THE GRAND BARGAIN: PRO-BORROWER RESPONSES TO THE HOUSING CRISIS AND IMPLICATIONS FOR FUTURE LENDING AND HOMEOWNERSHIP

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I. INTRODUCTION

Foreclosures, beginning in the late 2000s and continuing into the present day, have reached levels unmatched since the Great Depression.[1] As a result, legislatures and courts nationwide have implemented procedures seeking to limit the damage of this foreclosure crisis. Using empirical evidence from previous studies, this Article undertakes a critical examination of the potential costs and benefits of legislative and judicial changes to states' foreclosure processes in response to the escalating number of foreclosures.

Section II begins by examining the effects of foreclosures on both individual homeowners and on society as a whole. Section III examines the various responses to the crisis, including moratoria, lengthened notice periods, mediation regimes, and changes in the burden of proof required to foreclose. Section IV then examines the likely effects of such changes, both on the single-family and societal levels, and Section V summarizes the author's conclusions.

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1. *See, e.g.*, Judson Berger, *Study: Housing Collapse Steeper Than During Great Depression*, FOXNEWS.COM , June 15, 2011, http://www.foxnews.com/politics/2011/06/15/housing-collapse-steeper-than-during-great-depression-analyst-says/. *See also* Mark Gongloff, *Housing Shocker: Home Prices Still Falling*, MARKETBEAT, WALL ST. J. BLOG (May 31, 2011, 9:03 AM), http://blogs.wsj.com/marketbeat/2011/05/31/housing-shocker-home-prices-still-falling/ (noting that housing prices have fallen more than during the Great Depression).

Three main points are elucidated in this Article: (1) society as a whole pays for efforts to enact consumer-friendly changes to foreclosure processes; (2) since society as a whole also benefits from foreclosure prevention, policymakers and consumer advocates attempting to spur pro-delinquent homeowner policies must do a better job explaining the evidence showing that such prevention benefits all members of society; and (3) when it comes to enacting more consumer-friendly foreclosure processes in the current crisis, due to the lasting and society-wide effects of such changes, it behooves legislators to tread lightly.

II. EFFECTS OF FORECLOSURES

A. SINGLE FAMILY EFFECTS

The effect of a foreclosure on a family or individual may be enormous. Foreclosure primarily entails the loss of one's living space. Apart from incarceration, the forcible removal of a person from their home may be the harshest remedy meted out by courts in this country. Given that it is a traditional adage that homeownership is a hallmark of the "American Dream,"[2] the loss of homeowner status cannot be overstated. One can imagine that this loss may have debilitating effects, given that many, if not most, homeowners have immense sentimental attachment to their homes.[3] The shame of losing one's home is also immense.[4]

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2. *See, e.g.*, *Understanding America's Homeownership Gaps*, FANNIE MAE (2003), *available at* http://www.fanniemae.com/global/pdf/media/survey/survey2003.pdf (last visited Mar. 3, 2011) [hereinafter FANNIE MAE] (explaining succinctly that "Our Business is the American Dream of Homeownership").

3. The author must credit Professor Christopher Peterson for driving this point home when co-speaking on a panel with the author at a recent conference on Residential Mortgage Lending, wherein Professor Peterson began his comments with highlights of several recent news stories about homeowners committing suicide rather than surrendering their property. Christopher Peterson, Assoc. Dean for Academic Affairs, S.J. Quinney College of Law, Address to Conference Institute's Sixth National Forum on Residential Mortgage Litigation and Regulatory Enforcement Panel: The Borrower's Perspective: Insights from the Plaintiffs' Bar and Consumer Advocates (Apr. 8, 2011).

4. Gail Cunningham, *Commentary: Avoiding the Fear and Shame of Foreclosure*, CNN.COM, Nov. 25, 2008, http://articles.cnn.com/2008-11-25/politics/cunningham.foreclosure_1_foreclosure-problem-loan-modification-housing-issues?_s=PM:POLITICS (Cunningham, a longtime credit counselor, noting that "the shame that accompanies foreclosure tops anything I've ever experienced").

Simultaneous to the eviction, the homeowner may endure credit damage above and beyond that of simply being in default for a prolonged period. The stamp of foreclosure on one's credit history is not a minor issue, as it can have implications for future job prospects, purchases, and even security clearances.[5] In some instances, in a manner similar to a bankruptcy, a foreclosure may even result in job loss for those working in the financial industry or in jobs requiring security clearance.

The resulting eviction and tarnishing of one's credit may result in effects beneath the surface as well. Families facing foreclosure are more likely to skimp medical expenses.[6] Not surprisingly, people who have experienced foreclosures are more likely to say that their physical and emotional health has declined.[7] Accordingly, default and foreclosures are likely to contribute to significant stress and strain on familial relations. This is especially so given that many families do not understand the foreclosure process, leading to even more uncertainty and stress before an actual sale.[8] Aside from these rather obvious effects on individual homeowners, society also pays a heavy price for foreclosures.

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5. *See, e.g.*, Resources for Law Enforcement, *Security Clearance Process for State and Local Law Enforcement*, FBI, http://www.fbi.gov/stats-services/law-enforcement/clearance (last visited Mar. 3, 2012) (explaining that "[c]redit and criminal history checks will be conducted on all applicants").

6. Dawn Phillips et al., *Rebuilding Neighborhoods, Restoring Health: A report on the impact of foreclosures on public health*, CAUSA JUSTA :: JUST CAUSE & ALAMEDA CNTY. PUB. HEALTH DEP'T, September 2010, at 21, http://www.acphd.org/media/53643/foreclose2.pdf.

7. *Id.* at 26. *See also* Gary G. Bennett, Melissa Scharoun-Lee & Reginald Tucker-Seeley, *Will the Public's Health Fall Victim to the Home Foreclosure Epidemic?*, PLOS MEDICINE, June 16, 2009, http://www.plosmedicine.org/article/info%3Adoi%2F10.1371%2Fjournal.pmed.1000087;jsessionid=F10B31457FB407C0686500B76F069F9C.ambra02 (citing M.P. Taylor, D.J. Pevalin & J. Todd, *The Psychological Costs of Unsustainable Housing Commitments*, PSYCH. MED. 37, 1027–36 (2007), *available at* http://www.ncbi.nlm.nih.gov/sites/entrez?db=pubmed&cmd=Search&doptcmdl=Citation&defaultField=Title%20Word&term=Taylor%5Bauthor%5D%20AND%20The%20psychological%20costs%20of%20unsustainable%20housing%20commitments ("Taylor recently showed that UK residents with housing payment problems had poorer levels of psychological well-being, independent of financial hardship. These psychological costs were positively related to financial problems of greater intensity and duration.").

8. Andrea Kupfer Schneider & Natalie C. Fleury, *Conflict Resolution and the Economic Crisis*, *There's No Place Like Home: Applying Dispute Systems Design Theory to Create a Foreclosure Mediation System*, 11 NEV. L.J. 368, 381 (2011).

B. SOCIETAL EFFECTS

Apart from the harsh toll foreclosure can take on families and individuals enduring the process, foreclosure and eviction also impact society as a whole. Foreclosures result in increased crime,[9] decreased property values,[10] increased numbers of people willing to walk away from their homes,[11] and increased strain on judicial resources.[12] Some assert that the delay in processing foreclosures caused by the unprecedented number of cases also contributes to the economic crisis.[13] The quicker foreclosures can be processed, this argument reasons, the quicker property prices can bottom out and investment in our housing stock can increase again.[14]

To adequately gauge whether changes in states-foreclosure-law frameworks—which apply equally to every homeowner and affect prospective homeowners—are, in fact, merited or necessary, this Article next discusses whether the societal effects of foreclosures are demonstrable, significant, and net negative. The Article proceeds to examine some of the existing literature regarding societal effects of an increased number of foreclosures.

9. *See, e.g.*, Lin Cui, Foreclosure, Vacancy and Crime (Nov. 1, 2010) (unpublished manuscript), *available at* http://ssrn.com/abstract=1773706 ("[V]iolent crime increases more than 15% once the foreclosed home becomes vacant.").

10. *See, e.g.*, Atif Mian et al., Foreclosures, House Prices, and the Real Economy 4 (May 15, 2011) (unpublished manuscript), *available at* http://ssrn.com/abstract=1722195.

11. *See*, *e.g.*, Ryan M. Goodstein et al., *Are Foreclosures Contagious?* 5 (George Mason University Department of Economics, Working Paper No. 11-12, 2011), *available at* http://ssrn.com/abstract=1764271.

12. *See, e.g.*, Greg Allen, *Florida Court System Faces Funding Crisis*, NPR.ORG, Apr. 5, 2011, http://www.npr.org/2011/04/05/135135532/florida-court-system-faces-funding-crisis ("[Florida's] Supreme Court chief justice has said he needs $72 million to avoid furloughs and serious delays in litigation.").

13. *See, e.g.*, Dawn Kopecki, *Obama Loan Program May Extend Foreclosure Crisis, Watchdog Says*, BLOOMBERG NEWS, Mar. 24, 2010, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aSatt89an.1c (noting the risk of "'merely spreading out the foreclosure crisis'" over the course of several years).

14. Les Christie, *Shadow Inventory Threatens Housing Recovery*, CNNMONEY (Jan. 20, 2011, 7:34 AM), http://money.cnn.com/2011/01/20/real_estate/shadow_inventory_rise/index.htm (explaining that longer foreclosure processing times constitutes a large contribution to the "shadow inventory" of housing that can be a drag on the overall economy).

1. CRIME

One of the topics scholars have frequently examined is the effect increased foreclosures may have on crime. On an intuitive level, anyone familiar with the "broken-window" theory could postulate that an increase in foreclosures would cause an increase in crime due, quite simply, to an increase in the number of vacant properties and, correspondingly, in the amount of public disorder.[15] One could also make a reasonable guess that the increase in foreclosures, and the resulting decrease in homeownership, could cause a breakdown of stable and safe neighborhoods marked by self-interested and vigilant anti-crime surveillance and investment.[16] These initial postulations could be tempered by the assumption that many of the newly vacant homes might have already been vacant or otherwise unoccupied due to the rampant speculation going on at the height of the housing bubble. Regardless, in a crisis where it is possible for a 32-story condominium building to be inhabited by only one resident,[17] it is easily imaginable that blocks and blocks of neighborhoods are being affected by the black eye of vacant homes and the resultant increase in crime such vacancies can bring.

Goodstein and Lee examined many of these issues.[18] Although Goodstein and Lee used data collected prior to the current foreclosure crisis, we can apply some of the empirical findings they made to the current crisis.[19] They found statistically significant and positive correlations between increased foreclosures and increased crime.[20] In particular, they determined that a 1% increase in foreclosures correlated to a 10%

15. *See* George L. Kelling & James Q. Wilson, *Broken Windows: The Police and Neighborhood Safety*, ATLANTIC MONTHLY, March 1982, http://www.theatlantic.com/magazine/archive/1982/03/broken-windows/4465/.

16. *See, e.g.*, Ryan M. Goodstein & Yan Y. Lee, *Do Foreclosures Increase Crime?* 2 (FDIC Ctr. for Fin. Research, Working Paper No. 2010-05, 2010), *available at* http://ssrn.com/abstract=1670842 (noting the need for "eyes on the street").

17. FOXNEWS.COM, *Sole Resident of 32-Story Florida Condo Building Wants Out*, Mar. 8, 2010, http://www.foxnews.com/us/2010/03/08/sole-resident-story-florida-condo-building-wants/.

18. Goodstein & Lee, *supra* note 16.

19. *Id.* ("We investigate the effect of foreclosures on crime using a national county-level panel dataset covering the period 2002 to 2007.").

