MADISON'S TIMBER PREVIEW

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October 08, 2010

The continued fallout of home foreclosures in the US due to defaulted mortgages has moved to the top of elected representatives' and government agency agendas. Members of Congress are calling for an industry-wide federal investigation, and several state attorneys general are seeking a freeze on all foreclosures in their states. Bloomberg News reported Wednesday that authorities in at least seven states are probing whether lenders used false documents and signatures to justify hundreds of thousands of foreclosures.

A furor has been growing as mounting evidence has surfaced that mortgage lenders have been evicting homeowners using flawed court papers.

Democrat congressional representative Edolphus "Ed" Towns for New York state, chair of the House Committee on Oversight and Government Reform, Thursday called on top US mortgage lenders and banks to voluntarily halt home foreclosures in all 50 states and the District of Columbia until the banks' legal departments review their company's procedures.

Follow the link, http://pdfserver.amlaw.com/cc/foreclosure_letter100710.pdf, to see Towns' letter to banks following recent disclosures that some lenders have been operating mass foreclosure mills and not following correct legal procedures. In its own letter to banks, link http://pdfserver.amlaw.com/cc/FanMae_Letter100710.pdf, the nation's largest mortgage buyer, Fannie Mae, also cracked down on lenders. It threatened to penalize or even terminate contracts with those that fail to meet its foreclosure guidelines, and directed all of its servicers to immediately start reviewing their procedures "relating to the execution of affidavits, verifications, and other legal documents in connection with the default process."

At least three major lenders as of Thursday afternoon — Ally Financial Inc's GMAC Mortgage, JPMorgan Chase & Co, and Bank of America Corporation — stopped foreclosures and evictions in 23 states while they review procedures, stating that there may be documentation issues with some defaulted mortgages they own or service, following acknowledgments by employees at some servicers that they signed affidavits necessary to move thousands of foreclosure cases a month toward judgment without reviewing the documents. Since then, other banks and servicers have taken their lead and temporarily ceased foreclosing on properties as they investigate their processes and documentation.

Finding the trail of who owns a home in default through the maze of paperwork for mortgages packaged and repackaged for sale five or more years ago could prove to be a monumental task.

If millions of foreclosures past and present were invalidated due to the way the hurried secur itization process muddied the chain of ownership, banks could face lawsuits from homeowners and from investors who bought stakes in the mortgage securities - an expensive and potentially crippling proposition.

In an unexpected outcome, if a foreclosure is delayed, the servicer must typically keep advancing payments that will go to all bondholders, including the junior debt holders, even though the home loan itself is producing no revenue stream. The latest events thus set up an odd circumstance where junior bondholders—typically at the bottom of the credit structure—could actually end up better off than they expected. Senior bondholders, typically at the top, could end up worse off.

Not surprisingly, senior debt holders want banks to foreclose faster to reduce expenses. Junior bondholders are generally happy to stretch things out. What is more, it isn't entirely clear how the costs of re-processing tens of thousands of mortgages will be allocated.

For the fragile housing market, already clogged with foreclosure cases, it could mean gridlock and confusion for years.

Continued foreclosures could begin to add more homes to housing inventory as weak sales will have more trouble offsetting them. That would put downward pressure on prices. But if foreclosures slow due to delays, then this may allow inventory to stay constant for some months, providing buyer demand more time to recover from its post-credit hangover.

There are some who believe that banks have already been intentionally holding back defaulted homes in shadow inventory for precisely this reason. These foreclosure delays might simply make that practice even easier. If the strategy works as those banks hope, then prices won't fall as far. If it doesn't, however, then the market will still ultimately sink -- it will just take longer to hit bottom.

Meanwhile, US President Barack Obama has rejected a bill that the White House fears could worsen the mounting problems caused by flawed or misleading documents used by banks in home foreclosures after it quietly zoomed through the Senate last week. White House press secretary Robert Gibbs said Thursday that Obama is sending a newly passed bill back to Congress to be fixed because the current version has "unintended consequences on consumer protections."

The bill would loosen the process for providing a notary's seal to documents and allow them to be done electronically. It would also allow foreclosure and other documents to be accepted among multiple states.

In other news, the US Federal Reserve hopes to prod home buying by driving mortgage rates to record lows; Freddie Mac reported Thursday that the average rate for a 30-year, fixed mortgage had fallen to 4.27 per cent, down from the prior week's 4.32 per cent and 4.87 per cent a year ago. After increasing for a few weeks beginning at the end of August, rates have resumed their retreat.

However, the National Association of Realtors' index for pending sales of used homes increased 4.3 per cent to 82.3, the industry group said Monday. US pending home sales rose for the second consecutive month in August as low interest rates helped along a sluggish market. Year over year, the pending sales index was 20.1 per cent below its level of 103 in August 2009.

Even as *Madison's* writes this, there is more breaking news. "*Updating the US Foreclosure Scandal*", screams a late-Thursday headline out of London's Financial Times. During the political upheaval of the US mid-term elections into November, its not likely much work will be done on this issue in Congress, however the American public, and the companies and agencies directly involved, are correct to continue looking for answers until that government body reconvenes.

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