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ESSAY

HOME OWNERSHIP RISK BEYOND A SUBPRIME CRISIS: THE ROLE OF DELINQUENCY MANAGEMENT

*Melissa B. Jacoby**

A surge in delinquency among risky subprime home mortgages has produced calls for front-end regulatory fixes as well as emergency foreclosure avoidance interventions. Whatever the merit of those interventions, this Essay calls for home mortgage delinquency management to be conceptualized as an enduring component of housing policy. The Essay identifies and evaluates a framework for the management of delinquency that is not limited to formal foreclosure law and includes other debtor-creditor laws such as bankruptcy, industry loss mitigation efforts, and third-party interventions such as delinquency housing counseling. The Essay also proposes that delinquency management be evaluated through the lens of objectives commonly used to justify public investment in home ownership and home mortgage markets: to build household wealth and economic self-sufficiency, to generate positive social-psychological states, and to develop stable neighborhoods and communities. Because those ends are not inexorably linked to ownership generally or owning a particular home, a system of delinquency management that honors these objectives should strive to provide fair, transparent, humane, and predictable strategies for home exit as well as for home retention.

INTRODUCTION

Home ownership has become the preferred housing tenure in the United States,[1] with corresponding underinvestment in safe and affordable rental

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* George R. Ward Professor of Law, University of North Carolina at Chapel Hill, and Faculty Fellow, University of North Carolina Center for Urban and Regional Studies. I am grateful to Lei Ding, Adam Feibelman, Kathleen Engel, Anna Gelpern, Elizabeth Gibson, Patricia McCoy, Katherine Porter, and Elizabeth Warren for helpful comments and insights, as well as participants in the international research collaborative Comparative Socio/Legal Approaches to Consumer Overindebtedness, Debt Adjustment and Insolvency, at the 2007 Joint Meeting of the Law and Society Association and the Research Committee on the Sociology of Law where I presented an earlier version. Thanks also to Michael Shumaker for research assistance in the 2006–07 school year, Nick Sexton for library assistance, and the University of North Carolina School of Law and the University of North Carolina Center for Global Initiatives for financial support.

housing.[2] Commentators often cite three justifications for investing in and promoting home ownership: (1) it builds household wealth and economic self-sufficiency; (2) it generates positive social-psychological states; and (3) it fosters stable neighborhoods and communities.[3]

Home ownership and mortgage obligations do not inherently further these objectives, however.[4] As the recent surge in delinquency among subprime mortgages suggests, home ownership and mortgage obligations sometimes undermine these objectives. A range of parties have sharply criticized recent trends in subprime mortgage lending for undercutting the goals with which home ownership is so often associated.[5] Misleading

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1. *See generally* Chasing the American Dream: New Perspectives on Affordable Homeownership (William M. Rohe & Harry L. Watson eds., 2007); Critical Perspectives on Housing (Rachel G. Bratt et al. eds., 1986); *see also* Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government's Promotion of Home Equity Financing*, 69 Tul. L. Rev. 373, 374 n.1, 406 n.177 (1994) (reporting on presidential touting of home ownership and surveys reflecting the desirability of home ownership); Anne B. Shlay, *Low-Income Homeownership: American Dream or Delusion?*, 43 Urb. Stud. 511, 513 (2006) (noting home ownership as a longtime centerpiece of housing policy); Joan Williams, *The Rhetoric of Property*, 83 Iowa L. Rev. 277, 326 (1998).

2. *See, e.g.*, J. Peter Byrne & Michael Diamond, *Affordable Housing, Land Tenure, and Urban Policy: The Matrix Revealed*, 34 Fordham Urb. L.J. 527 (2007); J. Michael Collins, *Federal Policies Promoting Affordable Homeownership: Separating the Accidental from the Strategic*, *in* Chasing the American Dream, *supra* note 1, at 69; Edward G. Goetz, *Is Housing Tenure the New Neighborhood Dividing Line? The Polarizing Politics of Homeownership*, *in* Chasing the American Dream, *supra* note 1, at 96; William M. Rohe & Harry L. Watson, *Introduction: Homeownership in American Culture and Public Policy*, *in* Chasing the American Dream, *supra* note 1, at 1, 3–4, 11; William M. Rohe et al., *The Social-Psychological Effects of Affordable Homeownership*, *in* Chasing the American Dream, *supra* note 1, at 215, 232; William M. Rohe, *Conclusion: Toward More Efficient and Equitable Homeownership Policies*, *in* Chasing the American Dream, *supra* note 1, at 263 (noting many writers' emphasis on the need for balance between owner and renter policy); Lawrence J. Vale, *The Ideological Origins of Affordable Homeownership Efforts*, *in* Chasing the American Dream, *supra* note 1, at 15 (describing deliberate efforts to promote home ownership and "to instill an ideologically grounded belief in the moral value of the owned home"); Paulette J. Williams, *The Continuing Crisis in Affordable Housing: Systemic Issues Requiring Systemic Solutions*, 31 Fordham Urb. L.J. 413, 471 (2004).

3. This general taxonomy is common. *See, e.g.*, Shlay, *supra* note 1, at 513 (critiquing justifications); HUD, Urban Policy Brief No. 2: Homeownership and Its Benefits (1995), http://www.huduser.org/publications/txt/hdbrf2.txt.

4. *See* Melissa B. Jacoby, *Bankruptcy Reform and Homeownership Risk*, 2007 U. Ill. L. Rev. 323, 325 n.6 (citing literature); *see also* Jacob S. Hacker, The Great Risk Shift 173 (2006) ("The most serious financial error that Americans commonly make is overextending themselves to buy a house.").

5. *See, e.g.*, *Evolution of an Economic Crisis?: The Subprime Lending Disaster and the Threat to the Broader Economy: Hearing Before the J. Economic Comm.*, 110th Cong. 9 (2007) (statement of Martin Eakes, Center for Responsible Lending); *Possible Responses to Rising Mortgage Foreclosures: Hearing Before the H. Financial Services Comm.*, 110th Cong. 3–4 (2007) [hereinafter *Hearings*] (statement of Janis Bowdler, Senior Policy Analyst, Housing, National Council of La Raza); *id.* at 3 (statement of Kenneth D. Wade, Chief Executive Officer, NeighborWorks America); *see also* Kathleen C. Engel & Patricia A. McCoy, *Turning a Blind Eye: Wall Street Finance of Predatory Lending*, 75 Fordham L. Rev. 2039, 2076 (2007) (discussing the impact of predatory subprime lending on "borrowers, neighborhoods, and cities" as a justification for regulatory intervention); Cathy Lesser Mansfield, *The Road to Subprime "HEL" Was Paved with Good Congressional*

representations by mortgage brokers, inflated property appraisals, and lax underwriting have encouraged origination of hybrid mortgages destined from the outset to terminate early.[6] Also, prepayment penalty clauses have hindered refinancing or selling, particularly in a declining market.[7]

The most visible triggers of the surge in subprime delinquency have produced calls for emergency foreclosure avoidance interventions, front-end regulatory fixes, and market self-corrections. Whatever the merit of these proposed emergency foreclosure avoidance interventions, a system of mortgage delinquency management should be an enduring component of housing policy. Clearly, furtherance of policy objectives hinges in part on the conditions under which home ownership is obtained, maintained, leveraged, and, in some situations, exited. Concerns about undue encouragement of unstable or financially risky home ownership preceded this recent rise in subprime delinquency.[8] A modest expansion in home ownership rates in recent decades has been accompanied by substantial increases in foreclosure filings, mortgage debt, and home owner bankruptcies.[9] Given that high leverage or trigger events such as job loss

Intentions: Usury Deregulation and the Subprime Home Equity Market, 51 S.C. L. Rev. 473, 555 (2000) (discussing earlier subprime debates, loss of wealth, and adverse neighborhood impact).

6. *See* Christopher L. Cagan, Mortgage Payment Reset: The Issue and the Impact 4 (2007) [hereinafter Cagan 2007], *available at* http://www.facorelogic.com/uploadedFiles/Newsroom/Studies_and_Briefs/Studies/20070048MortgagePaymentResetStudy_FINAL.pdf (predicting that thirty-two percent of teaser loans will default after reset); Christopher L. Cagan, Mortgage Payment Reset: The Rumor and the Reality 21–22, 24–25, 27 (2006) [hereinafter Cagan 2006], *available at* http://www.loanperformance.com/infocenter/whitepaper/FARES_resets_whitepaper_021406.pdf.

7. *See, e.g.*, Kathleen C. Engel & Patricia A. McCoy, *From Credit Denial to Predatory Lending: The Challenge of Sustaining Minority Homeownership*, *in* Segregation: The Rising Costs for America (James H. Carr & Nandinee K. Kutty eds.) (forthcoming 2008) (manuscript at 95, on file with authors).

8. Emily Paradise Achtenberg & Peter Marcuse, *The Causes of the Housing Problem*, *in* Critical Perspectives on Housing, *supra* note 1, at 4, 9 (noting that in the 1980s a "growing number who live a paycheck or two ahead of the bank risk the loss of their equities—as well as their homes—to foreclosure"); William N. Eskridge, Jr., *One Hundred Years of Ineptitude: The Need for Mortgage Rules Consonant with the Economic and Psychological Dynamics of the Home Sale and Loan Transaction*, 70 Va. L. Rev. 1083, 1087 (1984) (expressing concern about "the confusing array of often risky alternative mortgages"); Michael E. Stone, *Housing and the Dynamics of U.S. Capitalism*, *in* Critical Perspectives on Housing, *supra* note 1, at 41, 58–59 (referring to the "desperate" situation of unstable home ownership in the 1980s). *See generally* Vale, *supra* note 2 (reviewing home ownership advocacy and critiques in early twentieth century).

9. The U.S. Census Bureau reports home ownership rates of 63.9% in 1985, 63.9% in 1990, 64.7% in 1995, 67.4% in 2000, and 68.9% in 2005. U.S. Census Bureau, Statistical Abstract of the United States 611 tbl.956 (2007). *But see* George S. Masnick et al., *A Critical Look at Rising Homeownership Rates in the United States Since 1994* (Joint Center for Hous. Studies, Harvard Univ., Working Paper No. W99-2, 1999) (questioning whether methodological changes in census affect data on home ownership trends in the 1990s); *see also* Michael LaCour-Little, *Equity Dilution: An Alternative Perspective on Mortgage Default*, 32 Real Est. Econ. 359, 360 (2004) ("[S]ince 1986, . . . foreclosure rates on government-insured loans have tripled and foreclosure rates on conventional loans have increased by 50%."); Mansfield, *supra* note 5, at 553–54 (reporting on the increase in foreclosures at an "almost frightening rate" in the 1990s); Margot Saunders, *The Increase in*

and medical problems play significant roles in determining mortgage delinquency independent of loan terms, improved origination practices cannot eliminate the need for better tools to manage mortgage delinquency.[10]

This Essay identifies and examines a rough management framework for delinquency already in place. Although the United States has well-functioning courts and workable debt collection laws relative to other countries, many American home owners who become delinquent on mortgages do not, in fact, lose their homes in foreclosure sales.[11] Mortgagor protections in foreclosure laws play some role but cannot fully explain this outcome. It no longer makes sense for legal scholarship to discuss mortgage enforcement exclusively in terms of foreclosure. Instead, the discussion must include other debtor-creditor laws such as bankruptcy, industry loss mitigation efforts, and third-party interventions such as delinquency housing counseling.[12] Relatively little legal research has examined the intersections between these components,[13] although some legal scholars have started to explore how innovations in mortgage funding may affect loss mitigation responses.[14]

Researchers and commentators may be tempted to evaluate mortgage delinquency management tools primarily by the impact of mortgagor

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Predatory Lending and Appropriate Remedial Actions, 6 N.C. Banking Inst. 111, 114 (2002); Peter J. Elmer & Steven A. Seelig, *The Rising Long-Term Trend of Single-Family Mortgage Foreclosure Rates* 1 (Fed. Deposit Ins. Corp., Working Paper No. 98-2, 1998) (noting "the long-term trend, although rising gradually, translates into a dramatic increase in foreclosures in the course of a generation").

10. *See infra* Part II.

11. *See infra* notes 52, 162.

12. *See, e.g.*, Roberto G. Quercia et al., *Sustaining Homeownership: The Promise of Postpurchase Services*, 17 Housing Pol'y Debate 309 (2006). Functionally, these components may be said to constitute a public-private partnership, which is a familiar concept in housing policy. *See, e.g.*, Nestor M. Davidson, *Relational Contracts in the Privatization of Social Welfare: The Case of Housing*, 24 Yale L. & Pol'y Rev. 263, 284 (2006); Peter W. Salsich, Jr., *Saving Our Cities: What Role Should the Federal Government Play?*, 36 Urb. Law. 475, 479–80 (2004); Peter W. Salsich, Jr., *Solutions to the Affordable Housing Crisis: Perspectives on Privatization*, 28 J. Marshall L. Rev. 263 (1995).

13. Debra Stark identified bankruptcy filers within her sample of foreclosure defendants. *See* Debra Pogrund Stark, *Facing the Facts: An Empirical Study of the Fairness and Efficiency of Foreclosures and a Proposal for Reform*, 30 U. Mich. J.L. Reform 639, 700–01 (1997) [hereinafter Stark, *Facing the Facts*]; Debra Pogrund Stark, *Foreclosing on the American Dream: An Evaluation of State and Federal Foreclosure Laws*, 51 Okla. L. Rev. 229, 230 n.3 (1998) [hereinafter Stark, *Foreclosing on the American Dream*]. Marshall Tracht has discussed the relationship between redemption rights in foreclosure law and private workouts. *See* Marshall E. Tracht, *Renegotiation and Secured Credit: Explaining the Equity of Redemption*, 52 Vand. L. Rev. 599, 610–11 (1999). I started questioning bankruptcy's role in mortgage delinquency management in Jacoby, *supra* note 4, and Melissa B. Jacoby, *Collecting Debts from the Ill and Injured: The Rhetorical Significance, but Practical Irrelevance, of Culpability and Ability to Pay*, 51 Am. U. L. Rev. 229 (2001).

