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Six Years On and Still Counting: Sifting Through the Mortgage Mess

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Six years after reaching their bubble-era peaks and then plunging, U.S. primary and secondary real estate and mortgage markets remain one of the principal drags upon economic recovery. As many as 12 million new mortgages face foreclosure in the coming six years, assuming no further price declines—which cannot be safely assumed owing to symbiotic linkages between home prices and macroeconomic performance. Why do we remain in self-perpetuating slump? The answer is exceedingly complex thanks to the large number of causal factors in play. This Article catalogues and imposes order upon these mutually interacting factors by first identifying the principal interests at stake and the principal constituencies that hold these interests. The Article then identifies an overlapping convergence of interests among most constituencies. The Article then proceeds to identify all of the principal impediments to satisfaction of the convergent interests identified. It finds that the most important impediments are rooted in collective action challenges that authorized collective agents could surmount. Next, the Article identifies and assesses alternative means that collective agents can employ to remove the mentioned impediments. The principal conclusion reached is that municipalities exercising their eminent domain powers in partnership with investors are best situated to move the nation out of its ongoing mortgage mess.

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I. INTRODUCTION: THERE MUST BE SOME KIND OF WAY OUT OF HERE[1]

Six years after reaching their bubble year peaks and then plunging, U.S. primary and secondary mortgage and real estate markets remain one of the principal drags upon economic recovery.[2] Notwithstanding signs of improvement in some localities, the S&P Case Shiller 20 City Index shows home prices down 7.5 percent from their previous post-bubble high, itself low in relation to trend, reached in May of 2010.[3] Meanwhile a backlog of nearly 400,000 homes awaited liquidation at the end of 2011, with another 2.86 million mortgages 12 or more months delinquent.[4] The upshot is a current "shadow inventory" of some 3.25 million homes either already foreclosed or on the brink of foreclosure—an inventory that weighs heavily on home prices, families, and the nation's economy alike.

In light of these trends, real estate analysts estimate that between 7.4 million and 9.4 million *additional* home loans are now in danger of default over the next six years—an impending foreclosure tsunami of unprecedented proportion.[5] This assumes no further price declines or interest rate rises.

Owing to feedback effects, however, further price declines *cannot* realistically be assumed away.[6] Homeowners who live under

1. With warm thanks and apologies to the bard, Robert Zimmerman, for a most evocative bit of poetry of the ensuing couple of lines: "There must be some kind of way out of here, / said the joker to the thief, / There's too much confusion; / I can't get no relief." I hope both that I am neither joker nor thief. Bob Dylan, "All Along the Watchtower" (Columbia Records 1967).

2. *See, e.g.*, Robert Hockett, Daniel Alpert & Nouriel Roubini, *The Way Forward: Moving Past the Post-Bubble, Post-Best Economy to Renewed Growth and Competitiveness*, CORNELL LAW SCHOOL, LEGAL STUDIES RESEARCH PAPER SERIES (Jan. 12, 2012), *available at* http://papers.ssrn.com/sol3/ papers.cfm?abstract_id=1987139. *See also* FED. RESERVE BOARD, The U.S. Housing Market: Current Conditions and Policy Considerations, Jan. 4, 2012, available at www.federalreserve.gov/ publications/other-reports/files/housing-white-paper-20120104.pdf; Robert Hockett, *A Fixer-Upper for Finance*, 87 WASH. U. L. REV. 1213 (2010) [hereinafter Hockett I]; Robert Hockett, *Bail-Outs, Buy-Ins, and Ballyhoo*, 52 CHALLENGE 36 (2009) [hereinafter Hockett II].

3. *See, e.g.*, FED. RESERVE BOARD, *supra* note 2, at 3. *See also* William C. Dudley, Housing and the Economic Recovery, FED. RESERVE BANK OF N.Y. (Jan. 6, 2012), www.newyorkfed.org/ newsevents/speeches/2012/dud120106.html.

4. *See, e.g.*, Laurie Goodman et al., *The Case for Principal Reductions*, 17 J. STRUC. FIN. 29 (2011). *See also* Gus Lubin, *Laurie Goodman on Why Another 11 Million Mortgages Will Go Bad*, BUS. INSIDER (July 26, 2011), www.articles.businessinsider.com/2011-0726/markets/ 30092548_ 1_shadow-inventory-default-rates-loans.

5. *See, e.g.*, Goodman et al., *supra* note 4; Lubin, *supra* note 4.

6. *See, e.g.*, Alpert, Hockett & Roubini, *supra* note 2; FED. RESERVE BOARD, *supra* note 2; Dudley, *supra* note 3 for support of the claims made in this paragraph. For more on feedback

debt overhang usually don't spend money, which slows growth. Because homes represent the largest store of wealth for the American middle class, and because the middle class represents the greatest source of American consumer demand, this drag on the economy is massive. Our foreclosure tsunami is accordingly apt to prove self-worsening. Mass foreclosures depress home prices, which depress consumer expenditures, which depress employment and income, which heighten the incidence of default and foreclosure, which depresses home prices yet further.

Certainly, Congress, the Obama Administration, the Federal Reserve, and multiple U.S. states have tried multiple programs both to keep families in their homes and to hasten a return to full health in the mortgage markets and the broader U.S. economy.[7] Why, then, are we still in slump? The answer is exceedingly complex due to the large numbers of causal factors in play.

This Article aims to catalogue and impose order upon the large number of mutually interacting factors now underwriting continued uncertainty and slump in the mortgage markets. Doing so will serve to render this tangled problem both more tractable and, therefore, more soluble. Sorting out the distinct but interacting challenges and tracing their interactions should enable us better to map out distinct but complementary solution strategies responsive to each distinct factor.

Part II of the Article identifies the principal interests at stake in the mortgage market troubles, as well as the principal constituencies that hold these interests. That assists both normative and political feasibility analysis of alternative solutions. Part III identifies an overlapping convergence of interests among most constituencies, including the public. That affords hope that a politically feasible solution that benefits all or near all can indeed be developed. Part IV identifies the principal impediments to mortgage market recovery. Part V identifies and assesses alternative means by which to remove or diminish the mentioned impediments. A Conclusion then looks ahead to next steps, while an Appendix summarizes the Article's principal factor and causal-relational findings in schematic, "flowchart" form.

In view of the disproportionate importance of coordination and collective action challenges in blocking progress in solving the

effects of the sort that figure prominently in this Article—a sort that I label "recursive collective action problems," *see* Robert Hockett, *Recursive Collective Action Problems* (unpublished manuscript) (on file with the author); Robert Hockett, *Bretton Woods 1.0: An Essay in Constructive Retrieval* (Cornell Law Faculty Working Papers, Working Paper No. 82, 2011).

7. For details of these and other programs, *see* Alpert, Hockett & Roubini, *supra* note 2; FED. RESERVE BOARD, *supra* note 2; Dudley, *supra* note 3.

mortgage crisis thus far, the Article concludes that what it calls "controlling mortgage bloc assembly" presents the most important next step. That is a step which the Author has urged upon federal instrumentalities since 2008, but which is most likely now to be taken by municipalities exercising their eminent domain power in partnership with investors.

II. INTERESTS AND CONSTITUENCIES

To remain clear about what is at stake and politically feasible as we sift through the mortgage mess, this part identifies seven principal interests and five constituencies to consider.

A. INTERESTS

1. Maximization of Mortgage Loan Value Received, Ideally Up to the Full Amounts Owed, and of the Value of Underlying Collateral

Mortgage loans are contractual in character, and lenders expect and desire to receive all or as close as possible to what they are contractually owed, with well-preserved collateral-mortgaged homes, serving as backup. In ordinary times, most borrowers do pay what they owe, and so lenders need not resort to foreclosure on collateral. The present time is not ordinary, however, and lenders accordingly hope to receive as close to what they are owed as possible, in the form either of payment, of attached collateral, or both. This is true whether we speak of lenders in primary and secondary markets, or about the first lien or second lien holders.[8]

8. Lenders in "primary" markets are those who hold repayment rights on loans that they have originated and held. Lenders in "secondary" markets—including the markets for securitized mortgages and associated mortgage-backed securities ("MBS")—are those who have acquired repayment rights from primary lenders. "First" lien holders are creditors with priority over other rights-holders to payments made by borrowers. "Second" lien holders are creditors lacking in such priority. Creditors with distinct priorities, notoriously, face collective action problems in the vicinity of borrower insolvency. That fact will prove important below, and so will the collective action challenges faced by first lien holders when loans are pooled and scrutinized. Take "interest" to mean *legitimate* interest throughout.

2. Maximization of Mortgage Loan Value Remitted, Ideally Up to the Full Amounts Owed, and of the Value of Underlying Collateral

While this interest is materially identical to interest II.A.1,[9] we consider it here from the borrower's rather than the lender's point of view.[10] In some settings, borrowers' and lenders' points of view can diverge, though they do not always diverge in the degree or manner that some might suppose in the present environment.

Borrowers generally wish to pay all or as close as possible to what they owe[11], as well as to preserve the values of the homes that they purchase with borrowed funds. Presently, however, where many borrowers are unemployed or under-employed and many homes are market-valued at less than what borrowers owe, mortgagors hope to pay less than the face values of their loans. Most realistically minded lenders would be content with that, too.[12]

3. Expedition of Fair, Efficient, and Reliable Mortgage Loan Foreclosure, Collateral-Attachment, and Collateral-Sale Proceedings: "Expeditious Mortgage Loan Foreclosure Proceedings"

Ordinarily, nobody wishes to see lenders attach and foreclose on the collateral securing borrowers' obligations on a mass scale. Lenders are in the business of lending and investing, not home or other collateral-maintaining or selling. When mass foreclosure is unavoidable, there is a presumable interest that proceedings proceed fairly and efficiently.[13]

Notwithstanding that fact, there can be substantial disagreement over when indeed "unavoidability" kicks in. In this connection, one prospect that emerges below is that many seemingly unavoidable foreclosures are in fact theoretically avoidable, in manners that satisfy

9. Interests II.A.1. and II.A.2. are satisfied by the same actions, and thus materially equivalent.

10. *See also* Interest II.A.7., *infra*, which concerns retention of homes by their purchasers.

11. A wish not to repay the loan amount is not a cognizable interest for legal or policy purposes and because the general reliability of debt contracts is in the interest of all as it keeps down borrowing costs.

12. The fact that it is not happening notwithstanding this desire suggests formidable coordination and collective action problems, a suggestion that we shall find corroborated below.

13. Criminals, sociopaths, and some orthodox welfare economists may argue that no one who benefits by unfairness has an interest in fairness, just as they may argue that borrowers do not have an interest in paying back their debts. But to treat others unfairly is not cognizable as interests for purposes of legal or public policy analysis, any more than are the "interests" of criminals in avoiding prosecution. *See* Robert Hockett, *Pareto versus Welfare* (Cornell Law Sch. Legal Studies Research Paper Series, Legal Studies Research Paper No. 08-031, 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id= 1309699. *See also* Robert Hockett, *Why Paretians Can't Prescribe: Preferences, Principles, and Imperatives in Law and Policy*, 18 CORNELL J. L. & PUB. POL'Y 391 (2009).

both interests II.A.1. and II.A.2., if only certain coordination and collective action problems that now afflict the primary and secondary mortgage markets can be collectively addressed. That fact will figure prominently in the proposals laid out in Part V.

4. Minimization of Transaction Costs Occasioned By Mortgage Finance, Refinance, and Foreclosure Arrangements

All transactions occasion costs. Transacting parties generally prefer to minimize such costs. Where the transaction costs are fees paid to various "service" providers, on the other hand, some parties prefer that they be maximized. That fact as well figures importantly below.

5. Maintenance of Safety, Soundness, Fairness, Efficiency, Health and Stability of U.S. and Global Financial Institutions and Markets, Hence of the Residential Mortgage Backed Securities Markets: "Maintenance of the Health of the U.S. and Global Financial Markets"

Since the mid-1990s at latest, residential mortgage-backed securities ("RMBS") have come to constitute a very large segment of the U.S. and indeed global securities markets.[14] The reasons are many. For one thing, at least until recently these instruments were widely and indeed plausibly viewed as safe investments for parties seeking relatively modest but reliable returns. For another thing, their popularity itself, stemming both from their safety and from their relative novelty in the years immediately following their introduction, rendered them higher-return investments for a lengthy period of time as accelerating purchases drove up their market prices. Finally, the aforementioned features rendered them particularly popular for purposes both of baby boomer pension fund diversification and of serving as collateral for burgeoning repo markets. Hence their importance to financial markets and the institutions that operate in them.

But this means that RMBS also implicate the long recognized interest in safety, soundness, fairness, efficiency and stability on the part of the mentioned institutions and markets, the latter in turn serving as predicates to sound and stable macroeconomic growth featuring full employment and low-to-moderate borrowing costs. Hence the interest in primary and secondary mortgage markets is an

14. *See, e.g.*, Hockett I, *supra* note 2, in support of the claims made in this and the following paragraph; *see also* Hockett II, *supra* note 2.

interest not only in housing, but also in generalized macroeconomic health. It also bears noting that well functioning RMBS markets lower borrowing costs for would-be homeowners.[15] That was part of the point of the Hoover and Roosevelt era innovations to the American system of mortgage finance over the course of the 1930s—the decade that brought us FHA, FHA mortgage insurance, the 30 year fixed rate mortgage, and the first GSE—Fannie Mae. This system functioned quite well over its first 70 years prior to the bubble, converting the nation from one in which fewer than 40 percent of households owned their own homes, to one in which nearly 70 percent did. We shall accordingly treat restoration of that state of health that the mortgage finance industry enjoyed prior to the bubble as one possible component of interest II.A.5.

