

A Collins Center Special Report | April 2010

Balancing Economic Interests and Fairness in Florida's Residential Mortgage Foreclosure System



COLLINS CENTER
FOR PUBLIC POLICY
Thinking. Doing. For Florida.

EXECUTIVE SUMMARY



Several proposals being considered by state lawmakers would fundamentally change the mortgage foreclosure process in Florida. The proposals seek to change Florida from a “judicial foreclosure” state that relies on the courts to govern the process, to a “non-judicial foreclosure” state that relies primarily on private lenders to govern the process. In most cases the change would allow lenders to bypass the court system and oversee the foreclosure process from start to finish.

Support for the change rests largely with lending institutions beset by the costs associated with a staggering foreclosure backlog. They argue that the current process results in substantial delays that can be remedied in part by a non-judicial process; that borrowers often get scant attention from judges handling heavy caseloads; and that neighborhoods could benefit from an accelerated foreclosure process that puts homes back on the market in as little as 90 days.

In the wake of these proposals, the Collins Center for Public Policy examined the potential impacts of changing to a non-judicial foreclosure state. For the past year, the Collins Center has administered residential mortgage foreclosure programs in three of Florida’s 20 judicial circuits. This has provided the Center with a unique insight into the current crisis. While it is true that the foreclosure backlog presents a daunting challenge for lenders, care needs to be taken to preserve the rights of homeowners when considering solutions. It bears mentioning here that:

- Anyone who has bought a home is its owner. The bank that provided the money has only a security interest in the home to secure its loan.
- If the homeowner defaults, the bank gets the house only by foreclosing its security interest – its mortgage.
- The Florida Supreme Court has ordered that an effort must be made for all foreclosures to go through mediation, a process jeopardized by the proposed changes. The mediation process gives credit counseling to the homeowner and makes sure the bank in fact has a valid security interest. Many foreclosure suits have been brought when the lender cannot show it has a valid security interest.
- Lenders, through these proposals, want the right to take a homeowner’s residence without a judicial proceeding unless the homeowner goes through the cost and turmoil of bringing a lawsuit to stop the process.

There is ample blame to go around for Florida’s present foreclosure crisis. Homeowners borrowed beyond their means. Investors gambled and lost. Lenders extended credit without due diligence. In the aftermath, thousands of borrowers are clinging to their homes, neighborhoods are struggling, and lenders are sorting through the wreckage. Easing the crisis is a worthy goal, but not at the expense of a homeowner’s right to have a day in court.



Balancing Economic Interests and Fairness in Florida's Residential Mortgage Foreclosure System

Florida's formal system for processing residential mortgage foreclosures provides opportunities for lenders to assert and protect their economic interests and for borrowers to assert and protect their interests in their homes.

The system attempts to balance those interests by having a neutral and independent judge, sometimes assisted by a neutral and independent mediator, hear and review all claims, counterclaims, arguments, defenses and other matters before reaching a final conclusion. The foreclosure system in Florida strives to be a public and equitable process for deciding home ownership, a highly important matter.

However, a tsunami has hit the residential mortgage foreclosure system. Florida is especially hard-hit because the real estate and banking markets are of vast importance to the state's economy and its budget. Mortgage foreclosures in Florida have increased 549 percent since December 2006, fueled in large part by subprime defaults. In February of this year, Florida registered the third-highest rate of foreclosures (1 in every 163 units) in the nation. The onslaught has clogged the court system and trapped borrowers and lenders alike in a cycle of delays and accumulating costs. Finding equitable ways to ease the crisis has been elusive. One such proposal – moving residential foreclosures out of the court system – holds the promise of clearing cases from the court docket, but at the cost of shifting the legal and financial burden from lenders to borrowers.

Many of those borrowers hope the economy will turn and lenders will work with them to avoid losing their homes. Others are using unscrupulous delay tactics to stay in their homes cost-free, or simply walking away and leaving their homes in a state of dilapidation. At the same time, there is an increasing number of complaints about unresponsive and, at times, irresponsible lenders proceeding with foreclosure despite good-faith efforts by borrowers, and despite the inability of those lenders to produce paperwork as fundamental as the promissory note that establishes the claim and the amount owed.