14. *See generally* Kurt Eggert, *Comment on Michael A. Stegman et al.'s "Preventive Servicing Is Good for Business* and *Affordable Homeownership Policy": What Prevents Loan Modifications?*, 18 Housing Pol'y Debate 49 (2007); Engel & McCoy, *supra* note 5 (explaining how securitization hinders private workouts).

protection on cost and access to credit ex ante or by the number of homes temporarily saved from foreclosure. My proposed analysis considers mortgage delinquency management tools through the lens of purported ends of housing policy, including whether they honor and further the goals of wealth building, positive social-psychological states, and community development. Because those ends are not inexorably linked to owning a particular home, a system of delinquency management that honors these objectives should strive to provide fair, transparent, humane, and predictable strategies for home exit as well as for home retention.[15] Although more empirical research is needed, this Essay begins to consider existing mortgage delinquency management tools within the context of these housing policy objectives, recognizing that delinquency resolutions probably do not inherently honor these objectives in a systematic way outside of the context of carefully designed and closely monitored affordable mortgage programs.[16]

Several caveats should be noted here. First, this Essay proceeds from the assumption that the articulated objectives legitimately justify public investment. That does not mean that laws and policies shaping housing and the mortgage market have always been executed with these objectives in

15. *See, e.g.*, *Hearings*, *supra* note 5, at 5–6 (statement of Richard F. Syron, Chairman & Chief Executive Officer, Freddie Mac); U.S. Senate Banking Comm., Homeownership Preservation Summit Statement of Principles para. 6 (2007) ("[N]ot every foreclosure can be prevented nor every home saved. All parties should work to minimize the damage to borrowers, communities, and the mortgage market when saving the home is not possible."); Eggert, *supra* note 14, at 54 ("Early intervention and modeling software will not help a borrower who fundamentally cannot afford a loan."); Jacoby, *supra* note 4.

16. For example, as discussed in more detail in Part IV, lenders' loss mitigation strategies are shaped by perceived financial benefits. *See, e.g.*, Brent W. Ambrose & Charles A. Capone, Jr., *Cost-Benefit Analysis of Single-Family Foreclosure Alternatives*, 13 J. Real Est. Fin. & Econ. 105, 117 (1996) [hereinafter Ambrose & Capone, *Cost-Benefit Analysis*] (noting that "lenders can find profitable opportunities in extending all types of foreclosure alternatives"); Anthony Pennington-Cross, *The Duration of Foreclosures in the Subprime Mortgage Market: A Competing Risks Model with Mixing* (Fed. Reserve Bank of St. Louis, Working Paper 2006-027A, 2006), *available at* http://research.stlouisfed.org/wp/2006/2006-027.pdf.

mind,[17] nor that public investment associated with the mortgage market inevitably expands home ownership.[18]

Certain terminology deserves up-front explanation as well. This Essay's references to "home exit" mean parting with ownership of particular property. Ideally, this need not be construed as a permanent return to the rental sector; although no easy roadmap is offered here, a significantly reformed delinquency management and foreclosure process might enable people to transition into financially manageable home ownership in relatively short order. Also, consistent with the conventions of much of the real estate finance literature, this Essay uses the term "lender" to signify a party with rights to enforce the mortgage, but admittedly this is a term of convenience that obscures the number and dispersion of parties with a direct or indirect economic stake in mortgage performance.[19] Although some might criticize the continued use of the traditional lender-borrower model, it seems premature to abandon this framework altogether. Furthermore, the terms "default" and "serious delinquency" in this Essay refer to mortgages that are at least ninety days delinquent, employing the convention of the real estate finance research, whereas "delinquency" refers to any deviation from the terms of the mortgage obligation.

17. The real estate finance industry, realtors, highway builders, and housing developers have benefited from the governmental push for home ownership. *See, e.g.*, Achtenberg & Marcuse, *supra* note 8, at 6–7; Barry Checkoway, *Large Builders, Federal Housing Programs, and Postwar Suburbanization*, *in* Critical Perspectives on Housing, *supra* note 1, at 119, 120 ("Key decisions in postwar suburbanization were made by large operators and powerful economic institutions supported by federal government programs . . . ordinary consumers had little real choice in the basic pattern that resulted."); *id.* at 127–28 (noting the efforts of federal housing policy to encourage building in suburbs and discourage city development); Rohe & Watson, *supra* note 2, at 3 (noting that some have questioned whether home ownership promotion is a product of special interests); Tom Schlesinger & Mark Erlich, *Housing: The Industry Capitalism Didn't Forget*, *in* Critical Perspectives on Housing, *supra* note 1, at 139, 142; Shlay, *supra* note 1, at 512; Stone, *supra* note 8, at 51; Williams, *supra* note 1, at 328 (linking housing policies to suburbanization).

18. For example, upper-income households who already have a high home ownership rate are the principal beneficiaries of the mortgage interest tax deduction. *See* Collins, *supra* note 2, at 79, 82; Cushing Dolbeare, *How the Income Tax System Subsidizes Housing for the Affluent*, *in* Critical Perspectives on Housing, *supra* note 1, at 264, 265 (reporting tax laws are among the largest federal housing subsidies); Michael Sherraden, *Assets for All: Toward Universal, Progressive, Lifelong Accounts*, *in* Ending Poverty in America: How to Restore the American Dream 151, 152 (John Edwards et al. eds., 2007) (reporting who benefits from tax deduction). By contrast, Federal Housing Administration (FHA) insurance of mortgages may increase home ownership among more modest income households. *See, e.g.*, Albert Monroe, How the Federal Housing Administration Affects Homeownership 5, 30 (Nov. 24, 2001) (unpublished manuscript, on file with Harvard Univ. Dep't of Econ.).

19. *See* Ren S. Essene & William Apgar, Understanding Mortgage Market Behavior: Creating Good Mortgage Options for All Americans 1 (2007); William C. Apgar & Allen J. Fishbein, *The Changing Industrial Organization of Housing Finance and the Changing Role of Community-Based Organizations*, *in* Building Assets, Building Credit: Creating Wealth in Low-Income Communities 107, 108–14 (Nicolas P. Retsinas & Eric S. Belsky eds., 2005); Engel & McCoy, *supra* note 5, at 2045 (reporting that nearly eighty percent of subprime mortgages are securitized); Richard K. Green & Susan M. Wachter, *The American Mortgage in Historical and International Context*, 19 J. Econ. Persp. 93, 93 (2005) (discussing the shift in funding of mortgages to secondary market investors).

Part I reviews determinants of mortgage delinquency from the real estate finance literature and isolates several implications of that literature for this project. Part II identifies certain contributors to the delinquency management system from debtor-creditor law, including those from the bankruptcy system, and from private loss mitigation efforts. This part distinguishes home exit tools from home retention tools, although the law does not always divide neatly into these categories. Part III identifies housing policy objectives as lenses through which to evaluate delinquency management tools and then begins to conduct that evaluation.

I. DETERMINANTS OF MORTGAGE DELINQUENCY

A. *Literature Review*

Building a society of home owners generally requires mortgage market development, which in turn is premised on a reliable system of contract enforcement against borrowers who default.[20] Researchers in the United States have been leaders in studying the determinants of mortgage delinquency.[21] Traditionally, real estate finance scholars theorized mortgage termination as an option of the borrower to forfeit the home if the mortgage debt exceeded the home's value.[22] More recent theoretical and empirical work has not abandoned this basic construct but includes more realistic assumptions and more in-depth analysis. For example, the literature has subdivided mortgage termination into termination due to moving, termination due to prepayment, and termination due to default.[23] Perhaps more significantly, real estate finance experts no longer assume that delinquency on a mortgage should be equated with mortgage termination and a borrower's home loss.[24] Notwithstanding these

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20. *See, e.g.*, Daniela Fabbri & Mario Padula, *Legal Institutions, Credit Markets, and Poverty in Italy*, *in* Credit Markets for the Poor 113, 135, 141 (Patrick Bolton & Howard Rosenthal eds., 2005); Anthony B. Sanders, *Barriers to Homeownership and Housing Quality: The Impact of the International Mortgage Market*, 14 J. Housing Econ. 147, 151–52 (2005) (discussing the importance of strong legal enforcement to mortgage market development and identifying factors comprising sufficient legal enforcement).

21. *See* Luis Diaz-Serrano, *Income Volatility and Residential Mortgage Delinquency Across the EU*, 14 J. Housing Econ. 153, 156 (2005).

22. *See generally* Brent W. Ambrose et al., *Optimal Put Exercise: An Empirical Examination of Conditions for Mortgage Foreclosure*, 23 J. Real Est. Fin. & Econ. 213 (2001); Brent W. Ambrose et al., *Pricing Mortgage Default and Foreclosure Delay*, 29 J. Money, Credit & Banking 314, 315 (1997) [hereinafter Ambrose et al., *Pricing Mortgage Default*]; Robert B. Avery et al., *Credit Risk, Credit Scoring, and the Performance of Home Mortgages*, 82 Fed. Res. Bull. 621, 623 (1996); Gerson M. Goldberg & John P. Harding, *Investment Characteristics of Low- and Moderate-Income Mortgage Loans*, 12 J. Housing Econ. 151, 164 (2003); Roberto G. Quercia & Michael A. Stegman, *Residential Mortgage Default: A Review of the Literature*, 3 J. Housing Res. 341, 350–51 (1994).

23. *See, e.g.*, Goldberg & Harding, *supra* note 22, at 153.

24. *See, e.g.*, Brent W. Ambrose & Charles A. Capone, *Modeling the Conditional Probability of Foreclosure in the Context of Single-Family Mortgage Default Resolutions*, 26 Real Est. Econ. 391 (1998); Quercia & Stegman, *supra* note 22, at 371–74; Elmer & Seelig, *supra* note 9, at 8, 11–12.

refinements, home owners' equity positions continue to be a major explanatory variable in predicting mortgage default.[25]

Some studies have explored the role of trigger events in explaining rising delinquencies and foreclosure.[26] Oft-mentioned events include job problems, medical problems, and family breakup, all of which can reduce a home owner's income while sometimes increasing other expenses.[27] The trigger event theory of delinquency can intersect with the option theory in several different ways. Some researchers have acknowledged that residential home owners are unlikely to monitor their home equity position for the optimal moment to prepay or default.[28] However, a trigger event may prompt such an assessment.[29]

The theories might also be reconciled by contemplating two distinct types of delinquency. Brent W. Ambrose and Charles A. Capone argue that

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25. *See, e.g.*, Avery et al., *supra* note 22, at 623–25 (noting that studies consistently find equity to be a "robust predictor of default"); Raisa Bahchieva et al., *Mortgage Debt, Bankruptcy, and the Sustainability of Homeownership*, *in* Credit Markets for the Poor, *supra* note 20, at 73, 92 ("As a substantial body of research indicates, loan-to-value ratios are the major determinant of whether financially distressed homeowners are at risk of ultimately losing their homes to foreclosure . . . ."); LaCour-Little, *supra* note 9, at 363 ("Virtually all researchers conclude that borrower equity, or loan-to-value ratio, are critical determinants of default probability."); Thomas M. Springer & Neil G. Waller, *Termination of Distressed Residential Mortgages: An Empirical Analysis*, 7 J. Real Est. Fin. & Econ. 43, 52 (1993); Michael A. Stegman, *An Affordable Homeownership Strategy That Promotes Savings Rather Than Risk*, *in* Ending Poverty in America, *supra* note 18, at 165, 169. *But see* Elmer & Seelig, *supra* note 9, at 5 (noting that traditional determinants of mortgage default "appear to explain some, but not all, of the long-term foreclosure rate trend").

26. *See, e.g.*, Amy Crews Cutts, Freddie Mac, Facts and Figures on New Mortgage Products, Protecting Consumers in the New Mortgage Marketplace—Federal Trade Commission Workshop 11 (2006), *available at* http://www.ftc.gov/bcp/workshops/mortgage/presentations/cutts.pdf (reporting hardship reasons for delinquency, including 41.5% job problems, 18.9% illness, and 10.3% "excessive obligation"); Terrence M. Clauretie, *State Foreclosure Laws, Risk Shifting, and the Private Mortgage Insurance Industry*, 56 J. Risk & Ins. 544, 548 (1989) (including the variable for trigger events notwithstanding mixed evidence of their role); Peter J. Elmer & Steven A. Seelig, *Insolvency, Trigger Events, and Consumer Risk Posture in the Theory of Single-Family Mortgage Default*, 10 J. Housing Res. 1, 2 (1999); LaCour-Little, *supra* note 9, at 363. *Compare* Dennis R. Capozza & Thomas A. Thomson, *Optimal Stopping and Losses on Subprime Mortgages*, 30 J. Real Est. Fin. & Econ. 115, 126, 130 (2005) (finding that trigger events did not play their expected role), *with* Quercia & Stegman, *supra* note 22, at 376 (indicating that the role of borrower-related characteristics remained unclear as of 1994).

27. *See, e.g.*, Cutts, *supra* note 26, at 11; Howard Lax et al., *Subprime Lending: An Investigation of Economic Efficiency*, 15 Housing Pol'y Debate 533, 553 (2004); *see also* Diaz-Serrano, *supra* note 21, at 165, 167 tbl.3 (finding income volatility to have a negative effect on home ownership in a study of eight European countries).

28. *See* Richard Stanton, *Rational Prepayment and the Valuation of Mortgage-Backed Securities*, 8 Rev. Fin. Stud. 677, 679 (1995).

29. *See, e.g.*, Avery et al., *supra* note 22, at 622–24; Yongheng Deng et al., *Mortgage Default and Low Downpayment Loans: The Cost of Public Subsidy*, 27 Regional Sci. & Urb. Econ. 263 (1996); Diaz-Serrano, *supra* note 21, at 154; Anthony Pennington-Cross, *The Value of Foreclosed Property*, 28 J. Real Est. Res. 193, 197 (2006); Quercia et al., *supra* note 12, at 313 (citing Kerry D. Vandell, *Imperfect Information, Uncertainty, and Credit Rationing: Comment and Extension*, 99 Q. J. Econ. 841 (1984)).

loan servicers should handle trigger-event defaulters differently from no-equity defaulters.[30] Accordingly, they advise lenders and servicers to offer a consensual resolution to delinquency only to trigger-event defaulters who "have a demonstrated desire to avoid foreclosure."[31] Some researchers suggest that trigger-event defaults should be expected among subprime loans independent of risk associated with particular loan terms.[32]

Of course, apart from option theory and trigger event theory, it is possible for other factors, such as specific loan product features, to play a major role in mortgage default.[33] Even before the recent rise in subprime mortgage originations and delinquencies, one could find some empirical support for an association between loan features (e.g., adjustable interest rates) and higher default risk.[34]

B. *Implications*

This research reflects that a completed foreclosure sale (or voluntary forfeiture of the home) is not an inevitable consequence of mortgage delinquency, even in a nation with relatively strong debt enforcement laws.[35] Otherwise, there would be little reason for real estate finance and policy scholars to study the consequences of delinquency, as the plot would already be written by the formal law.[36] This justifies further inquiry into the existence of some form of delinquency management system, however ad hoc it may be.

The literature also bolsters the concern that emergency responses to the most recent surge in subprime mortgage delinquencies do not serve as substitutes for a long-term strategy that recognizes the centrality of

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30. Ambrose & Capone, *supra* note 24, at 392–95, 406. Brent W. Ambrose and Charles A. Capone characterize trigger event defaulters as those who want to keep their homes but "use their non-payment status as a means of financing other expenditures." *Id.* at 393. "Ruthless defaulters optimize their behavior by allowing foreclosure to occur, whereas borrowers in the trigger-event cohort may only go to foreclosure for reasons beyond their control." *Id.* at 395.

31. *Id.* at 394.