6. Maintenance of Traditional State and Local From Federal Jurisdiction Over Agency, Commercial, and Real Property Law Matters in the U.S.

The U.S. is a federated republic, comprising multiple states that are themselves taken as loci of sovereignty. Moreover, most U.S. states have "home rule" statutes, pursuant to which many spheres of authority are formally recognized as properly vesting in municipalities whose organs of government are closer, and in consequence more immediately responsive to the wishes of their populations.[16]

This overall scheme of governance, as the U.S. counterpart of the familiar European and Roman Law principle of "subsidiarity," can be understood both in political-theoretic and in orthodox economic terms. Politically, it coheres well with the American ideal of popular sovereignty, inasmuch as the greater responsiveness thought to inhere in smaller units of government is responsiveness to the "will of the people" itself. Economically, subsidiarity figures as an information- and agency-cost reducer, precisely by dint of its minimizing the space, hence the slack, that might otherwise open between community needs on the one hand, the instrumentality charged with satisfying those needs on the other hand. There is, then, a longstanding interest, justifiable on multiple grounds, in maintaining the greatest degree of state and municipal responsibility for policy-formulation and program execution—sometimes lumped together under the rubric of "the police power"—as is consistent with federal authority over matters of truly national concern. That is arguably the case, on the

15. For more on matter discussed in this paragraph, *see* Robert Hockett, *A Jeffersonian Republic by Hamiltonian Means*, 79 S. CAL. L. REV. 45 (2006) [hereinafter Hockett III].

16. *See, e.g.*, LYNN BAKER & CLAYTON GILLETTE, LOCAL GOVERNMENT LAW 36 (2004).

aforementioned political-theoretic and economic grounds, in any nation. But it also is legally the case in the U.S., the Constitution of which embodies the principle both in its structure and in many of its specific provisions.

7. Maintenance of as Many Homeowners in Their Current Homes as is Practicable[17]

In view of the many costs, traumas, and other harms to homeowners, their families, their communities, and the local, state, and national economies more generally occasioned by mass foreclosure and eviction, there is of course a considerable interest in keeping as many willing current home-owners in their homes as is possible. There is documentation aplenty cataloguing the many costs in personal suffering, familial instability, interrupted childhood education, depressed housing quality and home-values, elevated crime rates, and other social ills—including reduced consumer demand and consequent economic slump themselves—occasioned by widespread housing foreclosure. There is accordingly a significant interest in keeping as many people in their homes, when they wish thus to stay, as is practicable. This interest, however, can rest in some tension with some of the other interests catalogued above, in particular interests II.A.3. and II.A.4. under some scenarios.

B. CONSTITUENCIES

1. Mortgage Lenders/Investors

Mortgage lenders/investors ("investors") are one class of constituents whose interests are implicated by the ongoing challenges in our mortgage markets. We can partition this class into three subclasses, whose interests sometimes diverge, particularly in the vicinity of borrower insolvency. The first subclass is that of first lien holders who hold undivided interests in mortgage promissory notes and the mortgages that secure them. The classic, pre-securitization era bank or thrift mortgage lender is of this type, a type characterized by the one loan, one holder formula. The loans in such cases are often called "portfolio" loans.

The second subclass of mortgage investor is that of first lien holders who hold divided interests in mortgage notes and the mortgages that secure them. The prototypical example is someone

17. Sometimes Parts II.A.2. and II.A.7. are conjoined, the conjunction being dubbed "stay and pay."

who holds interests in a pool of loans, in which others likewise hold interests. The interests in such cases are typically mortgage-backed securities ("MBS"), and each mortgage loan underlying the MBS issued by a particular pool is held, in effect, by multiple persons. Where the MBS is associated with underlying residential real estate, it often is called an "RMBS."

The third subclass of mortgage investor is that of second lien holders, who are able to claim on borrowers only after first lien holders have been paid. For present purposes, it does not matter whether the second liens are held in portfolio or securitized form. What matters is that the different priorities in bankruptcy enjoyed by first and second lien holders underwrite an important potential conflict of interest between them.

2. Mortgagors / Mortgage Borrowers

Mortgagors/mortgage borrowers ("borrowers"), to whom we will sometimes refer as "mortgagors" or "debtors," are the second class of constituents. Borrowers are those who owe on the promissory notes that residential real estate mortgages secure. While the interests of members of this class largely converge, it is helpful to partition this class into three subclasses.

The first subclass of borrowers comprises those who purchased their homes during the bubble years and now find their mortgages "underwater." Having borrowed at fixed rates to purchase homes that appreciate or depreciate in value at variable rates, these borrowers now find that they owe more than their homes are worth. This subclass of borrower is salient for several related reasons. First, underwater mortgages are difficult to refinance in private credit markets at lower interest when interest rates fall. Second, "walk-away" or "strategic default" is economically rational in respect of these mortgages. Third, many of these mortgagors reasonably feel swindled by the unforeseen collapse in real estate markets, over which they had no control, and sometimes find "walk-away" not only expedient, but just. Finally, underwater mortgages default at a much higher rate than others, meaning that they pose the greatest drag of all on recovery in the mortgage markets and the economy at large.

The second subclass of borrowers comprises those who face temporary difficulty in keeping current on mortgage payments owing to temporary unemployment or underemployment. Mortgagors in this subclass are faced with foreclosure even when they were model borrowers prior to an unemployment or underemployment event, and even when they might well be reemployed and well able to resume their mortgage payments within as few as, say, 90 or 120 days. And this is so whether or not the mortgagor in this subclass is obligated on an underwater mortgage. As if all of this were not challenge enough, creditors, still spooked in the wake of the crash, hesitate to offer bridge loan assistance to borrowers who face it—particularly in view of the not-privately-capturable positive externalities it would generate. In this sense there is a classic "missing market" for bridge loan assistance, a fact I exploit elsewhere.[18]

Finally, a third subclass comprises borrowers who would unlikely have owned their own homes but for the unusually easy credit available during the bubble years. Many of these borrowers were encouraged to aspire to ownership rather than rental precisely because home values were rising so quickly that, it was thought, they could readily refinance low front-end "teaser rate" mortgage loans on the strength of the appreciating collateral, prior to the higher "balloon" rates' kicking in. Many of these borrowers will likely have to return to renting, even if in some cases "renting to own." We will revisit that prospect below.

3. Mortgage Servicers

The business of securitized real estate finance in the U.S. has featured a well-developed division of labor for several decades. One specialization is the mortgage loan servicers ("servicers"), primarily banking institutions, which collect payments from borrowers and transfer them to lenders. Where commercial real estate is financed, there are important distinctions between subcategories of servicer, particularly among so-called "master," "primary," and "special" servicers. In residential real estate finance, by contrast, such further differentiation is rare. We shall see shortly that the lack of such distinctions is a pity, and in need of change. The securitized RMBS markets can benefit by replicating certain attributes of the commercial mortgage-backed securities ("CMBS") markets.

While the paucity of "special" servicers in the residential real estate mortgage finance industry is one problem to which we'll attend, another has to do with the technologies that the industry employs. It is difficult to examine the recent dysfunctions that have afflicted the foreclosure process over the past several years without concluding that the servicing industry's infrastructure has been better suited to environments in which mortgage defaults are rare—as indeed they were before 2007—than environments in which they occur in abundance. More of this below.

18. Sometimes Parts II.A.2. and II.A.7. are conjoined, the conjunction being dubbed "stay and pay."

4. The Federal Government, Principally in the Name of the U.S. Citizenry or General Public.

Insofar as our ongoing mortgage and real estate market slumps, and the attendant macroeconomic slump to which they still stand in symbiosis, are national problems, one can speak of "the nation" as a party in interest. I shall accordingly sometimes speak of "the Federal Government" or "the citizenry" or "general public" as a party in interest, and include under this designation various federal agencies and instrumentalities as agents—notably the Federal Reserve ("Fed"), the Federal Deposit Insurance Corporation ("FDIC"), the Federal Housing Administration ("FHA"), the mortgage-bundling government-sponsored entities ("GSEs") Fannie Mae and Freddie Mac, and the GSEs' federal overseer known as the Federal Housing Finance Agency ("FHFA"). Insofar as the general public or salient sectors thereof are faced with collective action challenges, the mentioned instrumentalities, including the Federal Government, are those collective agents who are best positioned to implement the workable solutions I later propose.[19]

The Federal Government—through the Department of Treasury, the Federal Reserve Bank of New York ("FRBNY" or "New York Fed"), and the presently government-held GSEs—is also an Investor in more or less the Part II.B.1. sense. One strategy these instrumentalities employed to place a bottom beneath plunging MBS markets in 2008 was to purchase and hold substantial portfolios of MBS. Even as their primary interests were *pro bono publico,* I will treat these instrumentalities principally as acting in the name of the U.S. public.

Other agencies or associated entities of the Federal Government that bear responsibility for financial regulation and/or real estate matters—for example, the Office of the Comptroller of the Currency ("OCC"), the FDIC, the Securities and Exchange Commission ("SEC"), the Commodity Futures Trading Commission ("CFTC"), the Department of Housing and Urban Development ("HUD"), the FHFA, the GSEs Fannie Mae and Freddie Mac, etc.—likewise bear interests that complementary to those of the Federal Government.

5. State Functionaries, in the Names of Their States

There is also space for a constituency of state functionaries operating in parallel to the Federal Government. Those functionaries

19. For more on the need of collective agency to which collective actions give rise, *see* Hockett I, *supra* note 2; Robert Hockett, *Bubbles, Busts, and Blame*, 35 CORNELL LAW FORUM 14 (Cornell Law Sch., Ithaca, N.Y.) Spring 2011.

will presumably act in the interests of the citizens of their states. While they will not be indifferent to the interests of the nation or to the interests of Federal Government functionaries, and vice versa, there is nevertheless, some divergence in their interest.

III. CONVERGENCE AND CONFLICT AMONG INTERESTS AND CONSTITUENCIES

We can now provisionally correlate the interests catalogued in Part II.A. with the constituencies catalogued in Part II.B. The interests of Investors, Borrowers, and the Federal Government are on the whole convergent, with some divergence between first and second lien holders among the Investors.[20] This cluster of interests potentially diverges, on the other hand, from the interests of some Servicers[21] and, potentially but to lesser degree, some State Functionaries.

A. INVESTOR INTERESTS

Investors aim to maximize mortgage loan values (II.A.1.)—to maximize loans' or collateral homes' expected values ("EVs")—on reliable and predictable schedules, via Borrower Repayment (II.A.2.) or expeditious foreclosure-and-resale (II.A.3.), at minimal transaction cost (II.A.4.). They also wish to see stable financial markets (II.A.5.). Finally, Investors wish to see borrowers stay in their homes (II.A.7.), since investors are in the business of lending rather than that of maintaining or selling real estate.

B. BORROWER INTERESTS

Borrowers aim to maximize the mortgage loan value remitted (II.A.2.)—to maximize collateral home and loan EVs—on reliable and predictable schedules, at minimal transaction cost (II.A.4.). Also, at least *ex ante*, Borrowers want there to be expeditious foreclosure,

20. Discussion on some intra-constituency conflicts of interest *infra*.

21. Servicers of securitized residential mortgage loans, at any rate. Matters are different where Servicers of securitized commercial mortgage loans are concerned, in that the "special" Servicers in that industry hold interests that complement those of Investors, Borrowers, and the Federal Government.

collateral-attachment, and collateral-sale procedures in place (II.A.3.), in order that real estate markets and home prices, be kept stable and interest rates, hence borrowing costs be kept low (II.A.5.). Finally, Borrowers wish to be able to remain in their homes rather than to be evicted in the event of default or delinquency (II.A.7.).

C. SERVICER INTERESTS

Servicers aim to maximize servicing revenue, and hence desire to keep transaction costs low (II.A.4.). There are many arrangements for Servicers' compensation. Currently, such arrangements misalign Servicer incentives on the one hand, Investor and Borrower incentives on the other. I shall assess alternative, more incentive-aligning compensation arrangements below.

D. THE FEDERAL GOVERNMENT INTEREST

The U.S. Federal Government aims to maintain healthy financial markets and a well functioning macroeconomy (II.A.5.). To do so, it must promote solvency and confidence among the principal mortgage market participants—namely, Investors, Borrowers, and intermediating institutions—by facilitating the reliable performance of mortgage contracts where possible, or maximizing home and mortgage loan EVs (including through legitimate foreclosure) where full performance is not possible (II.A.1., II.A.2., II.A.3., II.A.4.). The Federal Government also presumably favors the prospect of helping borrowers keep their homes in the interest of community and local economy (II.A.7.). Finally, at present, the Federal Government also is itself a Lender of Last Resort ("LLR") "Investor" in the (secondary) mortgage markets, with interests that attend that status.[22]

E. STATE FUNCTIONARIES' INTERESTS

State functionaries aim to maintain as much traditional state jurisdiction over agency, commercial, and real property law matters as possible (II.A.6.), while presumably also being sympathetic to the

22. As Investor, while the Federal Government is not solely concerned with its "bottom line," it is not indifferent to it either. This stance manifests in the current policies of the FHFA in preventing the GSEs from offering refinancing options more widely. *See supra* note 9, Part III. *See also infra*, Part IV.

interests of maximizing loan or home EV (II.A.1., II.A.2.), expeditious foreclosure (II.A.3.), minimizing transaction costs (II.A.4.), maintaining health in the financial markets with low-to-moderate interest rates (II.A.5.), and maintaining as many homeowners in their homes (II.A.7.).