20. Goodstein & Lee, *supra* note 16, at 4-5.

increase in burglary rates.[21] Furthermore, larcenies and assaults also appear to increase alongside increased foreclosures.[22]

Goodstein and Lee made some observations that are particularly relevant to this Article's analysis of changes in state-foreclosure-law frameworks. First, they note that the increase in crime correlated with increased foreclosures, which appears to be more significant in high-density areas.[23] From this observation, one may extrapolate that the increases in foreclosures may result in particularly harsh crime increases in areas that are already prone to poverty and crime, such as dense, inner-city neighborhoods. Second, they note that their estimates about increases in crime may be understated, given that crimes are underreported in areas with high foreclosure rates.[24]

Finally, in an attempt to quantify how much increased crime may cost, Goodstein and Lee report, in an "extremely rough estimate," that 100 additional foreclosures may result in an additional 43.3 burglaries, resulting in a nationwide bill for $4.6 billion in burglary costs, and $17.4 billion in costs for all crime increases.[25] Again, they note that the costs of burglaries may be underestimated given that much damage to foreclosed properties, such as copper-wire stripping, may be unseen and thus unreported.[26] Although one may, with the authors' own blessing, view those numbers with some skepticism,[27] the numbers can at least give policymakers and commentators some measuring stick with which to compare costs of crime against the costs of altering state-foreclosure-law frameworks. All of society bears the costs for increased crime as a result of vacant foreclosed properties.

Lin Cui's study puts a finer point on Goodstein and Lee's examination of the relationship between crime and foreclosures.[28] Cui points out that we should not necessarily equate foreclosure

21. Goodstein & Lee, *supra* note 16, at 4-5.
22. *Id.* at 5.
23. Goodstein & Lee, *supra* note 16, at 5.
24. *Id.* at 27.
25. *Id.* at 22, 50.
26. *Id.* at 27.
27. *Id.* (noting their estimates were based on pre-crisis foreclosure levels and were therefore likely "lower-bound estimates").
28. Cui, *supra* note 9.

filings with crime.[29] Rather, it is vacancy itself—including vacancies that may result from foreclosures—that can lead to increased crime.[30] Similar to Goodstein and Lee, Cui finds an increased level of violent crime and property crime correlates with higher vacancy rate.[31] Additionally, Cui notes that longer vacancy periods may result in increased crime.[32] Cui therefore concludes that the most effective way legislators can control the externalities of foreclosures would be to direct their efforts toward reducing vacancies.[33]

While Cui makes a valid point about ex ante legislation directed at vacancy being a worthwhile endeavor, he fails to reconcile that legislative attempts to increase modifications may, in fact, keep families in homes permanently, thereby preventing vacancy. For those loans that will not be modified, or for which modifications will not ultimately work out, keeping families in their homes for longer than would have been the case without modification programs can also temporarily prevent vacancy. Since many foreclosed properties linger on the market for interminable periods, even keeping homes occupied for a brief additional period may be a worthwhile crime-inhibiting act. Regardless of his policy proscriptions, Cui's work strongly suggests that crime increases as a result of foreclosures.

Any discussion of foreclosures and crime would be incomplete without noting the work of Immergluck and Smith.[34] Their work is vital to discuss on two points. First, they provide more empirical evidence that violent crime increases as foreclosures increase.[35] They estimate that a 1% rise in foreclosures can result in a 2.33% rise in violent crimes.[36] Secondly, Immergluck and Smith's work is distinct because, unlike Goodstein and Lee, and Cui, they do not find that a

29. Cui, *supra* note 15.

30. *Id.*

31. *Id.*

32. Cui, *supra* note 9, at 20-21.

33. *Id.* at 22.

34. Dan Immergluck & Geoff Smith, *The Impact of Single-family Mortgage Foreclosures on Neighborhood Crime*, HOUSING STUDIES (Nov. 2006), *available at* http://www.prism.gatech.edu/~di17/HousingStudies.pdf.

35. *Id.* at 863.

36. Immergluck & Smith, *supra* note 34, at 863.

statistically significant rise in property crime correlates with increased foreclosures.[37] However, lest policymakers and scholars point to this finding to downplay crime as a primary community-wide externality of foreclosures, the authors posit that the lack of statistical significance does not mean that there is no causal connection.[38] Rather, they suggest, as Goodstein and Lee did, that much property crime, particularly against the foreclosed property itself, is underreported.[39]

Finally, as an interesting aside to their empirical findings, Immergluck and Smith recommend that legislators concerned with crime resulting from foreclosures target and decrease the numbers of subprime loans being issued, as it is those loans that are foreclosed more often than prime loans.[40] While it is unlikely that Congress was specifically thinking of the crime externality of increased foreclosures when they enacted the Dodd-Frank Act, some have suggested that the more stringent requirements for lenders contained in the Act, such as requiring lenders to ascertain the borrowers' ability to pay, will result in less subprime lending.[41]

Many are concerned about the lingering "shadow inventory" of foreclosed homes.[42] Given the findings of the above-mentioned scholars, the crime increases as a result of such long-vacant properties and will likely continue for the foreseeable future. Therefore, despite foreclosure actions being specifically directed toward individual borrowers and their families, there is little doubt that crime spurred by vacant, foreclosed homes is a problem endured by all of society.

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37. Immergluck & Smith, *supra* note 34, at 863.

38. *Id.*

39. Immergluck & Smith, *supra* note 34, at 863.

40. *Id.* at 863-64.

41. John Pottow, *Ability to Pay* 37 (U. Mich. Law Empirical Legal Studies Ctr., Working Paper No. 11-006, 2011), *available at* http://ssrn.com/abstract=1844570. The wide-ranging Dodd-Frank Bill of 2010, formally known as the Dodd-Frank Wall Street Reform and Consumer Protection Act, "transform[ed] the landscape of consumer credit in the United States." *Id.* at 1. For a more thorough analysis of the Dodd-Frank Act, *see, e.g.*, David Skeel, *Making Sense of the New Financial Deal*, 5 LIBERTY U. L. REV. 181, 186-90 (2011).

42. *See, e.g.*, Chris Arnold, *Foreclosed Homes Wait in 'Shadows' To Go On Sale*, NPR.ORG, June 24, 2011, http://www.npr.org/2011/06/24/137366866/foreclosed-homes-wait-in-shadows-to-go-on-sale.

2. DECREASED PROPERTY VALUES

Foreclosed properties have also inflicted economic losses on society at large due to their depressing effect on home prices in surrounding areas. It is quite intuitive that a buyer who sees a foreclosed property selling for $100,000 will not buy property in the same neighborhood for $200,000, even if that was what the property was valued at just a few years earlier. One could posit, however, that a simple supply and demand analysis can explain the marked decreases in home values over the past few years. Overbuilding and a reduction in demand could have led to the same home value decreases. To distinguish the marginal effects foreclosures have above and beyond the contracting real estate market as a whole, scholars have examined whether foreclosures and the often rock-bottom prices foreclosed properties retain can themselves spur surrounding home values to further decrease.

In hypothesizing about how foreclosures may account for decreases in surrounding home values, the academic literature commonly suggests a few different possibilities. First, foreclosure auctions and bank-owned property sales are distressed sales, meaning their sellers will not wait until an optimum price is reached. Buyers, in turn, realize that the foreclosing entity (or distressed homeowner at the pre-foreclosure auction stage) will likely accept reduced prices, which reduces the price of offers.[43] Secondly, depressed foreclosure sales prices may result in decreased surrounding prices due to the comparable nature of real estate appraisals. That is, one depressed sale price will necessarily be compared to other potential listings in the immediate area.

Next, even without seeking a realtor's appraisal, homeowners in a neighborhood with foreclosures may subjectively interpret their home value as decreased due to the proximity to foreclosed homes with depressed prices.[44] Furthermore, foreclosures may depress surrounding prices due to reduced upkeep on the part of the distressed homeowner in the time

43. The flooding of the market can also result in an "imbalance of demand and supply in an illiquid neighborhood housing market." *See* John Y. Campbell et al., Forced Sales and House Prices 1 (July 2010) (unpublished manuscript), *available at* http://kuznets.fas.harvard.edu/~campbell/papers/forcedsales072410.pdf.

44. John P. Harding et al., *The Contagion Effect of Foreclosed Properties*, 66 J. URB. ECON. 164, 164 (2008), *available at* http://ssrn.com/abstract=1160354.

period leading up to a foreclosure or short sale.[45] Finally, foreclosures may drive up neighborhood crime to the extent that homes are vacant for a period of time.[46]

In the economic literature testing these hypotheses, scholars have found statistically significant evidence of foreclosures depressing surrounding property values. With that said, the range of estimates varies greatly. On one end of the calculations, for example, Mian found a "strong" effect on home prices due to foreclosures.[47] By their estimations, using Zillow.com house price measures, "one standard deviation increase in foreclosures per homeowner in 2008 and 2009 [led] to a 5%–7% relative drop in house price growth."[48] Thus, they conclude, foreclosures can lead to starker declines in property values than would have ordinarily occurred during economic downtimes.[49]

However, earlier data did not produce such high estimates. Immergluck and Smith's widely cited study, examining data from 1997–1998 in the Chicago area, found that each instance of foreclosure on a single-family home resulted in a marginal price decrease of 1.136% for homes within one-eighth of a mile.[50] Consistent with other studies, they found a decreased effect as distance from the foreclosed property increased.[51] Even with this relatively modest estimate of the marginal effect of foreclosures on surrounding home values, Immergluck and Smith still estimated that foreclosures in Chicago during 1997–1998 resulted in an astonishing aggregate equity loss of $598 million to $1.39 billion.[52] This converted to "average losses of between $159,000 and $371,000 per foreclosure."[53]

45. Harding et al., *supra* note 44.

46. *See infra* Section II(B)(1); *see also id.*

47. Mian et al., *supra* note 10, at 21.

48. *Id.* at 21.

49. *Id.* at 5-6.

50. Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 FANNIE MAE FOUNDATION, HOUSING POL'Y DEBATE 57, 69 (2006), *available at* http://findforeclosurecounseling.net/network/neighborworksProgs/foreclosuresolutions/pdf_docs/hpd_4closehsgprice.pdf.

51. *Id.*

52. Immergluck & Smith, *supra* note 50, at 73.

53. *Id.*

Another scholar, Daniel Hartley, used similar data from Cook County, Illinois. Expanding on the years studied by Immergluck and Smith, Hartley examined foreclosures from 1998–2008.[54] He found that the effect of an additional foreclosure within a 250' radius resulted in a 1.4%–1.6% reduction in the price of single-family homes.[55]

Other examinations of regional data support the depressing effect of foreclosures on surrounding home values. Campbell, for example, examining data of Massachusetts home sales from 1987–2009, found evidence of such spillover effects of price-depressed foreclosure sales.[56] Schuetz used data from New York City from 2000–2005 and found that each foreclosure filing had a depressing effect on surrounding homes of .5%–1.4 %, depending on how much time had elapsed between the foreclosure filing and the sale of the neighboring property.[57]

Using data from the entire United States, Calomiris estimated that the a large wave of foreclosures would have a relatively small effect on house prices.[58] It is important to note, however, that Calomiris seems to reason that "relatively small effects" on house pricing are declines of less than 6%.[59] Given that Immergluck and Smith's (2006) modest 1%–2% marginal-foreclosure-price decrease effect correlated to an estimate of between $500 million and $1.4 billion in value lost, though, one cannot immediately dismiss a 6% decrease as "small," as Calomiris has done. Notably, Immergluck and Smith's estimates do not even include the lost values inflicted on "condominiums,

54. Daniel Hartley, *The Effect of Foreclosures on Nearby Housing Prices: Supply or Disamenity?* 4 (Fed. Reserve Bank of Cleveland, Working Paper 10-11, 2010), *available at* http://ssrn.com/abstract=1670820.

55. Hartley, *supra* note 54, at 3.

56. John Y. Campbell et al., Forced Sales and House Prices (July 2010) (unpublished manuscript), *available at* http://kuznets.fas.harvard.edu/~campbell/papers/forcedsales072410.pdf.

57. Jenny Schuetz et al., *Neighborhood Effects of Concentrated Mortgage Foreclosures* 17 (N.Y.U. Sch. of Law, Law & Econ. Research Paper Series, Working Paper No. 08-41, 2008), *available at* http://ssrn.com/abstract=1270121.

58. Charles W. Calomiris, Stanley D. Longhofer & William Miles, *The Foreclosure-House Price Nexus: Lessons From the 2007-2008 Housing Turmoil* 17 (NBER, Working Paper 14294, 1998), *available at* http://www.econ.ucla.edu/workshops/papers/History/Foreclosure-Price%20NexusComplete.pdf.

