Report on Meeting of Uniform Law Commission Drafting Committee on Residential Real Estate Mortgage Foreclosure Process and Protections, June 8-9, 2012, Donovan House Hotel, Washington, D.C

James Smith, Co-Reporter

July 6, 2012

FRIDAY, JUNE 8, A.M. SESSION

Chairman Bill Breetz welcomed the attendees. All present were introduced. The attendees included President Michael Houghton, Executive Committee Chair Harriet Lansing, Division Chair Barry Hawkins, and Executive Director John Sebert of the Uniform Law Commission (ULC); Co-Reporter Prof. James Smith, and Barry Nekritz, American Bar Association advisor. Co-Reporter Prof. Alan White was unable to attend the session because he is teaching in South America. Drafting Committee Members attending the meeting were: Thomas Buiteweg, Bruce Coggeshall, Michael Ferry, Dale Higer, Melissa Hortman, Carl Lisman, Fred Miller, Carlyle Ring, Martha Walters, and Lee Yeakel. A list of observers in attendance during some or all of the meeting is attached.

Chair Breetz began by summarizing some of the points made in a White Paper issued by the Federal Reserve titled *The U.S. Housing Market: Current Conditions and Policy Considerations* (Jan. 2012) and then turned to the list of issues identified in his Memorandum (May 16, 2012) circulated to Drafting Committee Members, Observers, and other participants in advance of the meeting.

The language in the headings for most of the issues discussed at this meeting, set forth below in this report, is taken verbatim from the resolution of the ULC Executive Committee approving the appointment of the Drafting Committee (Jan. 21, 2012).

1. Should the act put an outside deadline on the time given financial institutions to approve or deny short sales?

A "short sale" is a sale by the borrower to a third-party (not the lender) that yields sales proceeds less than the debt, with the borrower customarily released from further liability on the mortgage loan. The Federal Housing Finance Agency (FHFA) has established time limits for loans held by government-sponsored enterprises (GSEs) for both short sales and loan modifications. The present time guidelines are: The servicer has 30 days after receipt of the complete borrower package to make a decision. The servicer must acknowledge receipt of the package within 3 days, and notify the borrower if additional information is needed. The servicer may be entitled to an additional 30 days if it needs that time to acquire more information. If the servicer fails to meet the schedule, "compensatory fees" (not fines) are payable to government, and the borrower may ask for accelerated consideration of the proposed short sale. The FHFA guidelines do not apply to loans held by institutions other than the GSEs. The Consumer Financial Protection

Bureau (CFPB) will be issuing guidelines, which may include regulation of short sales. Those guidelines may come out in July 2012.

After discussion and comments from observers, it was the consensus of the Committee that this issue requires further work before a determination can be made as to whether and how short sales might be addressed by the act.

2. Should the act mandate judicial supervision over foreclosures of all residential mortgages, and over the accounting of foreclosure sale proceeds and a prompt release of any surplus to the borrowers?

Chair Breetz recommended that the act not include a mandate of judicial supervision of all residential foreclosures or judicial supervision of the sale proceeds for all foreclosure sales. The Committee unanimously concurred. This decision is consistent with the Committee's understanding of its charge to draft the act "as an overlay to, rather than a replacement of, existing state legislation" as a directive to preserve the distinction between states that allow non-judicial foreclosure and those that require judicial foreclosure.

3. Should the act require that homeowners be given a meaningful notice of their rights before the lender commences foreclosure, and be personally served with the notice of sale or foreclosure complaint?

The Fannie Mae/Freddie Mac Uniform Note requires the mailing of notice of default prior to acceleration of the debt and foreclosure. It was reported that all non-judicial foreclosure states require a mailed notice prior to a foreclosure sale. One issue is the choice between methods of notification: mailing of notices, mailing of notices by certified mail, personal service by judicial process, and service by publication. At some point, multiple notices to borrowers may not be helpful. A safe-harbor notice provision, similar to those found in UCC Article 9, may be useful.

After discussion and comments from observers, it was the consensus of the Committee that the act should address notice but that further work is necessary to determine how the act should treat notice.

