174]

HAMP, while increasing its activity, has had great difficulty catching up to the volume of foreclosures. For example, during the nine-month period from January 1, 2010, through September 30, 2010, almost 2.7 million homeowners received foreclosure notices and banks repossessed more than 800,000 homes.[175] HAMP's record of less than 500,000 permanent loan modifications, and almost half of 1.4 million trial modifications cancelled, paled in comparison. Banks reportedly were agreeing to short sales (accepting an amount less than the amount of the outstanding mortgage balance) in greater numbers.[176] Critics emphasized the slow pace and complexity of the HAMP process,[177] as well as the high expectations created by the initial announcement that three to four million homeowners would be helped by the program,[178] and the loss in credibility that resulted when the early results fell so far short of the announced target.[179] By December 31, 2011, only $2.056 billion of HAMP's $22.7 billion TARP allocation had been expended on 450,000 trial modifications converted to permanent modifications.[180]

174. Making Home Affordable Servicer Performance Report, August 2010 (Sept. 22, 2010), *retrieved from* http://www.treasury.gov/initiatives/financial-stability/results/MHA-. . . (Mar. 31, 2012).

175. SIGTARP: Office of the Inspector General for the Troubled Asset Relief Program, Quarterly Report to Congress 11 (Oct. 26, 2010), *retrieved from* www.hmpadmin.com/portal/program/hamp.html (Oct. 27, 2010).

176. Dina ElBoghady & Dan Keating, *Walking Away with Less*, Wash. Post, Sept. 26, 2010, at A1; Alan Zibel, *Mortgage Relief Is Not Enough for Some*, St. Louis Post-Dispatch, Sept. 23, 2010, at A8.

177. Shahien Nasiripour & Arthur Delaney, *Extend and Pretend: The Obama Administration's Failed Foreclosure Program*, Huff. Post, Aug. 4, 2010, http://www.huffingtonpost.com/2010/08/04/extend-and-pretend-the-ob_n_668609.html (last visited Oct. 19, 2010) ("The strategy has achieved stability for the housing market, but not for the people inside the houses. Families are merely given more time to wonder when sheriff's deputies will finally pile their belongings on the curb.").

178. The Special Inspector General for TARP was particularly critical of Treasury for failing to acknowledge the "implications of these facts with sufficient transparency" and for making "the remarkable argument that every single one of these modifications is a success, including the nearly 700,000 that have failed and the more than 173,000 that remain in limbo," SIGTARP Report (Oct. 2010), *supra* note 175.

179. *HAMP, Servicer Abuses, and Foreclosure Prevention Strategies: Hearing Before the Cong. Oversight Panel on the Troubled Asset Relied Program Cong. Oversight Panel*, at 22, 111th Cong., 2d Sess. at 22 (Oct. 27, 2010) (statement of Julia Gordon, Senior Policy Counsel, Center for Responsible Lending), http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/testimony-julia-gordon-10-26-2010.pdf.

180. SIGTARP Report (Jan. 2012), *supra* note 153, at 64. A GSE HAMP program that does not use TARP funds had converted an additional 480,000 trial modifications to permanent ones in the same period. In both cases, between 80,000 and 90,000 permanent loan modifications later were cancelled. *Id*.

D. Home Affordable Foreclosure Alternatives (HAFA)

An alternative program, announced by the Treasury Department in April 2010 offers incentives to servicers to encourage use of alternatives to foreclosure such as short sales and deed-in-lieu of foreclosure (DIL) transactions.[181] Short sales are arm's-length transactions in which participating servicers agree to accept the net proceeds of the sale "in full satisfaction of the total amount due on the first mortgage," even though that amount "may be less than the total amount due on the mortgage."[182] The term "deed-in-lieu of foreclosure" describes a process in which the borrower "voluntarily transfers ownership of the mortgaged property to the servicer in full satisfaction of the total amount due on the first mortgage."[183] The homeowner's ability to deliver marketable title is a key requirement for servicer participation, and homeowners usually are required to make "a good faith effort to sell the property through a short sale before a DIL will be accepted.[184]

HAFA has been a small program, with only a few thousand closed transactions in the first year of the program, although short sale and DIL transactions increased by 73.7 percent in April 2011 over the previous month.[185] "Low payouts" reportedly hurt the acceptance of the program by servicers, investors, and subordinate lien holders.[186] By December 31, 2011, just over 26,000 short sales or deeds-in-lieu of foreclosure transfers had been completed, resulting in payments to borrowers, investors, and servicers of $99.5 million from the $4.2 billion TARP allocation to this program.[187]

IV. More Aggressive Prevention and Departure Strategies

The extent of the mortgage market collapse,[188] the impact of MERS,[189] reports of serious flaws in the foreclosure process,[190] and the inability of voluntary governmental programs such as HAMP to make a significant

181. U.S. Treasury, Supp. Dir. 09-09 Rev., Home Affordable Foreclosure Alternatives–Short Sale and Deed-in-Lieu of Foreclosure Update (Mar. 26, 2010).

182. *Id*. at 2.

183. *Id*.

184. *Id*.

185. Carrie Bay, *HAFA Short Sales up Over 70% in April*, DSNews, http://www.dsnews.com/articles/hafa-short-sales-up-over-70-in april-2011-06-10.

186. *Id*.

187. SIGTARP Report (Jan. 2012), *supra* note 153, at 70–71.

188. So many housing loans are in serious default or foreclosure that in many states it could take ten years or longer to clear the backlog. New York is at the extreme of sixty-two years. David Streitfeld, *Backlog of Cases Gives A Reprieve on Foreclosures*, N.Y. Times, June 19, 2011, at 1.

189. Section II.B.2.a.

190. Dash & Schwartz, *supra* note 18 (reporting that "[a]lmost overnight, what had been a factory-like business that relied on workers with high school educations to process monthly payments needed to come up with a custom-made operation that could solve the problems of individual homeowners.").

dent in the foreclosure volume have generated numerous calls for more aggressive intervention, including calls for a nationwide moratorium on foreclosures.[191]

Financial analysts, economists, and lenders have pushed back against moratoria recommendations, arguing that the best way to restore the housing market is to move the large volume of foreclosures through the legal system as quickly as possible.[192] Consumer advocates and others stress the importance of preventing foreclosures where possible and easing the transition of defaulting homeowners when prevention of foreclosure is not possible.[193] They believe that a successful strategy must include a combination of foreclosure prevention techniques (counseling, mediation, loss mitigation), reform of the mortgage servicer role, and greater emphasis on rental housing alternatives.[194]

But intervention is easier said than done. The mortgage market consists of millions of private contracts between borrowers and lenders, borrowers and servicers, lenders and investors, lenders and servicers, and investors

191. H. Res. 344, 112th Cong. (2011), Expressing the sense of the House of Representatives that the States should enact a temporary moratorium on residential mortgage foreclosures, Rep. Marcy Kaptur (D-Ohio), July 8, 2011, http://www.opencongress.org/bill/112-hr344/text; Sewell Chan, *Treasury Links Foreclosure Ills to Lower Housing Prices*, N.Y. Times Oct. 28, 2010, at B1 (quoting Julia Gordon of the Center for Responsible Lending calling for a "temporary pause" on foreclosures); Ariana Eunjung Cha and Jon Gordon, *Most Americans Worry About Ability to Pay Mortgage or Rent, Poll Finds*, Wash. Post Oct. 28, 2010, http://www.washingtonpost.com/wp-dyn/content/article/2010/10/27/AR2010102703683.html?hpid=topnews&sid=ST2010102703800 (reporting poll results including "just over half of the country thinks the administration should impose a national moratorium on foreclosures to sort out whether banks are improperly seizing the homes of struggling borrowers").