This White Paper outlines:

- Florida's judicial mortgage foreclosure system for balancing economic interests with fairness considerations.
- Proposed changes to that system.
- Potential impacts of the proposed changes.
- An examination of the arguments for non-judicial foreclosure.

Florida's Judicial Mortgage Foreclosure System

Florida is a “judicial foreclosure state,” one that relies on the state’s circuit courts to balance economic interests and ensure fairness in each case.

If a borrower does not regularly repay amounts borrowed from a lender and secured by a mortgage lien on the borrower’s home, the lender can file a foreclosure action with the courts. This formal legal action seeks to terminate the ownership interests that the borrower and others may have in the home. If the borrower does not pay amounts legally due and related costs of collecting the past due debt, the courts – after a formal legal hearing that provides opportunities for both lender and borrower to present facts and arguments – may order that ownership of the home be transferred to the lender. The lender then normally seeks to recover its losses by selling the home. If the proceeds from the sale do not repay the amount borrowed from the lender and the costs of debt collection, the lender may seek a deficiency judgment against the borrower.

Florida’s judicial foreclosure system requires:

- **Formal written legal documents filed with the state’s courts.**

This is called a “complaint.” A notice of lis pendens (pending lawsuit) is also filed with the court. The complaint specifies the debt amount, includes statements that the borrower has not paid on time, and has other facts that would permit the lender to foreclose and take the property as security for the loan. The complaint is supposed to include a copy of the promissory note signed by the borrower and other documents proving that the lender filing the complaint owns the loan and has authority (what the courts call “standing”) to foreclose. At the time the complaint is filed, the lender must pay a filing fee to the courts, which reaches \$1,905 for homes valued over \$250,000.

- **Formal written notice of the complaint to the borrower.**

The lender gives written notice to the borrower of the lis pendens and provides a copy of the formal complaint filed with the courts. This can be done by personal delivery to the borrower, by U.S. mail or “by publication” if the borrower cannot be located.

- **Opportunity for the borrower to respond to the lender’s complaint, to pay amounts due and to cure other defaults.**

The borrower may halt the foreclosure process at any time before it is completed by paying the lender all amounts due, including the lender’s costs of seeking to collect the debt. This is called a “right of redemption.”

- **Opportunity for the borrower to be heard by the court.**

A formal court hearing is scheduled before foreclosure is ordered. At the hearing, the borrower has the opportunity to present facts and arguments in his defense that may provide reasons why the foreclosure should not occur. The lender has similar opportunities to state its reasons for proceeding with

the foreclosure. The court seeks to balance the interests of the lender and the borrower and issues a final order that authorizes or denies the request of the lender to foreclose.

- **Review by the court of costs of collection.**

Lenders can incur substantial costs to carry out a foreclosure action and to otherwise seek to collect the debt. In issuing a final order of foreclosure, the judge will review the lender’s claimed expenses and authorize those that seem reasonable and deny those that appear excessive or unjustified.

- **Final opportunity to redeem the property.**

If the court orders the foreclosure to proceed, the property normally is assigned to a “sheriff’s sale” and auctioned “on the courthouse steps” or by online auction through a formal, advertised process. The borrower has a final opportunity before or at the auction to “redeem” his interests in the property by paying the lender all amounts due plus the lender’s costs of collection. At the auction, the highest bidder takes title to the property, assuming that he provides payment in the amount he bid and subject to final confirmation of the sale by the court.

- **Overall “equitable” powers of the Florida courts to try to ensure that mortgage foreclosures are fair.**

Florida Statutes Section 702.01 gives the state’s courts explicit statutory authority to exercise “equitable” or fairness powers, including the ability to conduct a trial without a jury of counterclaims that the borrower may have against the lender. Florida Statutes Section 702.07 gives courts the power to rescind, vacate and set aside a decree of foreclosure before a sale has occurred. Under Florida Statutes Chapter 44, the circuit courts also have the power to order mediation before the matter comes before the court for final judgment.