4. Should the act provide borrowers with a substantive right to cure a default by catching up on missed payments without penalty at least 60 days before a mortgage holder demands immediate full payment of the entire mortgage balance, and before beginning any foreclosure proceeding?

5. Should homeowners be guaranteed the right to re-instate the mortgage by paying the arrearage and costs up to the time of a foreclosure sale?

The Fannie Mae/Freddie Mac Uniform Note allows the borrower to avoid acceleration of the debt by making up past-due installments within 30 days after the lender sends a notice of default. This reflects a substantive right to cure the default. A right to cure "without

penalty" could mean several different things. Lenders typically require the payment of the late charges specified in the note in addition to the past-due installments of principal and interest. Generally, there are few additional fees other than late charges within the first month or two after default, but fees assessed later on, including attorneys' fees, can be very substantial. Once acceleration of the debt has taken place, many states (perhaps 15 to 20) have statutes that allow borrowers to reinstate by paying arrearages and costs. The statutes vary widely with respect to details such as timing and costs. Many observers said that if the act does include provisions on a borrower's right to cure, that right to cure should end at some definite, and not overly distant, time, so that there is finality. The question was raised whether the right to cure defaults and to reinstate should be limited to defaults in payment, or should extend to other defaults. The leaning of the Committee was to confine the issue to payment defaults.

After discussion and comments from observers, it was the consensus of the Committee that the act should address the borrower's right to cure, and possibly the right to reinstate, but that further work is necessary to determine how the act should treat the subject.

6. Should the act empower state foreclosure judges to temporarily restructure mortgage notes on principal residences, so long as (1) a statutorily established percentage of the borrowers' current income is sufficient to service an "A" note equal to at least the current appraised value of the home based on currently available mortgage terms, and (2) the entire balance of the "B" note is payable upon sale of the home or the borrower's subsequent default?

Chair Breetz recommended that the Committee not consider authorizing judges to restructure the terms of mortgage debt due to the probability that such a provision would not be accepted by state legislatures. The Committee concurred without objection.

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Foreclosure Mediation Panel Presentation

At the invitation of the Drafting Committee Chair Bill Breetz, a panel consisting of the following five mediation experts made presentations describing their experiences with foreclosure mediation procedures in the context of residential mortgage foreclosures:

1. Heather S. Kulp, Resolution Systems Institute, Chicago. Ms. Kulp has agreed to serve as a special consultant to the Drafting Committee concerning ADR matters.
2. Roberta Palmer, Connecticut Judicial Branch
3. Annette Rizzo, Judge, First Judicial District Comm., Pennsylvania
4. Verise Campbell, State of Nevada Foreclosure Mediation
5. Kahlill Palmer, Center for Dispute Settlement, Washington D.C.

Issues discussed by the panelists, Committee members, and observers included: (a) the distinction between loss mitigation programs and mediation; (b) the distinction between "meet and confer" laws and mediation; (c) judicial supervision of mediation compared to administration by other third parties; (d) the distinctions between "opt in" and "opt out" mediation programs (that is, programs in which the borrower must affirmatively choose to participate versus those programs that automatically include the borrower unless the borrower declines to participate); (e) the sending to the parties of notices of the availability of mediation; (f) how mediation programs are financed; (g) distinctions between state-wide mediation programs and local programs; (h) the need for preparation in advance of the mediation, including the exchange of documents and information; (i) whether the parties and their representatives who attend mediation sessions have the authority to settle; (j) the significance of legal requirements that parties participate in mediation in good faith and sanctions for a party's failure to do so; and (k) the success rate for mediation, which the panelists indicated may include as "successes" not only a mediation that result in an agreement that allows the owners to retain their property and mortgage loan but also a mediation in which the owners understand that they cannot afford their home and should arrange for a "graceful exit." Further discussion by the Committee was deferred until later in the day (see #11 and 12 *infra*).

7. Who can commence foreclosure?

8. What evidentiary proof (e.g. note, copies, lost note affidavits, electronic versions) is required to commence a foreclosure, and at what point must certain proofs be produced?