192. *See, e.g.*, Peter J. Wallison, *The Foolish Foreclosure Moratorium*, The American (Am. Enter. Inst., Oct. 13, 2010), *retrieved from* http://www.american.com/archive/2010/october/the-foreclosure-mor. . . (Apr. 3, 2012); Caren Bohan & Corbett B. Daly, *White House Rejects Foreclosure Moratorium*, Reuters (Oct. 12, 2010), *retrieved from* http://reuters. com/assets/print?aid=USTRE69B3BH20101012 (Apr. 3, 2012).

193. *See, e.g.*, Prof. Peterson "first priority 'seed lien'" recommendation, *infra* notes 205–06 and 267–68 and accompanying text. Nobel Prize-winning economist Joseph Stiglitz was a proponent of a temporary foreclosure moratorium in 2010, arguing that "the bad practices were so rife, the inequities were so rife, the fraudulent behavior was so common, that at this point we don't know what is a valid mortgage or not. And the consequences of throwing somebody out of their home, when they shouldn't be, are hard to reverse." Amy Goodman, *Nobel Laureate Joseph Stiglitz: Foreclosure Moratorium, Government Stimulus Needed to Revive U.S. Economy*,Transcript of Interview (Oct. 20, 2010), *retrieved from* http://www.democracynow.org/2010/10/20/nobel_laurate_joseph_stiglitz (Apr. 3, 2012).

194. Among organizations that have advanced these recommendations are the Center for American Progress, the Center for Responsible Lending, and the National Consumer Law Center.

and servicers. Sanctity of contract is one of the pillars of our capitalistic system, as Article I, Section 10 of the Constitution makes clear.[195]

That courts will protect private contracts from interference by the government was reaffirmed in *United States Trust Co. v. New Jersey*,[196] in which the Supreme Court applied the Contract Clause to invalidate a 1974 New Jersey statute repealing a 1962 statutory bond covenant between the states of New Jersey and New York limiting the ability of the Port Authority of New York and New Jersey to subsidize rail passenger transportation from revenues and reserves. In concluding that the Contract Clause prohibits the retroactive repeal of the 1962 covenant, the Court stated that "a State cannot refuse to meet its legitimate financial obligations simply because it would prefer to spend the money to promote the public good rather than the private welfare of its creditors."[197]

The Contract Clause, however, is not an absolute bar to public intervention in private contractual relations. The state police power has been used successfully to override private contracts in times of severe financial stress or other emergencies.[198] The leading case is *Home Building & Loan Assn. v. Blaisdell*,[199] in which the Supreme Court upheld a Minnesota statute[200] imposing a two-year moratorium on foreclosure sales at the height of the Great Depression that, among other provisions, authorized state courts to grant defaulting mortgagors extra time to redeem their property following foreclosure and allow them to retain possession during the redemption period so long as they paid a reasonable income or rental value to the mortgagee. In upholding the statute as a valid exercise of the state's police power, the Court stated

> While emergency does not create power, emergency may furnish the occasion for the exercise of power. . . . The constitutional question presented in the light of an emergency is whether the power possessed embraces the particular exercise of it in response to particular conditions. . . . The policy of protecting contracts against impairment presupposes the maintenance of a government by virtue of which contractual relations are worthwhile—a government which retains adequate authority to secure the peace and good order of society.
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> . . . .

195. U.S. Const., Art. I, § 10 ("No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . .").

196. 431 U.S. 1 (1977).

197. *Id*. at 29.

198. During the Great Depression, twenty-seven of the then forty-eight states adopted foreclosure moratoria. David C. Wheelock, *Changing the Rules: State Mortgage Foreclosure Moratoria During the Great Depression*, Review 569, 575 (Fed. Reserve Bank of St. Louis Nov./Dec. 2008), http://research.stlouisfed.org/publications/review/08/11/Wheelock.pdf.

199. 290 U.S. 398 (1934).

200. Minnesota Mortgage Moratorium Law, Ch. 339, Laws of Minn. 1933, at 514, approved Apr, 18, 1933. The law was to remain in effect "only during the continuance of the emergency and in no event beyond May 1, 1935."

> It cannot be maintained that the constitutional prohibition should be so construed as to prevent limited and temporary interpositions with respect to the enforcement of contracts if made necessary by a great public calamity such as fire, flood, or earthquake. . . . And if state power exists to give temporary relief from the enforcement of contracts in the presence of disasters due to physical causes such as fire, flood or earthquake, that power cannot be said to be non-existent when the urgent public need demanding such relief is produced by other and economic causes.[201]

With the prospect of as many as 13 million foreclosures by 2014,[202] the current foreclosure crisis would appear to meet the Supreme Court's public purpose standard for use of the police power to override contract provisions. Representative Kaptur included specific reference to *Blaisdell* in her proposed House resolution calling for the president to declare a national foreclosure emergency and for the states to enact moratoria similar to Minnesota's two-year moratorium upheld in *Blaisdell*.[203]

Intervention policies may be grouped into four categories for discussion purposes: (1) foreclosure response, (2) land records modernization, (3) rental housing alternatives, and (4) the future of the GSEs. While categorization may simplify analytical organization, it also risks masking the interrelated nature of the elements of any intervention strategy.

A. Foreclosure Responses—Prevention as an Ideal

The enormity of the foreclosure crisis[204] and the difficulties voluntary programs such as HAMP have encountered have led consumer advocates and others to focus on more aggressive foreclosure prevention strategies. Professor Christopher Peterson, in written testimony to the House Judiciary Committee,[205] offered a number of recommendations for intervention or lack thereof by Congress, including congressional prohibition of GSE (Fannie Mae, Freddie Mac, and Ginnie Mae) purchase of "MERS-recorded loans," congressional resistance to calls for federal preemption legislation to shield MERS from state commercial and property laws, congressional provision of "block grants to county governments to upgrade their recording technology in return for adopting uniform standards" for recording and searching public land records, and congressional enactment of "emergency legislation . . . [establishing] a first priority 'seed' lien" of $15,000 payable to the departing family from the proceeds of the foreclosure sale.[206]

201. *Home Building & Loan*, 290 U.S. at 426, 435, 439–40.

202. Gordon Testimony, *supra* note 179, at 3 (citing Hatzius & Marschoun, *supra* note 15, at 16 (projecting 13 million foreclosures).

203. H. Res. 344, *supra* note191.

204. Gordon Testimony, *supra* note 179, at 3.

205. *Causes and Effects of the Foreclosure Crisis, Hearing Before the H. Comm. on the Judiciary*, 111th Cong. (2010) (written statement of Christopher L. Peterson, Assoc. Dean and Prof. of Law, Univ. of Utah), *available at* http://judiciary.house.gov/hearings/pdf/Peterson101215.pdf.

206. *Id.*

The Center for Responsible Lending (CRL) has been a leading proponent of a "temporary pause" in foreclosures, arguing that taking "defined, objective, and transparent measures . . . to ensure the integrity of the system is the best way to stabilize the market."[207] Stating "[i]t is time to take the gloves off," Julia Gordon, CRL's Senior Policy Counsel, urged "everyone concerned about the stability of the housing market and the sustainability of our economic recovery to address the foreclosure problem head-on with every tool available."[208] But given the uncertainty surrounding the impact of a nationwide foreclosure moratorium on the fragile housing sector, steps short of that can and should be taken, many of which are included in CRL's recommendations.[209]

CRL has recommended devoting more resources to foreclosure counseling, requiring lenders and loan servicers to cooperate in good faith with foreclosure counselors, strictly enforcing state foreclosure notice and procedure laws, imposing mandatory loss mitigation requirements as preconditions to foreclosure,[210] requiring lenders and loan servicers to participate in good faith in foreclosure mediation efforts, authorizing state-level foreclosure moratoria where warranted by extreme circumstances, and enacting legislation authorizing bankruptcy courts to modify mortgages on principal residences in Chapter 13 bankruptcy proceedings in the same way that current law permits restructuring of loans for vacation and investment homes.[211]

1. Foreclosure Counseling

Foreclosure counseling can be extremely effective in helping distressed homeowners remain in their homes, particularly if those homeowners can obtain counseling while they still remain current on their loan obligations.[212] Counselors can help borrowers understand their situations, particularly the serious consequences of foreclosure. They can explain the available alternatives and help their borrower clients contact

207. Gordon Testimony, *supra* note 179, at 3.

208. *Id*. at 4.