Florida has an additional feature to the residential mortgage foreclosure process that has been added over the past year and is now expanding: mandatory mediation after the formal legal complaint has been filed and before the courts will conduct a final hearing that could result in foreclosure and sale of a residential property. The mediation process provides the lender and borrower with an opportunity to have a neutral third party (a mediator) sit down with them and adjust the terms of the loan, resolve the matter without further legal action or proceed to foreclosure.

Florida has 20 circuit court systems that are the state’s basic trial courts. They process all of the foreclosure actions in the state. In 2009, the chief judges of several circuit courts ordered a mandatory mediation process. At the end of that year, the Florida Supreme Court ordered that all 20 circuit courts establish such programs. The process of organizing programs in all circuit courts is now under way.

Proposed Legislative Changes to Florida's Judicial Mortgage Foreclosure System

Legislation is pending in the Legislature that would change Florida's system from judicial to non-judicial.

The proposed legislation would permit lenders to follow a statutory foreclosure process for residential properties that would not rely on the courts for processing or supervision. Instead, lenders would give a notice of default directly to the borrowers with no filing of a complaint and related lis pendens with the courts. If the borrower did not respond to the lender within 20 days or did not repay the mortgage debt and related costs of collection within 60 days, the lender could foreclose in 90 days.

The lender could foreclose by giving notice of the foreclosure to the borrower, recording a notice of foreclosure in the public records of the county in which the property is located and posting a notice of foreclosure in a conspicuous place on the property itself.

Within 15 days of notice, the borrower could request a meeting with the lender and, within 20 days, could file an action in court objecting to the foreclosure, paying required filing fees. If the borrower requested a meeting, the lender would have to schedule it at a mutually agreeable time. This meeting could be conducted by telephone. There would be no requirement for a face-to-face meeting.

At the meeting, the borrower could seek modifications in the terms of the mortgage debt if he provided the lender with financial statements and other documents sufficient for negotiation of alternative terms. Within 10 days after the meeting, the lender would have to notify the borrower of its decision whether to proceed with the foreclosure.



In addition to this non-judicial foreclosure process, a lender could initiate a formal action in the circuit court seeking judicial foreclosure, injunction or some other remedy. And, as stated previously, the borrower or another secured creditor affected by the foreclosure would have the right to file an objection to the non-judicial foreclosure with the court. The objection would have to state a bona fide defense to the foreclosure and include a certification under oath that the objection was not being filed solely for the purpose of delay. All such formal objections would require filing fees to be paid by the borrower or secured creditor.

The proposed legislation would also give lenders rights to foreclose by auction, by a negotiated sale or by appraisal.

The proposed non-judicial foreclosure system would include these key characteristics:

- **Default notices would be filed directly to the borrower, not the court.**

The non-judicial process would begin with a formal notice of default from the lender to the borrower and continue with a formal notice of foreclosure to the borrower, recorded in the public records and posted on the property. Nothing would be filed with the court unless the borrower or another creditor chose to file a formal action with the court, paying the required fees and certifying that there is a bona fide defense and that the action is not filed for purposes of delay.
- **Foreclosure could proceed without the borrower's receipt of a confirmation default notice.**

The lender would give notice to the borrower of the default and, if the borrower did not cure the default, of the foreclosure. Requirements for notices in the proposed legislation are complicated and lengthy. There would be no insurance of timely notice to the borrower, and no provision for outside monitoring of the notice process.
- **Lender would decide merits of borrower's defense.**

The borrower's response to the initial notice given to him by the lender would include statements of any defenses he might have, along with a request to seek a meeting with the lender. The lender, not a court, would decide whether the borrower had any legal or other defense.
- **Borrowers, not lenders, would initiate court action.**

Unless the borrower chose to file a formal action with the courts, there would be no opportunity to be heard by a court or other independent party. If the borrower filed an action, he/she would pay filing fees and certify that the defenses were bona fide and the action was not being filed solely to delay the foreclosure. The proposed legislation would provide the owner of a homestead property with 45 days to file an action in court objecting to the foreclosure. The owner of a non-homestead property would have 20 days to file such an action.

■ **No court review of collection costs.**

There would be no review by anyone of the lenders' claims for costs of collection that could be charged against proceeds of a sale or other disposition of the foreclosed property. The borrower could be charged for those costs through a "deficiency judgment."