59. *Id.* at 17.

larger multifamily rental properties, and commercial buildings."[60] Harding, in 2008, also examined national data.[61] By his calculation, the "contagion effect" on reduction in prices is "roughly -1% to -1.5%."[62]

Therefore, by all scholarly accounts, foreclosures do result in lower property values for society as a whole. One might instinctively assume that this decrease in value inflicts negative effects on society. On one hand, the case against property value decreases is strong. Most homes, many families' most sizable investment,[63] have decreased in value in recent years. This cannot be good for the overall economic health of the nation. Furthermore, continually decreasing property values may cause some buyers to wait indefinitely before they elect to purchase a home.[64] Thus, continually decreasing or stagnating housing prices, or fear thereof, can prevent demand for homes from rebounding.

Counter intuitively, however, the theory that foreclosures drive down home prices is not, in and of itself, a net negative for our society as a whole. First, perhaps society is somehow better off when houses are valued appropriately and are not overvalued. The second and closely related point is that this decrease in home values may provide us with a new set of values regarding homeownership. Whereas homeownership has been portrayed as the sign of American success,[65] in these times of stagnating or decreasing property values, surely prospective borrowers are reevaluating the idea that home equity is a sure path to prosperity. Perhaps, then, society is better off when people attempt to become wealthy through investing in businesses, startups, and other endeavors that may bear more positive societal fruit than a piece of land with a house merely sitting on it.

60. Immergluck & Smith, *supra* note 50, at 58.

61. Harding et al., *supra* note 44, at 11 (using data from 1989–2007).

62. *Id.* at 4-5.

63. *See, e.g.*, Melissa B. Jacoby, *Home Ownership Risk Beyond a Subprime Crisis: The Role of Delinquency Management*, 76 FORDHAM L. REV 2261 (2008) (noting that homeownership has traditionally been most households' primary source of wealth).

64. *See, e.g.*, Christie, *supra* note 14.

65. *See, e.g.*, FANNIE MAE, *supra* note 2.

Nonetheless, although the market correction in home prices may induce more fruitful investing strategies in the future, one would still be strained to make the argument that the collective lost wealth caused by the crash in the housing bubble is a net positive for society. Furthermore, the decrease in housing wealth aggravated by foreclosures may induce a continuing downward spiral for housing.[66] Immergluck and Smith have noted this possibility, intuiting that decreasing home values may feed into foreclosures, which then reflect back in terms of further decreases in home values, and so on.[67]

Increased foreclosures have also had the effect of overwhelming courts and lengthening court processing times,[68] which can feed back into the cycle of decreasing home values. Zhu and Pace calculated that a six-month additional delay in foreclosure processing time could result in a 6.5% decrease in the eventual price of the home.[69] Therefore, empirical assessments all support the contention that foreclosures decrease surrounding home values.

3. STRAIN ON JUDICIAL AND LOCAL RESOURCES

Foreclosures wreak havoc on society at large not only in terms of increased crime and decreased property values, but also in terms of judicial and municipal costs. The incredible numbers courts have dealt with have driven court funding in some states into crisis mode.[70] Furthermore, municipal cost increases are demonstrable as well. First, the academic literature has feared that foreclosures driving down house prices could result in lower tax bases.[71] This fear seems to be borne out by the crisis of the last few years.[72] Secondly, increased crime and code violations

66. Immergluck & Smith, *supra* note 50.

67. Immergluck & Smith, *supra* note 50, at 70.

68. *See infra* Section III.

69. Shuang Zhu & R. Kelley Pace, The Influence of Foreclosure Delays on Future Default, Loan Losses, and Contract Rates 2 (Dec. 16, 2010) (unpublished manuscript), *available at* http://srsabr2011.files.wordpress.com/2011/01/foreclosure_pace_zhu_1204.pdf.

70. *See, e.g.*, Allen, *supra* note 12 ("[Florida's] Supreme Court chief justice has said he needs $72 million to avoid furloughs and serious delays in litigation.").

71. *See, e.g.*, Schuetz et al., *supra* note 57, at 1.

72. *See, e.g.*, Nathan Halverson, *Lawmakers React to Growing Anger over Foreclosures*, SONOMA COUNTY PRESS-DEMOCRAT, Oct. 2, 2010,

from foreclosures have taxed local governments as well. One estimate in 1995 calculated that, combined with the effect of decreasing tax bases, each foreclosure costs local cities $27,000.[73] Again, these costs are borne by society as a whole and must be considered in any utilitarian analysis of proposed legislative alterations to the foreclosure process.

4. CONTAGION AND LACK OF SHAME

Increases in foreclosures can also produce an effect that is not immediately apparent from reading news reports. Academics have begun to examine whether, ceteris paribus, an increase in foreclosures in one's community can increase the likelihood that an individual borrower will default. The hypothesis in this area is as follows: a contract can be seen as a moral obligation. Yet if a borrower sees friends, relatives, and neighbors begin to stop paying their home loans, it may lessen that borrower's hesitance in refraining from paying when hardship arises. Similarly, this social influence may lead those who have hardship to default before they have exhausted all available credit and savings. Lastly, we can guess that if the influence of neighbors and friends is truly significant, then it may lead those with no hardship whatsoever to default due to the lack of economic benefit in retaining a home with negative equity (commonly referred to as "strategic default").[74] Thus, the academic literature has exposed the fact that in some instances foreclosures can begin to feed on themselves and spread like a virus. For those citizens continuing to pay their home loans who deal with decreased home prices due to foreclosures, and for all members of society dealing with increased crime and decreased home values due to foreclosures, of course, foreclosure contagion looms as a specter of a vicious cycle decimating the hardest hit communities.

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http://www.watchsonomacounty.com/2010/10/washington/lawmakers-react-to-growing-anger-over-foreclosures/ (Foreclosures "drain the coffers of local governments that rely on home values to generate property tax revenue for social services and other programs.").

73. Zhenguo Lin et al., *Spillover Effects of Foreclosures on Neighborhood Property Values*, 38 J. OF REAL EST. FIN. & ECON. (2009), *available at* http://ssrn.com/abstract=1033437 (internal citation omitted).

74. Goodstein et al., *supra* note 11, at 3 (describing strategic default as the choice to stop making monthly mortgage payments "despite being able to afford" them) (internal citation omitted).

Goodstein and Hanouna examine this phenomenon in depth and find statistically significant contagion effects.[75] Notably, they find that an increase in foreclosure rates, using a five-mile radius of an individual property, significantly increases the probability of default.[76] By their estimate, one standard-deviation increase in that area increases default probability by an astounding 24%.[77] Lest we simply equate such numbers with the fact that many areas are harder hit than others, notably, Goodstein's work on contagion provides evidence that the influence of increased area foreclosures is strongest on strategic and voluntary defaulters.[78]

To distinguish borrowers who have a choice about defaulting from those who may have been forced into default due to financial hardship, Goodstein examined borrowers with Loan to Value (LTV) ratio of 120% or more, discriminating between those with high and low credit scores, between areas with high and low per capita income, and between high and low median property values of the zip code, as compared with the Metropolitan Statistical Area.[79] By all three measurements (credit scores, area per capita income, and relative property values), Goodstein found statistically significant evidence that for those underwater homeowners with the financial wherewithal to choose whether or not to default, increased foreclosures lead to increased choices to "strategically" default.[80]

Agarwal and Ambrose asked a related question—whether concentration of subprime loans, which presumably would eventually have led to increased foreclosures during the housing crisis, can have a spillover effect.[81] While they only used data from a single Arizona county, Agarwal and Ambrose confirmed that the local foreclosure rate increasing raises the probability of a borrower defaulting.[82]

75. Goodstein et al., *supra* note 11, at 3-4.

76. *Id.*

77. *Id.* at 4.

78. Goodstein et al., *supra* note 11, at 4.

79. *Id.* at 14-20.

80. *Id.* *See also* Goodstein et al., *supra* note 11, at 14-19.

81. Sumit Agarwal et al., *Thy Neighbor's Mortgage: Does Living in a Subprime Neighborhood Impact Your Probability of Default?*, REAL EST. ECON. (forthcoming), *available at* http://ssrn.com/abstract=1593734.

82. Agarwal et al., *supra* note 81, at 18. Interestingly, however, Agarwal and Ambrose did not find that heavier concentration of subprime loans in a single area

While a number of explanations for the phenomenon of foreclosure spillover or contagion exist, what cannot be argued over is the empirical evidence about the existence of such an effect. Accordingly, policymakers must consider that one more externality of increased foreclosures is more foreclosures.

This Article seeks to take the problem a step further. Many legislators apparently agree that foreclosure takes a heavy toll on society, and it is the hidden effects of their attempts to rectify the situation that this Article seeks to examine. For behind every glowing press release about passing a bill to prevent foreclosures, second- and third-level effects are produced that may be counter intuitive, and, more importantly, counterproductive.

III. THE LEGISLATIVE AND JUDICIAL REACTION

Legislative and judicial reactions to foreclosures have been many and varied. This Article seeks only to engage the most commonly enacted and discussed procedural and substantive reforms in the foreclosure process. These reforms include moratoria, lengthening notice periods, mediation regimes, and changes to the burden of proof on the foreclosing entity.

A. MORATORIA

In response to the unprecedented numbers of foreclosures, some states initiated temporary moratoria on foreclosures.[83] These states include California, Colorado, Michigan, and Nevada.[84] Many of these moratoria were geared at halting foreclosures until modification eligibility could be determined or until mediation could be completed.[85]

In contrast to modification-oriented moratoria, some state actors, such as states' attorneys general, have called for a moratorium on foreclosures until paperwork snafus and

was correlated with increased default risk. *Id.* at 17. The authors, however, estimate that this may be because some of those highly concentrated subprime areas saw some of the highest home value growth during the boom years of 2003 and 2004. *Id.*

83. Dan Immergluck et al., *Legislative Responses to the Foreclosure Crisis in Nonjudicial States* 16 (January 27, 2011) (unpublished manuscript), *available at* http://ssrn.com/abstract=1749609.

84. *Id.*

85. Dan Immergluck et al., *supra* note 83, at 16.

fraudulent documentation issues can be resolved.[86] Some legislators were aboard the moratorium bandwagon as early as 2009, urging—for example in the case of Senator Barney Frank—that a national moratorium go into effect until aid to homeowners was released.[87] On the other hand, once news of "robo-signing" spread across the nation, several politicians straggled along to release their own personal version of an urge for a moratorium in light of how shocking they found the act of filing fraudulent paperwork in courts.[88]

Results on the ground varied, but no national moratorium on foreclosures was enacted. Rather, a mash-up of different companies enacted their own "personal" versions of moratoria, based on the clear evidence that they were filing fraudulent documents in courts around the nation.[89] JPMorgan Chase, Bank of America, Ally Financial, and PNC Financial Services, among others, all instituted some version of moratorium on their foreclosure files for a time to review any questionable documentation.[90] Many of the lenders instituting such foreclosure moratoria started with judicial foreclosure states before eventually succumbing to a pause in their foreclosures in

86. *See, e.g.*, Yuki Noguchi, *Foreclosures: A Busted System or Veiled Opportunity?*, NPR.ORG, Oct. 6, 2010, http://www.wbur.org/npr/130376768/foreclosures-a-busted-system-or-veiled-opportunity (noting that several states called for a foreclosure moratorium).

87. Ross Kerber, *Frank Now Supports Foreclosure Moratorium*, BOSTON GLOBE, Feb. 10, 2009, http://www.boston.com/business/ticker/2009/02/frank_now_suppo.html.

88. *See, e.g.*, Press Release, John Conyers, Jr., Conyers and Kilpatrick Demand Lenders Extend Housing Foreclosure Moratorium to Michigan; No More Foreclosures Until Fraudulent Paperwork is Resolved (Oct. 6, 2010), *available at* http://conyers.house.gov/index.cfm?FuseAction=News.PressReleases&ContentRecord_id=83615846-19b9-b4b1-1247-3fc1c004a073; Press Release, Elijah Cummings, Cummings Calls for Immediate Foreclosure Moratorium (Oct. 3, 2010), *available at* http://cummings.house.gov/2010/10/cummings-calls-for-immediate-foreclosure-moratorium.shtml.