IV. IMPEDIMENTS TO SATISFACTION OF CONVERGENT INVESTOR, BORROWER, AND FEDERAL GOVERNMENT INTERESTS[23]

A broad array of mutually interlocking impediments stand in the way of satisfying interests II.A.1. through II.A.5. I now turn to cataloguing them in an intuitively tractable order.

A. IMPEDIMENTS TO MAXIMIZATION OF MORTGAGE LOAN VALUE RECEIVED

The principal impediment to maximizing mortgage loan value received (II.A.1.) appears to be the continuing slump in the real estate and broader markets,[24] rendering it more difficult for Borrowers to stay current on payments, and/or "economically irrational," in the view of some economists, for them to do so. That is the case when home values push houses further "under water." When this happens, some borrowers "walk away" (so-called "strategic defaults") from their mortgage. Seeing other borrowers "walking away" makes walking away all the more thinkable, and less shameful.[25] The "negative equity" problem is exacerbated by home equity lost by Borrowers pursuant to "home equity line of credit" ("HELOC") transactions conducted during the bubble years.[26] Furthermore, homes that are abandoned pursuant to "strategic defaults" tend to deteriorate rapidly, resulting in more value lost to lenders and to the nation's stock of wealth.

23. No discussion of impediments to Servicer and State Functionary interests inasmuch as these interests do not converge with Federal Government interests.

24. As I will more fully explain, that causality here is bidirectional. More on the "feedback" structure of slump's relation to interest II.A.1. presently. *See supra*, Introduction.

25. Literature on the ethics and economic rationality of "strategic default" has sprouted since 2007. For a well-rounded study of strategic default and negative home equity, *see, e.g.*, Christopher L. Foote, Kristopher Gerardi & Paul S. Willen, *Negative Equity and Foreclosure* (Fed. Reserve Bank of Boston Fed. Gov't Policy Discussion Papers 08-3, 2008), www.bos.frb.org/ economic/ppdp/2008/ppdp0803.pdf.

26. *See* Alpert, Hockett & Roubini, *supra* note 2, at 25.

Partly at the root of the continuing slump in the market are factors that impede efficient mortgage loan *modifications* that can maximize the EVs of troubled loans and thus advance loan EV maximization (II.A.1. and II.A.2.). These latter factors underwrite a negative symbiosis or "feedback" effect between mortgage market slump and loan EV maximization. Continuing slump is also partly rooted in factors that act as direct impediments to satisfying the interest of expeditious mortgage foreclosure proceedings (II.A.3.). Hence, impediments to satisfying interest II.A.3. also act as impediments to satisfying loan EV maximization. Micro-details of all of these mechanisms follow.

1. Impediments to Efficient EV-Maximizing Mortgage Loan Modification

There appears[27] to be a multitude of impediments to efficient EV-maximizing mortgage loan modification, each warranting separate consideration. I proceed from structural, contractual, and other institutional impediments to more specifically legal impediments. Note that, as I shall find occasion to point out at various points as we proceed, empirical study will be needed if we wish to determine precisely *how* significant the actual effects of these impediments.

a. Inaccessible Information

Anecdotal reports suggest that one impediment to efficient EV-maximizing loan modification is rooted in the difficulties Borrowers face in determining who bears ultimate authority to renegotiate their loan terms. Possible solutions to this problem are discussed below, which include endorsing the Regulation of Mortgage Servicing Act of 2011, which aims to ensure clarity about such matters, changing the mortgage and note *recording* system, and seeking greater clarity in states' bodies of agency law.

b. Borrower Humiliation and Demoralization

Anecdotal reports suggest that defaulting Borrower humiliation and demoralization complement the inaccessible information problem discussed above.[28] Borrowers in insolvency are too ashamed

27. Because more empirical study is required to determine precisely how significant the actual effects of these impediments, we are presently largely confined to identifying tendencies rather than measuring effects.

28. *See, e.g.*, Alpert, Hockett & Roubini, *supra* note 2; Adam J. Levitin, *Resolving the*

or deflated to engage in "proactively" seeking out opportunities to modify their loans, and might even fear answering telephone calls from what would turn out to be loan-modifying agents after months of dunning and badgering from collection agents. Any solution to the information problem may best be *complemented* by "outreach" programs aimed at inducing distressed Borrowers to respond to or even "proactively" pursue loan-modification opportunities.

c. Pooling and Servicing Agreement Restrictions

The terms of many of the Pooling and Servicing Agreements ("PSAs") pursuant to which private-label residential real estate loans are securitized appear to prevent (e.g., via unanimity or supermajority voting requirements) loan Servicers from seeking proposed mortgage loan modifications. Further empirical data would be helpful to determine whether restructuring restrictions are prevalent and to what extent such provisions block efforts toward making EV-maximizing mortgage modifications.[29] If the abundant anecdotal and

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Foreclosure Crisis: Modification of Mortgages in Bankruptcy, 2009 WIS. L. REV. 565, 624 (2009).

29. There is substantial evidence that modification rates for distressed portfolio loans are substantially higher than those for securitized loans, and this may suggest that PSAs present real frictions to modification. *See, e.g.*, OFFICE OF THE COMPTROLLER OF THE CURRENCY, OFFICE OF THRIFT SUPERVISION, MORTGAGE METRIC REPORT FOR THIRD QUARTER 2008 (2009); OFFICE OF THE COMPTROLLER OF THE CURRENCY, OFFICE OF THRIFT SUPERVISION, MORTGAGE METRIC REPORT FOR FOURTH QUARTER 2008 (2009); OFFICE OF THE COMPTROLLER OF THE CURRENCY, OFFICE OF THRIFT SUPERVISION, MORTGAGE METRICS REPORT FOR FIRST QUARTER 2009 (2009). These and additional reports are *available at* www.occ.treas.gov/publications/publications-by-type/other-publications-reports/index-mortgage - metrics.html.

To what extent the differences between portfolio loan and securitized loan modification rates are traceable to contract provisions, compensation-based Servicer incentives, or coordination problems among creditors remains less than fully determined. For possible explanatory mechanisms and further corroboration of the correlation between securitization and nonmodification, *see* Tomasz Piskorski, Amit Seru & Vikrant Vig, *Securitization and Distressed Loan Negotiation: Evidence from the Subprime Mortgage Crisis* (Chicago Booth School of Business Research Paper, No. 09-02, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_ id=1321646.

A contrary view is found in Manuel Adelino, Kristopher Gerardi & Paul S. Willen, *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization* (Fed. Reserve Bank of Boston, Fed. Gov't Policy Discussion Papers No. 09-4, 2009), *available at* www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf, which (1) purports to cast doubt on the mentioned correlation, and (2) attributes nonmodification primarily to self-cure and redefault risk. *See also* Christopher L. Foote et al., *Reducing Foreclosures* (Fed. Reserve Bank of Boston, Fed. Gov't Policy Discussion Papers No. 09-2, 2009), *available at* www.bos.frb.org/economic/ppdp/ 2009/ppdp0902.pdf, which purports to find inadequate gains to Investors from loan modifications a better explanation than contract (PSA) rigidities in accounting for low securitized loan modification rates.

On the frequency with which modification restrictions appear within PSAs, there is thus far preliminary and fragmentary data. *See, e.g.*, John P. Hunt, *What Do Subprime Securitization Contracts Actually Say About Loan Modification? Preliminary Results and* preliminary statistical evidence proves representative, however, these restrictions are indeed prevalent.[30] Legal factors addressed below appear to play a critically important part in *prompting* PSA terms of this sort; the latter are accordingly not apt to be satisfactorily addressable absent complementary changes to the former.[31]

d. Servicer Compensation and Incentives

The PSAs typically lay out the arrangements pursuant to which securitized loan Servicers are compensated.[32] At least where it is residential rather than commercial real estate loans that are securitized, these compensation arrangements do not appear fully to align the incentives of generic Servicers—who combine payment processing and (rather minimal) loss mitigation functions—on the one hand, with the incentives of Investors and Borrowers, on the other hand, when a mortgage loan becomes troubled.

In the context of residential mortgage Borrower insolvency, Servicer compensation is largely independent of loan performance; compensation is based on a number of fee-types assessable apart from Borrower principal and interest payments. The upshot is that Servicers can actually fare better financially over a twelve-to-eighteen month course of drawn-out Borrower default than over a comparable period of debt renegotiation, restructuring, and workout.[33]

Meanwhile, (1) the comparatively low stakes, relative to commercial real estate mortgage loans, attached to individual residential real estate mortgage loans in securitized mortgage pools, (2) wide dispersion among securitized residential mortgage Investors, and (3) weak bargaining power on the part of Borrowers, all work together to impede spontaneous development of more incentive-

Implications (Berkley Center for Law, Working paper, 2009), *available at* http://papers.ssrn. com /sol3/papers.cfm?abstract_id=1369286. *See also* Credit Suisse, *The Day After Tomorrow: Payment Shocks and Loan Modifications* (2007).

30. *See, e.g.*, sources cited *supra* note 28.

31. A thorough overview of much of the terrain here circa 2009 is Anna Gelpern & Adam J. Levitin, *Rewriting Frankenstein Contracts: Workout Prohibitions in Residential Mortgage-Backed Securities*, 82 S. CAL. L. REV. 1075 (2009). *See also* Alpert, Hockett & Roubini, *supra* note 2.

32. Detailed description of these arrangements, as well as of their incentive effects and much more on the servicing industry, can be found in Larry Cordell et al., *The Incentives of Mortgage Servicers: Myths and Realities, Finance and Economics Discussion Series, Divisions of Research & Statistics and Monetary Affairs* (Fed. Reserve Board, Wash. D.C., No. 2008-46, 2008), www.federalreserve.gov/pubs/feds/2008/200846/revision/200846pap.pdf. *See also* Alpert, Hockett & Roubini, *supra* note 2; Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 YALE J. ON REG. 1 (2011).

33. *See, e.g.*, sources cited *supra* note 27. *See also* Sarah Bloom Raskin, Putting the Low Road Behind Us, Remarks at the Midwinter Housing Finance Conference (Feb. 11, 2011), www.federalreserve.gov/newsevents/speech/raskin20110211a.pdf.

aligning compensation arrangements in the securitized residential real estate loan market.[34] More quantitative empirical cataloguing of prevalent Servicer compensation arrangements, and what causal role they are apt to be actually playing in impeding EV-maximizing loan modifications, will accordingly be helpful.[35]

e. Creditor Coordination Problems

The tranching structures of typical private label residential real estate loan securitization arrangements often present serious structural obstacles to modifying underlying loans.[36] The reason is that different tranches stand to benefit or lose under different circumstances, such that a given tranche (or more) might fare better under non-modification even when all tranches collectively fare better under modification. The most obvious cases are those of junior and senior tranches: Absent changes to their pre-modification contractual rights, junior tranches are first to take losses in the event of modification, while the senior tranches are the last to suffer in the absence of modification. Insofar as PSAs as discussed *supra*, and/or the law (e.g., Trust Indenture Act, more on which *infra)* confer veto authority on each tranche, then, these tranches will bear significant hold-up power in preventing EV-maximizing modifications.

At the same time, senior tranches likewise suffer significantly when there are substantial repossessions and liquidations of mortgaged homes. Some in the investment banking industry observe that lack of movement in the modification "space" might well owe to the "damned if you do, damned if you don't" upshot. Servicers, per this line of thought, just like portfolio loan holders, might simply be succumbing to inertia for the benefit of their beneficiaries, who remain in "holding patterns" while awaiting and hoping for secular change in the market. If every private actor is thus "waiting," however, no change is apt to come until some collective actor—a government instrumentality—breaks the ice.

Empirical data on these arrangements is needed to ascertain the prevalence and use of such power, and/or the degree to which its very

34. In the securitized commercial real estate mortgage market, by contrast, the sizes of individual loans in the pools appear to have rendered Investors and Borrowers more active in negotiating more incentive-aligning Servicer compensation arrangements. Here securitized commercial loan Servicers divide into two specialties—transaction processors and loss mitigators, with delinquent loan payments triggering shifts in responsibility from the former to the latter. The latter, in turn, are paid in proportion to restructured loan performance, rather than in the form of fees that are independent of such performance.

35. For important preliminary work along these lines, *see* sources cited *supra* notes 27–31.

36. *See generally* sources cited *supra* notes 27–31.

presence discourages at modification. The likelihood is already apparent.

f. Bankruptcy Law

Insofar as PSAs and other factors (e.g., the Trust Indenture Act, considered below) impose supermajority creditor voting requirements on would-be loan modifications, they confer hold-up power upon recalcitrant creditors. Where this combines with securitized pooling arrangements that can produce conflicting interests among distinct tranches or classes of creditor in the context of insolvency, it gives rise to insurmountable coordination obstacles to loan modification, as noted above.

In many contexts, bankruptcy law operates specifically to overcome such obstacles. Equity trumps law to permit and encourage value-maximizing loan restructuring. Regrettably, while 11 U.S.C. §§ 1123(b)(5) and 1322(b)(2) authorize Chapter 11 and Chapter 13 debtors, respectively, to seek modification of creditor claims secured by property that does not constitute those debtors' *primary residences*, no such provisions authorize debtors to seek modification of creditor claims that *are* secured by debtors' primary residences.[37] Indeed, the latter provision prohibits it. An additional problem here is the fact that some states possess "homestead" exemptions of portions of home values from loss in bankruptcy (see Part IV.C.1.e.), which interact in sometimes unpredictable ways with these provisions of the Bankruptcy Code.

A simple change to the federal Bankruptcy Code could afford an immediate federal solution to the problem of modification-unavailability, effectively sidestepping any need there may otherwise be to address multiple PSAs, Servicer contracts, or relevant state laws (more below). Recent Congressional attempts to take this step—in the form of S. 61, the Helping Families Save Their Homes in Bankruptcy Act of 2009, and H.R. 225, the Emergency Homeownership and Equity Protection Act of 2009—have failed to reach the floors for vote.