■ **Final opportunity to redeem property.**

Under the proposed legislation, borrowers would retain the right to "redeem" their interests in foreclosed properties by paying the lender all amounts due plus the lender's costs of collection prior to final sale or other disposition of the properties.

■ **Foreclosure without any formal court action.**

The proposed legislation states that the "principles of equity" that Florida courts may exercise are applicable to the new non-judicial system "unless displaced by a particular provision of this chapter." That provision would open the door to challenges to any exercise of equitable powers by the courts. The proposed legislation would not change the powers of the courts to order mediation, but the courts would have jurisdiction to do so only if a formal action had been filed with them. The proposed legislation would provide for a way to avoid mandatory mediation, assuming that the borrower either would not or could not file a formal action.

Generally, the proposed legislation streamlines the foreclosure process. It does so by shifting most of the powers to make decisions about these matters to private lenders and away from public court supervision, changing the Florida foreclosure process from a public to a private system.

Potential Impacts of Proposed Changes

1. Would reduce consumer protections.

By largely eliminating the courts from the foreclosure system, the proposed legislation would restrict the rights of homeowners to due process of law, a trial on the merits, the rules of evidence and the rules of civil procedure, except for those homeowners who could afford legal representation and court filing fees. Considering the financial stress experienced by many Florida homeowners, it is unlikely many could afford to challenge a foreclosure action in court. This is especially troubling for homesteaded properties that have special legal protections under state law.

2. Would provide no obligation for lenders to verify claims.

Contested foreclosures often involve a number of disputed issues, including fraudulent origination, missing negotiable notes and other records and faulty security instruments (mortgages). A lender could claim a debt is owed but be under no obligation to prove that it is valid. A University of Iowa study of 1,700 bankruptcy mortgage claims found that 53 percent lacked one or more required proofs of claim. In 41 percent of the 1,700 cases, the most fundamental piece of evidence in support of a claim – a copy of the promissory note or instrument establishing the existence and terms of debt –

was missing from the filing. Such notes are essential to verify that the amount asserted to be owed is correct.

3. Would reduce revenue for Florida's courts.

Filing fees for mortgage foreclosures and related real estate transactions account for a substantial portion of the general operations funds that support Florida's courts. They represent 80 percent of the State Court Revenue Trust Fund, which provides nearly 60 percent of the total court funding. It is estimated that 318,000 mortgage foreclosure cases will come through the court system in fiscal 2010-11, generating \$294 million for the State Courts Revenue Trust Fund. The non-judicial foreclosure system could eliminate most of the revenue generated by filing fees without providing for an alternative revenue source.

4. Would modify the contracts borrowers signed when taking their mortgages.

All existing mortgages were signed under the clear understanding that judicial foreclosures were required. The proposed legislation would change the mortgage contracts between borrowers and lenders. This raises constitutional issues. Florida has a well-established legal doctrine that the parties to a contract may rely on the law at the time the contract was made. Using the proposed non-judicial process might be interpreted as an unconstitutional taking of property, especially if pre-existing contractual rights are violated in the process. This is especially important for homestead properties.

5. Would provide no monitoring of lenders' charges for collection costs.

Under the judicial foreclosure system, judges scrutinize the claims of lenders and their attorneys for reimbursement of collection costs from the proceeds of a foreclosure sale. No such monitoring or protection would exist in the proposed non-judicial system.

6. Would eliminate monitoring of lenders' discretionary decisions.

Lenders would have few statutory requirements to meet in order to proceed with foreclosure. They would be required if requested by a homeowner to hold a single meeting, which could be conducted by telephone, before unilaterally deciding whether to modify the terms of the mortgage loan or accept other relief sought by the homeowner.

7. Would reduce standards for giving notice to borrowers.

Notification requirements are very flexible in the proposed legislation and difficult to understand. Even if unsuccessful in notifying the borrower, a lender could proceed with foreclosure. This raises the specter of a homeowner's being unaware of the foreclosure process, yet losing the home in as little as 90 days from when the notice purportedly was sent.