209. *Id*. at 9–15.

210. Sara Weed & Sonia Garrison, *Foreclosure as a Last Resort: States Can Stabilize the Housing Market by Preventing Unnecessary Foreclosures*, CRL POL'Y BRIEF at 7 (Oct. 2010) (recommending loss mitigation "as a flexible but effective tool for states"). There are four ways in which a loss mitigation component has been integrated, either implicitly or explicitly, into state foreclosure laws: (1) as a precondition to foreclosure filing, (2) as part of a foreclosure mediation program, (3) as a precondition to foreclosure sale, and (4) as the basis for a challenge post-foreclosure sale. *Id*. Acknowledging that "not all foreclosures are preventable," CRL argued that "this range of approaches . . . would ensure that the foreclosure sale is a last resort." *Id*. at 7–8. 211. In its policy brief *Common-Sense Solutions Are Within Reach* (Dec. 12, 2008), CLR reported that Congress was considering legislation (H.R. 3609/S. 2136) that would extend the loan restructuring authority to families in Chapter 13 proceedings who were on the verge of losing their homes.

212. A study of foreclosure counseling by a task force in the St. Louis area concluded that "[h]omeowners who were current on their loan [at the time of counseling]

lenders and loan servicers to discuss those alternatives. Counselors also can help borrowers pull together necessary documentation of their loan histories and assist them in completing loan modification applications.

The Bush administration's HOPE NOW Alliance[213] began a collaborative counseling program in January 2008. Later that year sections 2305 and 2401 of the Housing and Economic Recovery Act of 2008 (HERA) appropriated $180 million for housing counseling services, including loss mitigation counseling.[214] The National Foreclosure Mitigation Counseling (NFMC) program, administered by NeighborWorks® (NW America), was established to distribute these funds to "competitively selected Grantee organizations [such as Beyond Housing in St. Louis], which in turn provide the counseling services, either directly or through Subgrantee organizations."[215]

A cluster of studies by the Federal Reserve,[216] the Urban Institute,[217] the Joint Center for Housing Studies of Harvard University,[218] and the National Council on Aging[219] document impressive results gained by foreclosure counselors: 200 percent increase in the likelihood of obtaining a loan modification with lower monthly payments and lower interest rates (average of $110/month and five basis points, respectively);[220] homeowners more likely to be able to cure serious delinquencies or avoid foreclosure; and homeowners more likely to remain current on their new loans.[221] Growing

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were likely to sustain homeownership." Will Winter & Todd Swanstrom, The Effectiveness of Foreclosure Counseling in St. Louis: A Report Prepared for the Metro St. Louis Foreclosure Intervention Task Force and Beyond Housing 18 (Pub. Pol'y Research Ctr., Univ. of Mo.-St. Louis, Mar. 15, 2010).

213. HOPE NOW Alliance, *supra* notes 118–38 and accompanying text.

214. Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, Title III, § 2305 and Title VI, § 2401, 122 Stat. 2654.

215. Charles A. Calhoun et al, National Foreclosure Mitigation Counseling Program Evaluation: Preliminary Analysis of Program Effects, September 2010 Update, at 1 (2010), http://www.urban.org/publications/412276.html.

216. Maximilian D. Schmeiser, *The Effects of Foreclosure Counseling for Distressed Homeowners*, Fed. Reserve Bd. of Governors, June 21, 2011.

217. Peter A. Tatian, Kenneth Temken, Neil S. Mayer & Charles Calhoun, *National Foreclosure Mitigation Counseling Program Evaluation: Does Foreclosure Counseling Help Troubled Homeowners?* (Urban Inst., Nov. 2009), http://www.995hope.org/wp-content/uploads/2011/07/Urban_Institute_Study.pdf.

218. Chris Herbert, *Housing Counseling: Past and Future Trends* (Joint Ctr. for Housing Studies of Harvard Univ., June 21, 2010), https://secure.ahcoa.org/resources/index/news/AHCOA_110622_99.pdf.

219. Barbara R. Stucki, *HECM Reverse Mortgage Counseling: Critical for Consumer Protection* (Nat'l Council on Aging, June 21, 2011).

220. Schmeiser, *supra* note 216, at 11–12; Carrie Bay, *Independent Research Studies Validate Benefits of Mortgage Counseling*, DSNews, June 24, 2011, http://www.dsnews.com/articles/print-view/independent-research-studies-validate-benefit. . . (reporting Federal Reserve study findings).

221. Tatian et al, *supra* note 217, at 5–7 (reporting results of Urban Institute research).

affordability problems are likely to increase the need for counseling,[222] and seniors need counseling to consider the pros and cons of home equity conversion mortgages (HECM), also known as reverse mortgages.[223]

NW America engaged the Urban Institute to evaluate the first two years of the program (Rounds 1 and 2). In doing so, the Urban Institute reviewed approximately 180,000 loans of borrowers who received NFMC counseling and 155,000 loans of borrowers who did not receive counseling.[224] In a preliminary analysis of the activity between January 2008 and December 2009, the Urban Institute concluded that counseling

> raised the cure rate for loans being modified, preparing more loans for cure-and-sustain outcomes, increased the size of the reduction in mortgage payment in modified and cured loans, with a resulting positive impact on sustainability, and raised sustainability of modified and cured loans additionally outside of the effect on loan payment level, presumably through financial counseling and some limited financial assistance.[225]

Homeowners who obtained NFMC counseling after receiving foreclosure notices "had a relatively likelihood of curing their foreclosure that was 1.7 times greater than if they had not received counseling from NFMC grant recipients," Urban Institute researchers concluded.[226]

More counseling resources are needed,[227] though, as a "log-jam" of clients has been created by the substantial disconnect between the number of homeowners receiving trial loan modifications under HAMP and the extremely small number who then receive permanent modifications, leading to "soaring" increases in client loads.[228] In addition, the voluntary nature of HAMP and other federal initiatives "have placed strong responsibilities on . . . local counselors to advocate for mortgage modifications, but very little control over the rest of the modification process to ensure equitable solutions for homeowners."[229]

222. Herbert, *supra* note 218, at 12.

223. Stucki, *supra* note 219.

224. Calhoun et al, *supra* note 215, at 2.

225. *Id*. at 63–64.

226. *Id*. at 65.

227. NeighborWorks America announced the fifth round of counseling funding on June 7, 2011, with awards totaling $67.7 million to 138 state and local counseling agencies. Eligible applicants had sought more than $212 million. NeighborWorks America, NFMC Round 5 Counseling Funds (June 7, 2011), http://www.nw.org/network/foreclosure/nfmcp/round5.asp (June 27, 2011). An additional award of $73.8 million to go to "32 state housing finance agencies, 18 HUD-approved housing counseling intermediaries, and 86 community-based NeighborWorks organizations" was announced Mar. 19, 2012. Esther Cho, *Foreclosure Counseling Agencies to Receive $73.8M*,DSNews, *retrieved from* http://www.dsnews.com/articles/print-view/foreclosure-counseling-agencies-to-receive-738m-2012-03-20 (Mar. 20, 2012).

228. For example, Beyond Housing, a nonprofit loan counselor in St. Louis, saw its caseload increase from about 100 clients in April 2008 to 935 clients in July 2009. Winter & Swanstrom, *supra* note 212, at 21.

229. *Id*.