37. *See, e.g.*, sources cited *supra* note 30. For a proposed "lease swap" solution to the problem, *see* Robert Hockett, *How about Lease Swaps as a Mortgage Market Cure?*, BENZINGA (Oct. 14, 2011), www.benzinga.com/news/11/10/1987688/how-about-home-lease-swapping-as-a-mortgage-market-cure#. *See also* Robert Hockett, *Lease Swaps as Mortgage Market Cure*, DORF ON LAW (Oct. 16, 2011), www.dorfonlaw.org/2011/10/post-by-bob-hockett-lease-swaps-as.html.

g. "Bankruptcy-Remote" Organizational Forms

Complementing the Bankruptcy Code's operation is the fact that most entities through which mortgage loans are securitized are structured to *prevent* their filing for bankruptcy. One way that this is affected is by organizing the entities as trusts, which, per 11 U.S.C. § 109(a), do not count as "persons" eligible to file under the Bankruptcy Code.[38]

A complementary strategy is contractually, e.g., via the PSAs, to prohibit the securitization vehicle from voluntarily filing for bankruptcy, and likewise to prohibit, through covenants, the parties from filing involuntary bankruptcy petitions against the trust.[39] The trust will also be prohibited by contract from engaging in various transactions with third parties, of kinds that might enable the third party to file involuntary petitions against the trust. The aim is to keep the securitization arrangement "bankruptcy-remote," one of its attractions to creditors.

In this connection, the "skin in the game" requirements imposed under the Dodd-Frank Act could yield a welcome side-benefit where bankruptcy-remoteness is concerned: Current securitization vehicles are kept clear of the possible financial difficulties of loan *originators* by so-called "true sales," pursuant to which originators sell the entireties of the mortgage loans they sell in order that the latter not be counted as assets in originators' bankrupt estates. Retention requirements will of course render that no longer possible.

h. Trust Indenture Law

Though the question does not appear to have been litigated, the terms of the Trust Indenture Act of 1939, 15 U.S.C. § 77aaa-77bbb ("TIA")—which applies to all bonds instruments, including RMBS—would seem to require unanimous consent among bondholders before rights to receive principal and interest payments on the securities can be altered.[40] That would impede modifying the terms of underlying mortgage loans, assuming modifications would alter payments into the legal entity on whose behalf the Servicer collects on underlying mortgages before distributing proceeds to RMBS-holders. This would be so even were modifications to underlying loans *demonstrably to*

38. There is an exception for "business trusts," but the Code does not define the term and different courts come out differently on what counts as a business trust for Bankruptcy Code purposes. To guard against the possibility that courts may find them to be business trusts, securitization vehicles typically employ additional, complementary strategies to ensure bankruptcy-remoteness. For thorough treatment, *see* Levitin, *supra* note 27.

39. Or, rather than prohibiting the parties from thus filing, the vehicle's PSA might require supermajority voting in favor of such filing.

40. *See, e.g.*, Levitin, *supra* note 27.

improve expected EVs. For the TIA's requirements are categorical, while actually securing the categorically required express unanimity among thousands or millions of RMBS holders worldwide so highly improbable as to amount to impossibility.

While it is not clear to what extent, if any, the TIA currently figures into the thinking of Servicers and trust administrators considering mortgage modifications, given the many more conspicuous factors already cited that serve to dissuade modification, it surely would present an obstacle were the other obstacles to be removed. It must accordingly be considered when we turn below to policy options.

i. Internal Revenue Code (Prior to 2009)

Sections 860A through 860G of the Internal Revenue Code ("Code"), as interpreted by the Internal Revenue Service ("IRS") under its Revenue Procedures and Treasury Regulations, at least until September 2009, conditioned the pass-through tax treatment of Real Estate Mortgage Investment Conduits ("REMICs"), which hold securitized mortgages, upon strict passivity. Modifications of underlying mortgage loans for their part were treated until recently as *departures* from the required passivity. Hence, securitized mortgage obligations up to that point could be modified only on pain of significant back-tax penalty.

Changes made by the IRS to the text of its Revenue Procedures[41] and Treasury Regulations[42] in mid-September of 2009, however, which apply retroactively to early 2008, have arguably removed this erstwhile impediment to loan modification. It might nevertheless be advisable to attempt to corroborate empirically that these changes are having their intended effect. I can attest on the basis of conversations with some acquaintances at upscale Wall Street law firms and investment banks, for example, that at least some professionals are scratching their heads over how best to synthesize the newly introduced language with other language that remains in the operative provisions. Investment bankers of my acquaintance maintain vigorously that there must be a complete and unambiguous safe harbor where modification is concerned, applying to all REMICs to date. The alternative, they argue, is continuing passivity, which is anathema to the maximization of recovery.

41. *See* Rev. Proc. 2009-45, 2009-40 I.R.B. 471.
42. *See* Treas. Reg. § 1.860G-2 (2009).

j. Accounting Standards

Tax considerations are not the sole considerations that have given REMICS reason to eschew loan modification so as to assure passivity. The wish to preserve *off-balance-sheet* status appears to continue to operate similarly.[43] For a loan originator, who typically continues on as a Servicer, to realize a gain on the sale of the loan and remove the loan form its balance sheet as it aims to do, the trust to which it sells the loan must be "qualified" under the accounting standards as promulgated by the Financial Accounting Standards Board ("FASB") and employed by the SEC in its regulatory roles. That in turn requires that the originator retain no "control" over the assets.[44]

Although (a) the standards do not elaborate on what counts as "control," and (b) some SEC staff have opined that modifications of imminently defaulting loans probably would *not* count as "control" of the sort that will shift assets back to originator/Servicer balance sheets,[45] there is sufficient uncertainty on the matter as to render the avoidance of modification prudent in the eyes of cautious originator/Servicers. If and insofar as continuing to allow securitizing entities to maintain off-balance-sheet status is thought desirable, then (a perhaps dubious proposition in light of recent financial history), it might be well advised to alter regulatory regimes that render that status contingent upon forms of passivity that preclude EV-enhancing modification of underlying mortgage loans. This point reinforces that made just above in Section IV.A.1.i. It might be that a comprehensive safe harbor, where modification is concerned, should be made unambiguously available.

2. Impediments to Satisfying the Interest of Expeditious Mortgage Foreclosure (II.A.3.), In Turn Impedes the Maximization of Loan Value Received (II.A.1.)

Part IV.C., *infra*, hereby incorporated into this subpart by reference, will provide a complete catalogue of impediments to fair, efficient, and reliable mortgage foreclosure. It does so because, per Part II.A.3., *supra*, this is an interest in its own right. I incorporate it here by reference, however, because impediments to its satisfaction

43. *See* FASB, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, in Statement of Fin. Accounting Standards No. 140, ¶¶ 8–13 (2008).

44. FASB, *supra* note 42, ¶¶ 8–13.

45. *See, e.g.*, Letter from Christopher Cox, SEC Chairman, to Rep. Barney Frank, Chairman of Comm. on Fin. Servs., U.S. House of Representatives (July 24, 2007).

also impede satisfaction of interest II.A.1., for reasons suggested above. In order better to picture the many interactions mentioned in the Introduction and further discussed herein, please see the flowchart in the Appendix.

B. IMPEDIMENTS TO MAXIMIZATION OF LOAN VALUE REMITTED (II.A.2.)

The principal impediments to maximizing mortgage loan value *remitted* (II.A.2.) are the same as those discussed above in connection with maximization of loan value received, Part IV.A. These are continuing slump in the real estate and broader markets and the factors that contribute to that slump, including impediments to (1) efficient loan restructuring that could better maximize the EVs of troubled loans, and (2) expeditious foreclosure procedures. Steps taken to address these impediments will inure to the benefit of Borrower and Investor interests, as discussed above in Part III.

C. IMPEDIMENTS TO THE EXPEDITION OF FAIR, EFFICIENT, AND RELIABLE FORECLOSURE PROCEEDINGS (II.A.3.)

There are multiple impediments to the satisfaction of interest II.A.3.—expedition of fair, efficient, and reliable foreclosure. Many of these are rooted in complexities, along with attendant uncertainties or indeterminacies, as well as inter- or intra-state[46] inconsistencies, in real property law, commercial law, and related agency law regimes. Over the long term, these difficulties would likely keep mortgage borrowing costs higher than they need be.

Hence there will be reason to change them. On the other hand, in view of their rootedness in state laws concerning areas of traditional state jurisdiction, they are not apt to change quickly. The good news, however, is that, as we shall see, state law also affords very promising means of executing the most promising means of addressing the more immediate crisis—namely, via municipalities' assembling controlling blocs of mortgage notes through exercise of their eminent domain power. But for purposes of this Subsection we confine ourselves to the foreclosure piece of the story.

46. There are pronounced inter-state inconsistencies as well, but it is less clear that these cause uncertainty so much as they increase transaction costs.

1. Divergent and Complex Property Law Regimes

Real property laws governing proper mortgage foreclosure and, in some cases, deficiency judgment procedures, vary significantly among and within states. Such differences result in increased transaction costs (II.A.4.). Such differences also presumably introduce uncertainty among RMBS holders as to which securities are best secured, and which are least well secured, by their underlying mortgages. That is particularly so where the mentioned divergences are intra- rather than interstate. Empirical study is needed to show the precise extent, if any, to which this form of uncertainty may depress RMBS values.[47] For now, details of the complexities and legal divergences themselves follow.

a. "Judicial" Foreclosure Regimes

About 20 states permit "judicial" foreclosure alone, which typically involves time-consuming procedural steps and is often appealable.[48] In these states, foreclosure can take years to complete.[49] While these procedural steps may be necessary to protect Borrowers and keep them in their homes,[50] significant variations across and even within these states—for example, differences in judicially imposed notice periods and evidentiary requirements[51]—produce uncertainties and result in higher transaction costs, as detailed in Part IV.D.

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47. *See infra* notes 45–48 and accompanying text, for such work as seems thus far to have been done along these lines.

48. Typical judicial foreclosure includes nine basic steps: (1) filing of foreclosure complaint and lis pendens notice; (2) service of process on all potentially interested parties, including creditors of Mortgagor/Borrower; (3) hearing before judge or chancery master who reports to court; (4) entry of judgment or decree; (5) public notice of sale; (6) public foreclosure sale itself, conducted by sheriff or functional equivalent; (7) post-sale adjudication of disposition of foreclosure sale proceeds; (8) in states that permit, entry of deficiency judgment, should proceeds fall short of the debt; (9) in some cases, appeal of judgment. Time taken can be multiple years. *See, e.g.*, Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act*, 53 DUKE L. J. 1399 (2004); Karen M. Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit* (Board of Governors of the Fed. Reserve, Working Paper No. 2003-16, 2003), www.federalreserve.gov/pubs/feds/2003/200316/200316pap.pdf.

49. *See* sources cited *supra* note 47.

50. Where EV-maximizing mortgage loan modification is effectively unavailable for the reasons laid out supra, Part IV.A, this Borrower interest seems all the more compelling. Were modification more widely available, impediments to efficient foreclosure might be more readily deplored.

51. *See* Report of the Permanent Editorial Board for the Uniform Commercial Code, Application of the Uniform Commercial Code to Selected Issues Relating to Mortgage Notes, Nov. 14, 2011, at 13.

b. "Power of Sale" Regimes

About 30 states permit "power of sale," or "nonjudicial," foreclosure instead of or in addition to judicial foreclosure. Even though the processes for power of sale ("POS") foreclosure generally operate substantially more expeditiously than POS's judicial counterpart,[52] often requiring less than one year,[53] significant variations occur across and within states where *notice* and *evidentiary* requirements are concerned in both judicial and non-judicial foreclosure contexts.[54]

There is also much variation in the degrees, if any, to which purchasers in such sales may rely upon presumptions of sale validity given trustee representations of compliance with their states' non-judicial foreclosure statutes.[55] Insofar as these variations are present *within* states, they introduce uncertainties that would seem apt adversely to affect the values of mortgage loans and associated securities. Even when these variations are present *across* rather than within states, they occasion transaction costs of the Part II.A.4. variety, as discussed *infra*, Part IV.D.

c. "Statutory Redemption" Regimes

About 22 states—principally but not solely those that require judicial foreclosure—afford "statutory redemption" rights upon mortgagors and, in some cases, lienholders as well. These rights holders are afforded one year or longer to purchase or repurchase title to the property after the foreclosure sale by paying the foreclosure purchaser the sale price plus accrued interest and other expenses. This slows foreclosure yet further and represents a significant transaction cost—though, like slow foreclosure processes where loan modification is effectively unavailable, it offers benefits as well.[56] Among states that provide for statutory redemption, there is significant variation concerning time periods and terms, and this too represents a significant transaction cost.[57]

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52. The steps involved typically are (1) filing of public notice of sale by mortgagee/lender or a third party (typically a sheriff or trustee), and (2) publicly selling. Time taken typically ranges from six to eight months. *See generally* Nelson & Whitman, *supra* note 47.

53. *Id.*

54. *See* Joint Editorial Board for Uniform Real Property Acts, *supra* note 51, at 4.

55. *See id.* at 18. On the matter of benefits, *see supra* note 38 and accompanying text.

56. The rationales behind statutory redemption are (1) to afford more opportunity to mortgagor/debtors to retain their properties, and (2) to encourage fair pricing of foreclosed properties, since low bids are more apt to be successfully redeemed than are high ones.