As a general statement, following a default, if the mortgage loan includes a negotiable promissory note, the holder of the note is the person who is entitled to foreclose. There is on-going debate as to whether other persons, including agents of the holder or persons holding a security interest in the note, may also foreclose after default. Although there is some question as to whether the Fannie Mae/Freddie Mac Uniform Note is negotiable, there are a handful of recent cases holding that these notes are negotiable, with no decisions holding to the contrary. It was reported that almost all notes held by Fannie Mae are endorsed in blank, but that some judges do not allow a plaintiff who has possession of the note to foreclosure unless the note is endorsed to the plaintiff. One issue is whether the act might adopt the positions taken in the *Report of the Permanent Editorial Board on the Application of the Uniform Commercial Code to Selected Issues Relating to Mortgage Notes* (Nov. 14, 2011). The uniform act might authorize a "servicer" as defined in the federal Real Estate Settlement Procedures Act (RESPA) to foreclose. One issue is whether physical production of the note is necessary, or whether an alternative is sufficient; e.g. a lender's affidavit that it has possession of the note, perhaps accompanied by a copy or image of the note. There is also an issue of timing: If production of the note is essential, must it accompany the filing of the foreclosure complaint, or is it sufficient to produce the note later, along with other evidence proven by the plaintiff?

After discussion and comments from observers, it was the consensus of the Committee that the act should treat the issues of who can commence foreclosure and with what evidence.

9. Should the act require establishment of a chain of title for assignments and require proof of those assignments, whether or not recorded on the land records, before commencing a foreclosure?

At least ten states requires an assignment of the mortgage to the person who brings the foreclosure action. There appears to be no sound reason for such a requirement, given near universal acceptance of the rule that ownership of the mortgage follows ownership of the note.

After discussion and comments from observers, it was the consensus of the Committee that the act should authorize foreclosure with no requirement that the foreclosing party have an assignment, recorded or otherwise, from the original mortgagee or the last mortgagee of record. At the same time, the Committee should address in comments or otherwise the policy reasons underlying the contrary rule in the states that require an assignment.

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10. What pre-foreclosure notices must the mortgagee provide?

A pre-foreclosure notice of default to the borrower is essential. One additional issue is whether the lender should give a notice of default not only to the borrower, but also to a third party such as a state agency or a housing counselor. Some states have such requirements. One concern is whether some borrowers might not want the fact or allegation of their mortgage default sent to a third party.

After discussion and comments from observers, it was the consensus of the Committee that the act should treat the issue of pre-foreclosure notice to the borrower. The issue whether notices should go, or may go, to third parties requires further work.

11. What is the appropriate time and place in the foreclosure process for ADR? Can it be made effective for all parties, and offer legitimate relief to the borrower?

12. Should the act require mortgage holders to consider loss mitigation, including loan modification and other workout alternatives, as a condition to allowing the foreclosure of a home?

Earlier in the day Committee members and observers discussed mediation and ADR, with the presentations by the Foreclosure Mediation Panel serving as a basis for that discussion. See also Reporter Alan White's Memorandum on State Foreclosure Mediation Laws: Examples and Research for a Uniform Statute (May 11, 2012). It was the consensus of the Committee that the act should deal with mediation; that it is important to consider the relationship between mediation and related processes, including

loan modification and loss mitigation programs, and that one approach that may have merit is to draft "best practices" guidelines.

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13. What is the proper scope of statutory redemption periods, so that foreclosure processes are predictable, but borrowers are still afforded appropriate opportunities to save their homes?

14. Should the act guarantee homeowners a statutory right to redeem and reacquire title to their home, for a fixed period of time after a foreclosure sale?

Less than half of the states presently extend the right of statutory redemption to borrowers, allowing the borrower to redeem during a fixed time period after the foreclosure sale. The details vary widely from state to state. In many but not all states, waivers by borrowers of statutory redemption rights are allowed. In many but not all states, junior lienors in addition to borrowers have a statutory right to redeem. In many states, some of the rights and obligations of the parties during the redemption period are not clearly defined; for example, whether the lender, the borrower, or purchaser is responsible for paying homeowner association dues. In some states, a principal purpose of statutory redemption is to protect farmers, which is not present for most U.S. residential mortgage loans, in connection with which the borrower is not engaged in farming operations.

