

JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

I. Other Presentations In Which Either The Date And /
Or Sponsoring Organization Is Missing

6. Real Estate Finance/Mortgage Banking/Mortgage
Guaranty Insurance

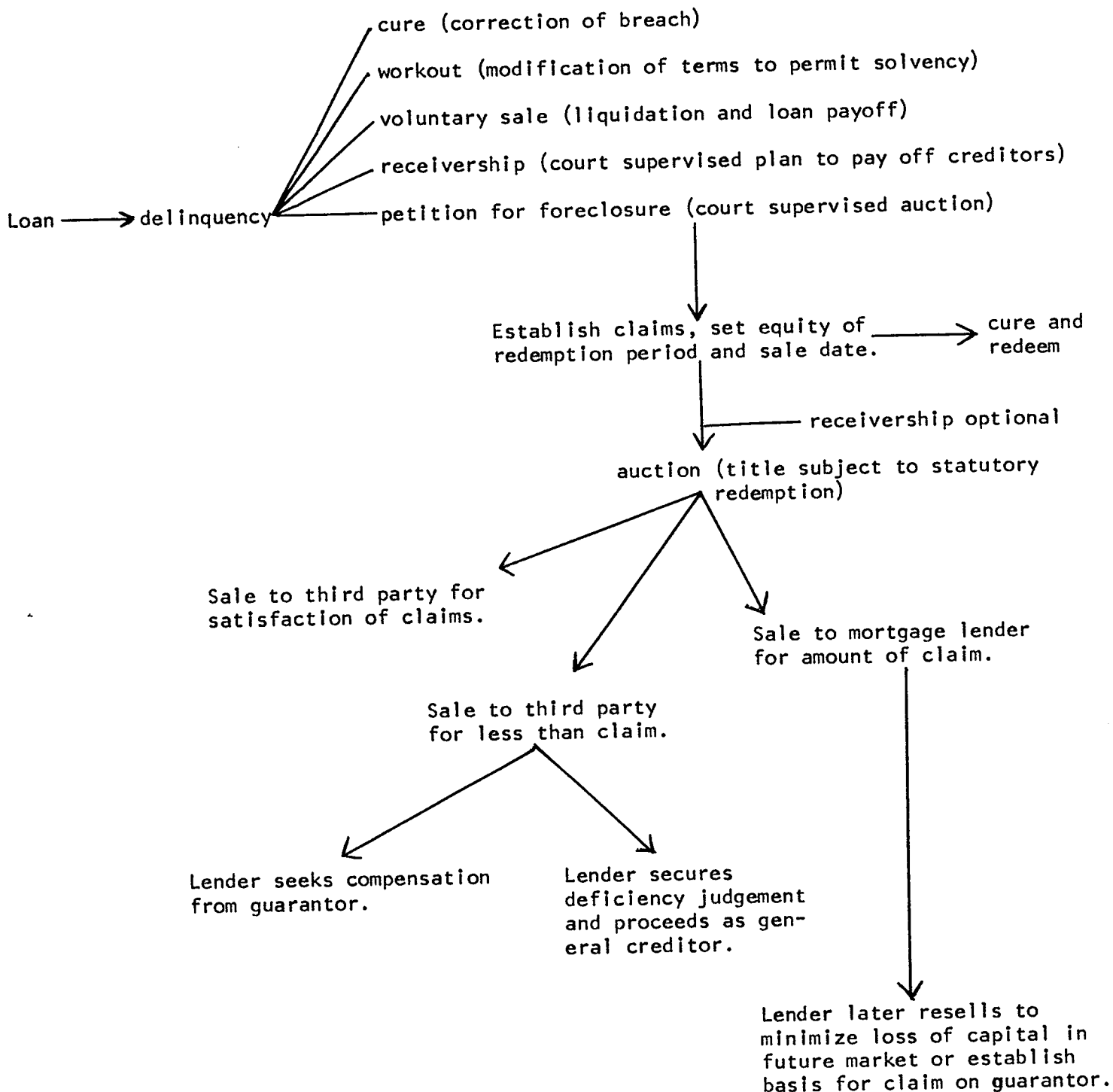
e. "The Foreclosure Process", no date

THE FORECLOSURE PROCESS

- I. The public generally associates mortgages with the unfortunate contingency of foreclosure, although no one is quite sure of what the exact process might be. One reason for the confusion is that the law differs in every state; another reason is that the law provides considerable discretion to the judge; and a third reason is that the vested interests of both parties is to avoid it wherever there are alternative remedies which can be accomplished.
 - A. Very basically, foreclosure calls for an auction sale of the property pledged under court supervision with proceeds distributed by the clerk of the court consistent with priorities established by the court. That process may take from thirty days to two years and involves many interim proceedings and lead to dissapointing results so it will be useful to examine the situation in detail to understand all of the risk management decisions.
 - B. Foreclosures vary by property type, locality, and state in terms of both frequency and severity. The reported number is only a fraction of the total loans in distress as lenders attempt to avoid ownership of property and regulatory inquire as to the need for foreclosure. Severity more important than frequency.
 - C. The number of non-farm real estate foreclosures in 1974 will probably be in the neighborhood of 5.0 per 1,000 mortgage loan and will be higher in 1975 as attempts to correct distressed properties and borrowers will fail. At current rates, about 3% of all loans made will end in foreclosure and virtually all of these will occur during the first five years of the loan.
- II. See Chart A.
- III. Amount of claim and award determined by terms of contract or judicial allocation.
 - A. Generally claim includes interest on compounding balance, defaulted taxes, insurance premiums, maintenance, and repair outlays made by lender.
 - B. Contract should provide for reasonable legal fees (2-10%).
 - C. Claim in excess of foreclosure sale price can be covered by deficiency judgement, with right to attach or garnishee.

CHART A

II. A tree diagram of the sequence of events leading to foreclosure is useful to structure all of the alternatives.



- D. Law of offset against accounts receivable, savings accounts etc.
 - E. Terms of endorsement or guaranty
 - F. Strict foreclosure with right of entry and peaceful possession
 - G. Foreclosure ~~by~~ newspaper publication and recorded notice in MAINE
- IV. To reduce variations in 50 different states, mortgage lenders have been pushing for 5 major reforms.
- A. The five subject areas are:
 - 1. The statutory period of redemption
 - 2. The deficiency judgement
 - 3. The public sale
 - 4. The issue of rents, profits, and possession pending final sale