57. *See* Joint Editorial Board for Uniform Real Property Acts, *supra* note 51, at 5.

d. "Deficiency Judgment" Regimes

About 25 states permit post-foreclosure "deficiency judgments" against mortgagor/debtors, wherein mortgagee/creditors sue mortgagors for the difference, if such there be, between foreclosure sale price and outstanding mortgage debt. There is further variation among these states in respect of *limitations* on deficiency judgments.[58] These laws concerning deficiency judgments affect the degree to which creditors can recover in full on the values of their investments in the event of default by Borrowers. Variation in them across states of course presents transaction costs of the Part II.A.4. variety, as discussed below in Part IV.D.

e. "Homestead" Regimes

Ten or so states have so-called "homestead" laws, which exempt primary residences or portions of the value thereof from creditors in the event of personal bankruptcy on the part of a homeowner. Homestead laws introduce an additional element of uncertainty into the foreclosure process.

f. Undetermined Causal Consequences

It will be helpful, in the interest of determining to what degree if any the Federal Government ought to concern itself with these regimes and divergences, to conduct or commission hard empirical work that tests for effects they might wreak upon residential real estate, mortgage loan, and RMBS prices. Ideally that work would attend not only to the effects wrought by specific state regimes, but also to those, if any, wrought specifically by *non-uniformity itself* across and within states.[59] A robust correlation between price-suppression and non-uniformity would presumably recommend greater efforts at harmonization—perhaps up to federalization itself.

58. Some states impose "one action," or "security first" rules that require that mortgagee/creditors foreclose first and sue for deficiency after, while others permit mortgagee/creditors to seek satisfaction from mortgagor/debtors' other assets before foreclosure on mortgaged property. Some states likewise have "fair value" laws which limit permitted deficiency judgments to the difference between mortgage debt and the fair value of the foreclosed property rather than that between mortgage debt and the realized foreclosure sale price.

59. RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 3.2 (1997) asserts that "legal differences from state to state can seriously impede the carrying out of [] business arrangements . . . ." But even assuming that this is true, it is a matter distinct from what effect such nonuniformity has on secondary markets once securitization is an accomplished fact. At least one scholar has argued that nonuniformity as such does not generate significant costs. *See* Michael H. Schill, *The Impact of the Capital Markets on Real Estate Law and Practice*, 32 J. MARSHALL L. REV. 269, 286–87 (1999).

It should be emphasized, however, that non-uniformity as such, at least insofar as it occurs across rather than within states, does not thus far appear to have been shown to generate significant price-suppressive effects. Non-uniformity within states presumably could be shown to do so insofar as it amounts to unpredictability. All forms of non-uniformity, in turn, will occasion higher transaction costs, and it might accordingly be useful to quantify these with a view to informing discussion concerning the costs and benefits of interstate non-uniformity.

We should bear in mind, however, that these are probably best viewed as questions for the longer term, given how difficult it would be to address these matters of traditional state concern at one fell federal swoop. Although they do presumably bear upon the markets' present valuation of RMBS, in view of the uncertainty they impart to attachable collateral value, the very promising "control bloc assembly" solutions I shall propose below will very likely moot them for present purposes.

2. Divergent and Confusing Commercial Law Regimes

There is considerable uncertainty within and across states concerning who may enforce mortgage-secured promissory notes against whom, and accordingly gain title to the mortgage deeds, hence the collateral, securing those notes. There is also confusion concerning whether mortgage deeds might be severed from the notes they secure in the event that note assignments are not accompanied by change-of-lienholder recordings in local property registries. Both sets of confusions appear to have played some role in prompting the fabrication of false *ex post* paper trails of the sort that have figured into recent "robo-signing" scandals. Both also occasion transaction costs as discussed *infra*, Part IV.D. Principal sources of uncertainty here are as follows.

a. Uniform Commercial Code Article 3

When a residential mortgage-related promissory note qualifies as a *negotiable instrument*, Article 3 specifies who is entitled to enforce the note against whom. But there appears to be widespread disagreement and confusion both across and even within states, not to mention among scholars, as to whether many—or even any—residential mortgage-related promissory notes meet the criteria of negotiability. When courts do treat such notes as negotiable, they appear often simply to assume negotiability or to find it on the basis of quite cursory analysis.[60] The reason is twofold: On the one hand, the language of Section 3-104(a), which elaborates the criteria of negotiability, appears to suggest that some provisos commonly attending modern securitizable mortgage notes might disqualify the notes as negotiable instruments; on the other hand, the language only suggests this rather than actually determining it, so that courts and others are left hanging.[61]

The long term stakes involved in Article 3's applicability or otherwise are high. For one thing, if a mortgage note is indeed negotiable, then the right to enforce that note can be transferred, under Article 3, only by *physical delivery* of the original note.[62] Hence, homeowners who have succeeded in defending against foreclosure have done so because the foreclosing parties could not deliver or show possession of the note upon the homeowners' requests. And hence, in consequence, the temptation among some would-be foreclosers to fabricate false *ex post* paper trails of the sort exposed in the recent "robo-signing" scandals. For another thing, if the note is negotiable, then the "holder in due course" doctrine is implicated and can preclude a distressed or defaulting Borrower's from raising an otherwise valid defense of *fraud in the origination* of

60. *See, e.g.*, Dale A. Whitman, *How Negotiability Has Fouled Up the Secondary Mortgage Market, and What to Do About It*, 37 PEPP. L. REV. 737, 755–56 (2010) (finding that, of the forty-two reported cases from 1990 to 2010 in which courts made determinations concerning (a) mortgage note negotiability or (b) "holder in due course" status which presupposes negotiability, only two featured full analysis of negotiability of the note, while thirty-three simply assumed negotiability without argument).

61. For example, U.C.C. § 3-104(a)(3) requires that the note "not state any other undertaking or instruction by the person promising or ordering payment to [perform] any act in addition to the payment," and there is much unresolved argument concerning whether some of such features of modern mortgage notes as the "written notification of prepayment" requirement found in the Fannie Mae and Freddie Mac residential mortgage form amounts to one of those disqualifying "other undertaking[s] or instruction[s]."

Dale A. Whitman & Ronald J. Mann, *Searching for Negotiability in Payment and Credit Systems*, 44 UCLA L. REV. 951, 984–95 (1997) take opposite views on this particular example, while both agree that there is no obvious answer and conclude that negotiability is accordingly best deemed obsolete and ought be abandoned. *See, e.g.*, *id.* at 755.

62. This is the upshot of U.C.C. §§ 3-301 and 3-203(a) read in tandem. It remains true notwithstanding the "lost note" provisions of U.C.C. § 3-309, at least prior to 2002, in that the terms of that section imply that the would-be note-enforcer must have been in possession of the note at the time that it was lost. The PEB's 2002 amendment to § 3-309 rectifies that problem, but only ten states have adopted it, and the language of the Section suggests that it is expected to be applied in "courts," hence perhaps not in non-judicial foreclosure proceedings.

Those forty states that have not adopted the 2002 amendment to § 3-309 divide over whether other UCC provisions, such as § 1-103(b)'s incorporation, inter alia, of all compatible general assignment principles of law and equity, or § 3-203's apparent vesting of all instrument-transferors' enforcement rights in transferees, might offer any assistance in "lost note" cases. Here is another source of uncertainty. Even where allowances are made for lost notes, compliance with attendant conditions by would-be enforcers entails substantial burdens.

the underlying loan. Again, then, much can ride on the surprisingly underdetermined question of mortgage note negotiability.

Another source of confusion concerning the upshot of Article 3 is that the concept of "person entitled to enforce" a mortgage-related note (also called a "holder") and that of an "owner" of a mortgage-related note are distinct even if overlapping concepts implicated by the Article, and there appears to be a widespread (not to say understandable) tendency to conflate them in light of the terms' rough synonymy per ordinary English usage.

This can in turn lead to confusion, even in courts, over who has *standing to foreclose* on a mortgage.[63] This potential confusion can be further compounded by the fact that yet another term relevant to Article 3—that of a note's "bearer," or person "in possession" of the note—is itself distinct from "holder" and "owner" alike, notwithstanding, again, all three terms' rough synonymy in ordinary English usage. Muddying these waters yet further was the practice of Mortgage Electronic Registration Systems ("MERS") in allowing its noteholder members to institute foreclosures in its name rather than in their own names, labeling MERS a "mortgagee of record."[64] These confusions present transaction costs and give rise to uncertainties that can adversely affect the present values of RMBS and residential real estate, since success in foreclosure seems to vary randomly across courts rather than systematically across states or not at all. Thorough empirical study and quantification of these effects, if possible, would be helpful—though again, the likelihoods seem clear already. It is also worth once again emphasizing, however, that the promise offered by "control bloc assembly" solutions to the present crisis that I shall emphasize below should enable us to take our time about addressing this matter as something for the longer term. It might also bear noting here, both in anticipation of the discussion of policy options below and in light of the longer term rather than shorter term significance of the subject, that the concept of negotiability itself is perhaps best regarded as simply out of place in modern mortgage markets. For the point of negotiability historically was to render instruments—principally bank-issued or bank-discounted instruments—liquid by assuring prospective bearers of cash-substitutability. That is something that simply cannot be expected of mortgage notes—issued *to* banks rather than *by* banks—whose value inevitably rides upon the ever-variable quality of heterogeneous underlying loans, collateral, and foreclosure law. Again, though,

63. *See* Joint Editorial Board for Uniform Real Property Acts, *supra* note 51, at 5.
64. *Id.*

there will be more to say about all of these matters below as the Article turns to proposed solutions to our present problems.

b. Uniform Commercial Code Article 9

Irrespective of whether a mortgage related promissory note qualifies as a negotiable instrument under Article 3, Article 9 will bear implications for any transaction involving that note. It will do so by dint of either or both of two possible characteristics of the transaction with which the note is associated: (1) by dint of the note's being issued pursuant to a transaction in which property serves as collateral for one party's (the Borrower's) obligation; and/or (2) if the note comes to be sold (e.g., to a securitizer) then also by dint of that sale's being the sale of a payment right.

Potential confusion apparently attends this "two track" means of falling under Article 9, at least where mortgage-related notes are concerned. For Article 9 employs the same term-of-art, "security interest," in connection with *both*, thereby inviting conflation. Specifically, Article 9 employs the term "security interest" to designate both (1) the note-holder's interest in the *collateral* securing the note—viz., the mortgaged property—and (2) the note-holder's *right to regular payment* under the note.

The fact that the same term is employed to designate both a primary right (that to payment) and a secondary recourse triggered by default on the primary obligation (that to collateral) can foster confusion concerning whether payment rights under transferred notes can become severed from rights to collateral under mortgages. Such confusion can result in note-holders' erroneously being thought to lack rights to foreclose on property absent physical possession of mortgage deeds. That may in turn afford another incentive for fabricating false *ex post* paper trails of the kind exposed in the "robo-signing" scandals.[65] It also occasions possibly price-suppressive uncertainties and, transaction costs.

The fact that both sets of Article-9-cognizable rights go by one name ("security interest") might encourage misperception that they are "on the same level," hence divisible and separately conveyable, notwithstanding UCC § 9-203(g)'s provision to the contrary codifying

65. *See, e.g.*, U.S. Bank Nat'l Ass'n v. Ibanez, Nos. 08 MISC 384283 (KCL), 08 MISC 386755 (KCL), 2009 WL 3297551, at *11 (Mass. Land Ct. Oct. 14, 2009) (casting doubt on the "mortgage follows the note" rule). *Compare, e.g.*, *In re* Bird, No. 03-52010-JS, 2007 WL 2684265, at *2–4 (Bankr. D. Md. Sept. 7, 2007) ("The note and mortgage are inseparable; the former as essential, the latter as an incident. An assignment of the note carries the mortgage with it.").

the longstanding common law principle that "the mortgage follows the note."[66]

c. Divergent Agency Law Regimes

There appears to be considerable variation across and within states concerning who may act as an agent on behalf of a mortgage loan holder in seeking (1) enforcement of a mortgage related promissory note and (2) foreclosure on the mortgage that secures it. These differences have especially plagued efforts by MERS to pursue foreclosures on behalf of mortgage loan holders who are members of the organization.

The troubles are partly of MERS's own making, insofar as it employed misleading terminology in describing its status in various proceedings, as noted above. But the fact remains that nonuniform agency law standards represents a potentially significant source of uncertainty where foreclosure, hence the ultimate value of collateral and of the loans and RMBS that the collateral effectively secures, are concerned. That uncertainty, and its effect on the mortgage markets and mortgage holding institutions that are members of MERS, are on vivid display now.

Non-uniformity also occasions transaction costs and presumably accounts at least partly for MERS's recent legal difficulties themselves.

D. IMPEDIMENTS TO THE MINIMIZATION OF TRANSACTION COSTS CAUSED BY MORTGAGE FINANCE, REFINANCE, AND FORECLOSURE ARRANGEMENTS

Many of the factors discussed above in connection with loan value maximization (IV.A.) and expeditious foreclosure (IV.C.) also present significant transaction costs of the sort that Investors, Borrowers, and presumably the Federal Government would prefer to minimize. Particularly important are the impediments below. Insofar as they impede value-maximizing loan modifications the parties wish to make, they too represent significant loan-value-reducing costs:

66. *See, e.g.*, sources cited *supra* note 63. The mentioned UCC provision reads: "The attachment of a security interest in a right to payment or performance secured by a security interest or other lien on personal or real property is also attachment of a security interest in the security interest, mortgage, or other lien."