32. *See* Dennis R. Capozza & Thomas A. Thomson, *Subprime Transitions: Lingering or Malingering in Default?*, 33 J. Real Est. Fin. Econ. 241, 244 (2006); Pennington-Cross, *supra* note 16, at 4–5. *But see* Capozza & Thomson, *supra* note 26, at 126, 130.

33. *See* Ctr. for Responsible Lending, *Subprime Lending: A Net Drain on Homeownership* (CRL Issue Paper No. 14, 2007), *available at* http://www.responsiblelending.org/pdfs/Net-Drain-in-Home-Ownership.pdf; *see also* Cagan 2007, *supra* note 6 (discussing mortgage payment reset); Cagan 2006, *supra* note 6 (same).

34. *See, e.g.*, Donald F. Cunningham & Charles A. Capone, Jr., *The Relative Termination Experience of Adjustable to Fixed-Rate Mortgages*, 45 J. Fin. 1687 (1990) (studying mortgages in Texas in the 1980s). *But see* Quercia & Stegman, *supra* note 22, at 376 (noting the limited research on the impact of mortgage product features on delinquency in the early 1990s).

35. *See, e.g.*, Ambrose & Capone, *supra* note 24; Quercia & Stegman, *supra* note 22, at 371–74; Elmer & Seelig, *supra* note 9, at 8, 11–12.

36. For a recent study and literature review, see, for example, Lei Ding et al., *Post-Purchase Counseling and Default Resolutions Among Low- and Moderate-Income Borrowers*, J. Real Est. Res. (forthcoming 2008).

delinquency management to housing policy goals. Average households with conventional fixed-rate mortgage loans and perhaps even modest achievements in equity building are far from immune from financial trouble that can carry over into mortgage delinquency.[37] Mortgage delinquency risk and associated costs can be reduced through regulation or market self-correction, but these interventions will not obviate the need for a management strategy.

Nontrivial levels of delinquency are tolerable from the perspective of the mortgage industry, investors, and regulators. Whether those same levels are tolerable for households and communities depends on the possible responses. At any level, however, financially distressed households and communities need constructive and predictable approaches to delinquency management.[38]

II. MORTGAGE DELINQUENCY MANAGEMENT

A. *Home Exit*

1. Responses in Debtor-Creditor Law

Although housing and mortgage policy is increasingly executed on the federal level, state foreclosure laws historically have provided the anticipated formal legal response to mortgage default.[39] These statutes regulate the debt collection efforts of lenders who seek to satisfy their debts through the sale of homes pledged as collateral. Generally, if a lender wishes to sell a home over a defaulting borrower's objections and to apply the sale proceeds to the loan balance, the lender must initiate a state law process to sever the borrower's "equity of redemption," which is the borrower's right to retain ownership of the property by paying the full amount of the debt in a lump sum.[40] As other scholars have amply addressed, the details of this process vary considerably from state to state.[41]

37. Some of the research is summarized in Melissa B. Jacoby, *The Debtor-Patient Revisited*, 51 St. Louis U. L.J. 307, 321–22 (2007). For original empirical research on rising risk among American families, see generally Hacker, *supra* note 4, and Mark R. Rank & Thomas A. Hirschl, *Rags or Riches? Estimating the Probabilities of Poverty and Affluence Across the Adult American Life Span*, 82 Soc. Sci. Q. 651 (2001).

38. Among many mortgages that are securitized, the risk to investors of prepayment is more significant than the risk of default. *See* Janneke Ratcliffe et al., Persistency Pays Off: Prepayment Behavior of Affordable Mortgages 5–7 (May 10, 2007) (unpublished manuscript), *available at* http://www.ccc.unc.edu/documents/prepay.pdf.

39. *See, e.g.*, Frank S. Alexander, *Federal Intervention in Real Estate Finance: Preemption and Federal Common Law*, 71 N.C. L. Rev. 293, 304–07, 311 (1993).

40. *See, e.g.*, Joseph William Singer, *The Reliance Interest in Property*, 40 Stan. L. Rev. 611, 685 (1988).

41. *See* Julia Patterson Forrester, *Still Mortgaging the American Dream: Predatory Lending, Preemption, and Federally Supported Lenders*, 74 U. Cin. L. Rev. 1303, 1360–61 (2006); Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act*, 53 Duke L. J. 1399, 1404 (2004); Pennington-Cross, *supra*

One key distinction is whether the foreclosure must be a judicial proceeding—requiring the filing of a law suit—as is the case in about forty percent of the states.[42] The remaining states also allow nonjudicial "power of sale" foreclosures if so designated in the original loan agreement.[43] In either type of process, the sale must be public, but the average power of sale foreclosure takes considerably less time to complete than judicial sales.[44] Power of sale foreclosures also tend to have less stringent notice requirements, although they run the risk of later court challenges.[45] Other notable state variations in foreclosure law (more directly relevant to home retention discussed later) relate to the allowance of deficiency judgments, redemption rights, and whether the occupants can remain in the home during the redemption period.[46] These distinctions affect the timeline of the process as well as the substantive rights of the lender and borrower.

States are not the exclusive providers of formal foreclosure law. The federal government has preempted state foreclosure law for certain home mortgage loans held by the U.S. Department of Housing and Urban Development (HUD).[47] The HUD laws streamline foreclosure more than many state law regimes.[48] This could reflect the existence of greater workout opportunities prior to foreclosure initiation, a governmental interest in cutting off ownership rights for home owners thought to be unsustainable, or the belief that a streamlined approach yields higher prices in foreclosure sales.[49]

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note 16, at 18. One finds variation among foreclosure laws in Europe. *See* Diaz-Serrano, *supra* note 21, at 158.

42. *See* Grant S. Nelson & Dale A. Whitman, Real Estate Finance Law 558 (4th ed. 2001).

43. *See* Nelson & Whitman, *supra* note 41, at 1415 n.88. For an in-depth explanation of power of sale procedures, see Nelson & Whitman, *supra* note 42, at 582–643. Two states permit strict foreclosure, or lender retention, without sale. *See id.*

44. *See* Nelson & Whitman, *supra* note 42, at 558, 582–84.

45. *See id.* at 582, 584.

46. *See, e.g.*, Richard A. Phillips & James H. VanderHoff, *The Conditional Probability of Foreclosure: An Empirical Analysis of Conventional Mortgage Loan Defaults*, 32 Real Est. Econ. 571, 576 (2004).

47. The government initially preempted state foreclosure laws for buildings with units for five or more households, and later did the same for single family homes and buildings housing two to four families. *See* 12 U.S.C. §§ 3701–3717 (2000); 24 C.F.R. §§ 27.1–.123 (2006); Nelson & Whitman, *supra* note 41, at 1413–14; Stark, *Foreclosing on the American Dream*, *supra* note 13, at 238–39. A longer list of federal supplements or overrides to state foreclosure law may be found in Alexander Gordon IV, Gordon on Maryland Foreclosures §§ 37.1–.10 (4th ed. 2004). Congress unsuccessfully considered a federal statute that would authorize power of sale foreclosure for "all federally owned, insured, or guaranteed loans." Nelson & Whitman, *supra* note 41, at 1413. For further discussion of the history of this proposed legislation, see *id.* at 1413–15.

48. According to Debra Pogrund Stark, the U.S. Department of Housing and Urban Development (HUD) laws embody the harshest and most unforgiving features of state law. Stark, *Foreclosing on the American Dream*, *supra* note 13, at 241–42.

49. *See id.* at 242–43. For example, federal regulations impose timetables and other guidelines, such as face-to-face meetings, for pursuing foreclosure on loans that are guaranteed or insured by the FHA. *See* 24 C.F.R. §§ 203.500, 203.604, 203.606; Nelson & Whitman, *supra* note 42, at 549. Loans insured by the Department of Veterans Affairs are

Federal law also supplements the state law of home exit through the Bankruptcy Code. Bankruptcy acts as an antideficiency statute for borrowers who already have lost their homes in foreclosure sales.[50] In other words, a borrower may file for bankruptcy after a foreclosure sale that failed to produce proceeds sufficient to cover the full debt, and a bankruptcy discharge will permanently enjoin collection of the shortfall. Bankruptcy also offers a shadow foreclosure sale process to the extent that a court permits the home to be sold without the formalities of state foreclosure law.[51]

2. Private Loss Mitigation

Lenders do not initiate, let alone complete, a formal foreclosure process in response to every breach of a mortgage obligation.[52] Likewise, borrowers do not initiate bankruptcy in response to every serious delinquency. Time permitting, a lender could allow a home owner to sell property privately and use the proceeds to pay off the loan—the optimal approach to home exit within the existing framework. Even if sale proceeds would not fully cover the loan, a lender could agree to a "short sale" and to waive pursuit of the deficiency.[53] With the borrower's postdefault consent, the lender also may accept a "deed in lieu of foreclosure," becoming the owner of the property.[54] As discussed in Part III, economic conditions,

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also subject to foreclosure guidelines, but it is unclear whether those guidelines are binding. *See id.* at 548.

50. *See* 11 U.S.C. §§ 524(a), 727(a) (2004 & Supp. VII 2007). *See generally* Bahchieva et al., *supra* note 25. For a discussion of deficiency judgment restrictions, see, for example, Nelson & Whitman, *supra* note 42, at 659. Stark's study in Illinois, a state without restrictions on deficiency judgments, identified some individuals who filed for bankruptcy after the foreclosure sale. *See* Stark, *Foreclosing on the American Dream*, *supra* note 13, at 251–52 figs.5 & 6. But other states have antideficiency statutes, which essentially turn mortgages into nonrecourse loans in the hopes of encouraging lenders to seek foreclosure sale prices closer to fair market value. *See* Nelson & Whitman, *supra* note 42, at 659; Jane Kaufman Winn, *Lien Stripping After* Nobelman, 27 Loy. L.A. L. Rev. 541, 593–94 (1994).

51. *See* 11 U.S.C. § 363(b)(1). Although one often may expect this to take place in a Chapter 7 proceeding, it also may occur in a Chapter 13 proceeding. *See, e.g.*, *In re* Valdez, No. 13-06-12431 MA, 2007 WL 1464439 (Bankr. D.N.M. May 17, 2007).

52. *See, e.g.*, Ambrose et al., *Pricing Mortgage Default*, *supra* note 22, at 314–15 (reviewing studies finding that foreclosures are only a small portion of defaults); Ambrose & Capone, *Cost-Benefit Analysis*, *supra* note 16, at 106 ("Industry experience suggests that 90% of all loan defaults cure during the initial 90-day delinquency period. Approximately 75% of those that do reach the 90-day-delinquency status will ultimately reinstate, and the completion rate on actual foreclosure initiations after day 90 is less than 55%."); Avery et al., *supra* note 22, at 621; Charles M. Kahn & Abdullah Yavas, *The Economic Role of Foreclosures*, 8 J. Real Est. Fin. & Econ. 35, 36 (1994) (noting that foreclosures occur in a small proportion of instances of nonperformance and using the difference in rates as a proxy for renegotiation in the analysis); LaCour-Little, *supra* note 9, at 365; Mickey Lauria et al., *An Investigation of the Time Between Mortgage Default and Foreclosure*, 19 Housing Stud. 581, 584 (2004); Phillips & VanderHoff, *supra* note 46, at 572 (noting that twenty percent of defaults result in actual foreclosure).

53. Pennington-Cross, *supra* note 29, at 199.

54. *Subprime and Predatory Lending: New Regulatory Guidance, Current Market Conditions, and Effects on Market Conditions, Hearing Before the Subcomm. on Financial*

communication barriers, and other factors affect the viability of private exit options.[55]

B. *Home Retention*

1. Responses in Debtor-Creditor Law

The number of completed foreclosure sales is smaller than the number of foreclosures filed.[56] This could be at least partly because foreclosure law itself has property-retentive features.[57] All U.S. jurisdictions allow borrowers to redeem their homes through lump sum payment of the debt.[58] About half of the states continue to offer redemption rights after the foreclosure sale has taken place.[59]

Some states also allow borrowers to deaccelerate and reinstate mortgages by paying only the amount of debt in arrears, plus costs.[60] Debra Stark found substantial reinstatement activity in her study of Cook County,

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Institutions and Consumer Credit of the H. Comm. on Financial Services, 110th Cong. 20 (2007) [hereinafter *Subprime and Predatory Lending*] (statement of John M. Robbins, Mortgage Bankers Association); Comptroller of the Currency Adm'r of Nat'l Banks, Foreclosure Prevention: Improving Contact with Borrowers, Community Developments 7–8 (2007), *available at* http://www.occ.treas.gov/cdd/Foreclosure_Prevention_Insights.pdf; HUD, Providing Alternatives to Mortgage Foreclosure: A Report to Congress 31–32 (1996); Avery et al., *supra* note 22, at 622.

55. *See infra* Part III.

56. *See, e.g.*, Phillips & VanderHoff, *supra* note 46, at 572 ("[O]nly a minority (about 20% in recent years) of defaults result in foreclosure."); Stark, *Facing the Facts*, *supra* note 13, at 663; Stark, *Foreclosing on the American Dream*, *supra* note 13, at 242–43, 251–52 figs.5 & 6; Michael A. Stegman et al., *Preventive Servicing Is Good for Business and Affordable Homeownership Policy*, 18 Housing Pol'y Debate, 243, 258 (2007); *Foreclosure Data Seen as Key to Policies on Housing Market, Predatory Lending Curbs*, Bankr. L. Daily (BNA) (Mar. 13, 2007).

57. The basic theory of including mortgagor protection in foreclosure law is compulsory insurance when individuals are likely to underinsure privately. *See, e.g.*, Duncan Kennedy, *Cost-Benefit Analysis of Debtor Protection Rules in Subprime Market Default Situations*, *in* Building Assets, Building Credit, *supra* note 19, at 266, 279.

58. Tracht, *supra* note 13, at 600 (describing a central tenet of mortgage law, namely, that "[t]he equity of redemption is essential, immutable, and unwaivable"). For a brief history of the development of the concept, see Nelson & Whitman, *supra* note 42, at 7. Payment of the full amount of the debt is required on account of acceleration clauses contained in most mortgage loan agreements. *See id.* at 539.

59. Nelson & Whitman, *supra* note 42, at 9, 534, 689. Federal foreclosure laws applicable to HUD loans explicitly reject postsale redemption rights, implementing a power of sale process instead. Stark, *Facing the Facts*, *supra* note 13, at 688.

60. *See, e.g.*, Cal. Civ. Code § 2924c (West 1993) (permitting reinstatement up to five business days prior to sale); D.C. Code § 45-715.1 (2001) (permitting reinstatement up to five business days prior to sale, once every two consecutive years); 735 Ill. Comp. Stat. 5/15-1602 (2003) (providing a ninety-day reinstatement period after service with foreclosure action, limited to no more than once every five years in most situations); N.J. Stat. Ann. § 2A:50–57 (West 2000) (providing reinstatement right not more frequently than once every eighteen months); Or. Rev. Stat. § 86.753 (2003) (allowing reinstatement up to five days prior to the scheduled sale and specifying associated fees); Wash. Rev. Code § 61.24.090 (2004) (allowing reinstatement up to the eleventh day prior to sale).