 - 5. Development of a standardized contract
 - B. A number of studies indicate:
 - 1. Perhaps 1% of foreclosed properties are redeemed.
 - 2. About 7% of dollar deficiency judgements are realized. (low)
 - 3. In 95% of public sales, the mortgagee is the buyer.
 - 4. There is no pattern of law for rents, profits, and possession.
 - C. Therefore the U.S. ^aSavings and Loans League and other mortgage bankers are advocating legislation:
 - 1. To limit statutory redemption to not more than 6 months.
 - 2. To eliminate deficiency judgements
 - 3. To eliminate public sale.
 - 4. To assure rents, profits, and possession to the mortgagor during the redemption period.
 - D. Judicial auction sale may be weakest link in mortgage practice
 - 1. Removed deficiency judgement threat and limit right of redemption and borrower is protected against consequences of unfavorable market sale.
 - 2. Shorter redemption period reduces need for trustee to prevent waste.
 - E. Contemporary reform proposals have the following procedural order:
 - 1. Petition proper court for foreclosure
 - 2. Waive right to deficiency judgement in exchange for consent to debtor's continued occupancy for 3 or 6 months.
 - 3. Provide public notice of foreclosure date 3 or 6 months hence.
 - 4. Hear defenses, arguments, and other judgement creditors during last half of redemption period.
 - 5. At the end of 3 or 6 months would review case, foreclose unknown claims and redemption, and give mortgagee indefeasible title.

- F. Standardization of mortgage contract has been accelerated by federal agencies such as GNMA, FNMA and FHLBMC (Freddie Mac) who need fungible, easily assignable portfolios of mortgages in the secondary mortgage market. Even they couldn't agree for more than two years.
- V. The foreclosure problem ties down at least ^{three} 3 billion existing portfolios and probably an equal amount of loans in default which the lender is reluctant to foreclose. Most are held by institutional portfolios and federal agencies.
- A. Is problem result of faulty lending procedures?
- B. Does foreclosure rate simply reflect the greater assumption of legitimate risks by government or private capital so that marginal returns still exceed marginal losses?
- C. What about the doomsayers and the Book of Ecclesiastes, "He that buildeth his house with other men's money is like one that gathereth himself stones for the tomb of his burial."
- D. At this point in the course the key points to remember are:
1. Delinquency is not as significant as cure rate
 2. Default rate is not as significant as percentage of faults which must be foreclosed
 3. Foreclosure rate is not as significant as net losses as a percent of gross portfolio income
 4. Foreclosure losses are most significant when attributable to a foreseeable trend or underwriting failure
 5. Most foreclosure losses occur because of unwillingness to pay rather than an inability to pay. Thus the majority occur because the borrower feels it is in his self-interest to exercise a put to the lender.