2. Mandatory Loss Mitigation

Loss mitigation has a long common law tradition. If someone breaches a contract to buy my goods, I must attempt to sell those goods to someone else before I can collect damages for the breach.[230] The loss mitigation principle applies also to contracts for the sale of real property, although the traditional willingness of courts to consider damages inadequate for breach of contracts to sell land makes specific performance the favored remedy.[231] In recent years, the mitigation doctrine has been extended to residential leases and, increasingly, to commercial leases. For example, the Supreme Court of Texas, in *Austin Hill Country Realty, Inc. v. Palisades Plaza, Inc.*,[232] noted that forty-two states and the District of Columbia had accepted the argument that the contractual aspect of a lease included the duty to make reasonable efforts to mitigate damages caused by a tenant's breach.[233] In addition to the contract logic, the court identified several public policy reasons for extending the loss mitigation rule to leases:

> First, requiring mitigation . . . discourages economic waste and encourages productive use of the property. . . . Second, a mitigation rule helps prevent destruction of or damage to the leased property. . . . Third, the mitigation rule is consistent with the trend disfavoring contract penalties.[234]

Mortgage loans resemble leases in the sense that both are contracts as well as conveyances of property interests: the tenant's right to possession and the mortgagee's right to dispossess the mortgagor upon default. The policies of discouraging economic waste and preventing destruction of, or damage to, property apply with equal or greater force to mortgage loans.

The Center for Responsible Lending has identified several levels of economic loss occasioned by the foreclosure crisis "[b]eyond the impact of the foreclosures on the families losing their homes," including

> . . . "spillover" costs to neighbors and communities are massive, [as much as] $1.86 trillion in lost wealth, which represents an average loss of over $20,000 for each of the 91.5 million houses affected. . . . [F]oreclosures cost states

230. "The mitigation principle is at the root of many of the rules of the law of damages." JOSEPH M. PERILLO, 11 CORBIN ON CONTRACTS § 57.11, at 302 (rev. ed. 2005). Technically, I may have no duty to mitigate damages, but if I do not make a reasonable attempt to do so, my ability to recover damages will be severely compromised. RESTATEMENT (SECOND) OF CONTRACTS § 347 (recoverable damages are "less . . . any cost or other loss that [the injured person] has avoided by not having to perform). For a review of the mitigation doctrine and an argument that it should be applied to liquidated damages clauses, see Lisa A. Fortin, *Note: Why There Should be a Duty to Mitigate Liquidated Damages Clauses*, 38 HOFSTRA L. REV.285 (2009).

231. *See, e.g.*, Giannini v. First Nat'l Bank of Des Plaines, 483 N.E.2d 924, 933 (Ill. Ct. App. 1985) ("Illinois courts have long held that where the parties have fairly and understandingly entered into a valid contract for the sale of real property, specific performance of the contract is a matter of right . . .").

232. 948 S.W.2d 293 (Tex. 1997).

233. *Id*. at 296.

234. *Id*. at 298.

> and localities enormous sums of money in lost tax revenue and increased costs for fire, police, and other services because vacant homes attract crime, arson, and squatters, [resulting in] an average of $19,229 in direct costs to the local government [for each foreclosure] . . . While tenants now have some legal protection against immediate eviction, most of them will ultimately be forced to leave their homes.[235]

State law controls the foreclosure process. As Julia Gordon of the Center for Responsible Lending emphasized in her testimony before the Congressional Oversight Panel, "states can require that servicers assess whether foreclosure is in the financial interest of the investor before proceeding to foreclosure."[236] She argued that a mandatory loss mitigation standard can function like the NPV test of HAMP[237] by requiring loan servicers to "weigh the investor's cost of foreclosure against the investor's anticipated cash flow from future modified mortgage payments"[238] in order to determine whether foreclosure is in the best interest of the parties. She recommended that states require loan servicers to perform a loss mitigation analysis "prior to filing for foreclosure," noting that states have added loss mitigation requirements at several stages of the foreclosure process: "(1) as a pre-condition to foreclosure filing;[239] (2) as part of a foreclosure mediation program;[240] (3) as a pre-condition to foreclosure sale;[241] and (4) as the basis for a challenge to a post-foreclosure sale."[242]

The mortgage servicing business administering commercial mortgage-backed securities (CMBS) features two servicers, a "primary servicer," which focuses "solely on transaction processing," and a "special servicer . . . responsible only for defaulted loans . . . [which] is compensated based on the return on the defaulted loans," in effect, a "loss mitigation specialist."[243]

Applying the loss mitigation concept to mortgage loans would not amount to an unconstitutional impairment of contract. Rather, it would be an acknowledgment that foreclosure and sale is a drastic remedy that should be utilized only as a last resort. In many cases, investors likely will

235. Gordon Testimony, *supra* note 179, at 5–6, citing Center for Responsible Lending, *Soaring Spillover: Accelerating Foreclosures to Cost Neighbors $502 Billion in 2009 Alone; 69.5 Million Homes Lose $7,200 on Average; Over Next Four Years, 91.5 Million Families to Lose $1.9 Trillion in Home Value; $20,300 on Average* (May 2009), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-3-.

236. *Id*. at 16.

237. *Id*. at 16–17.

238. *Id*. at 17.

239. *Id*. at 17, citing Maryland HB 472(2010).

240. *Id*.

241. *Id*.

242. Weed & Garrison, *supra* note 210.

243. Levitin & Twomey, *supra* note 67, at 86.

receive greater value through loan modifications such as interest reduction, term extension, and/or principal reduction than through foreclosure and sale of the property, not to mention the benefits borrowers and their neighbors will receive from avoiding foreclosure.

The National Mortgage Settlement filed on March 12, 2012, adopts many of these principles.[244] For example, the bank signatories are required "to notify potentially eligible borrowers of currently available loss mitigation options *prior to foreclosure referral*."

> Servicer[s] shall offer and facilitate loan modifications for borrowers *rather than initiate foreclosure* (author's emphasis) when such loan modifications for which they are eligible are net present value (NPV) positive and meet other investor, guarantor, insurer and program requirements. . . .
>
> . . . .
>
> If a borrower has not already been referred to foreclosure, Servicer shall not refer an eligible borrower's account to foreclosure *while the borrower's complete application is pending* if Servicer received . . . a complete loan modification application no later than day 120 of delinquency. . . .[245]

Of course, it is one thing to settle a complicated dispute and another thing to implement that settlement.[246] Participating state attorneys general have committed to play a major role in monitoring the implementation of this agreement.[247] Time will tell whether this settlement really is a breakthrough agreement or merely a first step at fixing an industrywide problem.[248]

3. Automatic Foreclosure Mediation

Foreclosure counselors such as Linda Ingram at Beyond Housing stress the value of mediation as a mechanism to enable stakeholders in the residential mortgage finance market to "come together to talk about the best way for all parties to resolve foreclosures quickly and effectively."[249] The

244. United States v. Bank of America Corp., Case 1:12-cv-00361-RMC, doc. 1–4 (Mar. 12, 2012) (consent judgment), *retrieved from* http://www.nationalmortgagesettlement.com/about-the-settlement (Mar. 24, 2012).

245. *Id*. at Exh. A-16 (author's emphasis).

246. For example, a landmark affordable housing agreement in 2009 to settle a fair housing complaint against Westchester County, New York, "has led to an often rancorous tug of war." Peter Applebome, *In Westchester, Doubts on Commitment to a Housing Deal*, N.Y. Times, Apr. 4, 2012, at A15.

247. *See, e.g.*, Missouri Attorney General, Mortgage Settlement Agreement Information 2 ("State AG oversight of national banks for the first time"), *retrieved from* http://ago.mo.gov/mortgageSettlementInfo.htm (Mar. 5, 2012).

248. *See, e.g.*, Jessica Silver-Greenberg, *As Foreclosure Problems Persist, Fed Seeks More Fines*, N.Y. Times, Apr. 2, 2012, at B1 (reporting Federal Reserve official's recommendation that fines be levied against eight additional financial institutions).