Illinois, foreclosures in the mid-1990s.[61] Even in states without these laws, reinstatement is part of the standard form mortgages capable of being purchased by Fannie Mae or Freddie Mac and also is provided by federal regulation and contract for Federal Housing Administration (FHA) insured loans.[62] One study reports a significant percentage of loan reinstatements among a sample of FHA mortgages, albeit somewhat less so among highly leveraged home owners.[63]

The federal bankruptcy laws present a related tool. Chapter 13 of the Bankruptcy Code allows a borrower to reinstate a mortgage by paying arrears in installments over several years with interest, assuming that the debtor's plan satisfies the requisite legal requirements.[64] As discussed further in Part III, Chapter 13's installment-based approach is one of several features that distinguish it from other reinstatement options.

Another common theme within the formal law can be described as "breathing room." Approaches to offering breathing room when a borrower's home is the collateral include temporary moratoria on foreclosures (putting aside the question of constitutionality),[65] mandatory time delays in foreclosure processes to attempt mortgage counseling or for other purposes,[66] and automatic stays imposed when home owners declare bankruptcy.[67] Although breathing room can promote home retention, it also has the potential to improve the circumstances of home exit.

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61. Stark, *Foreclosing on the American Dream*, *supra* note 13, at 251–52 figs.5 & 6 (showing that thirty percent and twenty-five percent of dismissed foreclosures in each sample were loan reinstatements).

62. For information on the standard form mortgage, see generally Nelson & Whitman, *supra* note 42, at 551; *see also* Chase Manhattan Mortgage Corp. v. Tudor, No. 2:06cv26, 2007 WL 4322187, at *8–9 (S.D. Ohio Dec. 7, 2007) (stating that the mortgage had a contractual reinstatement but the debtor instead used a bankruptcy reinstatement). For FHA loans, see 24 C.F.R. § 203.608 (2006) and Brent W. Ambrose & Charles A. Capone, *The Hazard Rates of First and Second Defaults*, 20 J. Real Est. Fin. & Econ. 275, 276 (2000). Federal guidelines provide a reinstatement right on loans insured by the Department of Veterans Affairs, but the binding status of those guidelines has been unclear. *See generally* Nelson & Whitman, *supra* note 42, at 548–49.

63. Ambrose & Capone, *supra* note 24, at 406; Ambrose & Capone, *supra* note 62, at 277 (reporting on reinstatements).

64. 11 U.S.C. §§ 1322, 1325 (2000).

65. For discussion of moratoria on foreclosures in the 1930s on short-term interest-only loans, see Nelson & Whitman, *supra* note 42, at 2, 658–59; Mansfield, *supra* note 5, at 479 (discussing the role of the Home Owners' Loan Corporation in implementing moratoria). For moratoria with more variation in duration and scope, see, for example, Nelson & Whitman, *supra* note 42, at 2, 658–59; Harold L. Levine, *A Day in the Life of a Residential Mortgage Defendant*, 36 J. Marshall L. Rev. 687, 700–01 (2003) (discussing the moratorium on HUD- and FHA-insured borrowers after September 11, 2001, for borrowers who wrote to their lenders and identified themselves as affected borrowers); Sean Zielenbach, *Moving Beyond the Rhetoric: Section 8 Housing Choice Voucher Program and Lower-Income Urban Neighborhoods*, J. Housing & Community Dev. L., Fall 2006, at 9, 22 (discussing the eight-week moratorium on FHA loans in Baltimore in 2000).

66. *See* Ill. Admin. Code tit. 38, § 1050.1280 (2005). For a review of state statutes that require preforeclosure delinquency counseling, see Levine, *supra* note 65, at 700.

67. 11 U.S.C. § 362(a).

The above discussion should not be construed as an exhaustive account of retentive tools found in the formal debtor-creditor law. For example, although the federal bankruptcy system generally permits less restructuring of home mortgages than of loans secured by other kinds of collateral,[68] mortgages sometimes can be modified.[69] Nonetheless, the options set forth here indicate a range of approaches beyond what one traditionally expects when focusing only on foreclosure law.

2. Private Loss Mitigation

Housing experts have noted that "[m]ost large-scale mortgage servicers have at their disposal a wide array of loan modification and other loan loss mitigation tools designed to help borrowers avoid foreclosure."[70] In a partial reinstatement, a borrower would resume monthly payments and set up a payment plan for the arrearage—similar to bankruptcy, although probably on a shorter time frame—or would allow the mortgagee to put the arrearage into a junior mortgage. In a short-term forbearance, a lender would suspend or reduce payments for several months and would recoup those amounts later.[71] A loan modification would make a permanent change to the terms of the loan obligation.[72] As discussed in Part III.C,

68. *See* Nelson & Whitman, *supra* note 42, at 706. Much has been written about this privileged treatment of loans secured by homes, raising arguments that this treatment increased and preserved the availability of mortgage credit. *See, e.g.*, Winn, *supra* note 50, at 578.

69. Some courts have approved repayment plans that strip junior mortgages from residences if the value of the residence was insufficient to cover the second mortgage. *See generally* Nelson & Whitman, *supra* note 42, at 710, 747–48. 11 U.S.C. § 1322(c)(2) is often interpreted to permit modification of home mortgages that end by their own terms prior to the end of the payment plan. Home owners qualifying as family farmers may modify home mortgage loans. *See* 11 U.S.C. § 1222(b). Occasionally, the granting of a mortgage might be subject to avoidance powers. *See, e.g.*, *id.* §§ 544, 548. For more expansive proposals, see R. Stephen Painter, Jr., *Subprime Lending, Suboptimal Bankruptcy: A Proposal to Amend §§ 522(f)(1)(B) and 548(a)(1)(B) of the Bankruptcy Code to Protect Subprime Mortgage Borrowers and Their Unsecured Creditors*, 38 Loy. U. Chi. L. J. 81 (2006). For pending legislative proposals, see *infra* note 115.

70. Apgar & Fishbein, *supra* note 19, at 133; *see also* U.S. Senate Banking Comm., *supra* note 15.

71. *See, e.g.*, Amy Crews Cutts & Richard K. Green, *Innovative Servicing Technology: Smart Enough to Keep People in Their Houses?*, *in* Building Assets, Building Credit, *supra* note 19, at 348, 356 (discussing the FHA program in which a lender extends an interest-free loan to the delinquent borrower to bring the mortgage current, and the loan is not payable until the property is sold or the first mortgage is paid off).

72. For a discussion of all these options in more detail, see *id.* at 354–56. *See also* Freddie Mac, Foreclosure Avoidance Research (2005), *available at* http://www.freddiemac.com/service/msp/pdf/foreclosure_avoidance_dec2005.pdf (listing the types of workout options and awareness of those options of survey participants). For more details on the substance of workout options, see *Subprime and Predatory Lending*, *supra* note 54, at 19 (statement of John M. Robbins, Mortgage Bankers Association); HUD, *supra* note 54, at 27; PolicyLab Consulting Group, Analyzing Elements of Leading Default-Intervention Programs (2006) (discussing a Fannie Mae–funded study on default intervention); Avery et al., *supra* note 22, at 621.

many factors shape whether borrowers with mortgage delinquency are actually offered feasible workouts.

III. DELINQUENCY MANAGEMENT THROUGH THE LENS OF HOME OWNERSHIP OBJECTIVES

A. *Objectives*

Evaluation of delinquency management responses, to the extent it takes place, often proceeds down one of two paths. The first is to consider the tool's impact on the cost of and access to mortgage credit.[73] The second is to consider whether a home has been temporarily saved from foreclosure. Neither is sufficient. This Essay explores a different approach by examining delinquency management in light of three commonly identified objectives associated with the long-standing push for home ownership as the preferred housing tenure.[74]

1. Household Wealth Building

Equity or wealth building is a frequently asserted goal of home ownership. Home ownership can be a vehicle for private wealth accumulation and thus economic self-sufficiency.[75] For most groups of households in the United States, home equity—a function of forced savings in fixed-rate mortgages plus long-term real property appreciation—has been the largest source of wealth.[76] Many advocates want to expand home ownership opportunities for lower-income households and people of various racial and ethnic backgrounds for such wealth-building purposes.[77]

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73. For studies, see, for example, Jacoby, *supra* note 4, at 332 n.45.

74. *See supra* note 1. Policy makers have pressed particularly hard on low-income home ownership expansion in recent decades. Eric S. Belsky et al., *The Financial Returns to Low-Income Homeownership*, *in* Chasing the American Dream, *supra* note 1, at 191; *see also* Irina Barakova et al., *Does Credit Quality Matter for Homeownership?*, 12 J. Housing Econ. 318, 319 (2003) (discussing recent federal policy initiatives). Mortgage market innovations such as securitization have played some role in expansion, due in part to governmental influence through carrots, sticks, and subsidies. *See, e.g.*, Nelson & Whitman, *supra* note 42, at 365 (citing a presidential commission report and other sources); Bahchieva et al., *supra* note 25, at 91 (discussing the impact of Community Reinvestment Act enforcement and affordable housing mandates on Fannie Mae and Freddie Mac); Michael S. Barr, *Credit Where It Counts: The Community Reinvestment Act and Its Critics*, 80 N.Y.U. L. Rev. 513, 639 (2005) (discussing the securitization of mortgage loan pools by government agencies such as Freddie Mac, Ginnie Mae, Fannie Mae, and Federal Home Loans Banks); Forrester, *supra* note 41, at 1307 (discussing the promotion of the mortgage market).

75. *See* Quercia et al., *supra* note 12, at 309; Michael A. Stegman et al., *The Wealth-Creating Potential of Homeownership: A Preliminary Assessment of Price Appreciation Among Low-Income Homebuyers*, *in* Chasing the American Dream, *supra* note 1, at 171.

76. *See* Hacker, *supra* note 4, at 173; Melvin L. Oliver & Thomas M. Shapiro, *Reducing Wealth Disparities Through Asset Ownership*, *in* Ending Poverty in America, *supra* note 18, at 139, 141; Williams, *supra* note 2, at 468. According to Federal Reserve data, Americans have over $11 trillion in equity. *See* Cutts, *supra* note 26, at 10.

77. *See generally* Collins, *supra* note 2, at 73–75 (discussing arguments that financial benefits of home ownership should be shared equitably).

2. Positive Social-Psychological States

Enhancing the social-psychological states of individuals and households is another oft-stated goal. Scholars posit a relationship between social-psychological states and home ownership status at the household level.[78] Empirical work suggests that home ownership is positively associated with feelings of happiness, self-esteem, and life satisfaction.[79] A substantial body of research reports benefits to children's well-being from home ownership, although the underlying mechanism for the effects remains unclear.[80]

3. Neighborhood and Community Benefits

The third objective is to strengthen communities. Home ownership and home owners are thought to confer a variety of benefits—civic, social, and economic—on neighborhoods.[81] The stated advantages of home ownership include better and safer neighborhoods, better schools,[82] and higher levels of community involvement.[83] These are just a few of the many and diverse ways in which home ownership is said to enhance neighborhood and collective life, thus justifying governmental intervention.[84]

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78. For a recent literature review, see Rohe et al., *supra* note 2, at 223–30.

79. *See, e.g.*, John Cairney & Michael H. Boyle, *Home Ownership, Mortgages and Psychological Distress*, 19 Housing Stud. 161, 169–70 (2004) (reporting the "gradient in mental health status by housing tenure"); A. Mechele Dickerson, *Bankruptcy and Mortgage Lending: The Homeowner Dilemma*, 38 J. Marshall L. Rev. 19, 20 (2004) ("Research indicates that homeowners feel better about themselves, maintain better and safer neighborhoods, and live in neighborhoods that have better schools."); Shlay, *supra* note 1, at 518 (reviewing studies); Williams, *supra* note 1, at 327 (discussing surveys concluding that home ownership is viewed as an "empowering act, giving people a stake in society and a sense of control over their lives"). Researchers have questioned whether lower-income home owners enjoy the same effects. *See* William M. Rohe & Michael A. Stegman, *The Effects of Homeownership on the Self-Esteem, Perceived Control and Life Satisfaction of Low-Income People*, 60 J. Am. Plan. Ass'n 173 (1994); Lynne Dearborn, *Homeownership: The Problematics of Ideals and Realities*, J. Affordable Housing & Community Dev. L., Fall 2006, at 40.

80. For a review, see Shlay, *supra* note 1, at 521–22, 526.

81. *See* Quercia et al., *supra* note 12, at 309 (referring to societal benefits of home ownership as basis for home ownership promotion); *id.* at 514. For a much broader literature review on the relationship between housing and communities, see Alexander von Hoffman et al., The Impact of Housing on Community: A Review of Scholarly Theories and Empirical Research (Joint Center for Hous. Studies, Harvard Univ., Working Paper W06-1, 2006), *available at* http://www.jchs.harvard.edu/publications/communitydevelopment/w06-1_impact_of_housing_on_community.pdf.

82. Some of that literature is cited in Dickerson, *supra* note 79, at 21.

83. Forrester, *supra* note 1, at 407; *see also* Williams, *supra* note 1, at 327 (reviewing the findings of studies that home owners vote more and participate more in community affairs).

84. Collins, *supra* note 2, at 72–73 (discussing research on home ownership's positive externalities); Goetz, *supra* note 2, at 101–03.

B. *Analysis*

1. General Concerns About Achieving These Objectives Through Home Ownership

As noted in the introduction to this Essay, home ownership does not inevitably further the three objectives just mentioned. Starting with the first objective, the fact that many households hold most of their wealth in their homes does not mean that this form always is best or that all groups can benefit equally from this strategy.[85] According to some researchers, nontrivial numbers of low-income home owners end up returning to the rental sector after selling homes for less than they paid for them.[86]

The posited social-psychological effects of home ownership likewise deserve critical examination to determine the nature of the relationship and the circumstances under which those effects are not realized.[87] Heavy reliance on consumer credit to achieve major social initiatives such as home ownership produces inevitable tensions between means and ends.[88] Ongoing debt service can produce financial strain independent of wealth building,[89] thus threatening the posited social-psychological benefits of

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85. *See* Belsky et al., *supra* note 74, at 192–93; Goetz, *supra* note 2, at 100–01 (reviewing research); William N. Goetzmann & Matthew Spiegel, *Policy Implications of Portfolio Choice in Underserved Mortgage Markets*, *in* Low-Income Homeownership: Examining the Unexamined Goal 257, 272 (Nicolas P. Retsinas & Eric S. Belsky eds., 2004) (arguing that encouraging low-income home ownership will increase the wealth gap); Shlay, *supra* note 1, at 519–20 (same); *see also* sources cited *supra* note 79. Yet some lower income households do benefit from asset appreciation, such as many in Fannie Mae's self-help secondary-market demonstration program. *See* Stegman et al., *supra* note 75, at 180–81 (citing factors that shape asset-building potential, including timing and geography). Low-income home owners may be disadvantaged in wealth-building objectives in part because they usually do not get the benefit of the mortgage interest tax deduction. *See infra* note 92.