89. Alistair Barr, *"Robo-Signer" Controversy Spreads*, MARKETWATCH, Sep. 29, 2010, http://www.marketwatch.com/story/robo-signer-controversy-spreads-2010-09-29.

90. Debra Cassens Weiss, *Bank of America Extends Foreclosure Moratorium to All 50 States*, ABA J. ONLINE, Oct. 8, 2010, http://www.abajournal.com/news/article/bank_of_america_extends_foreclosure_moratorium_to_all_50_states/.

non-judicial foreclosure states as well.[91] This pause, however, was only temporary.[92]

Similarly, over the holiday periods of 2009 and 2010, certain government-sponsored entities enacted a temporary pause in foreclosures and evictions.[93] Private lenders have, in some instances, imitated these holiday-season foreclosure freezes.[94]

Beyond the moratoria put into place by lenders themselves, some judges became so fed up with certain banks' processes that they enjoined those particular banks from filing foreclosures until certain conditions were met.[95] Those decisions were, however, few and far between.

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91. *Id.* This initial hesitance raises questions beyond the scope of this Article about the motives for the banks in instituting their moratoria. Judicial states had led the way in finding the fraudulent documentation, and non-judicial foreclosure states see very little judicial oversight comparatively. Given this initial attempt to avoid instituting a fifty-state moratorium, the banks' attitudes toward rehabilitating their foreclosure-litigation processes come more clearly into focus. It would be unwise, therefore, to assume that merely because banks instituted a temporary moratorium, all paperwork errors and lies have ceased from being foisted upon courts by foreclosing entities. *See, e.g.*, Scott Walters & Diane Lade, *Banks Still Robo-Signing, Filing Doubtful Foreclosure Documents*, REUTERS, July 20, 2011, *available at* http://in.reuters.com/assets/print?aid=INIndia-58325420110720.

92. *See, e.g.*, Nelson D. Schwartz & Andrew Martin, *Largest Bank Will Resume Foreclosure Push in 23 States*, N.Y. TIMES, Oct. 18, 2010, http://www.nytimes.com/2010/10/19/business/19mortgage.html.

93. Mara Lee, *Fannie*, *Freddie Declare Foreclosure Moratorium*, S. F. BUS. TIMES, Nov. 20, 2008, http://www.bizjournals.com/sanfrancisco/stories/2008/11/17/daily83.html; Press Release, Freddie Mac, Freddie Mac Suspends Evictions from December 20 to January 3, 2011, (Dec. 1, 2010), *available at* http://www.freddiemac.com/news/archives/servicing/2010/20101201_eviction_suspension.html.

94. *See, e.g.*, Press Release, Citigroup Inc., Citimortgage and Citifinancial Announce National Foreclosure Suspension Program to Help Distressed Homeowners During the Holiday Season, Dec. 17, 2009, *available at* https://www.citimortgage.com/Mortgage/misc/Citi-Foreclosure_Suspension_ReleasePDF.pdf.

95. For example, in Nevada, one county judge issued an injunction against a division of Bank of America from foreclosing in the entire state of Nevada. Matt Ward, *County Judge Halts Bank of America Foreclosures Statewide*, PAHRUMP VALLEY TIMES, Jan. 26, 2011, http://pvtimes.com/news/county-judge-halts-bank-of-america-foreclosures-statewide/. That "moratorium" lasted less than a few weeks, however. *See* Steve Green, *Judge Overturns Order, Allows 8900 Nevada Foreclosures to Resume*, LAS VEGAS SUN, Jan. 31, 2011, http://m.lasvegassun.com/news/2011/jan/31/8900-nevada-foreclosures-can-resume-after-judge-ov/. For a less stark example of judicial exasperation with bank conduct

B. LENGTHENING NOTICE PERIODS IN NON-JUDICIAL STATES

Some states have enacted not moratoria, but time-lengthening provisions to the foreclosure process. California, for example, added ninety days to the current three-month waiting period for foreclosing entities between the notice of default and the notice of sale.[96] While this is not a moratorium to halt all foreclosure activity at one given time, as some had envisioned, the effect of a three-month delay is immense, as will be examined in Section IV, infra.

California was just one of many non-judicial foreclosure states that enacted legislation lengthening the foreclosure process in non-judicial foreclosure states.[97] Immergluck, for example, found twenty acts across the states that lengthened the pre-foreclosure period in non-judicial states between 2005 and 2009.[98] Apparently, the reasoning behind elongating the foreclosure process is to give borrowers more of an opportunity to obtain a better settlement, whether through a loan modification or otherwise.[99]

C. MEDIATION REGIMES

In an effort to spur loan modifications to keep homeowners in their homes, some states have implemented various mediation schemes. A total of twenty-one states had enacted some form of mediation regime by mid-2010.[100] However, only one non-judicial foreclosure state, Nevada, has implemented a mediation program aimed at foreclosures.[101] Another non-judicial state, California, implemented a requirement for a telephone conference between lenders or servicers and borrowers instead of a more traditional mediation.[102] Similar conceptions of negotiation, which lack the

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in foreclosure litigation, see *Superior Court Judge to Oversee New Jersey Mortgage Foreclosure Process*, ASSOCIATED PRESS, Mar. 29, 2011, http://www.nj.com/news/index.ssf/2011/03/nj_superior_court_judge_to_ove.html.

96. *See* Law of May 21, 2009, CAL. CIV. CODE § 2923.52 (West 2011) (repealed 2011). *See also California Foreclosure Prevention Act Sunsets*, CAL. DEP'T OF CORP. (2009), http://www.dfi.ca.gov/cfpa/default.asp.

97. *See* Immergluck et al., *supra* note 83, at 24.

98. *Id.*

99. *Id.*

100. *Id.* at 17.

101. *See* Immergluck et al., *supra* note 83, at 17.

102. *Id.* at 18.

requirement for attendance of a third party neutral, have been enacted in Indiana, Massachusetts, Michigan, and Oregon.[103]

Many mediation programs require that documentation from the borrower, such as a financial profile documenting income and expenses, be submitted to the lender or servicer prior to any mediation.[104] Similarly, other programs require lenders or servicers to offer some documentary proof, prior to mediation, of their right to enforce the loan.[105] Mediation is often cited as a step that legislatures and courts can require to help alleviate the housing crisis.[106] Given the large number of states that have enacted mediation regimes, it appears that many legislators and courts share optimistic views toward foreclosure mediation schemes.

D. INCREASED BURDEN OF PROOF LEGISLATION

States have also considered making the burden of proof upon lenders and servicers more stringent. Massive foreclosure documentation problems in courts around the country likely spurred this legislative interest in increasing the burden of proof.[107] In Virginia, for example, legislators considered a bill that would require the foreclosing entity to trace its interest in a mortgage back to the original mortgagee.[108] Arizona considered, but did not ultimately adopt, legislation that would have similarly required the foreclosing entity to prove the entire chain of title beginning with the originating lender.[109] Similar

103. Geoff Walsh, *The Finger in the Dike: State and Local Laws Combat the Foreclosure Tide*, 44 SUFFOLK U. L. REV. 139, 159-60 (2011).

104. *See, e.g.*, Admin. Order *In re* Case Mgmt. of Residential Foreclosure Cases No. 3.308-12/10*, at F(3)(b) (Fl. Cir. Ct. 2010) [hereinafter *Admin. Order 3.308*].

105. *See* Immergluck, *supra* note 34, at 18; *Admin. Order 3.308*, *supra* note 104, at 4(a).

106. *See, e.g.*, Editorial, *A Step Toward Reducing Foreclosures*, BALTIMORE SUN, Feb. 21, 2010, http://articles.baltimoresun.com/2010-02-21/news/bal-ed.foreclosure0221_1_foreclosure-prevention-servicers-foreclosure-crisis.

107. *See, e.g.*, Lorraine Woellert & Dakin Campbell, *JPMorgan Based Foreclosures on Faulty Documentation, Lawyers Claim*, BLOOMBERG NEWS, Sep. 27, 2010, http://www.bloomberg.com/news/2010-09-27/jpmorgan-based-home-foreclosures-on-faulty-court-documents-lawyers-claim.html.

108. *See* Dustin A. Zacks, *Standing in Our Own Sunshine: Reconsidering Standing, Transparency, and Accuracy in Foreclosures*, 29 QUINNIPIAC L. REV. 551 (2011) (discussing Virginia's H.B. 1506 (2011)).

109. Prashant Gopal, *Arizona Bill Would Void Foreclosures Without Full Title History*, BLOOMBERG NEWS, Feb. 23, 2011, http://www.bloomberg.com/news/2011-02-

proposals were considered in other states.[110] It is not unprecedented in the United States that foreclosure procedures would be changed in response to high levels of delinquencies.[111] Given that foreclosure documentation problems continue to exist,[112] legislators and courts will likely continue to examine procedures, such as requiring proof of a full chain of title, which might eliminate some of the documentation problems in the future. What remains to be examined is whether those changes will benefit society as a whole, or whether such changes could result in more problems than are worth the cost.

IV. PRIMARY, SECONDARY, AND TERTIARY EFFECTS OF LEGISLATIVE AND JUDICIAL RESPONSES

Legislation and procedural changes to the foreclosure process in response to the housing crisis will have lasting effects on future homeownership. This Section examines the various effects that may result from such changes. As will be seen, the positive results gained by, say, enacting mandatory mediation for those borrowers who request it, may ultimately be overwhelmed by the overall societal effects of lengthening the time it takes lenders to obtain a foreclosure sale. The increase in costs to lenders may, in turn, result in less future home lending, smaller amounts lent in future home loans, and more expensive future home loans. Furthermore, any legislation extending foreclosure time periods may result in increased numbers of strategic defaults, which can drive foreclosures up. As a result, the question policymakers must wrestle with is the traditional question examined in the context of state foreclosure laws—Is a policy aimed at keeping a homeowner in a home worth the overall effects such a policy may have?

23/arizona-bill-would-void-home-foreclosures-without-complete-title-history.html; *see also* David Dayen, *The Case of the Disappearing Arizona Foreclosure Fraud Bill*, FIREDOGLAKE, Apr. 22, 2011, http://news.firedoglake.com/2011/04/22/the-case-of-the-disappearing-arizona-foreclosure-fraud-bill/.

110. Gopal, *supra* note 109.

111. David C. Wheelock, *Changing the Rules: State Mortgage Foreclosure Moratoria During the Great Depression*, FED. RESERVE BANK OF ST. LOUIS REV. (Nov.–Dec. 2008), at 569-70, http://research.stlouisfed.org/publications/review/08/11/Wheelock.pdf.

112. *See, e.g.*, Walters & Lade, *supra* note 91.

A. MORATORIA

1. THE PROS

While no long-term nationwide or even statewide moratorium has gained traction other than the temporary moratoria initiated by private lenders and Government-Sponsored Enterprises (GSEs), we can estimate the positive effects that might be generated by such efforts. First, homeowners in financial distress would gain some much needed breathing room in which to regain their financial footing. This, in turn, may lead to more eventual modifications, eliminating many foreclosures. In a related point, homeowners not yet in foreclosure who are unprepared for adjustments in their interest rates may also be able to prepare for the coming adjustment.[113]

Next, an across-the-board moratorium would eliminate the increase and immediacy of some of the society-wide externalities of foreclosures, such as crime resulting from vacancies. If foreclosures were not being processed and homeowners were not being kicked out of their homes, it follows that crime increases as a result of vacancies would not occur. Similarly, the Congressional Research Service hypothesizes that a moratorium would halt the decline in property prices spurred by foreclosures.[114]

Finally, a moratorium would likely press lenders to settle all cases where settlements were possible.[115] Faced with the prospect of accepting a less-than-ideal monthly payment from a borrower and the alternative of waiting an indefinite period to be able to begin foreclosure proceedings, lenders might well become more accepting of less stringent and expensive modifications.