249. Alon Cohen, *Walk the Talk: Best Practices on the Road to Automatic Foreclosure Mediation*, at 1 (Ctr. for Am. Progress 2010), http://www.americanprogress.org/issues/2010/11/walk_the_talk.html. *Walk the Talk* is the third in a four-part series of papers, all published by the Center for American Progress, on foreclosure

Center for American Progress (CAP), a progressive think tank advocating foreclosure mediation, reported in June, 2010 that twenty-one states were sponsoring foreclosure mediation programs, ten of which were established in the previous twelve months. Since that time, five additional states have established foreclosure mediation programs, bringing the total to twenty-six states.[250] Benefits of foreclosure mediation cited by CAP include avoidance of lengthy delays occasioned by the volume of cases in

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mediation. Others in the series are Andrew Jakabovics & Alon Cohen, *It's Time We Talked: Mandatory Mediation in the Foreclosure Process* (2009), http://www.americanprogress.org/issues/2009/06/time_we_talked.html; Alon Cohen & Andrew Jakabovics, *Now We're Talking: A Look at Current State-Based Foreclosure Mediation Programs and How to Bring Them to Scale* (2010), http://www.americanprogress.org/issues/2010/06/foreclosure_mediation.html; and Alon Cohen, *Talking It Up: How the Federal Government Can Implement Automatic Foreclosure Mediation to Help Homeowners, Lenders, Investors, and Taxpayers* (2011), http://www.americanprogress.org/issues/2011/01/talking_it_up.html.

250. Cohen & Jakabovics, *Now We're Talking, supra* note 249, at 1. The states offering foreclosure mediation include:

- *California:* CAL. CIV. CODE § 2923.5 (2008)
- *Colorado:* COLO. REV. STAT. ANN. § 38-38-102.5 (foreclosure hotline)
- *Connecticut:* CONN. GEN. STAT. ANN. § 49-31m (2008)
- *Delaware:* Admin. Dir. No. 2009-3, Del. Supr. Ct., Vaughn, P.J. (Aug. 31, 2009)
- *Florida:* Admin. Order No. AOSC09-54, *Final Report and Recommendations on Residential Mortgage Foreclosure Cases*, Fla. Supreme Ct., Quince, C.J. (Dec. 28, 2009), http://www.floridasupremecourt.org/pub_info/documents/AOSC09-54_Foreclosures.pdf
- *Hawaii:* Mortgage Foreclosure-Appropriation, 2011 Hawaii Laws Act 48 (S.B. 651)
- *Illinois:* Admin. Ord. No. 2010-01, *Mortgage Foreclosure Mediation Program*, Circuit Court of Cook County, Ill. Div. of Chancery, Kinnard, P.J. (Apr. 8, 2010), http://www.suffredin.org/pdfs/Foreclosure.AdministrativeOrder.2010-01.pdf; Christopher Bonjean, *Justice Killbride, Chief Judge Kinney Announce New Foreclosure Mediation Program for Will County*, Ill. State Bar Ass'n (June 7, 2010), http://www.illinoislawyernow.com/2010/06/07/justice-kilbride-judge-kinney-announce-new-foreclosure-mediation-program-for-will-county/
- *Indiana:* IND. CODE ANN. §§ 32-30-10.5 et seq.
- *Iowa:* Information on Iowa Mediation Service's Mortgage Mediation Program, Iowa Mediation Services, http://www.iowamediationservice.com/ (foreclosure hotline and voluntary mediation services)
- *Kentucky* (single jurisdiction), Admin. Order No. 2009-09-03, Residential Foreclosure Conciliation Program (Mar. 2009) (Jefferson County), discussed in EMILY SPURLOCK, COLLEEN KENNEDY, CARLOS LOPES & MIKE CLARK, HOUSING FORECLOSURES IN KENTUCKY RESEARCH REPORT NO. 365 (July 9, 2009), http://www.lrc.ky.gov/lrcpubs/RR365.pdf
- *Maryland:* MD. CODE ANN., REAL PROP. § 7-105.1

the formal foreclosure pipelines, reduction in administration and carrying costs for servicers as over seventy percent of mediated cases have resulted in settlements, homeowners can remain in their homes by negotiating "sustainable modification[s]" or can negotiate a "'graceful' exit that can give [them] some say in the move out as well as assistance in transitioning

- *Maine:* ME. REV. STAT. ANN. tit.4, § 18-B (2009); *Judicial Branch Commission on Foreclosure Diversion*, State of Maine Judicial Branch Courts, www.courts.state.me.us/committees/foreclosure.html
- *Massachusetts:* MASS. GEN. LAWS ANN. ch. 244, § 35A (amended 2010)
- *Michigan:* MICH. COMP. LAWS ANN. § 600.3204 et seq.
- *Nevada:* Foreclosure Mediation Rules Including Amendments through Mar. 1, 2011, http://www.nevadajudiciary.us/images/foreclosure/adkt435_amendedrules.pdf
- *New Hampshire:* Office of Mediation and Arbitration. The Foreclosure Mediation Program was discontinued on Oct. 26, 2011, *retrieved from* http://www.courts.state.nh.us/adrp/foreclosure/index.htm (Apr. 2, 2012)
- *New Jersey:* Press Release, New Jersey Courts, Judiciary Announces Foreclosure Mediation Program to Assist Homeowners at Risk of Losing Their Homes (Oct. 16, 2008), http://www.judiciary.state.nj.us/pressrel/2008/pr081016c.htm
- *New Mexico* (single jurisdiction): Admin. Order No. 2009-00001, *In re* Foreclosure Mediation ADR Option, First Judicial Dist. Ct., State of New Mexico, Pfeffer, C.J. (Apr. 30, 2009, modified July 8,2009), http://www.firstdistrictcourt.com/Forms/pdf/Admin%20Order%203.pdf (Los Alamos, Rio Arriba, and Santa Fe Counties)
- *New York:* N.Y. C.P.L.R. § 3408 (2009).
- *Ohio* (multiple jurisdictions): 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."); Supreme Court of Ohio, Foreclosure Mediation Program Model (Apr. 14, 2008), http://www.nclc.org/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/ohio_prgm_model.pdf.; Foreclosure Mediation, Cuyahoga County Common Pleas Ct., http://cp.cuyahogacounty.us/internet/ForeClosureMediation.aspx
- *Oregon:* 2009 Oregon Laws Ch. 864 (S.B. 628), http://www.leg.state.or.us/09reg/measures/sb0600.dir/sb0628.en.html
- *Pennsylvania* (multiple jurisdictions): Jnt. Court Reg. No. 2008-01, Ct. of Common Pleas of Philadelphia Cnty., Jones, P.J., and Keogh, A.J. (Apr. 16, 2008), http://www.courtsphila.gov/pdf/regs/2008/cpjgcr-2008-01.pdf
- *Rhode Island* (multiple jurisdictions): Code of Ordinances of the City of Providence, http://library.municode.com/HTML/11458/level3/PII_C13_AX_s13-216
- *Vermont:*VT. STAT. ANN. tit. 12, § 4633 (2009)

to new housing."[251] Governments can benefit as successful mediation "reduces home vacancies, stabilizes government income from property tax, and serves as a review and appeal" of federal and state foreclosure relief programs.[252]

The fact that mediation is a voluntary process of negotiation can lead to concerns that it would not work on the scale required by the foreclosure crisis. Lenders/servicers may not see how mediation can be in their best interests, or may be so overwhelmed by the sheer number of cases in their portfolios that the prospect of submitting such cases to mediation leaves them cold. Consumer advocates may fear that foreclosure mediators will tilt in favor of lenders because borrowers have defaulted on their contractual obligations. Such reactions, understandable as they may be, are highly subjective and even emotional. The Center for American Progress's recommendation[253] that an automatic mediation component be added to the foreclosure process makes sense. The term "automatic" is less emotionally charged than the term "mandatory," and it introduces a more objective approach to the process. Adding the requirement that lenders/servicers demonstrate good faith participation in mediation as a condition to pursuit of foreclosure does not require them to accept unrealistic or unfair loan modifications or forbearance, but it does require them to consider objectively what alternatives may be in their best interests. Making mediation automatic introduces a degree of standardization to what has been an ad hoc and chaotic process.