86. *See, e.g.*, Eric S. Belsky & Mark Duda, *Asset Appreciation, Timing of Purchases and Sales, and Returns to Low-Income Homeownership*, *in* Low-Income Homeownership, *supra* note 85, at 15.

87. *See* Rohe et al., *supra* note 2, at 216; *see also* William M. Rohe et al., *Social Benefits and Costs of Homeownership*, *in* Low-Income Homeownership, *supra* note 85, at 384, 386–87; Shlay, *supra* note 1, at 518.

88. *See* Janet Ford et al., *Widening the Mortgage Safety Net: Some Questions of Effectiveness*, 12 Benefits 95 (2004) (noting and evaluating the risks associated with significant mortgage obligations due to job, medical, and family problems and the need for more social insurance relating to mortgages); Forrester, *supra* note 1, at 405 (noting the tension between laws protecting home owners and laws protecting lenders); Avital Margalit, *The Value of Homeownership*, 7 Theoretical Inquiries L. 467, 469, 475–76 (2006) (describing the duality of the cultural norm of home ownership and the financial risks of home ownership).

89. *See, e.g.*, Bahchieva et al., *supra* note 25, at 77 ("It is the debt that homeowners have, rather than the absolute value of their homes, that is crucial to a household's economic survival or failure. So long as homeowners can meet their monthly obligations, they can steer clear of the bankruptcy courts, whether the value of their homes rises or falls."). If a borrower has invested little capital up front, or has tapped much of the equity to borrow for nonhousing purposes, this increases the possibility that debt service will impose obligations that may become unmanageable in the event of financial trouble. *See* Rohe, *supra* note 2, at 265–66. *See generally* Dickerson, *supra* note 79; Forrester, *supra* note 1, at 409.

home ownership. To take a modest example, a recent study of home owners by regional planning scholars William Rohe, Roberto Quercia, and Shannon Van Zandt found that home owners who could not afford repairs to their homes had less "life satisfaction" than typical for financially well-off home owners.[90]

Concerns about such financially strained home ownership are not hypothetical.[91] Whether due to legal incentives from tax laws or debtor-creditor laws,[92] to attempts to use home equity to smooth consumption,[93] or to the aforementioned market innovation, mortgage debt in recent decades has increased substantially overall (adjusting for inflation),[94] as a proportion of total household debt[95] and as a proportion of income.[96] About sixty percent of low-income households with mortgages already spend at least forty percent of their incomes on debt service alone.[97] One recent study predicted that mortgage debt will consume unprecedented portions of income and have labor force implications for older Americans—partly because consumer debt will continue to shift over to debt secured by

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90. Belsky et al., *supra* note 74, at 212; Rohe et al., *supra* note 2, at 231–32. For discussions of financial burdens of nondebt-service obligations, see, for example, Stone, *supra* note 8, at 60 (referring to home loss in the 1960s among low-income and African American households because they could not meet mortgages, taxes, fuel bills, and maintenance and repairs to "keep their homes livable").

91. *See* sources cited *supra* note 4.

92. Tax laws privilege bigger mortgage debts and higher interest payments as well as debts secured by residences regardless of the use of the loan, although the benefits disproportionately are enjoyed by itemizers in higher income brackets. *See, e.g.*, Bahchieva et al., *supra* note 25, at 89, 91; Collins, *supra* note 2, at 78–79 (describing the mortgage interest deduction as an incentive to borrow rather than an incentive to become home owner); *see also* sources cited *supra* note 18. As an example of debtor-creditor law incentives, when states offer low homestead exemption protection, home owners essentially shield themselves against judgment creditors via larger mortgage debts that leave them with less equity. *See, e.g.*, Bahchieva et al., *supra* note 25, at 107.

93. Dickerson, *supra* note 79, at 19; Forrester, *supra* note 1, at 437; Anthony Pennington-Cross & Souphala Chomsisengphet, *Subprime Refinancing: Equity Extraction and Mortgage Termination*, 35 J. Real Est. Econ. 233, 236 (2007) (reporting that cash-outs of equity are much more common in the subprime market than in the prime market and reviewing literature suggesting equity cash-outs are used to finance current consumption).

94. *See* George S. Masnick et al., *Emerging Cohort Trends in Housing Debt and Home Equity*, 17 Housing Pol'y Debate 491, 491–92 (2006).

95. *See Improving Credit Card Consumer Protection: Recent Industry and Regulatory Initiatives, Hearing Before the Subcomm. of Financial Institutes and Consumer Credit of the H. Financial Services Comm.*, 110th Cong. 3 (2007) (statement of Sheila C. Bair, FDIC) (noting that mortgage debt was seventy five percent of total household debt at the end of 2006 as compared to sixty-six percent in 1992).

96. Masnick et al., *supra* note 94, at 495–96; Elizabeth Warren, *The Vanishing Middle Class*, *in* Ending Poverty in America, *supra* note 18, at 38, 43 (noting that the median home owner in 2004 made monthly mortgage payments that were seventy-six percent larger, inflation adjusted, than a generation earlier).

97. Joint Ctr. for Hous. Studies, Harvard Univ., The State of the Nation's Housing 19 fig.22 (2007). *See generally* Williams, *supra* note 2, at 424 (discussing high proportions of income committed to housing by low-income households). For concerns in the 1980s, see Stone, *supra* note 8, at 58–59.

a home.[98] Paths to low-income home ownership sometimes are premised on very highly leveraged acquisitions, leaving the "owners" dependent on housing price increases if they hope to build equity or exit without financial penalty for job relocation or changed financial circumstances.[99] In general, however, the explosion of mortgage debt in recent years has not necessarily expanded home ownership.[100]

Turning to the third objective, some researchers have suggested that the posited causal link between home ownership and community benefits requires more critical examination.[101] At the very least, financially strained home ownership can undercut community development by, for example, limiting the ability of home owners to keep up with needed repairs.[102]

Thus, before even confronting questions of delinquency and home loss, this brief discussion suggests that home ownership and these objectives do not perfectly overlap. As a consequence, the number of homes saved temporarily from foreclosure is not an ideal measure of whether the underlying justifications for home ownership promotion have been furthered. As a related matter, furtherance of these objectives may require better options for home exit as well as sustainable home ownership retention.

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98. Masnick et al., *supra* note 94, at 493, 515–17; *see also* William C. Apgar & Zhu Xiao Di, *Housing Wealth and Retirement Savings*, *in* Oxford Handbook of Pensions and Retirement Income 618 (Gordon L. Clark et al. eds., 2006); Jennifer Bayot, *As Bills Mount, Debts on Homes Rise for Elderly*, N.Y. Times, July 4, 2004, at 1 (reporting that a Harvard Joint Housing Center study found that mortgage debt of older Americans quadrupled, inflation adjusted, between 1989 and 2001, and observing that Americans over sixty-five have the fastest growing home debt, fastest growing personal bankruptcy filings, and largest growth in demand for credit counseling); Craig Copeland, *Debt of the Elderly and Near Elderly 1992–2004*, Emp. Benefit Res. Inst. Notes (Employee Benefit Research Inst. Educ. and Research Fund, Wash., D.C.), Sept. 2006, at 11 (reporting trends in rising housing debt for elderly and near elderly and concluding that "[t]he major implication is that more families have at risk what is typically their most important asset—their home").

99. Belsky et al., *supra* note 74, at 192–93; Forrester, *supra* note 1, at 407 (identifying restrictions on mobility and short-term housing declines as disadvantages of home ownership); Rohe, *supra* note 2, at 264 (noting that a sizable portion of the American population is mobile, making transaction costs of buying problematic); Shlay, *supra* note 1, at 519; *see also* Stone, *supra* note 8, at 44 (describing home ownership and housing generally as ill adaptive to changes in financial circumstances). For sober predictions of housing price trends, see, for example, *Evolution of an Economic Crisis?: The Subprime Lending Disaster and the Threat to the Broader Economy, Hearing Before the J. Economic Comm.*, 110th Cong. 2 (2007) (statement of Robert J. Shiller); Robert J. Shiller, Irrational Exuberance 13, 20 (2005).

100. *See* Dickerson, *supra* note 79, at 29 (noting the lack of information about whether mortgage expansion has promoted home ownership expansion or sustainable home ownership).

101. *See, e.g.*, Collins, *supra* note 2, at 72 ("[D]espite a growing body of research, it remains unclear whether homeownership itself is the cause of positive externalities."); Elisabeth Eaves, *Don't Buy That House*, Forbes.com, June 26, 2007, http://www.forbes.com/business/2007/06/26/home-ownership-negatives-biz-dream0607_cx_ee_0626house.html; *see also* Goetz, *supra* note 2, at 102 (discussing how neighborhood benefits are expected to flow from particular resident characteristics).

102. For example, home owners who barely can make mortgage payments may not be able to maintain the exteriors of their homes. *See, e.g.*, Engel & McCoy, *supra* note 7, at 98.

2. Some Implications for Debtor-Creditor Law

a. *Foreclosure Law*

Foreclosure law seems to receive the most extensive treatment in the legal literature of the various mortgage delinquency responses. A prominent critique of the state law foreclosure process implicitly challenges its ability to honor wealth-building objectives.[103] Many legal real estate scholars have argued that foreclosure law destroys home equity in practice even if not in theory.[104] In theory, a foreclosure process that yields fair market value with low transaction costs would convert home equity to cash, which then could be reinvested. But real estate scholars commonly claim that public foreclosure sales fail to produce market prices, which, coupled with high costs, result in the forfeiture of built-up equity.[105] The perceived unfairness of such an outcome is exacerbated by the belief that lenders frequently become the owners of foreclosed properties and then resell them later for higher prices.[106] These concerns have prompted proposals to make foreclosure more market mimicking or to use nonsale methods of value appraisal.[107]

Foreclosure's effect on wealth building should not be measured only in the short term, however. Home exit through any means has the potential to promote wealth building in the long-term; to the extent a foreclosure process allows households to part with homes they struggle to afford and maintain, it could improve the financial prospects of these families.

Foreclosure also has a potentially complicated relationship with social-psychological objectives. There may be a link between financial strain

103. *See, e.g.*, Nelson & Whitman, *supra* note 42, at 702 ("The foreclosure sale process, whether judicial or under a power of sale, is hardly designed to bring a fair price for mortgaged real estate."). *But see* Stark, *Facing the Facts*, *supra* note 13, at 686 (concluding from the Cook County study that the foreclosure process generally protects borrower equity for those that have equity). For a recent empirical assessment of price appreciation among foreclosed properties, see Pennington-Cross, *supra* note 29, at 193.

104. *See* sources cited *supra* note 103.

105. *See* sources cited *supra* note 103.

106. *See, e.g.*, Ambrose & Capone, *supra* note 62, at 276 (reporting that lenders generally buy property at foreclosure sales and then "must . . . manage and liquidate the property to recover funds lost on the mortgage"); Nelson & Whitman, *supra* note 41, at 1423–24; Steven Wechsler, *Through the Looking Glass: Foreclosure by Sale as* De Facto *Strict Foreclosure—An Empirical Study of Mortgage Foreclosure and Subsequent Resale*, 70 Cornell L. Rev. 850, 870 (1985); Pennington-Cross, *supra* note 16, at 3 n.1 (noting that lenders sell the property to recoup as much of their losses as possible). *See generally* Cagan 2006, *supra* note 6, at 31 (discussing whether lenders get full market price in selling homes postforeclosure). *But see* Johnson, *supra* note 50, at 989 (arguing that foreclosure should be a streamlined process for lenders and need not command market prices).

107. Nelson & Whitman, *supra* note 41, at 1440, 1444 (explaining negotiated sale and foreclosure by appraisal proposals); Stark, *Facing the Facts*, *supra* note 13, at 678–85 (explaining the bifurcated process proposal).

generally and adverse psychological and physical health consequences.[108] More specifically, the foreclosure process can be a trigger of stress and trauma for many home owners, and serious delinquency on a mortgage can impose social-psychological costs.[109] Public efforts to strongly link home ownership with success may only bolster the costs of failure.

On the other hand, any home exit process holds potential to reduce long-term stress associated with home ownership that, for whatever reason, has become unaffordable. A better designed foreclosure process, coupled with efforts to delink home exit with failure, could be akin to a fresh start in bankruptcy.[110]

Critics and researchers also have attributed adverse community impact to foreclosure and the related abandonment of properties.[111] The types of damage often associated with these vacant properties include lost property tax revenue, blight, declining revenues for nearby businesses and landlords, loss of volume for neighboring businesses, and declining values of nearby homes, diminishing neighbors' wealth-building goals.[112]

There is little question that communities have a stake in home retention, particularly regarding sustainable home owners facing temporary financial hardships. However, communities also have a stake in ensuring that properties are owned by parties who have the incentive and means to

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108. For literature reviews, see, for example, Jacoby, *supra* note 4, at 334, n.50, and Melissa B. Jacoby, *Does Indebtedness Influence Health? A Preliminary Inquiry*, 30 J.L. Med. & Ethics 560, 561–64 (2002).

109. *See* Diaz-Serrano, *supra* note 21 (reviewing literature); Engel & McCoy, *supra* note 7, at 97–98 (discussing the health and social consequences of involuntary home loss); Jacoby, *supra* note 4, at 325 n.6, 334 nn.51–54 (reviewing literature); William M. Rohe et al., *Social Benefits and Costs of Homeownership*, *in* Low-Income Homeownership, *supra* note 86, at 381.

110. *See* Jacoby, *supra* note 13, at 239–40 (explaining a common rationale for bankruptcy).

111. *Hearings*, *supra* note 5, at 3 (statement of Kenneth D. Wade, CEO, NeighborWorks America); Essene & Apgar, *supra* note 19, at 2; Engel & McCoy, *supra* note 5, at 2076; Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 Housing Pol'y Debate 57, 75 (2006) [hereinafter Immergluck & Smith, *External Costs*] (finding a "statistically and economically significant effect [of conventional foreclosures] on property values"); Dan Immergluck & Geoff Smith, *Measuring the Effect of Subprime Lending on Neighborhood Foreclosures: Evidence from Chicago*, 40 Urb. Aff. Rev. 362 (2005); Shlay, *supra* note 1 (reporting on the aftermath of FHA program to promote neighborhoods as a death sentence for those neighborhoods); Naomi Cytron & Laura Lanzerotti, *Homeownership at High Cost: Recent Trends in the Mortgage Lending Industry*, Community Investments, Dec. 2006, at 3, 6 (citing studies).