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113. EDWARD VINCENT MURPHY, CONG. RESEARCH SERV., RL34653, ECONOMIC ANALYSIS OF A MORTGAGE FORECLOSURE MORATORIUM 2 (2008), http://fpc.state.gov/documents/organization/110095.pdf.

114. *Id. See also id.* at 7 (explaining that "[i]n the short run, [a moratorium] would slow down the number of distress sales in the marketplace and reduce the downward pressure on prices").

115. J. Douglass Poteat argued this point in the midst of the Great Depression, contending that "[t]he reluctant mortgagee on whom the moratorium has imposed a debt holiday is in a more receptive mood to the suggestion of his mortgagor that lower interest and even a reduction of the principal of his obligation be granted in consideration for getting rid of this legislative intrusion." J. Douglass Poteat, *State Legislative Relief for the Mortgage Debtor During the Depression*, 5 LAW & CONTEMP. PROBS. 517, 136-37 n.117 (1938).

2. THE CONS

The ill effects resulting from moratoria are many and far reaching. As a rebuttal to the potential positive effects on individual homeowners in distress, consider the counterarguments to the points raised in Section IV(A)(1), supra. Although it may be tempting to think of a moratorium as an opportunity for homeowners in default to gather their financial resources together to attempt to qualify for a modification or to cure, a moratorium may just as likely decrease urgency to bolster their financial picture. That is, if a person knows the curtain will not fall on any foreclosure against them for, say, a six-month window, the impetus for them to immediately save money is likely to be small. It is just as likely that an average homeowner will simply push their problems off for another day, rather than saving for a date certain.[116]

A second, related counterargument is that many homeowners will not ultimately be able to cure, with or without a moratorium. Thus, while postponing the date of eviction may seem kind and benevolent, for some homeowners a delay will only increase their ultimate indebtedness at the close of the foreclosure process. Of course, this will not matter to those in states that do not permit lenders to seek deficiency judgments. For those in states that do allow for deficiencies, six months of additional indebtedness is likely to be a significantly larger amount than would have existed but for the moratorium.[117]

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116. On a related point, even given intense homeowner effort to bolster finances, empirical analysis of the moratoria enacted during the Great Depression suggested that, in many cases, "any 'temporary' halt in foreclosures would not provide enough time for earnings to increase to levels sufficient to avoid foreclosure . . . ." Lee J. Alston, *Farm Foreclosure Moratorium Legislation: A Lesson From the Past*, 74 AM. ECON. REV. 445, 451 (1984), *available at* http://links.jstor.org/sici?sici=0002-8282%28198406%2974%3A3%3C445%3AFFMLAL%3E2.0.CO%3B2-8&origin=repec. Similarly, no guarantee can presently be given to assure that, say, six months of a moratorium would be enough for borrowers in financial distress to increase income.

117. Indeed, this seems to be backed up, at least for those borrowers in default. *See* Anthony Pennington-Cross, *The Duration of Foreclosures in the Subprime Mortgage Market: A Competing Risks Model With Mixing*, MARQ. U. E-PUBL'NS, Feb. 1, 2010, at 12, http://epublications.marquette.edu/cgi/viewcontent.cgi?article=1015&context=fin_fac&sei-redir=1#search=%22ambrose%20duration%20foreclosure%20subprime%22 (Originally in J. REAL EST. FIN. & ECON., Vol. 40, No. 2 (Feb. 2010) at 18, wherein Pennington-Cross states that subprime loans that are delinquent for longer periods prior to lenders filing foreclosure are more likely to exit through a foreclosure sale

For society as a whole, the effects of a moratorium would be significant and serious. In contrast to those who would argue that a moratorium would stop any decline in home prices due to foreclosures driving prices down, others will argue that the moratorium would only lengthen the time in which potential buyers wait to purchase property. Consider the perspective of a potential home purchaser in the midst of a moratorium: the prospective buyer knows that eventually, the moratorium will lift and a flood of cheaply-priced properties will be on the market. What impetus does the possible home buyer have to buy now, therefore, when supply is likely to increase at some future point, driving prices down? In other words, any halt in the home value decreasing effect of foreclosure is likely to be temporary in nature, just like any potential moratorium.[118]

In addition to the obvious counterarguments to the possible beneficial effects of a moratorium considered above, literature analyzing the moratoria enacted by states during the Great Depression paints a gloomy picture of the effects of such moratoria. Twenty-seven states enacted some form of a temporary mortgage foreclosure moratorium during the Great Depression.[119] Critics of the Depression-era moratoria argued that the moratoria would reduce loan supply and increase interest rates being given on loans.[120] Empirical analysis of the effect of the moratoria seems to back up the critics' concerns. Alston, for example, found statistically significant evidence that lenders made fewer loans in those states that passed

than a repayment).

118. *See, e.g.*, Murphy, *supra* note 113, at 2 (noting that a moratorium could "simply delay the bottoming out of the housing market and extend the period of large unsold housing inventories, in which case potential buyers who are waiting for prices to trough might remain on the sidelines").

119. Wheelock, *supra* note 111, at 573. States enacted changes to their laws that limited the right to seek deficiency judgments and adding right to redemption statutes. *Id*. For the purposes of this Article, because deficiency judgment limitation and adding a right to redemption have not been among the most significant legislative and judicial proposals set forth in response to the current housing crisis, I have chosen not to examine those possible options. Note, however, that related relief has been enacted in the form of eliminating the taxability of forgiven home debt for homeowners. *See, e.g.*, *Bush Signs Tax Bill to Aid Ailing Homeowners*, MSNBC.COM, Dec. 20, 2007, http://www.msnbc.msn.com/id/22345416/.

120. *See* Wheelock, *supra* note 111, at 580.

moratoria.[121] However, mixed results were found on the correlation between raised interest rates and moratoria.[122]

Other economists have confirmed the correlation between reduced credit and the moratoria enacted during the Depression.[123] Rucker, for example, found that Depression relief legislation, including moratoria, "resulted in substantial reductions in the supply of agricultural credit from banks and individual lenders."[124] Given the lessons of the past, therefore, we can expect that in the face of moratoria, future credit for home purchases would be less plentiful. Thus, politicians calling for a moratorium ignore the empirical data at their own peril. At a time when lawmakers are practically begging banks to begin home-lending again, a moratorium on foreclosures would likely impede future lending in a serious way.

3. THE DISASTROUS

Beyond the effect of decreasing future credit or increasing the cost of future credit, a moratorium could have a disastrous effect by influencing more mortgagors to default. Primarily, a number of studies indicate that a longer foreclosure process can result in increased strategic default. Zhu and Pace note that the longer the time it takes to foreclose, the higher the odds are of an individual borrower defaulting.[125] Arguing that longer foreclosure periods are effectively easy financing by which borrowers can choose to allocate mortgage payments toward other burdens, Zhu and Pace note that the effect on propensity to default is the same for both prime and subprime loans.[126] To put their analysis into hard numbers, Zhu and Pace found that a six-month increase in foreclosure processing time results in a relative

121. *See* Alston, *supra* note 116, at 455.

122. *Id.* Alston's possible explanation is that creditors may have "found it less costly to adjust to the short-run disequilibrium arising from temporary moratoria by simply not granting loans to certain borrowers" and that creditors may have "raised interest rates to some prospective borrowers who at the higher price of credit dropped out of the market." *Id.*

123. Randal R. Rucker, *The Effects of State Farm Relief Legislation on Private Lenders and Borrowers: The Experience of the 1930's*, 72 AM. J. AGRIC. ECON. 24 (1990).

124. Rucker, *supra* note 123, at 30.

125. *See* Zhu & Pace, *supra* note 69, at 2.

126. *Id.* at 11-13.

increase in the risk of defaults by over 15%.[127] Given that Zhu and Pace assumed that borrowers did not have exact knowledge of the amount of added time a certain type of borrower-friendly process (as in judicial vs. non-judicial states) or procedural amendment (like mandatory mediation) might give, a moratorium which puts a specifically enumerated delay into a statute, therefore, can expect to spur similar, if not more, defaults.

In addition to increasing the number of defaults, a moratorium can expect to have the second-level effect of reducing future credit, much as the Depression era literature indicates. The beginning step in this analysis is to accept that longer foreclosure times increase lender losses. One can easily conjure the variety of ways in which lenders lose money through delays in processing foreclosures: not receiving payments, covering some of the necessary taxes and insurance the borrower is not paying, upkeep for abandoned properties, increased legal fees, and so on. The reality of these costs seems to be verified in the economic literature. Zhu and Pace, for example, estimated that a one-month delay in foreclosure translates into $7,280 greater lender loss per loan.[128] While for purposes of this Article no exact cost calculation is necessary, what is clear is that such cost increases are verifiable and not insubstantial.

Once it is accepted that increasing foreclosure times increases lender losses, the next step is analyze whether such losses eventually translate into reduced future credit. A number of studies have examined this phenomenon, and more often than not, the evidence points to a reduction in credit through increased interest rates in those states that have the longest foreclosure times, through smaller loans in such states, or in fewer loans given overall in those states. Perhaps the first major post-Depression empirical data on this issue emerged in 1984 when Economist Mark Meador examined differences in the mortgage rates among states that had judicial or non-judicial foreclosures, deficiency judgment or no deficiency judgment statute, and long or short foreclosure processing periods.[129] Particularly pertinent

127. *See* Zhu & Pace, *supra* note 69, at 13.
128. Zhu & Pace, *supra* note 69, at 2.
129. Mark Meador, *The Effects of Mortgage Laws on Home Mortgage Rates*, 34 J. ECON. & BUS. 143, 146 (1982).

to this Article's examination of the potential ill effects resulting from foreclosure delays or moratoria, Meador specifically found that on a beginning mortgage rate of 1000 basis points, "[e]xtending the foreclosure period by three months raises the mortgage rate by 4.75 basis points (new homes) or 10.04 basis points (existing homes)."[130]

Similarly, Zhu and Pace confirmed that lenders charge higher interest rates to compensate for lengthier and more costly foreclosure processes.[131] By their calculations, a six-month delay in foreclosure increased contract rates by 0.1%.[132] To help make the importance of their findings to the present examination of moratoria clear, Zhu and Pace succinctly explain: "The results indicate that policies leading to longer foreclosure process such as broad foreclosure moratoria may result in unexpected effects such as increased costs to prospective borrowers. In turn, the high rates may impede the recovery of the housing market."[133]

Unfortunately, interest rates are not the only area that moratoria are destined to affect. Economist Karen Pence of the Board of Governors of the Federal Reserve System provides more grounds for worrying that a moratorium would reduce future credit.[134] By her analysis, a 100-day increase in foreclosure time equates to a decrease in future loan sizes of 1.8%.[135] In contrast, Mian and Sufi, using a later set of mortgage data, did not find such a correlation.[136] Mian and Sufi estimate that differences between judicial and non-judicial states were blurred by lenders during the height of the bubble because the prospects of declining home prices were seen as very remote.[137] It should be noted, however, that Mian and Sufi did not specifically provide for the variable of time-delay during foreclosure. Rather, they simply

130. Meador, *supra* note 129, at 146.

131. Zhu & Pace, *supra* note 69, at 16.

132. Zhu & Pace, *supra* note 69, at 16.

133. *Id.* at 16-17.

134. Karen M. Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit* (Bd. of Governors of Fed. Reserve Sys., Working Paper No. 2003-16, 2003), *available at* http://ssrn.com/abstract=410768.

135. *Id.* at 25.

136. Mian et al., *supra* note 10, at 18. The data in Pence, *supra* note 134, was taken from 1994–1996, whereas Mian, Sufi, and Trebbi used data from 2000–2005. Mian et al., *supra* note 10, at 18.

137. *Id.*

distinguished between judicial and non-judicial states.[138] Since we can assume that judicial states' foreclosure processes take substantially longer than non-judicial states,[139] it would be reasonable to equate Mian and Sufi's calculations as a proxy for the specific time-delay variable.

