The Great Foreclosure Moratorium and What It Means for Troubled Homeowners

October 14, 2010 - Last week, Bank of America announced that it was halting home foreclosures in all 50 states. Two days ago, GMAC announced that it was conducting a review of all of its foreclosures. GMAC Mortgage has halted foreclosures in 23 states. And all 50 State Attorneys General have announced their own probes into bank foreclosure proceedings. While the press has tried to simplify the issue, the troubles that lenders are having actually run much deeper than what is being reported. The issue for the banks and borrowers is really about ownership of the loans; because only the owner of a loan can initiate a foreclosure. The immediate problem is that most mortgages have now been sliced and diced into securities, making it almost impossible to know who owns the loan. Until that can be determined, nobody has the right to foreclose on any given property. And that is creating a variety of issue for banks, homeowners and the government that may take years to sort out.

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To say that the issue of banks and foreclosures is a mess would be an understatement. If you watch the nightly news, you may already know, or think you know, that the reason several banks have halted or slowed foreclosures is because of "robo-signers". This is how the press is referring to the people who work for banks that have been signing off on foreclosures. The reason for the robo-signer moniker is that some of these people have admitted to signing off on thousands of foreclosures every month without ever reviewing the actual mortgage files. And the reason that this is a problem is because the documents they were signing were often affidavits in which they specifically swore under penalty of perjury that they had reviewed the files and that the banks had the legal right to foreclose. Not only were they lying, they were committing fraud.

But that is just the surface issue. The real issue is that the banks have sold off their mortgages by slicing them up and then re-bundling them as securities. If your mortgage has been bundled into securities (and it probably has), and your neighbor purchased a single security - or for simplification sake, a single share - then your neighbor owns a small portion of your mortgage. But that is far different from actually owning the mortgage itself and it doesnâ€™t give your neighbor the right to foreclose.

Now imagine that your mortgage was sliced and diced into 1,000 separate shares, and nobody owns more than one share. Who has the right to foreclose on you if you stop paying your mortgage?

Then, imagine again the millions of mortgages that are in exactly the same situation! While this is still a simplified view, it gives you an idea of the problem's scope.

This issue has been creeping up on the economy for more than two years now. In fact, we wrote about it in 2008 and then did an interview with Katherine Porter; a Harvard trained attorney and law professor who published a study on the subject in early 2008. Although her paper dealt with mortgage fraud as it related to the Bankruptcy Court, it is relevant to the current crisis. Her study specifically talked about cases in which banks couldn't prove that they owned the loans for homes they were attempting to foreclose on, and which courts were starting to side with borrowers. Yet federal regulators did nothing.

Nobody really knows how these issues will work out in the end but there are no good scenarios for consumers, banks or the economy.

In the case of banks, most foreclosures could be placed on hold for the foreseeable future. If that happens, many large lenders may face financial difficulties. This will cause them to start calling for another bank bailout; leaving taxpayers on the hook once more.

For consumers, the situation could be much worse than imagined. While those facing foreclosure may be able to stay in their homes for a longer period, most analysts agree that most of the people who will benefit from this situation actually owe the money that the banks are trying to collect. The real question is, "who do they owe it to?" How does allowing them to stay in their homes actually do anything other than draw out the inevitable?

Worse still are the problems that may be faced by homeowners who remain current on their mortgages. Their mortgages have been sliced and diced into securities too, but if they can't prove who actually owns their mortgage, they could wind up with a "cloud" on the title to their home. This could make their properties unsellable, uninsurable, or both until the issue is sorted out. This is especially true for anyone who has purchased a bank owned property over the past couple of years. Frankly, the bank you purchased you home from may not have had the right to sell it to you.

For the overall economy, if the situation is not resolved quickly the consequences could be dire. There are now millions of bank owned homes nationwide. Many of these will sit empty and unsellable until the banks are able to iron this mess out. If that happens, it will impact new housing construction because nobody is going to want to invest in new construction when there is a potential flood of homes that could hit the market. It will impact jobs because new home construction is one of the key drivers for the economy. It will impact banks and their ability to lend, even under the best of circumstances and to the best borrowers. And it will drag out uncertainty in the overall housing market; the very same housing market that caused the recession in the first place.

byJim Malmberg
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