Automatic foreclosure mediation can serve as a proxy for the type of individual evaluation local banks traditionally gave their borrowers. Jamie Dimon, C.E.O. of JPMorgan Chase, acknowledged to Roger Lowenstein of the *New York Times Magazine* that the "optimal way to deal with delinquent loans would be to evaluate customers one at a time." But local banks largely have given way to gigantic financial institutions, and personal service has for the most part been replaced with computerized responses to 800-number phone calls. The mass production of mortgages that took place earlier in the decade and the sheer number of borrowers who have defaulted on those mortgages caused Mr. Dimon to acknowledge that management of the resulting chaos "is way beyond the capacity of the machine."[254]

- *Washington:* Wash. Ch. 58 Laws of 2011 (H.B. 1362), http://apps.leg.wa.gov/documents/billdocs/2011-12/Pdf/Bills/Session%20Law%202011/1362-S2.SL.pdf
- *Wisconsin: Frequently Asked Questions*, Marquette University Law School, http://law.marquette.edu/foreclosure/lender-faqs.html (describing voluntary mediation program run by Marquette University Law Clinic)

251. Cohen, *Walk the Talk, supra* note 249, at 2.

252. *Id*.

253. *Id*. at 3.

254. Roger Lowenstein, *America's Least Hated Banker*, N.Y. Times Mag. 34, 41 (Dec. 5, 2010).

One of the key changes in servicer practices recommended by the National Consumer Law Center and others is that servicers should establish one point of contact for borrowers in default/foreclosure situations. Both Treasury and Fannie Mae have promulgated "single point of contact" requirements: Treasury for servicers participating in the HAMP and HAFA programs;[255] Fannie Mae for "all conventional mortgage loans held in Fannie Mae's portfolio," as well as loans packaged into mortgage-backed securities.[256] In a sense, automatic mediation fulfills the single point of contact function by insuring that borrowers facing foreclosure can sit down across a table with a flesh-and-blood representative of the loan servicer contemplating foreclosure.[257]

Foreclosure mediation is not a perfect system. As experience with farmer-lender mediation during the farm crisis of the 1980s,[258] as well as with court-ordered mediation[259] and contract-sanctioned arbitration or mediation teaches,[260] issues of mediator competence and objectivity, fairness, and transparency can arise.[261] Whether mediators should take a "broad" or a "narrow" approach can produce tension.[262] Mediators using the "broad" approach are open "to dealing with whatever issues are important to the

255. U.S. Treasury, Making Home Affordable Program–Single Point of Contact for Borrower Assistance, Supp. Directive 11-04 (May 18, 2011), https://www.hmpadmin.com//portal/programs/docs/hamp_servicer/sd1104.pdf.

256. Fannie Mae, Delinquency Management and Default Prevention, Announcement SVC-2011-08 (June 6, 2011).

257. Not everyone is happy with the specifics of the announced one point-of-contact rules. Alon Cohen, in a posting for the Center for American Progress, stated that "under the bank's proposed terms the single point of contact can be more than one person." Alon Cohen, *Federal Mortgage Servicing Settlement Scoops States: Federal Deal Over Fraud Allegations Could Leave States with Fewer Options*, Ctr. for Am. Progress, Apr. 14, 2011, http://www.americanprogress.org/issues/2011/04/mortgage_servicing.html.

258. For discussion of the use of mediation during that period, see LEONARD L. RISKIN, THE FARMER-LENDER MEDIATION PROGRAM: IMPLEMENTATION BY THE FARMERS HOME ADMINISTRATION (Administrative Conference of the United States 1991). Recommendations from the report were adopted by the Administrative Conference. Administrative Conference of the United States Recommendation 91-7, C.F.R. 305.91-7 (1991). *See also* Leonard L. Riskin, *Two Concepts of Mediation in the FmHA's Farmer-Lender Mediation Program*, 45 ADMIN. L. REV. 21 (1993).

259. For a discussion of the growth of court-ordered mediation and corresponding questions of fairness and transparency this growth raises, see Tracy Walters McCormack, Susan Schultz & James McCormack, *Probing the Legitimacy of Mandatory Mediation: New Roles for Judges, Mediators, and Lawyers*, 1 ST. MARY'S J. LEGAL MALPRACTICE & ETHICS 150 (2011).

260. Contract mediation refers to the increasingly common practice of including a clause in standard-form contracts that provides for arbitration and/or mediation of disputes in lieu of litigation. The author and his wife signed such a contract when purchasing new windows for their home in June 2011.

261. McCormack et al., *supra* note 259.

262. Riskin, *Two Concepts of Mediation*, *supra* note 258, at 44–56.

resolution of the difficulties between the borrower and the lenders."[263] For the "narrow" approach, the "principal—and sometimes the exclusive—issue is whether the creditors will adjust their debts. . . ."[264]

Foreclosure mediation, which has its roots in mediation between farmers and lenders, is less concerned with being an alternative to litigation and more concerned with giving borrowers "face-to-face" access to a decision maker. Once access has been gained, the results have been quite impressive—on average, approximately 70 percent of the mediated cases have resulted in settlements satisfactory to the parties.[265] In addition, mediation has been shown to cut the length of the foreclosure process by more than half—from an average of 200 days for nonjudicial foreclosures and 270 days for judicial foreclosures to approximately 100 days for mediation.[266]

4. Easing the Departure of Defaulting Families

Although a substantial number of families may be able to keep their homes through sophisticated and objective analysis of the alternatives to foreclosure, a large number will not. Some have fallen too far behind on payments to have any hope of catching up, others took on unrealistic amounts of debt when purchasing or refinancing their homes, and still others should not have attempted homeownership in the first place. Mediation can help such families confront their situations and prepare for the inevitable move to new housing—rental or more affordable ownership.

A creative idea suggested by Professor Peterson in his written testimony before the House Judiciary Committee would allocate the first $15,000 from the proceeds of a foreclosure sale to the owner-occupied borrowers who are losing their home through the foreclosure proceedings.[267] Patterned after "the informal 'cash-for-keys' policies the smartest lenders have used for generations," the program would be structured as a "temporary emergency homestead exemption," not unlike the traditional homestead exemption some states still recognize as protection from unsecured creditors.[268] Professor Peterson calls his idea "a first priority 'seed lien'" that could be established by Congress as a temporary measure.

> These emergency laws would dramatically improve the housing market in several ways. First, cash from the proceeds of a foreclosure could convince many defaulting borrowers to turn over their homes without a fight. Many economists believe that the economy cannot turn around until the glut of foreclosures work their way through the system. Leaving fifteen thousand dollars for the family at the finish line would put fuel injectors on this process. Since so many mortgage companies cannot seem to find the records to

263. *Id*. at 45. Professor Riskin believes the "broad" approach is "generally appropriate." *Id*. at 54.

264. *Id*. at 50.

265. Cohen, *Talking It Up, supra* note 249, at 6.

266. *Id*.

267. Peterson Testimony, *supra* note 205, at 16.

268. *Id*.

foreclose, the value of cooperation from borrowers in cutting through the red tape should not be underestimated.[269]

While other worthwhile means of encouraging resolution of the foreclosure crisis, such as use of Community Development Block Grant (CDBG) funds to support foreclosure counseling and mediation, require the use of limited public funds, Professor Peterson's "seed lien" does not. It rearranges the priorities for the proceeds from a foreclosure sale in a way that allows the departing family to re-establish itself within the community with a modicum of dignity.