Regardless of the inconclusive nature of the effect of foreclosure processing time on loan size, one can say with some degree of certainty, given the Meador and the Zhu and Pace studies, that interest rates on all future borrowers are raised when lenders face longer foreclosure times.[140] Accordingly, a moratorium would likely be the first of many "remedies" to the foreclosure crisis that would result in significant externalities suffered by society as a whole. The policy of a moratorium, geared only toward delinquent borrowers, would affect all future borrowers.

While this Article has made the case that the correlation between a moratorium and increased interest rates and, therefore, decreased future credit opportunities is a strong and significant correlation, weaknesses in the argument do exist. First, the Depression-era literature may not contain valid comparisons to the present situation. The Depression moratoria enacted by states are probably not exact replicas of the kind of moratorium policymakers may have considered in response to the current crisis. For example, to gain a moratorium reprieve during the Depression, borrowers would sometimes have to pay taxes and some sort of reasonable payment in the circumstances.[141] In contrast, today's legislators have not specifically enunciated a requirement that judges determine what a reasonable payment would be. Thus, one cannot be certain that the credit reducing effects of the Depression moratoria would hold true today.

Another difference between moratoria proposed today and that enacted during the Depression is that the Depression-era moratoria extended for years.[142] In contrast, no policymaker who

138. Mian et al., *supra* note 10, at 11-23.
139. *See* discussion *infra* Section IV(D)(3).
140. *See* Meador, *supra* note 129; Zhu & Pace, *supra* note 69.
141. *See* Poteat, *supra* note 115, at 536.
142. *Id.* at 537.

the author is aware of has proposed a moratorium for such a lengthy period.

Finally, the support of the empirical data of Pence, Meador, and Zhu may be weakened if we consider the theoretical framework of their hypotheses. Their idea, at its core, is that lenders can predict risks and costs into the future and that they price their loans accordingly.[143] Thus, a lender can easily consult with local legal counsel and determine how long an average foreclosure takes in a given state. In contrast, a one-off moratorium is impossible to predict, both in terms of scope and length of application. Given that it is not possible to predict the likelihood of such a moratorium being enacted, it is impossible to determine with certainty if lenders would price the risk of a moratorium into future loans.

B. LENGTHENING NOTICE PERIODS IN NON-JUDICIAL STATES

1. THE PROS

Among those non-judicial foreclosure states that lengthened the foreclosure notice-to-sale period, some believe that empirical data exists that supports the premise that longer notice periods correlate with increased settlement opportunities and increased cure rates. Immergluck suggests that Freddie Mac economists have analyzed and supported this contention.[144] Yet the primary sources from Freddie Mac seem to be inconclusive on this point. In fact, Freddie Mac economists candidly concluded that they "don't know how short a timeline is too short, causing too low a cure rate."[145]

Nonetheless, despite the lack of empirical support for the cause of lengthening non-judicial foreclosure timelines, anecdotal evidence from delinquent homeowners is clearly on the side of

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143. *See, e.g.*, Meador, *supra* note 129.

144. *See* Immergluck et al., *supra* note 83, at 24 (*citing* Amy Crews Cutts & William A. Merrill, *Interventions in Mortgage Default: Policies and Practices to Prevent Home Loss and Lower Costs* (Freddie Mac, Working Paper #08-01, 2008), *available at* http://www.freddiemac.com/news/pdf/interventions_in_mortgage_default.pdf.). Immergluck and his coauthors claim that Cutts and Merrill "find that when pre-foreclosure-sale periods are less than four months, cure rates . . . fall, so that foreclosure completion rates increase." Immergluck et al., *supra* note 83, at 24.

145. Cutts & Merrill, *supra* note 144, at 39.

lengthening timelines. News accounts of lender non-responsiveness to settlement overtures are numerous.[146] Indeed, from the author's own experience,[147] it is virtually impossible for a homeowner to obtain a final settlement from a lender—whether the settlement allows the homeowner to retain the home or not—in under ninety days. Thus, it would seem a reasonable proposition that a few homeowners in non-judicial states have used the extra notice periods to obtain a settlement.

2. THE CONS

Similar concerns must be raised in response to explicitly lengthening the foreclosure process,[148] in response to proposals for moratoria. Again, a longer process may actually decrease urgency for homeowners to attempt to bolster their finances rather than use the time to try and paint a credible picture for loan modification qualification. Similarly, many homeowners will not ultimately be able to cure, with or without a few months of extra time.

3. THE DISASTROUS

The externalities inflicted on society by lengthening the non-judicial foreclosure process are serious. Again, they are similarly related to the concerns raised in Section IV(A), supra, regarding moratoria. First, it is worthwhile to recall that Zhu and Pace calculated that a six-month additional delay in foreclosure processing time could result in a 6.5% decrease in the eventual price of the home.[149] Thus, we can expect that a three-month delay, as has been enacted in certain states, will depress home prices further.[150] Next, as with moratoria, a lengthened process can encourage people to default.[151] Finally, to the extent that lengthening the foreclosure process increases costs to lenders,

146. *See, e.g.*, Prashant Gopal, *Banks Block Obama's Mortgage Stimulus Plan*, BLOOMBERG NEWS, Aug. 16, 2011, http://www.bloomberg.com/news/2011-08-16/banks-block-obama-on-mortgage-stimulus-plan.html ("HAMP has been plagued by consumer complaints about lost paperwork.").

147. Admittedly from a practice focused primarily in the South Florida area, with a limited number of foreclosures.

148. *See* discussion *supra* Section IV(A).

149. *See* Zhu & Pace, *supra* note 69.

150. *Id.*

151. *Id.*

lenders are likely to increase interest rates, reduce lending in response to those costs, or both.[152] Because lengthening notice periods in non-judicial foreclosure states is not the same as a one-off, unforeseen moratorium, we can anticipate that lenders will more accurately predict the costs of such delays for the future.[153] These costs, in turn, will be passed on to future borrowers.[154] Therefore, lengthening notice periods in non-judicial states is yet another area where policies aimed at helping a small minority of the population—delinquent borrowers—produces serious externalities borne by society as a whole.

C. MEDIATION REGIMES

1. THE PROS

Foreclosure mediation regimes may result in a few positive outcomes. First, of course, a certain number of loans will be modified.[155] On the most basic theoretical level, all can agree that, in general, keeping a family in a home with a payment they can afford is a good thing. Uprooting families and blighting neighborhoods is, in and of itself, not a positive social outcome.[156] Secondly, mediation gives homeowners an opportunity to be heard.[157] This may be even more important in the context of foreclosures, as legal services are unavailable to most homeowners in foreclosure.[158] Thus, getting homeowners involved in the foreclosure process may encourage at least a modicum of scrutiny on lender's claims regarding, for example, the existence of default and the amounts allegedly owed.

The importance of this aspect of mediation regimes, while not lending itself easily to empirical measurability, should nonetheless not be understated. Lenders and banks, when

152. *See, e.g.*, Pence, *supra* note 134.

153. *See, e.g.*, *id.* at 5.

154. *See, e.g.*, *id.* at 3 (positing that "[t]he decrease in loan size suggests that lenders respond to costly foreclosure laws by reducing loan supply").

155. Schneider & Fleury, *supra* note 8.

156. Indeed, Jacoby, *supra* note 63, at 2277 (explaining that higher levels of homeownership correlate with better schools and more community involvement).

157. Schneider & Fleury, *supra* note 8, at 116.

158. *See, e.g.*, Malanca Carter & Maggie Barron, *Foreclosure: A Crisis in Legal Representation*, BRENNAN CTR. FOR JUST., Oct. 6, 2009, *available at* http://brennan.3cdn.net/a5bf8a685cd0885f72_s8m6bevkx.pdf.

confronted with indisputable evidence of robo-signing and fraudulent documentation, at first only halted their foreclosures in judicial foreclosure states.[159] This can only lead to the conclusion that banks did not expect that such fraud would be widely discovered in non-judicial states, where judicial scrutiny is far less prevalent. While certain banks eventually extended their temporary moratorium nationwide, their attitude toward scrutiny of documentation was clear—if they thought they could get away with submitting fraudulent documentation to courts, they would attempt to do so far from the gazing eyes of the public. Much the same reasoning must be inferred to the mediation scenario: when lenders are faced with the prospect of a mediation regime requiring that their proof of ownership or payment records be produced to homeowners even in the absence of legal representation, they may have additional motivation to avoid perpetrating frauds.

Finally, mandatory mediation schemes may induce more settlements in the pre-mediation stage, since the disclosure of each side's information (proof of income and expenses from borrowers; payment histories; proof of ownership from lenders) opens lines of communication and exploration for settlement.[160] In this instance, again, empirical data is difficult to generate.[161] How many highly motivated homeowners would settle without the need for a mediation regime in place? Despite the lack of proof of an answer to either side of that question, the anecdotal case for this is clear. Time after time banks will claim that they do not receive the financial profile from borrowers necessary to determine eligibility for loan modifications.[162] Thus, forcing a lender to invest resources in a time-intensive mediation may encourage it to improve its loan modification review processes for

159. *See* Weiss, *supra* note 90.

160. Schneider & Fleury, *supra* note 8, at 116.

161. *But see* J. Michael Collins, Ken Lam & Christopher E. Herbert, *State Mortgage Foreclosure Policies and Lender Interventions: Impacts on Borrower Behavior in Default* 19 (Oct. 2010) (unpublished manuscript), *available at* http://ssrn.com/abstract=1475505 (describing how sending a letter to the homeowner corresponds to a 2% marginal increase in loan modifications). While mediation is not as simple as sending a letter to the homeowner, optimistic mediation proponents might point to the work of Collins, Lam, and Herbert as evidence of mere contact between the lender and borrower being a facilitator toward settlement.

162. *See* Gopal, *supra* note 146.

the very reason that they would like to avoid incurring the time and expense of attending such mediations.

2. THE CONS

As to the primary positive effect of mediation of potentially saving homes, empirical evidence is not widely available and is widely disparate. Schneider and Fleury, for example, report that 42% of mediations in their Milwaukee-based program result in some form of a home retention solution, even if only temporary.[163] Yet even this optimistic figure includes forbearances, which may eventually result in foreclosure, and temporary modifications, which are no guarantee of a final agreement.[164] On the other end of the spectrum is the Florida Supreme Court's mediation program, which has had demonstrably weak results. Only about 4% of cases were resolved through the mediation program, with that number increasing to 27% if calculated using the total of mediations that actually occurred.[165] Again, those percentages include agreements that will not necessarily result in a homeowner retaining permanent ownership.[166] Accordingly, mandatory mediation is clearly no panacea to solving the housing crisis.

The second supposed benefit of mediation, giving homeowners an opportunity to be heard, should likewise be examined with due skepticism. First, homeowners will not always take advantage of mediation opportunities. In Palm Beach County, for example, just 27% of homeowners were even reached by the third party in charge of scheduling mediations.[167] One can imagine that for programs that require disclosure of mediation information as a part of an initial foreclosure complaint in judicial states, many of the mediation disclosures are not read. When the information regarding mediation is part

163. Schneider & Fleury, *supra* note 8, at 123.

164. Schneider & Fleury, *supra* note 8, at 123.

165. *See, e.g.*, Toluse Olorunnipa, *Slow Start For Florida's Foreclosure Mediation Program*, MIAMI HERALD, Apr. 27, 2011, http://www.miamiherald.com/2011/04/27/2188546/slow-start-for-floridas-foreclosure.html.

166. *See, e.g.*, Olorunnipa, *supra* note 165.

167. Kim Miller, *No Deal: Foreclosure Mediation Efforts Falling Flat*, PALM BEACH POST, Apr. 12, 2011, http://www.palmbeachpost.com/money/foreclosures/no-deal-foreclosure-mediation-efforts-falling-flat-1392169.html.

of a 50-page complaint, many homeowners simply will not bother to read the entire contents, including the mediation availability disclosures.[168]

Other criticisms of mediation are extant. First, any mediation scheme that requires the borrower to disclose financial information to the very entity attempting to foreclose can be troubling. One can assume that many borrowers will not know if their state provides for deficiency judgments in cases where a foreclosure sale price does not meet the total level of indebtedness.[169] Therefore, given that mediation regimes encourage negotiations and financial disclosures irrespective of the borrower's lack of legal representation, it is easily foreseeable that some homeowners are unwittingly providing the foreclosing entity with the ammunition to go after borrowers for deficiency judgments at a later point in time. Clearly, this is not the kind of borrower protection mediation proponents had in mind.