After discussion and comments from observers, it was the consensus of the Committee that this issue requires further work before a determination of whether the act should have provisions on redemption and, if so, how redemption should be addressed by the act. There was consensus that the need for, and value of, statutory redemption relates closely to the opportunities that owners have to save their homes from foreclosure prior to the filing of the foreclosure and prior to the completion of the foreclosure sale.

15. To what extent do current foreclosure processes (such as newspaper advertising requirements) impose unwarranted and hidden costs on the borrower?

In evaluating foreclosure notification procedures, it is important to differentiate between notice to owners and other holders of rights in the property, and notice to potential buyers. Newspaper foreclosure ads do not provide meaningful notice to homeowners of the pending foreclosure sale. Another problem is that foreclosure ads are sometimes run in obscure local newspapers, with limited circulation. In today's world, hard copy newspapers no longer perform the function of notifying residents and potential buyers as they once did. Newspapers, however, derive significant revenues from foreclose sales notices and other legal notices, and therefore may oppose an act that eliminates their role. Most newspapers have electronic versions. Perhaps ads can be placed there, or newspapers can run "short versions" of foreclosure notices in the hard copy newspaper, with a cross reference to additional information available online. Perhaps the act can

give lenders the option to place sales notices in local newspapers or to select another outlet. If the act requires that a lender sell the property in a commercially reasonable manner, the form of advertisement or public notice might be subsumed within that general standard. Other foreclosure costs that might be reduced include: (1) expenses associated with sheriffs' sales, which may exceed those for private sales, (2) transfer taxes paid to governments, and (3) legal requirements that foreclosure sales take place at the property location.

After discussion and comments from observers, it was the consensus of the Committee that the act should include a provision dealing with advertisement or public notice of foreclosure sales, and that further work is necessary to decide whether the act should include other cost-saving measures.

16. To what extent, and in what circumstances, may private actors fulfill the role of government officials in the foreclosure process?

One problem is that in some jurisdictions where the sheriff's office conducts sales, the sheriff's office lacks sufficient personnel to handle recent volumes of foreclosure sales. The act might authorize sheriff's sales, but also allow alternatives, such as sales conducted by private auctioneers.

After discussion and comments from observers, it was the consensus of the Committee that the act should include provisions describing the roles played by private actors in non-judicial foreclosure proceedings, and that issues related to allowing private actors to fulfill roles traditionally performed by government officials in judicial foreclosure actions require further work before a determination of whether and such issues might be addressed by the act.

17. What post-sale court process, if any, should be required to confirm the sale, and for what purpose?

State statutes vary considerably regarding post-sale confirmation, including the nature of the paperwork required and the form of the decree. In some situations the purpose of post-sale confirmation is to confirm good title in the foreclosure purchaser, and in others such as Georgia the purpose is to allow the lender to pursue a deficiency judgment. With respect to the quality of title, there is value in providing for the relatively quick issuance of a confirmatory deed. The recently approved Uniform Partition of Heirs Property Act has a confirmation of sale provision that may be useful to consult.

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After discussion and comments from observers, it was the consensus of the Committee that the act should treat the process required for judicial confirmation of foreclosure sales that take place in judicial foreclosure actions, and that issues related to confirmation of sales in non-judicial foreclosure proceedings require further work before a determination of whether and how judicial confirmation of non-judicial foreclosure sales might be addressed by the act.

18. To what extent is the purchaser at a non-judicial sale entitled to a presumption of the sale's validity based upon the trustee's representations of compliance with the state's non-judicial foreclosure statute?

States that allow non-judicial foreclosure generally have statutory provisions that create a presumption of the validity of the foreclosure sale, but those provisions vary considerably. The Uniform Nonjudicial Foreclosure Act, for which Professor Dale Whitman served as reporter, contains presumption provisions, which may be useful for this Committee to consider.

After discussion and comments from observers, it was the consensus of the Committee that the act should provide for a presumption of validity for foreclosure sales in non-judicial foreclosure states, but that the reporters should explore what additional statutory requirements might be imposed to address the potential for abuse in such situations.