112. *See* Joint Econ. Comm., The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got Here 1, 12 (2007) (predicting that state and local governments will lose more than $917 million in property tax revenues and that more than $32 billion in housing wealth will be lost by neighbors of foreclosed properties); Ctr. for Responsible Lending, *Subprime Spillover: Foreclosures Cost Neighbors $223 Billion: 445 Million Homes Lose $5,000 on Average* 5 (CRL Issue Paper, 2007), *available at* http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Subprime_mortgages/subprime-spillover111307.pdf; Engel & McCoy, *supra* note 7, at 94, 98; Immergluck & Smith, *External Costs*, *supra* note 111.

maintain them. Again, a properly designed process of home exit that does not leave properties vacant may help communities more than it harms them.

b. *Bankruptcy Law*

Bankruptcy has been evaluated for its mortgagor protection impact far less frequently than foreclosure law. But bankruptcy alters outcomes otherwise ordained by both the exit- and retention-oriented components of foreclosure law. By allowing deviations from sale formalities, discharging deficiencies, and empowering bankruptcy courts to approve repayment plans that reinstate mortgages in default, the bankruptcy system has become an important de facto formal law component of mortgage delinquency management.[113] Legislation in the Florida Senate would have required that lenders seeking to foreclose inform borrowers that declaring bankruptcy could save their homes.[114] Pending federal legislation would expand bankruptcy's tools with the goal of encouraging modification of subprime mortgages within the structure of the bankruptcy system.[115]

Whether or not these bills succeed, it is clear that many home owners with mortgage problems already know about and are filing for bankruptcy in the hopes of saving their homes or altering the financial consequences of losing their homes. Just as the rate of foreclosure filings has increased significantly since the early 1980s,[116] so has the proportion of home owners among bankruptcy filers according to the Consumer Bankruptcy Project.[117] From a study of Cook County, Illinois, foreclosures in the mid-1990s, Stark reports that about a third of the home owners in two samples interrupted the foreclosure process by filing for bankruptcy, mostly under Chapter 13.[118] A study of Houston, Texas, observed a striking rise in Chapter 13 filings directly before the "Foreclosure Tuesday" of each month.[119] In a recently

113. *See generally* Jacoby, *supra* note 13; Jacoby, *supra* note 4, at 324, 327.

114. S.B. 1460, 2007 S., 2007 Reg. Sess. § 1 (Fla. 2007) (proposed by Senator Arthenia Joyner).

115. *See, e.g.*, Home Owners' Mortgage and Equity Savings Act, S. 2133, 110th Cong. (2007); Helping Families Save Their Homes in Bankruptcy Act of 2007, S. 2136, 110th Cong. (2007); Emergency Home Ownership and Mortgage Equity Protection Act of 2007, H.R. 3609, 110th Cong. (2007).

116. *See* Saunders, *supra* note 9, at 114.

117. *See* Bahchieva et al., *supra* note 25, at 92 (reporting that the estimated rate of home owners in bankruptcy has risen from 2.8 per 1000 in 1981 to 10.9 per 1000 in 2001). According to this analysis from the 2001 Consumer Bankruptcy Project, more than half of bankruptcy filers in the sample were home owners, and an additional 5.8% of the sample had lost their homes for financial reasons within the five years prior to bankruptcy. *Id.* at 92–93. Another analysis of the Consumer Bankruptcy Project found that home ownership had the largest single effect on a bankruptcy filer's choice between Chapter 7 and Chapter 13. Teresa A. Sullivan et al., *Who Uses Chapter 13?*, *in* Consumer Bankruptcy in a Global Perspective 268, 279–80 (Johanna Niemi-Kiesiläinen et al. eds., 2003) (evaluating data from the 1981, 1991, and 1999 Consumer Bankruptcy Projects).

118. Stark, *Facing the Facts*, *supra* note 13, at 704.

119. *See* Michael Catrett, *A Month of Debtors: "Foreclosure Tuesday" and the Rush to Chapter 13 in the Houston Division of the Southern District of Texas*, Am. Bankr. Inst. J., May 2005, at 24, 81–82. Catrett reported that "[d]uring 1999 and 2001, 50 percent of the

published study of about 6000 subprime mortgage defaulters who were ninety days delinquent in September 2001, Dennis R. Capozza and Thomas A. Thomson reported that nearly a third had filed for bankruptcy as of the ninety-day delinquency mark, and an additional 475 went bankrupt within the subsequent eight-month study period.[120]

The frequency of bankruptcy usage does not guarantee bankruptcy's ability to promote outcomes consistent with wealth building, social-psychological benefits, and community development objectives. Some real estate finance researchers have been particularly reluctant to recognize a productive role for bankruptcy, often perceiving it as a last-ditch effort to stall an inevitable foreclosure.[121] Bankruptcy studies have not produced systematic findings on how frequently mortgages are reinstated or the circumstances under which borrowers ultimately part with their homes, although they do suggest that payment plan dismissal rates as well as repeat filings are quite high.[122]

Several studies from broader populations tell us something about the relationship between bankruptcy and mortgage delinquency outcomes, but have important limitations. From their recent analysis of about 6000 ninety-day subprime mortgage delinquencies through the eight-month study period, Capozza and Thompson report that "bankrupt loans rarely find their way to cure. Thus, transition to bankruptcy is a poor outcome. Loans that transition from delinquent into bankruptcy are loans that will take a longer period to reach their ultimate resolution."[123]

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sampled chapter 13 filings occurred on the Monday before and the morning of Foreclosure Tuesday, and in 2003, 40 percent of the filings occurred on those two days." *Id.* at 82. Catrett also found that filings initiated directly before or on "Foreclosure Tuesday" of the months studied had higher than usual dismissal and conversion rates and lower plan completion rates than other filings. *Id.* at 82 tbl.1.

120. *See* Capozza & Thomson, *supra* note 32, at 248 tbl.2.

121. *See, e.g.*, Ambrose & Capone, *supra* note 24, at 422 ("Lenders have long believed that [bankruptcy] filings were merely attempts by borrowers to prolong inevitable foreclosures."); Grant S. Nelson, *The Impact of Mortgagor Bankruptcy on the Real Estate Mortgagee: Current Problems and Some Suggested Solutions*, 50 Mo. L. Rev. 217, 255 (1985) (noting that the "impact of mortgagor bankruptcy on the real estate mortgagee can be both substantial and frustrating"); Phillips & VanderHoff, *supra* note 46, at 574 (referring to filing for bankruptcy as a delay and studying the impact of this delay on the resolution of default).

122. For a comprehensive longitudinal study of Chapter 13, see Scott F. Norberg & Andrew J. Velkey, *Debtor Discharge and Creditor Repayment in Chapter 13*, 39 Creighton L. Rev. 473 (2006). *See generally* Jacoby, *supra* note 4, at 330–32 (reviewing literature).

123. Capozza & Thomson, *supra* note 32, at 244. Based on logistic regression analysis, the researchers report the circumstances relating to the loan, collateral, and borrower making it more or less likely that a certain result will take place. For example,

> [T]he higher the payment to income ratio, the more likely the loan will transition to REO ["real estate owned" or "lender owned"] status. As the length of the borrower's time on job increases, the less likely is a transition to REO. The longer the borrower's time at property, the less likely a loan will transition from Bankruptcy to Default.

Id. at 256–57.

Unfortunately, Capozza and Thomson's report does not distinguish between Chapters 7 and 13. Chapter 13 filers may still be in bankruptcy eight months after a ninety-day delinquency because, at least so far, they are successfully paying their monthly installments that could span several years.[124] Thus, their continued presence in bankruptcy over an eight-month period should not necessarily be perceived as an indication of ultimate or inevitable home loss.

A few other studies suggest that some home owners reduce their future home ownership prospects by filing for bankruptcy. When Ambrose and Capone included a bankruptcy variable in their study of determinants of default resolutions, they found filing for bankruptcy increased the probability of mortgage reinstatement for those with significant equity in their homes but decreased the probability for borrowers with little or no equity.[125] More than half of home-owning bankruptcy filers in the 2001 Consumer Bankruptcy Project roughly fit the latter category.[126] In another project, Cheryl Long studied the impact of bankruptcy on home ownership prospects over a longer period of time and concluded that Chapters 7 and 13 had divergent impacts.[127] Specifically, she reported that Chapter 7 had a "significant and negative effect on homeownership" and that Chapter 13 had a nonsignificant but negative effect.

Given the framework for analysis this Essay proposes, these studies' implications for bankruptcy as delinquency management are not entirely clear. Perhaps the structure of bankruptcy helped people exit home ownership in a way that was more protective of existing home equity, less stressful, and less likely to produce a prolonged vacancy in the home than otherwise applicable foreclosure laws. The bankruptcy process may have allowed adequate time to arrange for substitute housing without fearing a period without shelter. Bankruptcy also has become a forum for enforcement of other consumer protection and real estate finance laws against lenders and servicers,[128] which may affect the pursuit of housing policy objectives as well.

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124. *See* 11 U.S.C. §§ 1322(d), 1325(b)(4) (2000) (providing guidance on the duration of Chapter 13 plans).

125. Ambrose & Capone, *supra* note 24, at 422. In their report of the raw data, 9% of the borrowers in their sample filed for bankruptcy and 72% of those 9% at least initially reinstated their loans. *See id.* at 405 n.27.

126. *See* Bahchieva et al., *supra* note 25, at 95–96.

127. Cheryl Long, Negative Effects of Personal Bankruptcy for Homeowners: Lost Homes and Reduced Credit Access (July 11, 2005) (unpublished manuscript), *available at* http://www.chicagofed.org/cedric/files/2005_conf_paper_session2_long.pdf (using Panel Study of Income Dynamics data).

128. *See generally* Steve Tripoli & Elizabeth Renuart, Nat'l Consumer Law Ctr., Dreams Foreclosed: The Rampant Theft of Americans' Homes Through Equity-Stripping Foreclosure 'Rescue' Scams (2005); Katherine M. Porter, *Misbehavior and Mistake in Mortgage Claims* (Univ. of Iowa Coll. of Law, Working Paper No. 07-29, 2007). For recent cases, see, for example, Meyer v. Argent Mortgage Co., LLC (*In re* Meyer), 379 B.R. 529, (Bankr. E.D. Pa. 2007) (alleging lending law violations relating to a mortgage loan, including violations of the Truth in Lending Act [TILA], Real Estate Settlement Procedures Act [RESPA], and state trade laws, in an adversary proceeding of a Chapter 13 bankruptcy

Even without a mutually understood picture of bankruptcy's role, it is probably the case that bankruptcy law currently undervalues the articulated housing policy objectives, particularly in Chapter 13 in which unsecured creditor distribution so often is perceived as paramount.[129] At the very least, lawmakers should consider reducing the amount of unsecured debt and other expenses that any Chapter 13 filer must repay to get a plan confirmed, or should consider ensuring that filers may set aside funds for home repairs or mortgage payments in case of some other financial emergency. Perhaps courts should be permitted to approve payment plans only if all fixed payments consume no more than forty-one percent of income, consistent with FHA guidelines.[130] Or, maybe courts could be

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filer); Dotson v. Heller Fin. (*In re* Dotson), No. 07-06018, 2007 WL 2710442 (Bankr. N.D. Ohio Sept. 13, 2007) (denying creditor's motion for summary judgment due to factual issues remaining in dispute about alleged Home Ownership and Equity Protection Act violations); Hopkins v. First NLC Fin. Servs., LLC (*In re* Hopkins), 372 B.R. 734 (Bankr. E.D. Pa. 2007) (raising TILA and RESPA claims in a Chapter 13 case); Tetterton v. Ocwen Fed. Bank (*In re* Tetterton), 379 B.R. 595 (Bankr. E.D.N.C. 2007) (granting servicer's motion for summary judgment on allegations of violations of state consumer protection laws); *In re* Dominique, 368 B.R. 913 (Bankr. S.D. Fla. 2007) (holding that a lender's failure to perform escrow analysis and notify borrower of deficiency amounted to waiver of the right to recover deficiency); Cooley v. Wachovia Mortgage Co. (*In re* Cooley), 365 B.R. 464, 473–74 (Bankr. E.D. Pa. 2007) (holding that a RESPA claim was not barred by the *Rooker-Feldman* doctrine but the TILA claim was and would need to be brought in state court).

129. The facts underlying *Murphy v. O'Donnell* (*In re Murphy*), 474 F.3d 143 (4th Cir. 2007), are illustrative. In the first of two distinct bankruptcy cases addressed by this decision, home owners who presumably had been current on their mortgage confirmed a Chapter 13 plan that would repay unsecured creditors about 28% of their claims. *Id.* at 146. After confirmation, the primary earner's income unexpectedly dropped by half. *Id.* The home owners sought permission from the court to engage in a cash-out mortgage refinancing so they could use some home equity to pay living expenses and plan payments. *Id.* Apparently dissatisfied with the debtor's proposal, the Chapter 13 trustee argued that these home owners should have to give more of their cashed-out home equity to the plan to pay their former unsecured creditors 100% of their claims. *Id.* In the second case addressed by the decision, a home owner who had no apparent mortgage arrearage confirmed a Chapter 13 plan paying approximately 37% of unsecured creditors' claims. *Id.* at 147. About a year later, the home owner needed to relocate for work to another state and sought permission to sell his principal residence. *Id.* The Chapter 13 trustee sought to force this debtor to triple the amount contributed to the plan with the sale proceeds so that unsecured creditors could be paid in full. *Id.* On doctrinal grounds relating to the standard to modify a plan, the bankruptcy court denied the trustee's request in the first case and accepted it in the second, and these determinations were upheld on appeal. *Id.* The court of appeals seems to treat the sale proceeds in the second case as a windfall and does not discuss the possibility that the debtor might have needed those funds to purchase a new home in his new state of residence. The larger point is that trustees are charged with maximizing unsecured creditor payment, which can be in tension with the oft-stated goals of housing policy, including wealth building.

130. FHA Loan Debt to Income Ratios, http://www.fha.com/debt_to_income_ratios.cfm (last visited Feb. 2, 2008). Federal legislative proposals would permit bankruptcy courts to approve repayment plans altering mortgage terms that, in some cases, would decrease monthly payments. *See, e.g.*, Emergency Home Ownership and Mortgage Equity Protection Act of 2007, H.R. 3609, 110th Cong. (2007) (giving courts the right to modify subprime mortgages in a limited set of circumstances). This kind of proposal often evokes the response that allowing modification will sufficiently affect price and access to credit as to reduce or eliminate posited benefits. Conversely, some would argue that the compulsory

directed to consider neighborhood factors in some way when determining whether to approve a plan that seeks to resolve a housing problem.