- Informational Barriers to Loan Renegotiation, per Part III.A.1.a.
- Borrower Demoralization Impediments to Loan Renegotiation, per Part IV.A.1.b.
- PSA Restrictions on Loan Modification, per Part IV.A.1.c.
- PSA-determined Servicer Compensation Arrangements, per Part IV.A.1.d.
- Creditor Coordination Problems, per Part IV.A.1.e.
- Current Bankruptcy Law, per Part IV.A.1.f.
- "Bankruptcy-Remoteness" Arrangements, per Part IV.A.1.g.
- Trust Indenture Law, per Part IV.A.1.h.
- Internal Revenue Code (until 2009), per Part IV.A.1.i.
- Accounting Standards, per Part IV.A.1.j.
- Complex and Divergent Property Law Regimes, per Part IV.C.1.
- Complex and Divergent Commercial Law Regimes, per Part IV.C.2.
- Divergent Agency Law Regimes, per Part IV.C.3.

Note that three of the impediments—Complex and Divergent Property Law Regimes; Complex and Divergent Commercial Law Regimes; and Divergent Agency Law Regimes—represent significant loan-value-reducing costs regardless of whether the divergences are inter- or intra-state. The latter, by introducing unpredictability and uncertainty to the pricing of real estate and RMBS, presumably are more deleterious than the former. But both forms of divergence give rise to a need on the part of Investors to research greater numbers of legal regimes in valuing real estate and RMBS, and accordingly raise transaction costs.

E. IMPEDIMENTS TO MAINTENANCE OF THE HEALTH OF THE U.S. AND GLOBAL FINANCIAL MARKETS (II.A.5.)

The principal impediments to satisfaction of interest II.A.5.—just characterized—are the same as those noted above in connection with maximization of loan value received (Part IV.A.), maximization of loan value remitted (Part IV.B.), expeditious foreclosure proceedings (Part IV.C.), and minimization of transaction costs (Part IV.D.). Any steps taken to address these impediments will advance relevant Federal Government interests as surely as they will Investor and Borrower interests.

F. Challenges to Maintenance of as Much Traditional State Jurisdiction over Agency, Commercial, and Real Property Law Matters in the U.S. as is Practicable (II.A.6.)

As this Article takes the point of view of the Federal Government, hence of Borrowers and Investors as well, I do not attempt here to catalogue all threats to this particular interest associated primarily with State Functionaries. Instead I shall simply keep this interest in mind when turning below to various possible means of addressing the impediments to Borrower, Investor, and Federal Government interests catalogued in the preceding Subparts. We now turn to those options.

V. Means of Removing or Diminishing Impediments to Satisfaction of Convergent Investor, Borrower, and Federal Government Interests

Each impediment discussed above can be addressed by any number of means. The focus here will be on means that (a) look realistically attainable and worthy of Federal Government support, (b) are conspicuously on offer at present from one quarter or another, or (c) both.

A. Maximizing Mortgage Loan Value Received

As the principal impediment to satisfaction of this interest seems to be continuing slump in the real estate and broader markets, one of the more direct means of satisfying this interest would seem to be to end the mentioned slump.[67] The Federal Reserve has long been hard at work on this score, via both its monetary and quantitative easing actions in general and its own MBS-purchases in particular. Additional efforts, however, are needed to address the specific impediments to loan modification that continue to impede EV-

67. *See* in particular "Pillar 1" of Alpert, Hockett & Roubini, *supra* note 2, for more on how best to design stimulus packages that address slump from the equity side of the debt/equity imbalance that is our current debt overhang problem. *See also* Robert Hockett, *White Paper in Support of the Nation Building Here at Home Act of 2012* (Cornell Legal Studies Research Paper, Working Paper No. 12-10, 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2029239; Robert Hockett & Robert Frank, *Public Infrastructure Investment, Renewed Growth, and the U.S. Fiscal Position* (Cornell Legal Studies Research Paper, Working Paper No. 2-04, 2012), *available at* http:// papers.ssrn.com/sol3/papers.cfm?abstract_id=1987656.

maximization, and the specific impediments to the expeditious foreclosure proceedings. I will now address a number of possibilities along these lines.

1. Facilitating Efficient EV-Maximizing Mortgage Loan Modification

a. More Accessible Information

One possible means of removing uncertainty concerning who is authorized to negotiate modifications is to pass S. 967, the Regulation of Mortgage Servicing Act of 2011, as noted above in Part III.A.1.a., or some counterpart bill, pending further study of the bill's ramifications. Another measure would be reform of the current mortgage and note recording system, ideally in the form of a readily accessible and editable electronic registry system—e.g., a fully generalized MERS system. Were such a system to include constant real time information concerning who is authorized to negotiate modifications on behalf of noteholders, there might be no need of further legislation on this particular score. The Federal Government, moreover, could support implementation of some such system at less political risk than would like attend support of a particular piece of pending legislation. Finally, it should be noted that neither of these measures will prove helpful absent additional measures targeting additional impediments that currently complement the informational impediment referenced here. More on those will be discussed below.

b. Borrower Counseling and Assistance

"Proactive" Borrower outreach and counseling programs could assist the cause of EV-maximizing loan modification by reducing the number of troubled Borrowers who are dissuaded from inquiring or learning about loan modification opportunities due to feeling humiliated and demoralized, particularly after dunning by collection agents. The Federal Government could presumably lend its support to such efforts at little to no political risk. Were the Federal Government via the Fed, FHA, Fannie, Freddie, FDIC, or Treasury to hold ownership of complete pools of mortgages as considered below, it would be particularly well situated actually to engage in such outreach itself.

c. Addressing Pooling and Servicing Agreement (PSA) Restrictions ; in Particular, by Assembling Controlling Blocks of RMBS

There appear to be three principal potential means of addressing current PSA restrictions on modification of underlying securitized mortgage loans. Each would represent collective means of surmounting the current collective action problem that prevents measures that stand to benefit all. One such measure would be the highly unlikely measure of cajoling all (or, where applicable, supermajorities of all) current holders of each vehicle's bonds into agreeing to modifications of currently underperforming underlying mortgage loans. This prospect is an abstract possibility at best, and therefore probably not worthy of further comment.

Another measure would be for one or more units of government to exercise eminent domain power to "take" at fair value all bonds necessary to acquiring the necessary contractual authority to approve underlying loan modifications in keeping with existing PSAs. While federal action along these lines might appear to have dubious precedential or statutory basis,[68] local such action would likely fare better. The reader can expect to see action along these lines in future, more on which prospect further below.

A third option would involve government agencies' purchasing, perhaps via cooperative arrangements among, e.g., the Fed, FHA, Fannie, Freddie, FDIC, even Treasury, RMBS on the secondary market with a view to assembling such blocks as would enable something like the second option noted above to be effected without exercise of eminent domain power. One might even imagine public-private partnerships along these lines, wherein new, "second order" securitization vehicles are formed specifically in order to assemble controlling blocks of current RMBS. Such vehicles also could be used, of course, in connection with the second option noted—the eminent domain option—as a means of financing.

Finally, a somewhat more narrowly targeted variation on this third option ("Three Prime") would be to purchase only those particular tranches of particular RMBS that object to modification, per Part V.A.1.e, below.

It is difficult to ascertain the *full extent* to which measures like Option Three or Three Prime are currently being exercised, though such efforts definitely have been at least modestly underway. Since I have been advocating that this be done on a grand scale since early 2008,[69] I cannot but be intrigued by the prospect of seeing more of it done. I still think that it might ultimately be the single most good-doing measure that the Federal Government and its peer agencies might take to establish, at long last, a "floor" beneath still sagging residential real estate and RMBS markets. It would in one stroke

68. *See, e.g.*, Howell E. Jackson, *Build a Better Bailout*, CHRISTIAN SCI. MONITOR (Sept. 25, 2008), www.csmonitor.com/Commentary/Opinion/2008/0925/p09s02-coop.html.

69. *See, e.g.*, Hockett II, *supra* note 2, at 48 for one more or less fully elaborated rendition.

eliminate or sidestep all obstacles to EV-maximizing loan modification recalled just above, as well as those to be recalled below.

The beneficial effects on the markets would likely be so pronounced as to preempt any political "backlash" that might otherwise be experienced in response to government "activism" in this realm. But there is no denying that it would constitute a "big" move, which might accordingly occasion at least some short term political expense. This might ultimately render Option 2—the eminent domain option—more workable. For this option would be most likely to be undertaken by municipalities aiming to keep families in their homes, hold communities together, maintain property values and necessary revenue bases, and stave off the blight and high crime rates that attend it. And action by municipalities and states seems to be more acceptable to many who decry federal action.

d. Reforming Servicer Compensation Arrangements

As noted above, Part IV.A.1.d., Servicer compensation arrangements currently standard in RMBS-associated PSAs fail to align Servicer with Borrower and Investor incentives when underlying mortgage loans enter the vicinity of insolvency. Arrangements in the securitized *commercial* real estate ("CMBS") market, by contrast, do. At first blush, at least, it would seem that the Federal Government could, at relatively low political risk, lend its name to calls made by others for reform of the RMBS servicer market along lines characteristic of the CMBS servicer market.

The Federal Government could also quietly encourage, then to endorse, moves by Fannie and Freddie to employ or require such arrangements in connection with mortgages or RMBS that they hold. Note, however, that anything along these lines would presumably be a matter of *future*, not present, residential real estate securitization arrangements. It would not of itself do anything about our current troubles—unless, say, "second order" securitization vehicles were formed, after such reform, to act along lines suggested immediately above, Part V.A.1.c.

e. Addressing Creditor Coordination Barriers to Loan Modification

As noted above, the tranching structures characteristic of typical private label residential real estate mortgage loan securitization arrangements present serious structural obstacles to modification of underlying loans. One way to address these would be for the Federal Government itself, via one or more public agencies and/or private sector partners, to purchase controlling blocks of RMBS, per Option Three considered *supra*, Part V.A.1.c.

Another, more narrowly targeted approach, however, would be to purchase those tranches of particular RMBS that bear incentives to "hold-up" would be loan workouts, per Option Three Prime mentioned above in Part V.A.1.c. Pursuit of this option by coalitions of agencies or public/private partnerships might not be unrealistic, and would not seem a great leap from what some agencies already are doing. Finally, the Federal Government might also wish, in this connection, to get behind efforts at bankruptcy law reform, as described next.

f. Bankruptcy Reform

As noted above, bankruptcy law is designed specifically to overcome creditor coordination problems of the sort just recalled. The problem is that the Bankruptcy Code as presently found does not permit Borrowers to force residential mortgage loan EV-maximizing modifications by filing for bankruptcy, at least not where the residences in question are their "primary" residences. While bills have been introduced in both houses of Congress with a view to addressing this impediment to loan modification, they have not yet gone anywhere.

The White House, the Federal Reserve, or both lending their weight to support of such legislation, but there would likely be some reluctance to do so in light of the present political stalemate. I presume that the best answer here rides on (1) how close to consideration and passage such legislation might be, relatedly (2) how likely it would be that the White House or Fed's support would tip the balance, and (3) how costly to the White House or Fed its support for the legislation would be in the event of failure to pass, or perhaps even in the event of success in passage.[70]

g. "Bankruptcy-Remoteness" Reform

A discussed above, most existing securitization vehicles arrange in a variety of ways to remain "bankruptcy-remote." They do so by organizing as trusts, which are not "persons" entitled to file under the Bankruptcy Code, and by covenanting out of bankruptcy via their PSAs and other contractual arrangements. Were the Federal Government, through one or more of its instrumentalities, to acquire full ownership in certain securitized mortgage pools, it could of course change these arrangements.

70. Passage would quickly result in such salutary effects as to diminish significantly any lingering "backlash" against White House or Fed support.

But there would be little need, for access to bankruptcy itself would be unnecessary in such case, in turn because there would no longer be a creditor coordination obstacle to modification of underlying loans. Measures like those considered above at V.A.1.c and V.A.1.e., then, would eliminate—or rather, would moot—the bankruptcy-remoteness obstacle as readily as they would address or sidestep the other obstacles to loan modification considered above and below.

h. Trust Indenture Law Reform

As noted earlier, the Trust Indenture Act of 1939, 15 U.S.C. § 77aaa-77bbb ("TIA") might render loan modification effectively impossible by dint of its unanimity requirements. Such is the case if it applies to RMBS—a question that does not appear yet to have been litigated. Were the Federal Government to purchase such RMBS in such manner as "bought out" all current holders who might object to underlying loan modifications, then it would be positioned to sidestep the TIA just as to sidestep existing PSAs as discussed *supra*, Part V.A.1.c. Absent a bold move of that sort, however, the White House, the Fed, or both might wish to propose, or to lend their support to others' such proposals, to amend TIA—at least prospectively.

i. Internal Revenue Code Reform?

As discussed above at Part IV.A.1.i., the IRS now understands its enabling act in a manner that no longer effectively prohibits loan modifications on pain of back-tax penalization. As also noted there, however, there might be some continuing unclarity, and attendant risk aversion, where the changes' precise significance is concerned. The White House and other concerned Federal Government parties might wish to conduct or support some measure of further study with a view to ensuring that no parties who would otherwise engage in loan modification efforts are holding off for fear of adverse tax consequences.

j. Accounting Standards Reform?

As noted above at Part IV.A.1.j., current accounting standards condition the off-balance sheet status of mortgage loans, from originators' point of view, upon originators' relinquishment of "control" over the loans that they sell. For an originator who continues on as a Servicer to engage in loan modification negotiations, however, might be to exercise "control" in the opposite sense, notwithstanding some SEC opinion letters to the contrary. Uncertainty about the matter, in any event, might well be dissuading some who would otherwise engage in loan modification negotiations from doing so. The White House or other concerned Federal Government parties might, then, wish to propose, or to lend support to, efforts by the SEC or others to ensure final clarity on this matter.