B. MERS, Public Land Records, and State Recording Acts

Controversies surrounding MERS have led to questions about the appropriate role of MERS in the housing finance system, particularly with respect to the foreclosure process and the public land records system. Professor Peterson, in his written testimony to the House Judiciary Committee discussed *supra*,[270] argues that MERS was created by mortgage bankers because "they did not want to pay [county] recording fees for assigning mortgages anymore."[271] The desire to create mortgage-backed securities was said to be the motivating factor because "[s]ecuritization . . . usually required several successive mortgage assignments to different companies."[272] Assignments would not have to be recorded if the same company, i.e., MERS, "always 'own[ed]' all the mortgages."[273] That aspect of the MERS system fell apart as the foreclosure crisis unfolded. A number of courts have refused to accept MERS-initiated foreclosures,[274] and investors in mortgage-backed securities have threatened to require lenders to repurchase such securities because of uncertainties about the ability of MERs to sustain foreclosures.[275] MERS subsequently announced that foreclosure proceedings no longer may be initiated in its name.[276]

269. *Id*.

270. *Id*.

271. *Id*. at 2, citing Phyllis K. Slesinger & Daniel NcLaughlin, *Mortgage Electronic Registration System*, 31 Idaho L. Rev. 805, 810–12 (1995) ("describing an Ernst & Young study commissioned by mortgage bankers to study how much money they could avoid paying to county governments through the MERS system").

272. *Id*.

273. *Id*.

274. *Supra* Part II.B.2.b.

275. Cohen, "Walk the Talk," *supra* note 249, at 2; Carrie Bay, *Mortgage Fraud SARs Jump 31% as Investors Demand Loan Buybacks*, DSNews.com (June 28, 2011) (reporting that the Federal Crimes Enforcement Network (FinCEN) "attributes the increases [in suspicious activity reports (SARs)] to more demands from investors for lenders to repurchase poorly performing mortgages, which have prompted additional loan reviews").

276. Carrie Bay, *MERS Bows Out of Foreclosure and Bankruptcy Proceedings*, DSNews (July 27, 2011), *retrieved from* http://www.dsnews.com/articles/print-view/mers-bows-out-of-foreclosure-proceedings (July 28, 2011) (discussing MERS Policy Bulletin No. 2011-5 (July 21, 2011).

In his congressional testimony, Professor Peterson offered a number of recommendations in response to transparency issues raised by MERS. In an effort to persuade lenders and servicers to restore transparency to secondary market transactions, he proposed that Congress prohibit the GSEs (Fannie Mae, Freddie Mac, and Ginnie Mae) from purchasing "MERS-recorded loans."[277] A similar proposal is contained in the pending Transparency and Security in Mortgage Registration Act of 2011.[278] Professor Peterson opposes legislation to shield MERS from state commercial and property laws by federal preemption of those laws[279] and supports legislation to provide "block grants to county governments to upgrade their recording technology in return for adopting uniform standards" for recording and searching public land records.[280]

Professor Tanya Marsh of Wake Forest Law School argues that "the residential foreclosure crisis, and the role of MERS [in that crisis], demonstrates that the American land title system is broken."[281] Her ideal system would be "a single, national system, but given the political difficulties of "dismantle[ing] the local system," she recommends that the federal government establish "an alternative recording system"[282] that includes the following features:

> An ideal system should be organized around some clear principles. It should be transparent. It should be easy to search, through dynamic, robust indexing, and easy to access, preferably through the Internet. Documents in PDF form should be downloadable. Electronic filing, which has been proposed by several scholars and implemented in limited ways, should be facilitated. There should be uniformity and consistency in the rules governing the form and substance of documents eligible for recording. The system should be public. Establishing and protecting a clear registry of property interests is and should continue to be an essential function of government.[283]

Arguing that the "original rationale for a local system has disappeared," but acknowledging the political difficulty of "dismantle[ing] the local

277. Peterson Testimony, supra note 205, at 15.

278. H.R. 2425, introduced by Rep. Kaptur (D-Ohio), July 6, 2011. The bill was referred to the House Committee on Financial Services, but no further action had been taken as of April 2, 2012. Thomas (Library Congress website), Bill Summary & Status, 112th Cong., 1st Sess. (2011–12), *retrieved from* http://thomas.loc.gov/cgi-bin/bdquery/z?d112:h.r.2425 (Apr. 2, 2012).

279. Peterson Testimony, *supra* note 205, at 16.

280. *Id*.

281. Tanya Marsh, *Foreclosures and the Failure of the American Land Title Recording System*, 111 COLUM. L. REV. SIDEBAR 19, 25 (2011), http://www.columbialawreview.org/articles/foreclosures-and-the-failure-of-the-american-land-title-recording-system.

282. *Id*. at 24.

283. *Id*.

system," Professor Marsh proposes that the federal government create an "alternative recording system" to which land records could "migrate" under the authority of a uniform state law. Existing records would remain in the local offices for historical research purposes, while "an abstract of title, along with certified copies of all documents named therein, would be added to the federal system." All subsequent conveyances would be recorded in the federal system.[284]

C. Rental Housing Alternatives

One of the clear lessons of the foreclosure crisis is that not all households have the emotional and financial resources to discharge the responsibilities associated with homeownership. While homeownership is touted as the American dream, it is not for everyone during all phases of their adult lives. Families that recognize this fact and choose to rent,[285] temporarily or permanently, should be applauded for acting responsibly rather than stigmatized for failing to contribute to their community. Researchers have noted that communities which accept the diversity that comes with offering a wide choice of housing types, including rental units, tend to be more resilient than those which emphasize only one form of housing, such as single-family detached houses.[286]

Local governments, particularly in the suburbs, historically have favored detached single-family housing on relatively large lots through their land use regulations. The late Justice Sutherland's aside that apartments often were "mere parasites" in his 1926 opinion upholding the constitutionality of comprehensive zoning[287] had the unfortunate effect of contributing to the notion that people who live in apartments do not contribute to their communities but rather take from them. But data increasingly showing that the foreclosure crisis extended beyond weak urban markets to "distant 'drive-'til-you-qualify' suburbs in strong market metros"[288] suggests that more attention needs to be paid to relaxing

284. *Id*. at 25. A "compromise . . . [that] would be a clear second-best solution" would be a state-run system "much like the registration system used for Article 9 filings under the Uniform Commercial Code," something that Iowa has established. *Id.*, citing Iowa Land Records, at https://iowalandrecords.org.

285. Anecdotal evidence suggests that families are paying more attention to the longer-term implications of purchasing a home. Jim Gallagher, *Shelter from Recession: Rental Market Does OK*, St. Louis Post-Dispatch, Dec. 21, 2010, at A1 (reporting that a young couple chose to rent a house rather than buy it because they were unsure about the future of the housing market and their economic prospects).

286. Todd Swanstrom, *Resilience in the Face of Foreclosure: How National Actors Shape Local Responses, in* Urban and Regional Policyand Its Effects (Margaret Weir et al. eds.) (Brookings Inst. 2012).

287. Vill. of Euclid v. Ambler Realty Co., 272 U.S. 365, 394 (1926) ("that in [detached house] sections very often the apartment is a mere parasite").

288. Swanstrom, *supra* note 286.

the suburban bias against multi-family housing that has endured since the 1920s.