One also might reasonably ask why bankruptcy must duplicate mortgage delinquency tools found elsewhere in debtor-creditor law and in private negotiations.[131] For example, Stark's study of foreclosure filings in Illinois, a state with a statutory reinstatement right, found many Chapter 13 bankruptcy filers among foreclosure defendants.[132] A larger constellation of financial problems unaddressed by foreclosure law might have led some home owners with mortgage delinquency to seek bankruptcy protection. However, other factors that might have led Illinois foreclosure defendants to opt for bankruptcy do not reflect an inherent preference for bankruptcy law rights.[133] For example, Illinois law limits reinstatement to once every five years, so perhaps the bankruptcy filers simply were not eligible for Illinois reinstatement in a subsequent foreclosure action.[134] In addition, the method of reinstatement is different, in that bankruptcy permits a debtor to spread the arrearages, plus legal fees and administrative costs, in a payment plan over months or years rather than requiring a lump sum.[135] This may make bankruptcy reinstatement seem more feasible than other reinstatement rights, which is perhaps what leads some bankruptcy commentators and courts to refer to bankruptcy as the only realistic option for individuals in foreclosure hoping to remain home owners.[136] Further, foreclosure

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insurance is justified. For some of this debate, compare Karen M. Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit*, 88 Rev. Econ. & Stat. 177, 180 (2006) (estimating that loan sizes are smaller in judicial foreclosure states and concluding that this reflects a reduced supply of credit), with Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 Va. L. Rev. 489, 491 (1991) (finding that interest rates were relatively insensitive to the presence of mortgagor protection). For other studies, mostly suggesting a restrictive impact of mortgagor protection, see Jacoby, *supra* note 4, at 332 n.45.

131. A recent Credit Suisse industry report characterized bankruptcy as a substitute for foreclosure and, correspondingly, asserted that the 2005 amendments to the Bankruptcy Code were contributing to an increase in foreclosures among subprime borrowers. Additionally, the report includes claims that more debtors who fail in their Chapter 13 repayment plans will roll back into foreclosure. *See HEAT HOT Topic: More Repay Plans Fail in Subprimes Under the 2005 Bankruptcy Law*, Subprime HEAT Update (Credit Suisse, Fixed Income Research, London, U.K.), Mar. 8, 2007.

132. Stark, *Facing the Facts*, *supra* note 13, at 704 (setting forth pie charts showing bankruptcy filings in the sample).

133. For general decision-making capacities in response to foreclosure, see, for example, Barbara L. Gross, *Consumer Responses to Time Pressure: A Qualitative Study with Homeowners in Foreclosure*, 21 Advances in Consumer Res. 120 (1994).

134. Repeated mortgage delinquencies are not rare occurrences. *See, e.g.*, Ambrose & Capone, *supra* note 62, at 277 (reporting on repeating delinquencies in large sample of FHA single-family residential mortgages); *see also* Jay Brinkmann, Mortgage Bankers Ass'n, An Examination of Mortgage Foreclosures, Modifications, Repayment Plans and Other Loss Mitigation Activities in the Third Quarter of 2007, at 10, 11, 14 (2008) (reporting on delinquencies that occur after workouts).

135. *See generally* Jacoby, *supra* note 4, at 327 (explaining Chapter 13 tools).

136. *See, e.g.*, Gordon Bermant & Jean Braucher, *Making Post-Petition Mortgage Payments Inside Chapter 13 Plans: Facts, Law, Policy*, 80 Am. Bankr. L.J. 261, 275, 277 (2006); *see also In re* Ferguson, 376 B.R. 109, 122 (Bankr. E.D. Pa. 2007) ("[T]he

defendants might not have sought legal advice to assess the range of options until it was too late to gather lump sum reinstatement money in time, or might not have seen a bankruptcy lawyer that specialized in Chapter 13,[137] rather than a lawyer that specialized in foreclosure action defense.[138] Similarly, a debtor may sometimes get to choose between a contractual reinstatement right and a bankruptcy reinstatement right, preferring bankruptcy only because the fees associated with a contractual reinstatement right are onerous.[139]

It is possible that delinquency management would be improved if certain tools from bankruptcy were exported elsewhere or, at a minimum, if the law neutralized the consequences of choosing one or another in terms of tax, credit scores, and otherwise.[140] For example, assuming no federal preemption challenge, mortgage reinstatement rights could be provided on an installment basis in other legal regimes, as a task force in Connecticut recently proposed.[141] More states could incorporate deficiency restrictions into their foreclosure laws rather than channeling foreclosure defendants to bankruptcy to obtain that protection.[142] State laws could adjust garnishment laws to allow automatic deduction of mortgage payments after an initial default, mirroring a practice of many Chapter 13 bankruptcy

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bankruptcy filing is perceived by many debtors as the only way they can save their home[s] from foreclosure."); *In re* Dominique, 368 B.R. 913, 918 (Bankr. S.D. Fla. 2007) (referring to the Chapter 13 cure and reinstatement right as "the only way that [many debtors] could save their homes following a mortgage default").

137. Scholarly work in the United States and Canada has shed light on the role of lawyers (and, in Canada, trustees) in decisions to file for particular types of bankruptcy based on their specialties. For a review of that literature, see Jacoby, *supra* note 13, at 243 n.59.

138. *See* Levine, *supra* note 65, at 698–716 (arguing that most lawyers do not have sufficient expertise to defend foreclosure defendants). The legal expertise for foreclosure and bankruptcy may be sufficiently different; even lenders may use separate counsel for each. *See, e.g.*, Holland v. EMC Mortgage Corp. (*In re* Holland), 374 B.R. 409, 430 (Bankr. D. Mass. 2007).

139. *See, e.g.*, Chase Manhattan Mortgage Corp. v. Tudor, No. 2:06cv26, 2007 WL 4322187, at *8–9 (S.D. Ohio Dec. 7, 2007) (upholding a bankruptcy court's finding that fees associated with contractual reinstatement were not required for Chapter 13 bankruptcy reinstatement).

140. Borrowers are not liable for taxes on imputed income from discharge of indebtedness if they go through bankruptcy. *See generally* HUD, *supra* note 54, at 127. Lawmakers have made limited changes to the tax consequences of failed home ownership outside of the bankruptcy context. *See* Mortgage Forgiveness Debt Relief Act, Pub. L. No. 110-142, 121 Stat. 1803 (2007) (codified in scattered sections of 26 U.S.C.). The IRS currently is offering to work with taxpayers in this situation to limit their exposure. *See* IRS, Special Web Section Unveiled for Homeowners Who Lose Homes; Foreclosure Tax Relief Available to Many (Sept. 17, 2007), http://www.irs.gov/newsroom/article/0,,id=174022,00.html.

141. Sub-Prime Mortgage Task Force, State of Conn., Final Report 32 (2007), *available at* http://www.chfa.org/MainPages/1109%20Subprime%20Final%20Report.pdf.

142. For deficiency statute discussion, see Nelson & Whitman, *supra* note 42, at 658–59. On this point, some real estate scholars argue this would increase foreclosure by home owners with little or no equity (high loan-to-value home owners). *See, e.g.*, Ambrose & Capone, *supra* note 24, at 425 (reporting from a study that eighty percent of high loan-to-value defaulters are in states that limit deficiency judgments).

trustees and courts.[143] A federal or uniform foreclosure process could incorporate any of these ideas.[144]

3. Private Loss Mitigation

Loan workouts between home mortgage borrowers and lenders or their servicers played an increased role in delinquency response starting in the 1990s, predating the recent rise in subprime default.[145] Private workouts, perhaps with the influence of third-party nonprofit organizations, have the potential to offer potent and cost-effective substitutes for formal law resolutions. For example, in a study of a community-based mortgage foreclosure prevention program in Minneapolis between 1991 and 2003, only approximately four percent of the participants ended up in Chapter 13 bankruptcy.[146]

One cannot too quickly delegate mortgage delinquency management to private actors without reflecting on whether and when lenders actually will offer home owners workout options, and how the existence of formal law options shapes the parties' behavior.[147] For example, a retentive workout is likely not cost-effective for lenders if there is a high probability that it will be followed shortly by another delinquency.[148] Workout opportunities also

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143. Trustees' arguments about the desirability of this practice can be found in Bermant & Braucher, *supra* note 136, at 275, 277. *See also* Cohen v. Lopez (*In re* Lopez), 372 B.R. 40, 46–47 (B.A.P. 9th Cir. 2007) (describing the dispute over the desirability of direct payment in affirming the bankruptcy court's overruling of a Chapter 13 trustee's claim that all mortgage payments had to be routed through the trustee's office); *In re* Perez, 339 B.R. 385, 390–91 (Bankr. S.D. Tex. 2006), *aff'd sub nom.* Perez v. Peake, 373 B.R. 468 (S.D. Tex. 2007) (expressing the undesirability of allowing direct payment); *In re* Hodonou, No. 04-82516-G3-13, 2007 WL 760235, at *2–3 (Bankr. S.D. Tex. Mar. 6, 2007) (describing the local rule that requires debtors to make ongoing mortgage payments through the trustee's office if the mortgage had delinquency and describing the criteria for considering whether to allow the debtor to make payments directly); *In re* Clay, 339 B.R. 784 (Bankr. D. Utah 2006). *But see* Gordon Bermant, *Chapter 13: Who Pays the Mortgage?*, Am. Bankr. Inst. J., June 2001, at 20 (finding no evidence that trustee-funneled plans are completed at a higher rate); Catrett, *supra* note 119, at 24 (reporting that wage orders were uncommon in the district, but noting that they might improve the duration of the plan).

144. *See, e.g.*, Nelson & Whitman, *supra* note 41, at 1509–13 (arguing that the proposed foreclosure laws should be enacted by Congress rather than by individual states).

145. *See* Cutts & Green, *supra* note 71, at 358 fig.14-3; *see also* HUD, *supra* note 54; Ambrose & Capone, *supra* note 62 (reporting on foreclosure avoidance interest, studying FHA loan reinstatement, and evaluating repeat default); Stegman et al., *supra* note 56.

146. Roberto G. Quercia et al., *The Cost-Effectiveness of Community-Based Foreclosure Prevention* 22 (Joint Center for Hous. Studies, Harvard Univ., Working Paper No. BABC 04-18, 2004).

147. According to a recent Moody's report, the level of modification of recently originated subprime loans is too low. *See* Michael P. Drucker & William Fricke, Special Report: Moody's Subprime Mortgage Servicer Survey on Loan Modifications (2007), *available at* http://www.americansecuritization.com/uploadedFiles/Moodys_subprime_loanmod.pdf.

148. *See* Ambrose & Capone, *Cost-Benefit Analysis*, *supra* note 16, at 117; Ambrose & Capone, *supra* note 62, at 290–91 (noting that a workout should stay intact for two years to be considered a success); Phillips & VanderHoff, *supra* note 46, at 573 n.4. Lenders presumably assess workout sustainability using modeling and technology, some of which

are shaped by many stakeholders, including mortgage investors, government agencies such as HUD, or government-sponsored entities such as Fannie Mae and Freddie Mac,[149] or third-party nonprofit delinquency counselors.[150]

The specialized industry that services loans has received particular attention recently as a potential hindrance to workouts.[151] Some commentators have suggested that servicers have either limited competence to handle individualized problems with borrower accounts,[152] or insufficient incentives to pursue workouts across a broad range of borrowing contexts.[153] These concerns may increase the importance of

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government sponsored entities have fostered. *See* Apgar & Fishbein, *supra* note 19, at 133; Cutts & Green, *supra* note 71, at 364–65. Technological innovations increase early and effective intervention. *See* HUD, *supra* note 54, at 11; Michael LaCour-Little, *The Evolving Role of Technology in Mortgage Finance*, 11 J. Housing Res. 173, 194 (2000).

149. *See, e.g.*, Comptroller of the Currency Adm'r of Nat'l Banks, *supra* note 54, at 10 (stating that loan servicers are supposed to refer borrowers with FHA-insured loans to housing counselors); Ambrose & Capone, *Cost-Benefit Analysis*, *supra* note 16, at 106 ("Secondary market agencies and insurers are now actively encouraging the use of foreclosure alternatives to control losses on mortgage defaults."); Ambrose & Capone, *supra* note 62, at 291 (discussing the FHA loss mitigation program with additional workout options); Cutts & Green, *supra* note 71, at 364–65 (discussing the Freddie Mac collections scoring program); Stegman et al., *supra* note 56, at 250–52.

150. *See, e.g.*, Quercia et al., *supra* note 12, at 314–17.

151. The servicer "occupies an intermediate position between the mortgage borrower and the mortgage investor." Richard J. Buttimer, Jr. & Che-Chun Lin, *Valuing US and Canadian Mortgage Servicing Rights with Default and Prepayment*, 14 J. Housing Econ. 194, 195 (2005). Servicers, who collect payments from borrowers, have call centers, provide paperwork to taxing authorities, report to investors and credit reporting companies, oversee escrow accounts, and implement lender policies and mortgage terms. *See id*; Cutts & Green, *supra* note 71, at 350. A specialty industry (with distinct subspecialties, such as subprime lending) has thus emerged. *See* Comptroller of the Currency Adm'r of Nat'l Banks, *supra* note 54, at 8; Buttimer & Lin, *supra*, at 195; LaCour-Little, *supra* note 148, at 175, 186, 192; Sanders, *supra* note 20, at 149.

152. *See, e.g.*, Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers*, 15 Housing Pol'y Debate 753 (2004). Concerns about servicer behavior have appeared in the bankruptcy literature. *See generally* Jones v. Wells Fargo Home Mortgage (*In re* Jones), Adv. No. 06-01093, 2007 WL 2480494 (Bankr. E.D. La. Aug. 29, 2007); Bermant & Braucher, *supra* note 136, at 264–65, 275; Porter, *supra* note 128.

153. Engel & McCoy, *supra* note 5, at 2079. ("[S]ervicers have reduced incentives to assist borrowers who go into default. Servicers can earn higher fees if they march borrowers to foreclosure rather than reform the borrowers' loan terms or reschedule payments."); *see also* HUD, *supra* note 54, at 49, 52 (explaining that servicers' interests differ from those of ultimate risk bearers). Servicers receive a small net servicing fee, the float earned on payments collected from home owners but not yet sent to the issuer (averaging two weeks of interest), late fees, and miscellaneous fees, such as for hard copies of documents sent by regular mail. Additionally, servicers generally aim for economies of scale. Buttimer & Lin, *supra* note 151, at 195–98; Cutts & Green, *supra* note 71, at 350; LaCour-Little, *supra* note 148, at 175, 186, 192. Delinquent borrowers are costly for servicers due to increased expense and lost opportunity. *See, e.g.*, Ambrose & Capone, *supra* note 62, at 290. Servicers generally must remit payment to the issuer, even if they have not received payment from borrowers, and must expend their own funds for foreclosure lawyers, property maintenance, and other expenses during formal proceedings. *See Subprime and Predatory Lending*, *supra* note 54, at 18 (statement of John M. Robbins, Mortgage Bankers Association); Comptroller

involving credit counselors or community organizations in delinquency resolutions.[154] According to some research, proactive loan servicing may be quite important to prevent delinquency from developing into foreclosure.[155] Yet systematic studies of servicers' impact on foreclosure avoidance have thus far produced mixed results.[156]

Although not necessarily determinative in other contexts, the attention to rising subprime delinquencies in a declining housing market has helped isolate other potential barriers to workouts. Contrary to industry assertions,[157] some scholars have argued that securitization of mortgage receivables hampers workouts due to the diffusion of parties with stakes in mortgage payment streams.[158] These scholars and others have pointed to contractual restrictions in the documentation of some transactions that cap workouts in a mortgage pool or require consideration of particular tax consequences for investors, or the difficulty of obtaining consent among all parties with some rights in the loan.[159] As a related matter, some scholars

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of the Currency Adm'r of Nat'l Banks, *supra* note 54, at 3; Buttimer & Lin, *supra* note 151, at 197.