2. Encouraging Expedition of Fair, Efficient, and Reliable Foreclosure Proceedings

As noted above, impediments to the expedition of fair, efficient, and reliable foreclosure proceedings also impede the maximization of mortgage loan value received (and remitted), and hence impede mortgage loan EV-maximization. I allude to foreclosure here to preserve the structure of this Article, which aims among other things to show the interrelations between interests. For fuller treatment of means to address obstacles to satisfaction of this interest, however, please see *infra*, Part IV.C.

B. MAXIMIZING MORTGAGE LOAN VALUE REMITTED

As noted earlier, the interest of Borrowers in fulfilling their loan obligations as best as they can is simply the flip side of the interest of Investors in being repaid to the fullest extent possible. Obstacles to the one interest are accordingly obstacles to the other, and measures taken to eliminate, diminish, or sidestep those obstacles accordingly redound to the interests of Investors and Borrowers alike.

C. ENCOURAGING EXPEDITION OF FAIR, EFFICIENT, AND RELIABLE FORECLOSURE PROCEEDINGS

Because impediments to the expedition of fair, efficient, and reliable foreclosure (I.A.C.) where mortgage loans simply cannot be repaid or restructured are rooted in complexities, as well as inter- or intra-state inconsistencies, in real property law, commercial law, and related agency law regimes, means of addressing these obstacles take the form of efforts to simplify and harmonize these regimes.

Efforts to facilitate more smoothly functioning foreclosure proceedings probably should be distinctly secondary to efforts aimed at facilitating more EV-maximizing loan modification, as discussed above through Part IV.A.1. There is much more value that is apt to be salvaged by the latter means, than there is loss apt to be avoided by the former means. Moreover, the Federal Government is much more able, by dint of the tools at its disposal, to act to real and salutary effect along lines suggested through Part V.A.1., than it is to make much difference to (remarkably slow moving) commercial, local real estate, and agency law reform efforts currently underway. For as will emerge below, these latter efforts are not new, and thus far seem stalemated in ways that the Federal Government seems unlikely to be able to do much to break.

1. Simplifying and Harmonizing Property Law Regimes?

As observed above in Part IV.C.1., there are significant cross-cutting differences among, and even within, states where the real property laws governing mortgage foreclosures and, in some cases, deficiency judgment procedures are concerned. *Inter*state divergence presumably increases transaction costs borne by securitized mortgage pools that hold mortgages from multiple differing jurisdictions; more agents and more legal research is needed in such case to pursue foreclosure. *Intra*state divergence likely increases not only transaction costs of that sort, but considerable uncertainty as well, in that one can no longer reliably predict, in such case, how foreclosure and related proceedings will unfold within particular counties or courts.

The transaction costs are regrettable, though not necessarily unwarranted insofar as state responsibility for real property law—an instance of Interest II.A.6.—has long been a fundamental feature of our federalism. The uncertainty, on the other hand, is not only regrettable, but seemingly unwarranted as well; our union is a federation of states, not local courts. It is not clear, however, that the Federal Government can, or ought, to do much about these things.

The Federal Government can justifiably and at relatively little political risk lend its moral support and expertise to law-simplification and—harmonization efforts initiated by such organizations as the American Law Institute ("ALI") and the Uniform Law Conference ("ULC"). Likewise, the Federal Government could purpose these organizations to take up such efforts. But since these groups have long been considered the primary agents in such efforts, a Federal Government party would be taking on considerable political risk were it to attempt too aggressively to "push" such efforts when these organizations are reluctant, or to "end-run" around them when they are recalcitrant. Additionally, a Federal Government party could persuade Fannie and Freddie to employ their conditionality leverage in the interest of more uniformity in this area.

These observations seem especially apt in light of two particular considerations. First, law-simplification and law-harmonization efforts in the areas now under discussion have been long underway yet do not seem to be making much headway; it is difficult to see how the Federal Government might change that. The second consideration is in the nature of a recollection—namely, how readily a Federal instrumentality might render the need for law reform less pressing in any event, simply by taking measures of the kind considered in the previous Subsection in connection with facilitating EV-maximizing mortgage loan *modifications*.

Since the latter lies more clearly within the Federal Reserve's and other Federal instrumentalities core expertise and the effective range of their policy tools, while also apt to preserve the most value, and the former is rather more peripheral to these instrumentalities' expertise and ability, while also not very promising as a near-term solution, it would seem that the Federal Government would do best to focus on Part V.A.1. efforts, while simply endorsing but not spending significant resources upon the Section V.C. efforts that I now turn to elaborating.

a. Reforming Judicial Foreclosure Regimes?

As noted in Part IV.C.1.a., about 20 states permit judicial foreclosure alone, which is generally a very time consuming process with a good bit of idiosyncratic variation from court to court even within states. As also noted there, however, it isn't clear that this form of process, or that these features of the process, are unwarranted in light of the values at stake. People's capacity to stay in their homes is one such value. State and perhaps even local autonomy in determining how best to vindicate that value is another.

Finally, process-responsiveness to the idiosyncratic differences perhaps likely to be present from foreclosure case to foreclosure case might be another such value. It is not clear to me that there is some countervailing value that is so much more pressing than those values, and that lies so squarely within the Federal Government's jurisdiction and expertise, as to warrant the Federal Government's taking a firm position in respect of foreclosure processes in the judicial foreclosure jurisdictions.

b. Reforming Nonjudicial Foreclosure Regimes?

As noted above in Part IV.C.1.b., about 30 states permit "power of sale" or "nonjudicial" foreclosure instead of or in addition to judicial foreclosure. While nonjudicial disclosure is generally more streamlined and brisk than its judicial counterpart, there is nevertheless some variation among and, in some cases, even within states where notice and evidentiary requirements, as well as legal presumptions, are concerned.

The Federal Government could, at little political risk, at least encourage efforts to bring greater uniformity in respect of these matters within state. To push for it across states, however, seems to implicate the same calculus as that noted in the immediately preceding Part, V.C.1.a. Moreover, the Uniform Law Conference has repeatedly promulgated and advocated uniform nonjudicial foreclosure acts, all to virtually no avail. These include the Model Power of Sale Foreclosure Act of 1940, which was never adopted by so much as a single state, and the Uniform Nonjudicial Foreclosure Act of 2002, which has fared no better.

c. Taking a Stand on Statutory Redemption Rights?

As noted above, about 22 states—principally but no solely those that employ judicial foreclosure—afford "statutory redemption" rights upon mortgagor/debtors and, in some cases, lienholders as well. These afford those who have been foreclosed upon the opportunity to regain their properties under certain conditions. Their principal effect is to prolong the foreclosure process yet further than as described above in Subparts IV.C.1.a. and V.C.1.a., and presumably therefore to add an additional degree of uncertainty, via nonfinality, as well. For essentially the same reasons as those adduced in connection with judicial foreclosure itself in Part V.C.1.a. above, however, this subject does not seem to me something upon which the Federal Government would wish to take a position—other than the usual endorsement of intra-state consistency so far as possible.

d. Taking a Stand on Deficiency Judgments?

As noted above in Part IV.C.1.d., about 25 state permit post-foreclosure "deficiency judgments" against mortgagor/debtors whose foreclosed homes do not bring sufficient revenue to cover the entireties of their outstanding obligations to their creditors. Differing states impose differing requirements upon these. Allowing such judgments, of course, tends to be mortgage loan EV-maximizing. Differences among states in respect of restrictions upon deficiency judgments, for their part, represent higher transaction costs for securitization trusts holding mortgage notes relating to properties in differing states.

The Federal Government could advocate for more extensive allowance of deficiency judgments across the union, and greater uniformity across states where the contours of deficiency judgment are concerned. Yet, for reasons adduced in the immediately preceding several Subparts, this does not seem to me an area in which the Federal Government should opine. The issues involved are quite sensitive, as well as traditional state concerns. Meanwhile, more value seems apt to be preserved by means of the sort considered above, Section V.A.1., in connection with facilitating mortgage loan modification. And since the latter means seem to be well within Federal Government expertise and capacity, they are better avenues down which the Federal Government might travel yet further than it already has.

2. Simplifying and Harmonizing Commercial Law Regimes?

As discussed in Part IV.C.2., the nonuniformity across and within states of current commercial law regimes have played some role not only in determining bizarre and unpredictable caselaw, but also certain practices brought to light in recent "robo-signing" scandals. Here, the Federal Government could do some real good, at minimal political risk. This is partly because commercial law is less likely to strike citizens viscerally as a province of state law alone; there is, after all, a Congressional Commerce Power. The lower degree of risk here also stems from the fact that there seems little to no compelling reason for complexity and variety, in the way that there is, to some degree, in the case of real estate law.

a. Uniform Commercial Code Article 3 Reform?

As noted above at Part IV.C.2.a., considerable confusion attends (1) whether modern mortgage-related promissory notes qualify as "negotiable" under UCC Article 3 and hence fall within that Article's ambit, and, to somewhat lesser degree (2) who actually has standing to enforce an Article 3-cognizable promissory note. These confusions owe partly to (1) less than perfect clarity over precisely what qualifies or disqualifies a promissory note as negotiable, and (2) what seems an unfortunate tendency on the part of Article 3 to employ terms that are more or less synonymous in ordinary English usage—e.g., "holder," "owner," "bearer"—to designate very different legal concepts.

The *stakes* involved in the negotiability question are high. Negotiable notes are transferrable only by physical delivery, which fact accounts for some of the temptations succumbing to which led some Servicers into "robo-signing"-type infractions. Negotiable notes also implicate the "holder in due course" doctrine, pursuant to which mortgagor/borrowers are left unable to raise origination fraud as a defense in foreclosure.

The mentioned unclarities in connection with which so much is at stake seem to be altogether rectifiable problems. There would not seem to be any significant political risk entailed by the Federal Government's lending its support to the cause of bringing greater clarity to Article 3 on the mentioned points. The recent PEB Memorandum on proper understanding of Article 3 is helpful in respect of point (2) just above,[71] but does not seem to have anything to say about point (1). Moreover, better than a memorandum to assist with point (2), it seems to me, would be simplification and clarification of the Article itself.

I recommend that the Federal Reserve, in conjunction with ALI and the ULC, conduct empirical research of the sort noted to be lacking above in Part IV.C.2.a., and act to instigate and further a process to revise Article 3. In addition to attending to points (1) and (2), it seems that this process ought also to involve serious consideration of (3) whether the concept of negotiability—the entailments of which stand in the way of an efficient electronic mortgage note transfer system while also risking serious injustice to defrauded mortgagor/borrowers—makes sense at all anymore where mortgage-related promissory notes are concerned.[72]

b. Uniform Commercial Code Article 9 Reform?

As noted above in Part IV.C.2.b., all mortgage-related promissory notes, as well as their associated mortgages, implicate Article 9 of the UCC irrespective of whether they implicate Article 3. Because the term "security interest" used in Article 9 refers both to the saleable payment right associated with a securitized promissory note and to the collateralized property that secures the note obligation via the mortgage, confusion plagues many foreclosure proceedings. Some have erroneously come to believe that mortgages are severable from their associated notes, and in consequence have erroneously come to believe that foreclosure cannot be had absent physical possession of a mortgage deed. That in turn has afforded yet another incentive to Servicers to engage in practices of the sort brought to light in some of the recent "robo-signing" scandals.

To solve this problem, all that would need be done is either or both (1) to employ different terms of art for rights to payment and rights to underlying collateral, rather than employing the term "security interest" to designate both; and (2) to add language to the text of Article 9 simply stating that in the case of mortgages and mortgage-related promissory notes, "the mortgage [does indeed always] follow the note," as has been the case since well before

71. *See supra* note 56, and associated text.
72. *See supra*, Part IV.C.2.a, for more on why it might not.

codification of this common law doctrine in the UCC. Little to no political risks are involved in these efforts.

c. Agency Law Clarification or Reform?

As noted above in Part IV.C.3., there appears to be considerable variation not only across, but also more troublingly within, states concerning who may act as an agent on behalf of a mortgage loan holder seeking (1) enforcement of a mortgage-related promissory note, and (2) foreclosure on the mortgage that secures it. These differences have especially plagued efforts by MERS of late to pursue foreclosures on behalf of its members.

Interstate variation of this sort occasions higher transaction costs, but intrastate variation occasions something worse—uncertainty. Also, there is no particularly compelling reason for intrastate variation on agency in connection with mortgage foreclosure, while there is also probably less such reason for interstate variation in this field than there is, say, for interstate variation in respect of real property law.

I tentatively conclude that the Federal Reserve, in conjunction with the SEC, could encourage and lend its assistance to efforts at making incremental reform to the law of agency through the Restatement process. It would not seem difficult to develop a simple and uniform standard pursuant to which the conditions that must be met for a putative agent to receive actual authority to engage in note-enforcement and mortgage-foreclosure proceedings on behalf of a noteholder were made plain.

D. LOWERING MORTGAGE FINANCE- REFINANCE- AND FORECLOSURE-RELATED TRANSACTION COSTS

As catalogued throughout Part IV.D., the factors that impede the interests off maximizing loan value (Interests II.A.1. and II.A.2.) and expeditious foreclosure (II.A.3.) also present significant transaction costs of the sort that Investors, Borrowers, and presumably the Federal Government would prefer to see minimized. All measures considered and recommended above in Sections V.A. and V.C. will act to lower these transaction costs too. Insofar as these are significant—a matter that could do with empirical study but also a matter in connection with which the probabilities seem obvious—the recommended measures look to be all the more forcefully justified.

VI. CONCLUSION: TWO RIDERS ARE APPROACHING, THE WIND BEGINS TO HOWL[73]

My hope is to have identified literally all factors that presently pose substantial threats to the recovery and longer term health of our primary and secondary mortgage and residential real estate markets. I hope also to have drawn out the way in which many of these factors mutually interact and complement one another in challenging the mentioned recovery and longer term health. And, finally, I hope to have adequately highlighted the various interests in terms in which "recovery" and "health" are best understood, and the various parties in interest whose interests and, therefore, incentives are implicated in the inquiry.

