



## The Foreclosure-Gate Freeze

Richard Ivar Rydstrom, Wednesday 20 October 2010 - 08:20:34

***REQUIRED READING:*** The foreclosure-gate freeze will act as the trigger for a wave of legal challenges. Foreclosure-gate freezes will mandate third-party audits consistent with the new Dodd-Frank Act financial regulations, challenging the foreclosure process for all 50 states, in part, for use of false or defective oaths/affidavits, post-dated assignments, fraudulent notarizations or general robo-signings.

If one-third of all sales are distressed properties, freezing foreclosures across the board could cost billions in a few months. It could perpetuate the state of uncertainty in real estate, mortgage finance and banking, and contribute to the economic drag. It will cause further overhang.

It is uncertain whether the freeze will put pressure on prices or ease pressure. During the freeze, less inventory will be available, but greater overall inventory will be in the bottle-neck pipeline. Once the period, frequency and liquidation rate of the bottle-neck become visible, supply and demand will adjust pricing.

Legally, freezes will create insecurity in marketable title for foreclosed homes, foreclosures in the pipeline, vacant properties, real estate owned properties, and properties sold within and outside of the state redemption periods.

Title and insurance companies will realize greater uncertainty and liability in want of judicial decisions. The extent to which defective foreclosures will be vacated - causing revival of title back to borrowers - is unknown. Enhanced litigation, ranging from the innocent bona-fide purchasers (BFPs) to the criminal foreclosure, will be tested in the court.

The legal answers to the many questions will vary from state to state, as property rights are defined by the states.

For example, the courts will re-test or decide certain matters. If a foreclosure was defective or wrongful, should innocent BFPs or non-BFPs (affiliate banks) keep title? Exactly what does it legally take to transfer or assign title and mortgage debt? Are valid trust deeds upon sale effective if the assignment of the trust and note fails for procedural improprieties?

How is the transfer and assignment of both the trust deed and the note perfected? What does it really require for the Mortgage Electronic Registration Systems (MERS), as nominee or beneficiary, to transfer the trust deed and note? Is a physical transfer of the note required, under local law, to perfect "the transfer of mortgage paper as collateral"? Can a wrongful foreclosure that rises to the level of criminal fraud and the uttering of false or unlawful instruments affecting title defeat a BFP, a BFP within the redemption period, or a non-BFP or affiliate bank?

Generally, BFPs will retain good title, but many reversions, rescissions and revivals of title will occur. However, the after-the-fact filing of "notices of rescission" by the servicer/trustee/foreclosing attorney, declaring the foreclosure "in error," will serve as admissions of liability that the foreclosure sale was wrongful, setting the stage for set-asides and punitive liability. Title insurance and litigation will now take center stage.

In many cases, return of the home may not be the remedy for the borrower, but the banks,

servicers, trusts/Real Estate Mortgage Investment Conduits, trustees, foreclosing attorneys, Realtors/brokers and property-preservation companies may be exposed to damages, including injunctive relief, treble and punitive damages. A court could shut down the foreclosure services operations of certain defendants by injunctive order under many varying state and federal laws.

These challenges will also reveal grounds for more attacks on the origination of the loans, the servicing of the loans and the foreclosure procedures of the loans.

On Oct. 14, The National Association of Attorneys General announced that 50 states had signed a joint Mortgage Foreclosure Joint Statement, stating, in part, "We believe [the robo-signing] process may constitute a deceptive act and/or an unfair practice, or otherwise violate state laws."

Depending upon the state of the foreclosure or eviction, some of the likely causes of action - assuming a wrongful foreclosure and forcible eviction did take place - may include unfair or deceptive business practices (per state law), wrongful foreclosure or eviction (per state law), trespass by forcible and unlawful entry, conspiracy to defraud (common law), slander of title; abuse of process, a litany of possible regulatory violations, among other causes.

Many of these claims for relief carry treble damages, attorney fees, injunctive relief and punitive damages. Legal liability may be material. Borrowers in bankruptcy may also file federal adversary lawsuits. Challenges to proof of claims in bankruptcy cases may be enhanced by the arguments for lack of authority or standing.

Challenges to the foreclosure process will trigger challenges to the origination process, including attacks on standing, securitization rules, definitions and practices, and electronic registration systems and authority (i.e., MERS). This will result in an explosion of investor lawsuits for buybacks or put-back litigation for failed representations and warranties.

If borrowers show that the banks or trustees failed to prove that they perfected title to the trust deeds and notes, or failed to prove that they owned the notes, investors will sue for fraud and redress of any losses realized on investments they did not own.

The bank and financial stocks are falling with the news of foreclosure-gate and foreclosure freezes. Without leadership in the banking or financial stocks, growth in the economy, earnings or bank lending, a drag will be put on a market recovery. With some 13.4 million homeowners, or 28% of homes, underwater with negative equity or near-negative equity, according to CoreLogic, and some 7 million homeowners behind on their mortgages, according to RealtyTrac, foreclosures will continue at capacity levels.

The recent downward movement or reduction in the number of underwater homes is attributed to the increase in completed "foreclosures." We must wait to find out if set-asides of wrongful foreclosures will reverse that relationship. In the highest negative-equity states, foreclosure-gate may reveal its greatest impact. Servicers and foreclosing attorneys must pay special attention to this material contingency.

We may have reached a critical economic and due process point in foreclosure capacity. In the overall mortgage meltdown solution recipe, it is time to efficiently modify a greater number of mortgages, offer principal reduction or forgiveness options, and/or shared-appreciation clawbacks. Unfortunately, the short payoff refinance program, released this past September, has (again) been met with little acceptance.

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