19. Are there areas in the Uniform Commercial Code that may be affected the act, and if so, are there any conforming changes that may be necessary?

A primary area of overlap involves the UCC rules dealing with negotiable notes. Issues to consider include whether the note has to be paper, rather than electronic; how the note is transferred; and the rules discharging the obligation by payment (whom the payor should pay). The act might adopt a rule authorizing the borrower to pay the original lender until notice is given to pay someone else.

After discussion and comments from observers, it was the consensus of the Committee that these issues require further work before a determination of whether any of these issues should be addressed in the act and, if so, how to address UCC-related issues.

20. Should the act incorporate a provision similar to Section 3-116 of the Uniform Common Interest Ownership Act, which provides unit owner associations with a senior lien for 6 months of unpaid common charges on a unit, together with legal fees, and thus provides the association the means to collect their common charges in the same manner as a tax lien?"

Roughly one half of the states presently have some type of super lien priority for homeowners' associations and other associations in common interest communities. The Uniform Condominium Act and the Uniform Common Interest Ownership Act both have super lien provisions. The issue is important because when owners stop paying their assessments, this creates a financial burden for the association, which ultimately falls upon the non-delinquent homeowners. The problem becomes more acute when a community has a sizeable percentage of delinquent owners. A number of issues have arisen under the super-priority legislation. When, if ever, does a lender become obligated to pay the assessments? If a lender pays off the lien that has priority over its mortgage, does a subsequent second failure to pay an assessment by the homeowner create a new lien? Does the super-lien assessment include attorneys' fees and other costs? How many months does the obligation last? Some states, such as Nevada, include "fees" as part of

the obligation without elaboration. Such fees could be better described and perhaps limited by type or amount. It was reported that some associations have attempted to collect very large additional fees, and that some lenders have delayed the completion of foreclosure proceedings in order to avoid the assumption of liability for assessments and fees. Lenders might attempt to manage the risks associated with unpaid assessments by opening escrows, just as they do for real estate taxes. This may be administratively difficult, and perhaps not feasible, due to the huge number of community associations.

After discussion and comments from observers, it was the consensus of the Committee that the act should provide for a senior lien for unpaid assessments in common interest communities and that an effort should be made to address the various issues raised by lenders.

21. Should the act address issues surrounding a voluntary or mandatory national electronic recording system for notes and mortgages? Are there any steps that we might take in this Act to ease the work of those who might be tasked in the future with crafting such a system?

The Drafting Committee and observers discussed a number of issues related to the electronic recording and storage of promissory notes, mortgages, and other loan documents. Professor Dale Whitman (an observer at this meeting) has written an article proposing that Congress enact legislation creating a national federally-operated registration system. States might adopt legislation to create electronic mortgage registration systems, or to give legal effect to documents entered into a national system. The area as a whole is complicated by the interplay between federal statutes and regulations and state law, one example being the federal E-sign act, which authorizes electronic documents. Electronic Signatures in Global and National Commerce Act, 15 U.S.C. §§ 7001 to 7031 (but the act does not address the legal status of paper documents whose images are stored in electronic databases). State and federal cooperation may facilitate the creation and operation of an effective national registration system.

President Houghton observed that the creation of an electronic registration system is outside of the scope of the work of the Drafting Committee, but that specific ancillary issues could be addressed. Two members of the Drafting Committee disagreed with that position, believing that the Committee should undertake at least to draft principles that would guide the development of an electronic registration system. A number of participants suggested that the act might anticipate that such a system will be created at some point in the future, and that the act, for example, might authorize the holder of documentation issued by an electronic registration system to foreclose. The Committee invited Thomas Baxter of the Federal Reserve Bank of New York to consider preparing and submitting a letter or memorandum expressing views on the federal government's interest and possible role in the subject.

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22. Should the act authorize a "keys for cash" foreclosure process in which the lender and borrower, either before or after commencement of a foreclosure action, might agree to payment of at least a statutorily minimum sum to the borrower, which would then enable the lender to proceed promptly to foreclose junior liens and take title to the property?