Furthermore, encouragement to borrowers to mediate without regard to their lack of legal representation may result in homeowners unknowingly forfeiting legal defenses.[170] This could include, for example, defenses on predatory lending grounds.[171] Other defenses not readily apparent could include discovery of fraudulent paperwork, the examination of which is unlikely to occur in the absence of legal representation.[172]

Finally, this author, as well as others, is concerned about lack of lender mediation in good faith.[173] The process has been characterized as a system of "take it or leave it," whereby no true back and forth negotiation occurs, in contrast to other civil litigation mediation.[174] This is yet another area where empirical

168. *See* Michael I. Meyerson, *The Reunification of Contract Law: The Objective Theory of Consumer Form Contracts*, 47 U. MIAMI L. REV. 1263, 1269 (1993) (asserting that "[i]t is no secret that consumers neither read nor understand standard form contracts").

169. Meyerson, *supra* note 168. If mortgagors do not understand the most basic terms of their mortgage, it is doubtful they have any idea about whether their state provides for deficiency judgments.

170. *See, e.g.*, Schneider & Fleury, *supra* note 8, at 116-17.

171. *Id.*

172. *See, e.g.*, Carter & Barron, *supra* note 158, at 22-24.

173. *See, e.g.*, Schneider & Fleury, *supra* note 8, at 117.

174. *Id.* at 118.

examination would be nearly impossible. But while we cannot accurately read the minds of lenders participating in mediation, the data regarding the utter scarcity of successful mediations could easily lend itself to support a proposition that lenders do not, in fact, take mediation seriously enough to consider a variety of modification options.

3. THE DISASTROUS

Mediation, it can be safely assumed, lengthens the process of foreclosure, both in judicial and non-judicial states. The additional time necessary to schedule mediation, disclose financial information, and draft and examine proposed settlements takes more time than simply proceeding to a notice of sale in non-judicial states or attempting to immediately seek summary judgment in judicial states. Indeed, at least in South Florida, many judges will freely grant additional time before a foreclosure sale is held, even in cases where lenders have obtained final judgment, if mediation is requested.[175]

Lengthening foreclosure time is not, on its surface, an awful result. For the individual homeowner, it is yet more time in which one can determine future living arrangements, continue to seek employment, and live in a property while not paying rent each month. But the costs that lengthening the time it takes to proceed to a foreclosure judgment inflict on society are immense.[176] Therefore, to the extent that mandatory mediation upon request contributes to lengthening the foreclosure process, society pays the price. Since this Article has examined the questionable success rates of obtaining permanent loan modifications, one must tangentially ask if the costs borne by society as a whole are merited by the weak success rates.

While data directly linking mediation to the negative externalities associated with anti-foreclosure litigation is scarce, one study sought to determine the exact effect that mediation programs may have on strategic defaults.[177] Demiroglu compared

175. Again, with the disclaimer that this stems from the author's geographically limited experience.

176. Examined in greater depth in Section IV(A)(2) & (3), the costs of a longer process are far-reaching and affect all members of society.

177. Cam Demiroglu, Evan Dudley & Christopher James, *Strategic Default and the Foreclosure Process* (Apr. 2011) (unpublished manuscript), *available at*

California's hazard risk with Arizona's hazard risk for strategic defaults among those with negative equity.[178] California had instituted a mandatory mediation requirement, while Arizona had not.[179] The results were "consistent with the hypothesis that lengthening the foreclosure process increases incidence of strategic default."[180] The initial assumption made in this Section, that mediation may lengthen the foreclosure process and therefore drive up externalities, has been confirmed by empirical evidence of at least in one study.[181]

An analogy can be drawn to the 2008 settlement between Countrywide and certain states' attorney generals. Mayer examined whether people respond strategically to news of mortgage modification programs.[182] In particular, Mayer and his co-authors examined whether homeowners would be influenced by news of Countrywide's settlement with state attorneys general.[183] To ensure that they were measuring strategic defaulters, and not people who needed to default for reasons of financial distress, they examined loans among those least likely to ordinarily default: borrowers with low credit card debt and with lower loan-to-value ratios.[184] Mayer and his co-authors found that strategic defaults did, in fact, increase after the announcement of the 2008 settlement.[185] In the months following the settlement, they found up to a 20% increase in relative default rates among those borrowers who were ordinarily least likely to default.[186]

While Mayer had to distinguish between those whose loans would not have qualified under the settlement's guidelines for modification (prime fixed rate mortgages were not covered by the

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http://ssrn.com/abstract=1829346.

178. Demiroglu, Dudley & James, *supra* note 177, at 22-23.

179. *Id.*

180. *Id.* at 23.

181. Demiroglu, Dudley & James, *supra* note 177, at 23.

182. Christopher Mayer et al., *Mortgage Modification and Strategic Behavior: Evidence from a Legal Settlement with Countrywide* (Colum. L. & Econ., Working Paper No. 404, 2011), *available at* http://ssrn.com/abstract_id=1836451.

183. *Id.* at 5.

184. *Id.* at 14.

185. Mayer et al., *supra* note 182, at 24.

186. *Id.* at 7.

settlement),[187] by contrast, mandatory mediation applies to every single homeowner.[188] The possibility exists, therefore, that a mandatory mediation regime creates false hopes and expectations on the part of all homeowners, leading to induce some homeowners who ordinarily would not have defaulted into doing so. Since many mandatory mediation laws apply to every homeowner who potentially defaults, the effect Mayer saw may indeed be amplified by mandatory mediation regimes.

In addition to costs driven up by lengthening the foreclosure process in general and to providing perverse incentives for people to default, mediation also has more direct costs—namely, lenders must often pay the cost for a mediator, for their legal representatives to attend the mediation, for their employees to examine the file to determine possible settlement outcomes, and for increased legal fees to their attorneys in drafting or reviewing any proposed settlements. In a manner similar to lengthening the foreclosure process, increasing direct costs to lenders also results in externalities that society, including non-homeowners, must bear.[189] This Article attempts to wrestle with the question of whether mediation or similar borrower protective reactions to the housing crisis are worth the price that all of society must eventually pay.

D. BURDEN OF PROOF ADDITIONS

1. THE PROS

Legislation that would increase the burden on lenders to document their ownership interests in loans would produce several positive effects. In legislation aimed at Mortgage Electronic Registration Systems, Inc. (MERS), MERS legislation, for example,[190] laws that would require the recording of all

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187. Mayer et al., *supra* note 182, at 7.

188. In Florida, for example, every homeowner who is living in the home being foreclosed upon is entitled to mediation. *In re* Final Report and Recommendations on Residential Mortgage Foreclosure Cases, Admin. Order No. AOSC09-54 (Fla. Dec. 28, 2009), *available at* http://www.floridasupremecourt.org/clerk/adminorders/2009/AOSC09-54.pdf.

189. *Cf.* Pence, *supra* note 134.

190. *See, e.g.*, Zacks, *supra* note 108, at 598-604. Legislation aimed at restricting MERS' ubiquitousness in foreclosure actions include, for example, prohibiting foreclosing in the name of a nominee or agent, or simply requiring the GSEs to disinvest from all MERS loans or securities that contain MERS loans. *Id.*

assignments documenting the transfer of beneficial ownership in loans could result in increased revenues for local governments.[191] MERS has effectively eliminated the centuries-old process of recording an assignment of mortgage with a county recorder or clerk.[192] As part of that process, local governments have lost out on the recording fees that would have been paid at each instance.[193] Accordingly, when MERS touts its cost-savings benefit to lenders, the corollary is that those cost-savings are revenue losses to local governments.[194] Forcing lenders to record each and every transfer of beneficial interest would restore that lost revenue.[195] In a time when governments at state and local levels are straining to pay their bills, this revenue is vital.

Even if states enacted chain of title legislation in the absence of requiring all assignments to be recorded, some measure of public confidence could be restored in public records of property interests.[196] As the system currently exists, when MERS is the original mortgagee, an infinite number of intervening transfers in the beneficial ownership of loans could occur without any corresponding change in the public records.[197] Upon researching who owns the note and mortgage pertaining to a certain piece of land, the public would only find the ubiquitous MERS. This information-masking quality has been much remarked upon.[198] Therefore, making lenders and foreclosing entities document those intervening transfers in court would bring to light the information that was not recorded in the public records. For those properties that proceed to foreclosure, the resulting deed would hold more weight and perhaps be worthy of more public confidence.

Next, requiring a more stringent burden of proof through requiring the bank to evidence an entire chain of title from origination to foreclosure could eliminate many of the fraudulent

191. Christopher Peterson, *Foreclosure, Subprime Mortgage Lending, and The Mortgage Electronic Registration System*, 78 U. CIN. L. REV. 1359, 1403 (2010).

192. *See, e.g.*, Zacks, *supra* note 108.

193. Peterson, *supra* note 191, at 1403.

194. Peterson, *supra* note 191, at 1403.

195. *Id.*

196. *Id.*

197. *Id.*

198. *See generally* Peterson, *supra* note 191, at 1400-04.

documentation and corner-cutting actions taken by lenders. Given fair warning that courts will require the entire chain of title, foreclosing entities may take a more serious look at ensuring the veracity of the documents they file.

Finally, increased judicial scrutiny may induce lenders to modify more loans or to grant more concessions to borrowers. Clauretie notes that empirical evidence backs up the assertion that lenders consider the potential costs of foreclosure when deciding whether to foreclose or renegotiate.[199] Thus, because increased burdens of proof may increase costs to lenders in foreclosure, more lenders may be induced to renegotiate loans. Similarly, Bauer notes that the increased burdens on plaintiffs in judicial foreclosure states may lead lenders to give more favorable concessions in cases where the homeowner bargains for a deed in-lieu of foreclosure.[200]

Empirical evidence generated by Collins seems to support these hypotheses.[201] Comparing foreclosures in the same metropolitan statistical area (MSA), which skirted two states' borders, Collins found a 3% "marginal increase in loan modifications compared to loans in the same MSA not subject to judicial proceedings."[202] Similarly, Yan Zhang, an economist at the Office of the Comptroller of the Currency (OCC), found in his study that foreclosure rates are significantly reduced in judicial states as compared with non-judicial states.[203] Pennington-Cross found a similar effect for subprime loans.[204] Accordingly,

199. Terence P. Clauretie, *The Impact of Interstate Foreclosure Cost Differences and the Value of Mortgages on Default Rates*, 15 AREUEA 152, 165 (1987).

200. Patrick B. Bauer, *Judicial Foreclosure and Statutory Redemption: The Soundness of Iowa's Traditional Preference for Protection over Credit*, 71 IOWA L. REV. 1, 72-73 (1985). Bauer also argues that judicial foreclosures may reduce trauma to homeowners. *Id.* at 70.

201. J. Michael Collins, Ken Lam & Christopher E. Herbert, *State Mortgage Foreclosure Policies and Lender Interventions: Impacts on Borrower Behavior in Default* (Oct. 2010) (unpublished manuscript), *available at* http://ssrn.com/abstract=1475505.

202. Collins, Lam & Herbert, *supra* note 201.

203. Yan Zhang, *Does Loan Renegotiation Differ by Securitization Status? An Empirical Study* (Dec. 2010) (unpublished manuscript), *available at* http://ssrn.com/abstract=1773103. Note that Mian, Sufi, and Trebbi found a weaker effect of a 3% decrease in per-homeowner probability of foreclosure. Mian et al., *supra* note 10, at 3.

204. Pennington-Cross, *supra* note 117, at 13. Pennington-Cross notes that for

increasing the burden of proof may result in similar positive gains in terms of settlements granted to borrowers, as lenders seek to avoid the additional costs incurred in proving their cases.