154. *See* Apgar & Fishbein, *supra* note 19, at 133; *see also Subprime and Predatory Lending*, *supra* note 54, at 21 (statement of John M. Robbins, Mortgage Bankers Association); Comptroller of the Currency Adm'r of Nat'l Banks, *supra* note 54, at 6, 9 (listing organizations counseling on foreclosure prevention); Drucker & Fricke, *supra* note 147, at 2 (including working with counseling agency as a proactive servicing practice); Joint Econ. Comm., Sheltering Neighborhoods from the Subprime Foreclosure Storm 17 (2007), *available at* http://jec.senate.gov/Documents/Reports/subprime11apr2007revised.pdf; Alan Mallach, Home-Ownership Education and Counseling: Issues in Research and Definition, Federal Reserve Bank of Philadelphia (2001), *available at* http://www.philadelphiafed.org/cca/capubs/homeowner.pdf; NeighborWorks Ctr. for Foreclosure Solutions, Preserving Homeownership: Analyzing the Elements of Leading Foreclosure Prevention Programs (2007).

155. Avery et al., *supra* note 22, at 648; Cutts & Green, *supra* note 71, at 365; Eggert, *supra* note 14, at 52–53; Harriet Newberger, *Foreclosure Filings and Sheriffs Sales Experienced by Low-Income First-Time Home Buyers*, 17 Housing Pol'y Debate 342, 382 (2006). *See generally* Stegman et al., *supra* note 56.

156. Studies are reviewed in Eggert, *supra* note 14. *Compare* Elmer & Seelig, *supra* note 9, at 12–13, 16 (finding no empirical support from their study for the hypothesis that a shift from relational banking to the use of servicers explains some of the long-term upward trend in foreclosures), *with* Stegman et al., *supra* note 56, at 273–74 (finding that the identity of the servicer affected the utilization and frequency of foreclosure intervention in an affordable mortgage program with more explicit preventive servicing obligations).

157. *See* Am. Securitization Forum, Statement of Principles, Recommendations and Guidelines for the Modification of Securitized Subprime Residential Mortgage Loans (2007), *available at* http://www.americansecuritization.com/uploadedFiles/ASF%20Subprime%20Loan%20Modification%20Principles_060107.pdf; *see also Hearings*, *supra* note 5, at 10–11 (statement of John Dalton, President, Housing Policy Council, on behalf of the Financial Services Roundtable).

158. *See, e.g.*, Eggert, *supra* note 14, at 57.

159. This is explained in detail in *id.*, *supra* note 14, at 58. *See also Hearings*, *supra* note 5, at 10–11 (statement of Sheila C. Bair, Chairman, FDIC); *id.* at 10 (statement of David Berenbaum, Executive Vice President, National Community Reinvestment Coalition); *Subprime Mortgage Market Turmoil: Examining the Role of Securitization, Hearing Before the Subcomm. on Securities, Insurance & Investments of the S. Comm. on Banking, Housing & Urban Affairs*, 110th Cong. 20–21 (statement of Kurt Eggert, Professor, Chapman University School of Law).

and housing experts have argued that the cost-benefit analysis for private workouts is different for investors in various kinds of mortgage-backed securities than for lenders that retain loans in their portfolios.[160]

Furthermore, legal issues relating to formal debt collection have been noted as deterrents to workouts. For example, at least one industry expert has expressed concern that a lender may compromise its legal rights by continuing or commencing workout efforts after initiating a foreclosure.[161] Although concerns about waiver should not be trivialized, there is plenty of evidence that workouts take place after a foreclosure action has been filed.[162] Also, the Mortgage Bankers Association has complained that workouts are hindered by disclosures required by the Fair Debt Collection Practices Act.[163] Certainly achieving contact with borrowers has been a significant problem, although debt collection law is probably not to blame.[164] A third example, also mentioned occasionally, is that formal debt

160. *See, e.g.*, *The Role of the Secondary Market in Subprime Mortgage Lending, Hearing Before the Subcomm. on Financial Institutes & Consumer Credit of the H. Comm. on Financial Services*, 110th Cong. 10 (2007) (statement of Michael D. Calhoun, Center for Responsible Lending); *see also* Engel & McCoy, *supra* note 5, at 2040–41; *Lenders Reach Out to Subprime Borrowers, but They Often Do Not Respond, Banks Say*, Bankr. L. Daily (BNA) (Aug. 23, 2007) (noting a state senator's worries that those holding securitized loans prefer foreclosures to workouts based on net present value calculation).

161. HUD, *supra* note 54, at 37. As the HUD report explains,

> There is a tension between wanting to give servicers time to develop an optimal workout program and the desire not to delay foreclosure. All attempts at a workout must cease once a judicial request of foreclosure is filed because the failure of that workout could jeopardize the legal standing of the case to foreclose. If they did not cease, the servicer would not be considered acting in good faith during the workout negotiations or not truthful about the need to accelerate the note.

Id.

162. *See, e.g.*, Comptroller of the Currency Adm'r of Nat'l Banks, *supra* note 54, at 9 (suggesting that longer time periods in judicial foreclosure allow for more time for workout development); Stark, *Foreclosing on the American Dream*, *supra* note 13, at 242–43, 251–52 figs.5 & 6 (reporting on the outcomes of Cook County, Illinois, foreclosures); Stegman et al., *supra* note 56, at 246 (reporting on the successful effort by Countrywide Mortgage to engage in workouts with borrowers already well into the foreclosure process); Pennington-Cross, *supra* note 16, at 3 (reporting on the outcomes of subprime mortgages actually in the foreclosure process and finding cure or partial cure among thirteen percent); *Foreclosure Data Seen as Key to Policies on Housing Market, Predatory Lending Curbs*, Bankr. L. Daily (BNA) (Mar. 13, 2007) (reporting that three quarters of mortgages that enter the foreclosure process do not end up getting sold in foreclosure sales).

163. *Subprime and Predatory Lending*, *supra* note 54, at 21 (statement of John M. Robbins, Mortgage Bankers Association).

164. *Id.*; Comptroller of the Currency Adm'r of Nat'l Banks, *supra* note 54, at 4, 11 (citing the results of a PolicyLab survey of borrowers and referring to the inability to contact a borrower as "greatest obstacle" to workouts); Apgar & Fishbein, *supra* note 19, at 133 (reporting that servicers say they have difficulty reaching low-income borrowers). For encouragement of home owners to contact servicers, see, for example, FHA & HUD, You Can Avoid Foreclosure and Keep Your Home, http://www.fha.gov/foreclosure/index.cfm (last visited Feb. 11, 2008); Freddie Mac, Foreclosure Avoidance Research (2005), *available at* http://www.freddiemac.com/service/msp/pdf/foreclosure_avoidance_dec2005.pdf; *see also Lenders Reach Out to Subprime Borrowers*, *supra* note 160. For encouragement of

collection resolves legal liability issues more definitively than private workouts, particularly if a borrower has multiple mortgages.[165]

To the extent these issues affect workout options in unanticipated ways, many are fixable. For example, servicers certainly can be given incentives to act consistently with underlying ownership interests, and investors in future transactions can delegate more power to those servicers to seek workout opportunities. The more fundamental question is how to shape mortgage investor incentives in ways that systematically promote housing policy objectives. Lenders base loss mitigation decisions on their ability to obtain "dramatic cost savings" and profitability as compared to initiating and completing foreclosure.[166] They are unlikely to base loss mitigation decisions on the furtherance of household wealth building, social-psychological factors, and community development.[167] Achieving financial benefits for lenders can be somewhat consistent with promoting policy ends.[168] However, the congruence must be cultivated and not just assumed.

It already is understood that the cost and complexity of formal law affect lenders' willingness to engage in loss mitigation, whether exit- or retention-oriented. By making and keeping foreclosure laws more cumbersome, the government tilts the cost-benefit analysis in favor of private resolutions in a wide range of circumstances.[169] Phrased more directly, if legislatures

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servicers to contact borrowers, see, for example, U.S. Senate Banking Comm., *supra* note 15.

165. *See Bill Would Exclude from Gross Income Residential Mortgage Debt Forgiveness*, Bankr. L. Daily (BNA) (May 30, 2007) (describing the different tax consequences for home owners of short sales and foreclosure sales). In addition, deeds in lieu of foreclosure may not cut off the interests of junior mortgages on property. *See* Nelson & Whitman, *supra* note 42, at 526–27.

166. Ambrose & Capone, *supra* note 24, at 392; *see also* Joint Econ. Comm., *supra* note 154, at 15–16 (reporting estimates of cost of foreclosure to lenders); Cutts & Green, *supra* note 71, at 352. *See generally* Stegman et al., *Preventive Servicing*, *supra* note 56. The HUD report explains,

> The point is that it is profitable to offer workout alternatives to all borrowers whose probabilities of successful completion are greater than a level that would make the expected costs of trying the workout equal to the expected cost of an immediate foreclosure. Such an "eligibility" criterion first presupposes that the borrower is suffering a true financial hardship, and then requires incentives for the borrower to want the workout to be successful.

HUD, *supra* note 54, at 42.

167. Joint Econ. Comm., *supra* note 154, at 16–17; Ellen Schloemer et al., Ctr. for Responsible Lending, Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners 22 (2006). This issue is distinct from the concern that "low road" lenders have business models relying on misappropriation of borrowers' equity, in which case, we cannot rely on the usual economic incentives. Kennedy, *supra* note 57, at 269–72; Painter, *supra* note 69, at 83–84, 86–95.

168. *See generally* Stegman et al., *supra* note 56.

169. *See* Comptroller of the Currency Adm'r of Nat'l Banks, *supra* note 54, at 9 (stating that longer time periods in judicial foreclosure allow for more time for workout development); Phillips & VanderHoff, *supra* note 46, at 573 (arguing for streamlining the foreclosure process by providing nonjudicial foreclosure and that minimizing redemption rights increase the foreclosure rate); *id.* at 584 ("It is probable that lenders, faced with the less costly nonjudicial foreclosure procedure, are less inclined to offer favorable terms or workouts in order to avoid court costs and are more likely to pursue foreclosure."); *id.* at 586

implemented proposals to greatly streamline foreclosure, lenders likely would pursue formal debt enforcement in a greater proportion of delinquencies.[170]

Relying on the complexity of foreclosure laws, however, is a rather blunt policy instrument. It may yield more private resolutions, but does not guarantee that lenders will select workouts using protocols consistent with policy objectives. More explicit incentives for loss mitigation can and should be pursued.[171] Public or not-for-profit entities also can intervene more directly to achieve objectives. As we already have seen, they can buy particular home mortgage loans from lenders, refinance certain borrowers into new loan products, or offer direct financial subsidies to bring them current on their existing mortgages.[172] Many believe that third-party foreclosure counseling holds promise for improving loan performance.[173] Thus, enhanced funding of not-for-profit housing counselors and clearly articulated objectives beyond merely avoiding foreclosure could result in more effective retentive and exit-oriented private resolutions.[174] These ideas should be seen as complementary to, and not substitutes for, proposals that also rely on public-private partnerships to develop products such as mortgage payment protection insurance to help avoid serious delinquency in the first place.[175]

("From the standpoint of lenders, the option to redeem is a contingent claim that increases the costs of foreclosure. When these contingent claims are removed, the costs of foreclosure are reduced; hence, foreclosure is pursued more aggressively."); *see also* Tracht, *supra* note 13, at 603–04; Ambrose & Capone, *Cost-Benefit Analysis*, *supra* note 16, at 117.

170. *See, e.g.*, Phillips & VanderHoff, *supra* note 46, at 573, 584; Ko Wang et al., *Nondiscriminating Foreclosure and Voluntary Liquidating Costs*, 15 Rev. Fin. Stud. 959, 976 (2002) (finding that "a bank is more likely to negotiate with borrowers when the liquidating cost is high"). *See generally* Terrence M. Clauretie & Thomas Herzog, *The Effect of State Foreclosure Laws on Loan Losses: Evidence from the Mortgage Insurance Industry*, 22 J. Money, Credit & Banking 221 (1990).

171. *See Hearings*, *supra* note 5, at 2 (statement of Daniel H. Mudd, President & Chief Executive Officer, Fannie Mae); Stegman et al., *supra* note 56, at 247–50 (discussing the role of the FHA and Freddie Mac in providing financial incentives for servicers' loss mitigation efforts). One possible conduit is Community Reinvestment Act credit. *See, e.g.*, Press Release, FDIC, Statement on Working with Mortgage Borrowers (Apr. 17, 2007), http://www.fdic.gov/news/news/press/2007/pr07032a.html; FDIC, Fin. Inst. Letter 35-2007 (Apr. 17, 2007).

172. *See, e.g.*, *Hearings*, *supra* note 5, at 2 (statement of Brian D. Montgomery, Assistant Secretary for Housing & Federal Housing Comm'r for HUD); Joint Econ. Comm., *supra* note 154, at 17; *Subprime and Predatory Lending*, *supra* note 54, at 6 (statement of Alex J. Pollock, Resident Fellow, American Enterprise Institute) (discussing historic precedent for refinancing approaches); Ambrose & Capone, *supra* note 24, at 406 (reporting from a study that a small percentage of defaulters went into the FHA assignment program); Ambrose & Capone, *supra* note 62, at 290 (discussing Freddie Mac loan repurchasing from mortgage-backed securities pools); Levine, *supra* note 65, at 701 (discussing the HUD assignment/buyout program).

173. *See* Quercia et al., *supra* note 12, at 321–22.

174. *See, e.g.*, Joint Econ. Comm., *supra* note 112, at 23 (discussing budget appropriations for housing counseling to achieve workouts).

175. *See* Ford et al., *supra* note 88, at 97; Margalit, *supra* note 88, at 487–88.

CONCLUSION

The sharp rise in the origination and failure of subprime mortgages has prompted an important discussion of managing home mortgage delinquency as an emergency measure. But questions of delinquency management should linger long after this particular crisis has fallen from public consciousness. Properly understood, delinquency management is a critical component of housing policy rather than just an occasional response to unduly high levels of default or just a matter of contract enforcement and debt collection. This is true even when levels of mortgage default are considered tolerable by regulators concerned with the financial system's safety and soundness and mortgage market investors concerned with profit.

With these ideas in mind, this Essay has explored a broader substantive and structural framework beyond traditional foreclosure laws relevant to delinquency management and has suggested a different analytical approach to evaluating the tools within this framework. Fleshing out the details of proposed improvements must await future work, but the aim of this Essay is to spark new ideas for future empirical and theoretical work to evaluate the impact of formal law and private party innovations.

Notes & Observations