The American public has a good deal of work to do if we are to bring full recovery and longer term health to the mortgage and real estate markets, hence to the broader financial economy and the yet broader macroeconomy. On the other hand, the task need not be as daunting as the sheer inclusiveness of the foregoing Parts might seem to suggest. For, in the first place, there is a remarkable degree of convergence and mutual complementarity among the particular interests and parties in interest that I have identified. In the second place, some of the measures that I have provisionally assessed can yield such substantial effects as to render other such measures less urgently needed in the short-to-medium terms even if well advised in the longer term.

If there is one family of such measures that "dominates" all others in importance, I think that it is that family of measures I proposed as the present crisis first grew acute in 2008,[74] on the basis of things I had written about earlier in the decade in connection with the federal home finance innovations pioneered by Presidents Hoover and Roosevelt in the 1930s.[75] This is the family of measures that address head-on the coordination and collective action problems that are (1) diffusely participated market undervaluation of MBS, and (2) diffuse creditor incapacity to negotiate all-too necessary principal write-downs. I call these, as noted above, "controlling bloc"

73. With apologies and thanks again to Mr. Zimmerman. *See supra* note 1. The last line of the work in question is "Two riders were approaching, / the wind began to howl."

74. *See, e.g.*, Hockett II, *supra* note 2, as well as sundry OpEds published during the same period. *See also* Robert Hockett, *Treasury's Planned Bailout is FHA's Bailiwick*, DORF ON LAW (Sept. 25, 2008), www.dorfonlaw.org/2008/09/treasurys-planned-bailout-is-fhas.html.

75. *See, e.g.*, Hockett III, *supra* note 15, at 105–06 (developed, I now feel waves of nostalgia in reporting, out of 2001 research paper written for Mike Graetz's and Jerry Mashaw's Designing Public Institutions course at Yale Law School); Robert Hockett, *What Kinds of Stock Ownership Plans Should There Be? Of ESOPs, Other SOPs, and "Ownership Societies"*, 92 CORNELL L. REV. 865, 924–26 (2007).

measures. They promise to work precisely by dint of their replacing collectively diffuse stakeholders, who are subject to all of the coordination and collective action challenges discussed above, with concentrated collective agents.

One such measure, as proposed earlier, would involve federal agencies' purchasing controlling blocks of MBS themselves. That would have been particularly well advised in 2008, at the time that I advocated it, but could still work now were the appropriate federal instrumentalities—be it Congress or, more plausibly right now, the FHFA—to recognize the potential and act upon it.

Another such measure would involve federal or, more likely in view of that "collective action problem" which is the U.S. Congress itself these days, state or municipal exercises of the eminent domain power to the same end. Municipalities—especially some of those in the so-called "sand states" that the bubble and bust hit most forcefully—have particularly compelling interests preventing mass foreclosure. For it is difficult to imagine a more calamitous hit to their property values, tax bases, and freedom from familial distress, blight, and crime, than a concentrated set of local foreclosures.

If a municipality can condemn physical property to remove people from their homes in the name of shopping mall development as did the City of New London in *Kelo v. City of New London*,[76] how much more apt to pass Due Process muster must it be for a town to condemn mortgage-backed promissory notes in the name both of keeping people in their homes and maximizing value for the note-holders themselves? All that would seem to prevent this right now is a want of sufficient imagination and knowledge on the part of those collective agents best situated at present to act in the name of us all—the municipalities.

Solution to a collective action problem typically requires a collective agent.[77] Only some such agent's taking charge will enable all parties in interest to the many troubled post-bust mortgages out there to enjoy the benefits of post-bust EV-maximization. For the time being, the best situated such agents appear to be the municipalities. There, then, is the locus of decision at which I believe the next important steps will be taken. They, along with investors who might partner with them in order to provide up-front financing for condemnation awards, jointly constitute the "two riders" referenced in the caption above.

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76. Kelo v. City of New London, 545 U.S. 469, 489–90 (2005).

77. *See* Hockett II, *supra* note 2, at 1290–91; Alpert, Hockett & Roubini, *supra* note 2, at 6–7. *See also* Robert Hockett, *How to Bypass the Impasse: Public-Private Partnering for Value-Salvaging Mortgage Condemnation* (working paper) (on file with the author).

Indeed, since first drafting this Article, the author has made significant headway, in some cases in collaboration with old friends and colleagues in the financial services industry, in fostering municipal and investor interest in this idea. Since Reuters first reported on the emerging success of the plan in June 2012,[78] there has been much press and other media coverage.[79] There has also been much interest shown by municipalities;[80] federal instrumentalities including the White House, Congress, and multiple regulators;[81] housing and community advocates;[82] the ALI;[83] the ABA;[84] the

78. *See* Tom Braithwaite, *Investors Invoke Law to Solve Housing Crisis*, FINANCIAL TIMES, June 10, 2012, http://www.ft.com/cms/s/0/8017cf44-b309-11e1-83a9-00144feabdc0.html#axzz2NvOxlJqq*; see also* Robert Hockett, *A solution for underwater mortgages: Eminent domain*, REUTERS (June 19, 2012), http://blogs.reuters.com/great-debate/ 2012/06/19/a-solution-for-underwater-mortgages- eminent-domain.

79. *See, e.g.*, Joe Nocera, *Housing's Last Chance?*, N.Y. TIMES, July 10, 2012, at A21. For a compilation of other media sources, *see* Articles: News and More, Eminent Domain, http://www.eminent-domain.us/index.php/component/content/article/79-publicationscategory/83-newsandmore (last visited Mar. 23, 2013).

80. *Id. See, e.g.*, Michael Morgan Bolton, *Brockton considers plan to seize bad mortgages*, BOSTON.COM (2013), http://www.boston.com/news/local/massachusetts/2013/01/03/brockton-explore-using-eminent-domain-seize-loans-foreclosure-crisis-city-study-loan-seizures/U1xmwQw706X1VhF1lUHijM/story.html.

81. *See*, e.g., Maxine Waters, *The Housing Crisis and Policy Solutions: Should Eminent Domain Be Used to Save Underwater Homeowners?* (Sept. 11, 2012), *available at* http://www.lawschool.cornell.edu/spotlights/upload/Testimony-of-Robert-Hockett-11-September-2012-Third-Round.pdf (testimony of Robert Hockett); Press Release, Rep. Waters Hosts Panel on Eminent Domain Proposals to Seize Underwater Mortgages, (Sept. 11, 2012), http://waters.house.gov /news/documentsingle.aspx?DocumentID=308238; Alan Zibel, *Eminent Domain Furor Hits Capitol Hill*, WSJ (Sept. 13, 2012), http://blogs.wsj.com/developments/2012/09/13/eminent-domain-furor-hits-capitol-hill/; Rep. Brad Miller, *No Wonder Eminent Domain Mortgage Seizures Scare Wall Street*, AM. BANKER (July 11, 2012), http://www.americanbanker.com/bankthink/eminent-domain-mortgage-seizures-terrify-wall-street-1050811-1.html; Fed. Housing Fin. Agency, *FHFA Sends Notice to Federal Register on Use of Eminent Domain to Restructure Performing Loans* (Aug. 8, 2012), *available at* http://www.fhfa.gov/webfiles/24143/eminent domainpr8812f.pdf.

82. *See, e.g.*, *More from Robert Hockett on Using Eminent Domain to Solve the Underwater Mortgage Debt Problem*, PUBLIC CITIZEN CONSUMER LAW & POL'Y BLOG (Dec. 5, 2012), http://pubcit.typepad.com/clpblog/2012/12/more-from-robert-hockett-on-using-eminent-domain-to-solve-the-underwater-mortgage-debt-problem.html; AFR Conference: Principal Reduction and the Economy TODAY (June 28, 2012), http://ourfinancialsecurity.org/2012/06/afr-conference-principal-reduction-and-the-economy-thursday-june-28/; Community Responses to Foreclosure Crisis Conference, http://www.projectnooneleaves.org/content/conference (Mar. 23, 2013).

83. *Eminent Domain and Land Valuation Litigation*, ALI-CLE.ORG, http://www.ali-cle.org/index.cfm?fuseaction=courses.course&course_code=CU027 (last visited March 23, 2013); *see also* Robert C. Hockett, Paying Paul and Robbing No One: An Eminent Domain Solution for Underwater Mortgage Debt That Can Benefit Literally Everyone (Cornell Law School: Legal Studies Research Paper Series), *available at* http://files.ali-cle.org/thumbs/datastorage/skoobesruoc/pdf/CU027_chapter_04_thumb.pdf.

84. *ABA Professor's Corner on Eminent Domain for Mortgage Modifications*, LAND USE PROF BLOG (Oct. 9, 2012), http://lawprofessors.typepad.com/land_use/2012/10/aba-professors-corner-on-eminent-domain-for-mortgage-modifications.html.

Federalist Society;[85] fellow academics including one of this author's past mentors;[86] and other quarters. There has also, naturally, been much attention, most of it hysterical, from the securitization industry and its hired attorneys—including one former Solicitor General of the United States.[87]

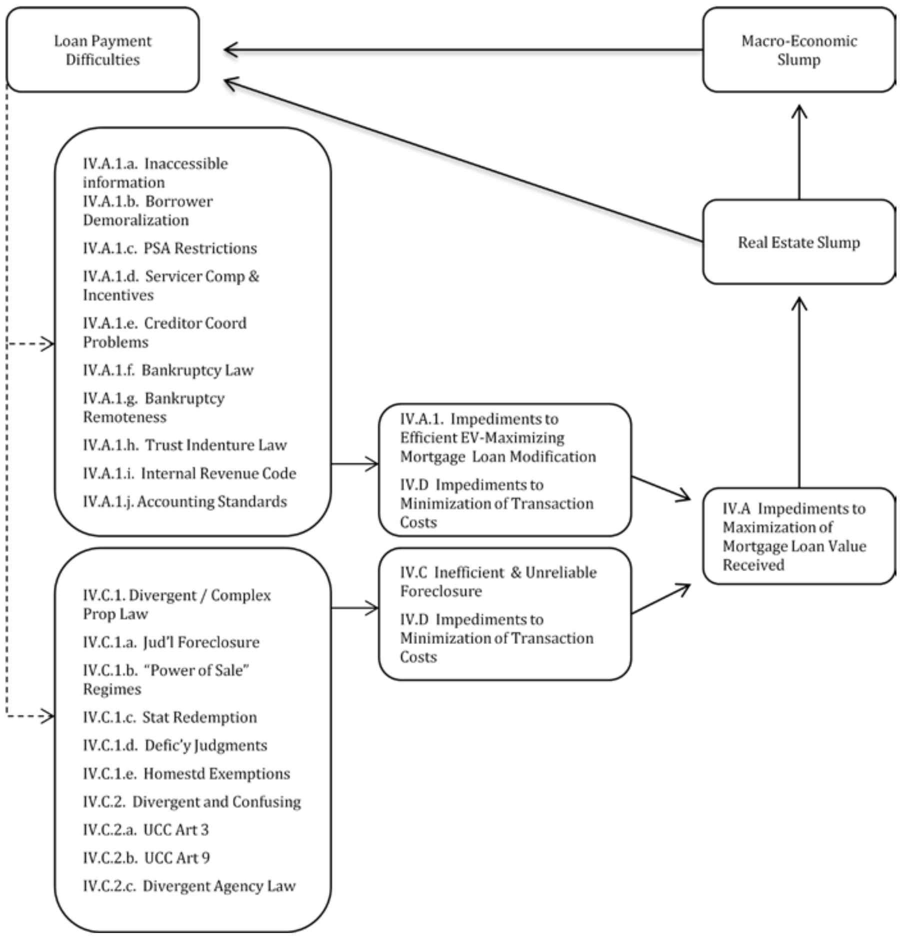
Time will of course tell how the plan will ultimately fare. In the meanwhile, the surprising degree of attention, both favorable and unfavorable, that the plan has drawn is testament to the seriousness of the problem it seeks to address. The sheer complexity of that problem, for its part, is what this Article has endeavored to catalogue in the interest of ultimately solving.

85. *See, e.g.*, *Are There Limits to Mortgage Condemnation?*, THE FEDERALIST SOCIETY, http://www.fed-soc.org/events/detail/are-there-limits-to-mortgage-condemnation (last visited Mar. 23, 2013).

86. Robert Shiller, *Reviving Real Estate Requires Collective Action*, N.Y. TIMES, June 24, 2012, at BU6.

87. *See*, *e.g.*, *Memo Questions Legality of California Eminent Domain Proposal*, SIFMA (July 17, 2012), http://www.sifma.org/news/news.aspx?id=8589939514; *SIFMA and Other Associations Submit Comments to the FHFA on the Use of Eminent Domain to Restructure Performance Loans*, SIFMA (Sept. 7, 2012), http://www.sifma.org/issues/item.aspx?id=8589940214; *see also* Robert C. Hockett, *SIFMA's FHFA Letter: More of the Same—and Then Some*, MORTGAGE RESOLUTION PARTNERS, http://mortgageresolution.com/hockett-on-sifmas-fhfa-comment-letter (last visited Mar. 23, 2013) (responding to SIFMA's letter to the FHFA questioning the legality of the use of eminent domain to seize mortgage loans).

Appendix: Causal (Including "Feedback") Roles Played by Factors Discussed in Article



Solid arrow lines represent simple causation. Dotted arrow lines represent additive causation. (Two items linked by dotted arrow add up together to cause next item on right, linked-to by solid arrow.)