Co-Reporter Jim Smith summarized his Memorandum on "Cash for Keys" Agreements (May 17, 2012). Lenders frequently use cash-for-keys agreements in two distinct situations. First, they negotiate agreements with homeowners to obtain possession without going through the time and expense of formal foreclosure. This is seen by some as a "graceful exit" option from the owner's perspective. Second, lenders negotiate agreements with residential tenants to obtain possession, typically when they believe that having the property vacant will enhance the value of the collateral or otherwise make the property more saleable. The act could authorize cash-for-keys agreements and set forth permissible terms, perhaps including minimums in terms of compensation, the time that the occupant may remain in possession before vacating, and discharge of liability on the mortgage debt. Courts could approve cash-for-keys agreements ex ante (before they become effective). One impediment under present law to cash-for-keys agreements involves junior liens, which ordinarily survive the execution of cash-for-keys agreements, thereby impairing title to the property.

After discussion and comments from observers, it was the consensus of the Committee that the act should contain provisions that authorize cash-for-keys agreements, and other similar alternative work-out scenarios, with appropriate terms to protect the parties and encourage and facilitate their use. Such terms might address such subjects as deficiencies, waiver of redemption periods, accelerated foreclosure, and other devices. Some terms may be optional, in which case the provisions probably should be drafted as a "safe harbor," thus leaving room for other approaches to cash-for-keys agreements, rent following foreclosure, and similar measures.

23. Should the act include special foreclosure procedures where the property in question is vacant and derelict?

Co-Reporter Jim Smith summarized his Memorandum on Abandoned and Vacant Properties (May 17, 2012). Dwelling units that have gone through foreclosure or are threatened by foreclosure are much more likely to be abandoned than other residential properties. Studies have shown that vacant homes have substantial negative impacts on their surrounding communities, including reduced property values, increased crime, public health risks, and added costs for local governments. Many states and local governments have responded to the avalanche of vacant residential properties by imposing duties upon owners and foreclosing lenders to maintain such properties. Cities usually have the legal right to maintain vacant properties after notice to the owner, and at the owner's expense secured by a lien on the property, but cities infrequently choose to

exercise that right. Many cities have enacted registration ordinances, which require that owners and sometimes mortgage lenders register vacant homes with the local government and pay fees specified by the ordinance. One problem, which existing statutes and ordinances often do not resolve, is how to define vacant and abandoned properties, including who makes that determination. The two main areas that an act might address are (1) the obligations of owners and lenders with respect to vacant or abandoned properties and (2) the foreclosure procedures that apply to vacant or abandoned properties, which could be streamlined, compared to the regular procedures for occupied residences.

After discussion and comments from observers, it was the consensus of the Committee that the act should contain streamlined foreclosure procedures for vacant and abandoned properties, and that issues related to maintenance and repairs require further work before a determination of whether and how maintenance and repair issues might be addressed by the act.

24. Should the act incorporate the servicing standards agreed to by the lenders who participated in the State Attorneys General consent decree?

The Drafting Committee and observers discussed a number of issues related to the roles played by loan servicers prior to foreclosure and during the foreclosure process. The act might incorporate the servicing standards agreed to by the five large servicers who participated in the national mortgage servicer settlement agreement (the "consent decree"). See Reporter Alan White's Memorandum on the National Servicer Settlement Foreclosure-Related Provisions (May 11, 2012). The CFPB is about to issue regulations, which may incorporate provisions from the settlement agreement dealing with the largest five servicers. The act could address whether owners should have a private cause of action against servicers who violated their obligations.

After discussion and comments from observers, it was the consensus of the Committee that this issue requires further work before a determination of whether, and if so how, to address servicing standards in the act.

Future Work

After the Drafting Committee and observers offered some additional comments, Chair Bill Breetz announced that the committee's next meeting will be held Nov. 2-3, 2012, in Washington D.C. at a location to be determined later. A reasonably comprehensive draft of a proposed act will be circulated well in advance of that meeting. Committee members and observers are invited to submit comments and documents, which should be sent to John Sebert.

The meeting adjourned at 3:58 p.m.