2. THE CONS

Counterarguments to the above potential positive benefits are easy to make. If states require that all assignments of beneficial interests in loans be recorded, the cost savings that MERS affords to lenders would evaporate.[205] Subsequently, it can clearly be expected that the additional expected costs of recording such assignments would be passed along in some form to future borrowers.[206] One can ask a simple question: if homeowners were afforded a choice at origination about whether to, for example, get a less expensive loan if they accepted their loan being granted to MERS, albeit with the concomitant future information-masking effects MERS has on the public records, would they choose that option over a more expensive loan that required all future beneficial ownership transfers to be recorded? This author, for one, would disagree with anyone that suggests anything approaching that a majority of homeowners would choose the more expensive loan, especially given that most homeowners likely have no idea what MERS is.

The resultant quandary for policymakers is a form of collective action problem—individual homeowners are unlikely to want to foot the bill on their loan for better public records.[207] Yet everyone suffers when the public records do not accurately reflect the true owners of loans.[208] The question to any individual member of society is similar to the question asked of a prospective borrower. For example, if members of the public were told that their loans would be more expensive in the future but that their

subprime loans, a delinquent loan in a non-judicial state is 53% more likely to end up being foreclosed than an identical loan in a judicial state. *Id.* Interestingly, he also found that subprime loans are also more likely to be cured or be paid off in non-judicial states. *Id.*

205. *See* Zacks, *supra* note 108 (noting that MERS's former Vice President predicted $200 million in yearly savings for lenders as a result of writing mortgages and deeds of trust in the name of MERS).

206. *Cf.* Pence, *supra* note 134.

207. *See* Peterson, *supra* note 191, at 1404.

208. *Id.* at 1400.

public records would be more accurate, would they elect to pay more?

On an aggregate level, MERS has been maligned for its role in making the securitization process easier, and thus in helping to create the housing bubble.[209] But to take this argument in reverse, it can be argued that MERS's facilitation of the securitization process meant that many homeowners who would not ordinarily have gotten loans were, in fact, offered credit for a home purchase. Accordingly, using MERS as a scapegoat for the housing bubble ignores the reality that many homeowners are still in possession of homes they might not have ordinarily been able to purchase due to the ease of securitization and the resulting demand for loans to securitize.

Finally, the argument that lenders would "get serious" about their well-documented fraudulent paperwork if courts made them produce a full chain of title must also fail. If anything, putting an immense amount of pressure on banks to produce documents that may or may not exist[210] would only create the perverse incentive to fabricate even more documents as evidence. Even with MERS mortgages, foreclosing entities apparently have a major problem in producing documentation in foreclosures, such as assignments of mortgage, that have any evidentiary value whatsoever.[211] Accordingly, skepticism must reign over any claim that necessitating more documentary evidence from banks would produce more truthful documents.

3. THE DISASTROUS

While an increase in costs of prosecuting a foreclosure action may spur lenders to give more beneficial settlements to delinquent homeowners, someone must bear the additional costs both in terms of judicial resources and in the additional costs to

209. *See, e.g.*, Hooker v. Nw. Tr. Servs., Civ. No. 10-3111-PA, 2011 U.S. Dist. LEXIS 57005 (D. Or. May 25, 2011).

210. *See* Kate Berry, *Countrywide Routinely Failed to Send Key Documents to MBS Trustees, B of A Employee Says*, AM. BANKER, Nov. 19, 2010, http://www.americanbanker.com/issues/175_224/countrywide-bank-of-america-foreclosures-1028945-1.html.

211. *See* June M. Clarkson, Theresa B. Edwards & Rene Harrod, *Unfair, Deceptive, and Unconscionable Acts in Foreclosures*, FLA. ATT'Y GEN., ECON. CRIMES DIV., 2010, *available at* http://pdfserver.amlaw.com/dbr/Foreclosure-Report-from-Florida-AG080311.pdf.

lenders. In this line of inquiry the Article will examine studies of judicial versus non-judicial foreclosures to determine who ultimately foots the bill from more stringent requirements to foreclosure. To begin, evidence exists supporting the contention that the additional cost to lenders to foreclose in judicial states gets passed on to future home purchasers. Demiroglu, for example, notes that loan rates are 1% higher in judicial states than in non-judicial states.[212] Meador's work calculated that for a 1000 basis point loan, judicial foreclosure adds additional basis points of 11.09 for existing homes and 12.11 for new homes.[213] Pence calculated that states with defaulter-friendly protections, such as judicial foreclosure states, see a 3.5–6.8% decrease in loan size.[214]

Therefore, there is no free lunch in granting delinquent homeowners the right to have a judge oversee their entire foreclosure. Rather, a potentially large number of future home purchasers bear the burden of paying for those protections. State foreclosure laws that increase procedural and substantive burdens on foreclosing entities will likely correspondingly increase the costs passed along to future borrowers.[215] This, in turn, could lead to further stagnation or depression of the housing market that impedes the recovery of the housing market. The reasoning, as spelled out by Zhu and Pace, proceeds as follows: higher foreclosure costs to lenders leads to higher loan interest rates.[216] Higher interest rates lead to higher rates of default. Therefore, increasing the burden of proof may lead to more foreclosures in the future.[217]

Next, judicial oversight, due to the fact that it leads to longer foreclosure processing periods, induces more homeowners to strategically default. Quite simply, Demiroglu showed that as negative equity declines, judicial review makes default more likely as compared with non-judicial states.[218] Even more alarming was that Demiroglu found that all defaults, not just

212. *See* Demiroglu, Dudley & James, *supra* note 177, at 7.
213. Meador, *supra* note 129, at 146.
214. Pence, *supra* note 134, at 22.
215. *Id.*
216. *See* Zhu & Pace, *supra* note 69, at 16.
217. *Id.*
218. Demiroglu, Dudley & James, *supra* note 177, at 20.

strategic defaults, were higher in judicial than in non-judicial states.[219] This may be a function of a possible coincidence between geographic locations of the hardest hit states corresponding with judicial versus non-judicial foreclosure processes. But given the empirical evidence, policymakers must be concerned about the linkage between strengthening judicial oversight of foreclosures and the corresponding increase in incentives for people to strategically default. In an effort to save homes, legislators may endanger many more.

V. CONCLUSION: BAILING OUT UNWORTHY BORROWERS OR RAISING THE TIDE TO LIFT ALL BOATS?

This Article began by examining the costs of foreclosures. Examining a wide swath of academic studies, including economic literature, the Article found that foreclosures take a heavy toll in several respects. For individual homeowners, foreclosures can result in an incredible amount of psychological stress. Credit histories can also be affected. This, in turn, can take a heavy toll on future purchasing power and, in some instances, even future job prospects. Furthermore, foreclosures can cause not only mental health problems, but also physical health problems.

Foreclosures also put a heavy strain on society as a whole. The Article examined the academic literature and found that foreclosures increase vacancy and crime. Neighborhood housing values are also depressed as a result of foreclosures. Furthermore, judicial and municipal resources have been heavily burdened by the costs of processing foreclosures and resulting code violations. Finally, foreclosures can lead to more foreclosures through weakening social mores that might ordinarily preclude people from defaulting on their home loans.

The Article next examined the changes in the foreclosure process that legislators and courts have considered in reacting to the foreclosure crisis, including moratoria, lengthened notice periods, mediation regimes, and increased burden of proof hurdles. In each instance, the proposed solution produces externalities on society as a whole. This is due to the solutions resulting in an increased likelihood of strategic default, a

219. Demiroglu, Dudley & James, *supra* note 177, at 20.

continuing reduction or stagnation in housing prices, and increased costs to lenders that are eventually passed on to future consumers in the form of more expensive or rationed credit.

Accordingly, one of the major conclusions of this Article is that when it comes to changing state foreclosure processes, there is no free lunch in enacting additional consumer protection. All of society is paying for government efforts to keep homeowners from losing their homes, whether in terms of increased funding necessary to pay for judicial costs or through lost home values as a result of extended foreclosure processes. Importantly, both current and future members of society carry these costs. This is because some future borrowers, who might not yet be born, will inevitably pay more for housing credit due to increased consumer protections enacted in response to the current crisis.

Given that society as a whole pays for the attempts to make state foreclosure processes more consumer friendly, there are two different ways to view these costs. One follows a sentiment commonly reported in the popular press, in which a homeowner who is making regular payments but whose home is "under water" rages about the government helping "deadbeats." This knee-jerk reaction is an understandable but ultimately shortsighted view. This Article seeks to elucidate the often unremarked upon counterargument to such a homeowner's suppositions.

This Article has shown that the externalities of foreclosures, such as crime, decreased housing values, and increased judicial and municipal costs are externalities that every member of society must pay for, even though delinquent homeowners are a small minority of all homeowners. Thus, even though there is no free lunch to enacting pro-consumer foreclosure protections, what the token current-and-angry homeowner does not see is that some measure of the value the "lunch" he has paid for is actually returned to him. Remember, for every foreclosure his tax dollars prevent, he may enjoy the pleasure of not having his home vandalized. Or, similarly, his city may not hemorrhage money trying to enforce code violations or to maintain some level of control over dilapidated vacant properties.

But these unseen potential benefits to all members of society of preventing even a single foreclosure are precisely why it may be difficult for a current homeowner to embrace consumer friendly changes to foreclosure processes. When a current homeowner reads his local newspaper, he does not get excited about a story relating a burglary of a vacant house that did not take place due to loan modification efforts keeping a homeowner in a home. Rather, he becomes upset at the above-the-fold newspaper announcements of more assistance to delinquent homeowners. This effect is only compounded by the fact that banks and lenders received substantial governmental assistance, but struggling current homeowners have yet to receive such meaningful help. Thus, one takeaway from this point for consumer advocates and legislators would be, when advocating pro-borrower foreclosure process changes, to adequately stress the positive and empirically demonstrable effects upon all members of society when foreclosure is prevented.

Aside from the fact that society-wide benefits of foreclosure process changes may not be immediately noticeable to the average individual current homeowner footing the bill for those changes, consider also that current homeowners did not request help for delinquent homeowners. Thus, even if one could measure the effect on each member of society of, say, a prevented burglary due to a prevented foreclosure auction, and even if that effect were substantial and worth the cost of changing the foreclosure process, the current homeowner was still never given a real choice of whether to spend his tax money in that fashion. Even assuming a societal net positive cost/benefit analysis of allocating resources toward changing foreclosure processes, homeowner advocates cannot necessarily argue that spending money on foreclosure prevention is the best use of government money. After all, who is to say that ethanol subsidies or wind farm subsidies or high-speed rail investments would not create more jobs and, ergo, prevent more foreclosures than changes to the foreclosure process?

In addition to the impossibility of saying that money spent in foreclosure process changes is inherently more productive for society as a whole than other government expenditures, there remains the sticky problem of extending the foreclosure crisis and inducing people into default. This Article has enumerated the myriad of ways in which lengthening the foreclosure process can cost everyone more and can increase moral hazard and strategic default. In this way, although society does benefit from certain aspects of consumer friendly foreclosure changes, policymakers and consumer advocates must always exercise caution that they do not tip the protective and palliative scales too far in the direction of encouraging homeowners to default.

Similarly, apart from any lengthening of the process, one can imagine that if the most pro-homeowner scenario becomes law, (e.g., principal writedowns, according to many commentators),[220] it will drive countless hordes of people who would not have ordinarily defaulted into delinquency. This fact, empirically supported in the literature examined above, is ignored by policymakers at their own peril.

Therefore, this Article proposes a simple policy of moderation. Given benefits or protections too great, homeowners, both current and delinquent, will surely seek to avail themselves of those benefits. Such benefits may ultimately induce more defaults, which will continue to depress or stagnate prices and prolong the housing crisis. Given protections too few, homeowners will be evicted based on fraudulent documentation, while vacancies, crime, and communal disharmony will increase. Accordingly, policymakers must be extremely cautious in enacting substantive or procedural changes in the foreclosure process without examining the likely second- and third-level effects of such changes. As this Article has argued, such effects are likely to be significant, lasting, and, in many cases, invisible.

220. *See, e.g.*, Adam Levitin, *Resolving the Foreclosure Crisis: Modification of Mortgages in Bankruptcy*, 2009 WISC. L. REV. 565, 647 (2009) (arguing that "permitting modification of all home mortgages in bankruptcy stands out as the best of all possible solutions proposed to the mortgage crisis").