8. Would provide limited remedies for borrowers in case of mistakes or fraud.

Unless the borrower took the separate step of filing a court action, paying fees and certifying that he had a bona fide

issue, there would be no public place to raise issues about lenders' mistakes or fraud by lenders or others, such as appraisers. The borrower could raise these issues at the single meeting required with the lender, but the lender would have complete discretion to ignore them. Likewise, there appears to be no provision in the legislation for the homeowner to recover damages for mistakes or fraud.

9. Would not provide for education or other assistance for homeowners.

Florida's mandatory mediation program requires credit counseling for homeowners and has a proactive system of encouraging them to pay close attention to their obligations under mortgage loans. The proposed non-judicial foreclosure system would not provide for those important services.

While this paper focuses primarily on the impacts to homesteaded properties, it bears mention that some proposals would restrict non-judicial foreclosure to non-homesteaded properties only. Non-homesteaded properties are often left vacant and become dilapidated, dragging down the values of all homes in the neighborhood. Expediting the foreclosure of non-homesteaded properties might benefit neighborhoods and may not have such a significant financial impact on the court system. It could also serve as a testing ground for non-judicial foreclosures as the state seeks to tackle the current crisis. However, the concerns about due process expressed above for homesteaded borrowers apply to non-homesteaded borrowers as well.

Examination of arguments for non-judicial foreclosure

The Collins Center is a non-partisan, non-profit organization dedicated to advancing social and economic public policy issues facing Florida while finding meaningful solutions. It has been a pioneer in partnering with government agencies to implement large-scale mediation programs, managing 20,000 insurance disputes, 30,000 hurricane insurance disputes and more than 300 RV Lemon Law disputes.

For the past year, the Collins Center has administered residential mortgage foreclosure programs in three of Florida's 20 circuits: the 1st, 11th, and 19th. The Center is submitting proposals to manage programs in several other circuits. Because of the unique insight provided by that experience, our corporate involvement in the mediation program, and the potential loss of due process rights presented by the proposed change to a non-judicial foreclosure process, the Collins Center has taken the step to counter the arguments presented in favor of the change.

1. Argument: The current process results in substantial delay; non-judicial process will shorten that significantly.

Supporters say the current process takes one to two years, while the new process will take four to 12 months. Each case is unique and can take years or months depending on a multitude of factors. However, some cases are already moving more quickly. For instance, the "rocket docket" in Lee County targets uncontested foreclosures for mass discharges, typically ending with a judge returning the home to the lender after a brief hearing.

By design, the non-judicial process is shorter since it has few procedural safeguards for consumers. It cuts the time borrowers can live "rent-free" (or payment-free) in the home. But that can be handled through normal procedures, such as "show cause" petitions to the court. In any event, the proposed new non-judicial system may not be implemented for a long time, if passed, because it may be challenged on constitutional grounds – breach of private contract rights, lack of procedural safeguards and lack of protection of homestead rights.

Litigators are already preparing for that possibility and may seek injunctions if the legislation passes. Another approach would be to find ways to speed up court processes within the judicial system rather than having a wholesale replacement of it with a non-judicial approach. Judges could get summary decisions in cases where the homeowner can't be reached and may have abandoned the property. Something like a "rocket docket" for those who try to "strategically default" might be useful. Special foreclosure courts are being established and tested in some of the hardest-hit circuits as an innovative way to handle the volume and give each case the proper individual attention.



2. Argument: Due process is not a consideration since judges have little time now, because of heavy workload, to consider individual cases.

This statement may not be entirely accurate as many homestead cases are heard individually. That would largely disappear under the non-judicial system. The procedural safeguards built into the current law about notice and other steps that lenders must take to let borrowers know that something serious is happening would largely disappear under the non-judicial system.

In order to assert rights, a borrower would have to take the costly and serious step of initiating litigation on his own, certifying that his assertions are bona fide and that the litigation is not solely for the purposes of delay.

The assertion that due process is not a consideration ignores the substantial failures of lenders to have the required documentation and to take the correct steps to initiate and follow through with foreclosure. The University of Iowa study cited earlier in this paper illustrates the frequency and seriousness of these defects. Discovering those errors under the non-judicial system would be difficult as there would no longer be oversight by the courts. There would be no forum to resolve these matters unless the borrower were to take the costly and time-consuming step of initiating litigation.

