MADISON'S TIMBER PREVIEW

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When the US housing market first began its frightening tail spin toward the end of the summer in 2006, no one foretold the level of damage that would ultimately unfold on the US economy. Traditional wisdom states that a full 25 per cent of US economic activity is driven by the real estate market. Too many people had been making 'easy money' by investing in repackaged mortgages, shuffling assets around and regrouping them in endless variety, then passing them off to the next investor as quickly as possible. With consistent returns of 10 per cent, investors the world over wanted to get into the game but no one wanted to be caught holding the bag when the whole thing came tumbling down, which was inevitable.

The global economic drama that ensued between then and now is well known; the effects of the collapse of these repackaged mortgage assets and the rampant foreclosures that resulted do not need to be revisited here.

The Obama administration plans to lay out its vision for overhauling the US housing finance system later this month. Initiated by FDR in response to the Great Depression, the almost eighty year foundation of housing finance has become an American institution akin to motherhood and apple pie. Any attempt to change it will be a battle royale. The plan Treasury Secretary Timothy Geithner is expected to unveil will be the next step in a debate over the future of Fannie Mae and Freddie Mac, US government agencies which back about half of the US$10.6 trillion in outstanding residential mortgages and - in combination with other federal agencies - more than 90 per cent of all new home loans.

As a result of that fast and loose securitized mortgage lending practice that resulted in the near downfall of global banking in 2008, the ownership of a mortgage could potentially be divided and transferred multiple times by the lenders. In one week alone, during the height of this investment mayhem, there were 808 mortgage transfers in just one county in Massachusetts. Add to an already confusing chain of events, and consider that many notes were signed "in blank". The paper was shuffled around from one lender to the next and put into trusts well past the legal limit allowed and the mess grew to epic proportions.

Claims of wrongdoing by banks and loan servicers triggered a 50-state investigation last year into whether hundreds of thousands of foreclosures were properly documented as the housing market collapsed.

The recent scrutiny by multiple levels of US authority of the legality of such practices on these foreclosures has prompted the unfolding of further economic drama. In 2010, the number of homes repossessed hit more than 1 million (figures released Thursday by RealtyTrac report). According to the *Associated Press*, some 5 million borrowers in the US have missed mortgage payments for at least two months, and the outlook for 2011 is worsens amid projections for a 20 per cent increase in foreclosure filings.

“We will peak in foreclosures and probably bottom out in pricing, and that’s what we need to do in order to begin the recovery,” Rick Sharga, RealtyTrac’s senior vice-president, told *Bloomberg News*. “But it’s probably not going to feel good in the process.”

RealtyTrac data also shows that 2.23 per cent of all US housing units — one in every 45 homes — received at least one foreclosure filing during 2010. The grim tally represents a nearly fourfold increase over the filings nationwide in 2006.

On January 7 the Massachusetts Supreme Judicial Court upheld a controversial decision by Land Court Judge Keith Long, who ruled in the case of two Springfield, MA homeowners that foreclosures on their homes were invalid because the mortgages were not officially recorded as being owned by the foreclosing banks, US Bancorp and Wells Fargo. In short, the Supreme Court upheld the March 2009 decision of the lower court that a bank can't foreclose on a home if it doesn't own the mortgage. The court didn't put a time limit on the decision -- its provisions are effective retroactively.

Many lenders believed they could complete foreclosure transactions and later produce formal proof they held a mortgage. Friday's ruling makes it clear that the practice will not be allowed in Massachusetts.

There is a good chance that other states will soon follow this decision. Indeed, a statewide class action in which Massachusetts homeowners accuse US Bancorp and Ally Financial Inc. of faulty foreclosures was on hold while the Supreme Judicial Court decided whether state law required foreclosures to be conducted by the mortgage owner. That case will now resume.

With the legality of clear title by banks on foreclosed properties put into doubt by the recent Massachusetts court case, the sale of foreclosed properties may plunge, putting further price pressure on home values. With the banks' legal right to have foreclosed on homes now in question, past purchasers of foreclosed properties are facing the nightmare of being unable to sell or remortgage their home until title issues are resolved. This is no small issue since over 3 million homes have been foreclosed on since 2007 which the banks have been selling as quickly as possible.

The Massachusetts case has come as a potential blow to Wells Fargo and could set a precedent for other cases. Wells Fargo is the fourth largest bank in the US by assets and the second largest bank by market cap and also the second largest bank in deposits, and home mortgage servicing. The potential reversal of its foreclosures could have a major impact. *Nasdaq News* estimates mortgage backed securities to be about US$3 trillion. This makes up nearly 22 per cent of the total mortgage debt outstanding in the US, down significantly from 53 per cent, or US$7.5 trillion, in 2009, according to Mortgage Debt Outstanding and the Federal Reserve.

Edward Bloom, president of the Real Estate Bar Association for Massachusetts, told the *Home Equity Theft Reporter* that the jurists created a legal traffic jam with Friday's decision. People who have been foreclosed on in Massachusetts will be checking to see if their foreclosure was legal, and it could turn out that buyers of foreclosures in that state really don't own their homes.

It might also lead to fresh claims from mortgage-bond investors who have earlier accused and have even sued servicers for systematically poor loan documentation, says *Nasdaq News*.

Q-Law Blog predicts banks will start using more modifications, short sales and deeds-in-lieu instead of foreclosures. That way, a sale is involved so the home's title would be subject to a title search and ownership would then be clearly transferred to a new buyer, leaving a clear, defensible paperwork trail.
On the other hand, the Woodstock Institute identified Thursday 1,896 "red flag" homes in Chicago that appear to have been abandoned by mortgage servicers during the foreclosure process. In 2010, the city of Chicago demolished 535 homes, the most annually in more than a decade and far more than the 283 residences torn down in 2009, according to *Monocchio*.

Last week, the 50 state Attorneys-General who launched their own investigation last autumn announced they will soon settle with the five biggest banks that together have 59 per cent of the mortgage-servicing market: Bank of America Corp, Wells Fargo, JPMorgan Chase, Citigroup, and Ally Financial.

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