The foreclosure crisis did not create the need for greater acceptance of rental housing; it merely added to an existing need created by changing demographics and housing choices. Arthur Nelson, professor of city and regional planning at the University of Utah, reported in February 2007, more than a year before the housing collapse, that the United States had an excessive number of large houses on large lots, and that the greatest need in the next quarter-century will be for rental and small-lot single-family housing types.[289]

Four years later he updated his analysis with a Power Point presentation he dubbed, "The Decade of Calamity: Demographic and Economic Drivers to 2020."[290] Anticipating an expected growth in the U.S. population of 33 million persons by 2020, he repeated his prediction that rental housing will be in the greatest demand in the next decade. The two largest cohorts seeking housing in this decade will be new households without children and senior citizens, both of which "lean toward multifamily and away from large-lot sprawl."[291] He also predicted that "many McMansions on the suburban fringe would be retrofitted as multifamily housing (2–3 units) and offered as rentals, co-ops or condominiums."[292] In Nelson's opinion, the country has "overbuilt by 5.3 million housing units."[293] Anticipated tighter rules for mortgage financing[294] will make homeownership more difficult

289. New Urban Network, Market for Smart Growth Stronger, NEW URB. NEWS, Mar. 1, 2007, http://newurbannetwork.com/article/market-smart-growth-stronger (reporting on presentation by Arthur C. Nelson at New Partners for Smart Growth conference, February 8-10, 2007).

290. Robert Steuteville, *The Coming Housing Calamity*, NEW URB. NETWORK, Apr. 28, 2011, http://newurbannetwork.com/news-opinion/blogs/robert-steuteville/14620/coming-housin . . . (discussing Arthur Nelson's presentation at the Journalists Forum on Land and the Built Environment, jointly sponsored by the Lincoln Institute of Land Policy, the Harvard Graduate School of Design, and the Nieman Foundation for Journalism at Harvard University, Cambridge, Massachusetts, Apr. 15–16, 2011).

291. *Id*.

292. *Id*.

293. *Id*.

294. Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act requires federal banking, housing, and securities agencies to "jointly prescribe regulations" requiring securitizers to "retain an economic interest in a portion of the credit risk [defined as not less than 5 percent of the credit risk]" of a residential mortgage asset transferred to a third party. § 941(b), adding new § 15G to the Securities Exchange Act of 1934 (15 U.S.C. §§ 78a et seq.), 124 Stat. 1890–1891 (July 21, 2010). Proposed rules were issued April 29, 2011. Credit Risk Retention Proposed Rules, 76 Fed. Reg. 24090 (Apr. 29, 2011).

for lower-income households. All of which adds up to a much stronger demand for rental housing, perhaps exceeding 41 percent of the total housing market by 2020, Nelson believes.[295]

American families that have suffered foreclosure apparently have come to the same conclusion as they reportedly have sought rental property five times as often as other forms of housing.[296] And the Obama administration was reported to be looking into the possibility of making foreclosed single-family houses available for rent as a way to help ease the glut of houses on the market.[297]

The framework for a collaborative approach to creating more diverse housing opportunities is in place with creation of the National Housing Trust Fund (NHTF) in 2008.[298] Though funding has been delayed because of the collapse of Fannie Mae and Freddie Mac and the increasing concern of Congress about the size of the federal deficit, new regulations proposed by HUD link the NHTF to the HOME block grant program, described by HUD as "the largest federal block grant program that produces affordable housing for [very low-income] households."[299] Funds would flow to states and cities through a "formula allocation" system that has been in place since 1992. While homeownership programs may be supported with trust fund monies, the statute and proposed regulations require at least 90 percent of annual grants to be used for rental housing production, particularly for persons in the lowest income quartile.[300]

Use of formula grants in the Neighborhood Stabilization Program, the federal government's initial response to the foreclosure crisis, has been criticized as "[s]preading the funds around" and thus "[shrinking] the

295. Robert Steuteville, *Housing: An Irresistible Force Meets an Immovable Object*, New Urb. Network, Apr. 29, 2011, http://newurbannetwork.com/news-opinion/blogs/robert-steuteville/14629/housing-irresis . . . (reporting Nelson's analysis of the potential demand for rental housing and transit-oriented development).

296. Zelman & Assocs., *Finding Foreclosure Victims: Majority in Single-Family Rentals, Fueling Investor Interest* (Sept. 27, 2011), https://www.zelmanassociates.com/IR_Apart_09262011.pdf.

297. Nick Timiraos, *Government Considers Ways to Rent Foreclosed Homes*, Wall St. J., July 22, 2011. In 2012, private equity firms and other investors began buying large quantities of homes vacated as a result of foreclosure in order to rent them in the hopes of making large profits. Motoko Rich, *Buying Homes by the Thousands: Investors Aim to Stockpile Fixer-Uppers to Fill with Tenants*, N.Y. Times, Apr. 3, 2012, at B1.

298. Housing and Economic Recovery Act of 2008 (HERA), Pub.L. No. 110-289, § 1131, adding new § 1338 to the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, 12 U.S.C. § 4501 & ff. (2006).

299. Dept. of Housing and Urban Development, Housing Trust Fund, Proposed Rule, 24 C.F.R., Part 92, Subpart N, 75 Fed. Reg. 66979, Oct. 29, 2010.

300. HERA § 1338(c)(7)(B), 1338(c)(10)(A); Proposed Rule, *supra* note 299, at 66993, § 92.730(a)(1).

opportunity space for neighborhood stabilization by impeding the ability of local actors to tailor the program to local conditions."[301] But while that "so-called peanut-butter approach"[302] risks a similar watering-down effect for the NHTF, it provides a mechanism, as well as potential political cover, for local officials to encourage greater acceptance of rental housing in communities that have resisted such housing.

Conclusion

The outline of a national foreclosure response strategy is emerging. The NFMC counseling program has reached hundreds of thousands of stressed borrowers and is growing in scope. Mandatory loss mitigation and automatic foreclosure mediation procedures have been successful in helping families remain in their homes when that is a realistic goal and have helped other families find alternatives that permit them to get on with their lives. The National Mortgage Settlement recognizes the validity of loss mitigation techniques. Professor Peterson's "first priority 'seed lien,'" which reverses the normal priority of claims to foreclosure sale proceeds, can cushion the re-entry process for families losing their homes. Greater acceptance of, and support for, rental housing in all residential neighborhoods can strengthen neighborhood resilience while offering decent housing opportunities to people who have lost their homes through foreclosure, or who find homeownership an unrealistic prospect at a particular stage of their lives. Fully funding the NHTF will provide an important financial resource for affordable rental housing development.

As the country picks up the pieces of the foreclosure debacle, important questions of federal policy remain to be answered. What is the future of Fannie Mae and Freddie Mac? Does the state-administered foreclosure system need to be revised? Should that system be nationalized? Does MERS serve a useful purpose, or should it be scrapped in favor of a revitalized public land records system?[303] If MERS is to play a meaningful role going forward, it must recognize and embrace the public trust aspect of its business. Answers to these questions, while currently being debated, must wait

301. Swanstrom, *supra* note 286.

302. *Id*.

303. Two commentators recently made the argument that "[l]and records should be available as a repository of copies not only of mortgages, but of their underlying promissory notes with legal incentives to the recording of both so as to eliminate the problem of lost paper," coupled with "a statewide system of uniform multiple electronic indexing input from transactional attorneys' desks." Adam Leitman Bailey & DovTreiman, *Moving Beyond the Mistakes of MERS to Have A Secure and Profitable National Title System*, 29:4 ACREL News at 5, 13–14 (Dec. 2011) (published by the American College of Real Estate Lawyers), *retrieved from* www.acrel.org/Documents/Newsletters/Dec2011.pdf (Apr. 5, 2012).

the resolution of the current crisis. The housing market must get back on its feet first in order for housing to resume its role as part of the American dream. The National Mortgage Settlement is a good first step. But it is only a first step. Implementation will be crucial. Institutionalization of the loss mitigation provisions in an effective manner can help restore buyer and lender confidence in the housing market.

Perhaps the wisest course would be to re-emphasize the definition of housing as a source of shelter, family security, and community identification, as promulgated by the Douglas Commission in 1969. Rental housing can serve those purposes along with homeownership. Reckless speculation in housing market appreciation should not be a part of that vision.