Dirt Law at Ground Level

THE GHOSTS OF CLOSINGS PAST

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In the last month of 2011, I finished a book by Michael Lewis on the financial upheavals of 2008, entitled The Big Short. About the same time, I noticed a news story about continuing layoffs at Morgan Stanley, Goldman Sachs, Bank of America, Citigroup and several other major participants in those events, from which they obviously have yet to recover fully. And I took my granddaughter to see "A Christmas Carol – The Musical" at the Rep, Marley's ghostly appearance wearing "the chains [he] forged in life" resonated with me.

Lewis contends that the very nature of the bundles of subprime mortgages that were at the heart of the crisis guaranteed that the mortgages that collateralized the mortgages bonds would default and, hence, so also would the bonds. Which they did, spawning thousands of foreclosures, judicial and non-judicial. Those mortgage notes generally had a traditional 30-year term, with the first two years at a fairly low fixed rate, and thereafter at an adjustable rate.

At least one banker friend has claimed that political pressure on Fannie Mae and other government-related purchasers of these mortgages was a major factor in encouraging the generation of subprime loans, perhaps on a par with Wall Street. Lewis mentions these entities exactly once, and then only in passing.

Ticking Bombs…

According to Lewis, a huge number of those mortgages were simply originated with no underwriting at all, and no attention given to whether or the borrowers could tolerate probable spikes in their interest rates. My strong impression is that very, very few Arkansas banks and established mortgage companies were tempted by the opportunity for high interest rates that these "programs" offered.

But, anecdotally, I can say that a client's mother received a mortgage loan from a mortgage banker (it went under early in the crisis), despite the fact that she was unemployed, mentally ill and the

owner of only a half interest in the mortgaged house, the other half being owned by her ex-husband, the title policy notwithstanding. Needless to say, attempting to foreclose the mortgage non-judicially has been difficult.

The Sins of the Few…

As a direct result of this sort of rogue behavior, all mortgage lenders have been subjected to new requirements for utilizing non-judicial (also called "statutory") foreclosure. Act 885 of 2011 is ably summarized by Prof. Lynn Foster in the Fall 2011 issue of the Arkansas Real Estate Review, freely drawn upon here. Its strictures are reminiscent of Chief Justice Roberts' standard when the Supreme Court considered Arkansas's tax forfeiture sales procedures. The tax collector needed to proceed as if he "really wanted to notify the taxpayer.

The Act requires that the creditor have "personal knowledge" of the following records, copies of which must be sent to the debtor by standard mail at least 10 days prior to the start of the foreclosure process: the terms of the note, the current holder of the note and its location, a payment and default history, the chain of ownership of the note, and the availability of all of the programs for debtor assistance. Further, the mortgage holder has to have determined that the debtor has been notified that he does not meet the criteria for such programs.

It means what it says…

Finally, an earlier amendment to the non-judicial foreclosure statute added another restriction on lenders wishing to use it, by adding a new section. Although, out of state banks clearly can loan on Arkansas real estate and can foreclose on it judicially in the event of default, all without registering as foreign corporations, the same is not the case for the non-judicial foreclosure. Although the new section was not artfully drafted and was frequently ignored, its impact was clarified by bankruptcy judge Audrey Evans---it says only lenders qualifying to do business here get to use the foreclosure statute and that is what it means.

So, will the added section and Act 885 give debtors the tools to get their financial (and actual) houses in order, currently and for the future? Well, maybe. As of fall 2011 over 880,000 homeowners had been able to modify their mortgage payments under the Treasury's two big foreclosure prevention programs operated with TARP funds. HUD administers similar programs for the FHA, as do Fannie Mae, and Freddie Mac, as to loans they own or guaranteed.

Too far underwater…

Will they slow down the foreclosure process and allow debtors the chance to negotiate with their mortgage lenders to obtain terms they can live with? With no research to guide me, I would guess the answer to be "sometimes." Nationally, Treasury's Making Homes Affordable program and its hardest Hit Fund have disbursed less than 10% of the funds available to provide relief.

In Arkansas, will these state statutes make use of non-judicial foreclosure far less attractive, while leaving it technically available? Absolutely. But, as the Treasury programs suggest, there are simply many, many loans that are beyond repair, whatever collection procedures are used. Tsunamis, floods, housing bubbles, earthquakes, financial crises---sometimes, as Ebenezer Scrooge would surely remind us, there just aren't any good fixes.

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