3. Argument: What should bankers do when borrowers “strategically default” and abandon the property?

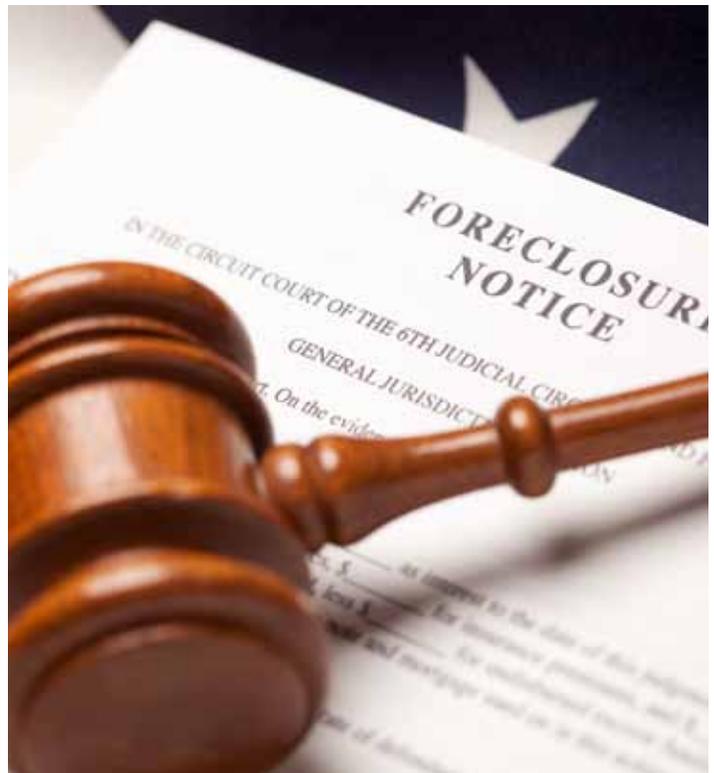
As discussed previously, remedies are being tested: special foreclosure courts with summary proceedings for cases where the borrower appears to have abandoned the property. More than half the foreclosures referred to mediation might fall into that category. Instead of spending time and money on lawyers who file foreclosures, the banks could retain personnel who proactively reach out to the borrowers prior to filing for foreclosure. After documented due diligence the courts could consider a summary judgment based on abandonment. As of now, the most accurate measure of screening out strategic defaults remains the determination of whether the property has a current homestead.

4. Argument: In some counties, nearly 50 percent of foreclosures are non-homesteaded properties.

Many of these, it is asserted, are second homes or rental properties. If this is the case, then special summary proceedings could be established for those – just like the abandoned properties – instead of treating homestead and non-homestead identically. Homesteaded properties require a greater degree of protection as they are often a primary residence.

5. Argument: We need to foreclose and resell quickly so that we can rebuild neighborhoods and the economy.

The real estate market is saturated with properties that have been on the market for extended periods with little or no interest from prospective buyers. In order to sell property, there must be a qualified buyer and, in most cases, a lender who will provide a loan and mortgage. Both of those are in short supply given the current state of the market. As more and more Floridians lose their jobs and have reduced incomes, the buying population has diminished greatly. Additionally, banks are very reluctant to lend money unless a borrower can provide a substantial down payment. While temporary periods of recovery exist, Florida is a long way from a recovery that will absorb all of the properties now subject to foreclosure.





COLLINS CENTER
FOR PUBLIC POLICY
Thinking. Doing. For Florida.

Former Florida Governor LeRoy Collins' legacy of uncompromising integrity in government and business continues at the Collins Center for Public Policy. Established in 1988 by distinguished Floridians who envisioned the need for an independent non-profit organization to find impartial solutions to controversial problems, the Collins Center exceeds the bounds of a traditional think tank—seeking opportunity and taking action on projects that impact the citizens of Florida and the nation.

For more information contact:

Ned Pope

Vice President of Program Development and ADR Initiatives
Director, Mortgage Foreclosure Mediation Program
850-219-0082, ext. 106

Chris Bailey

Deputy Director, Mortgage Foreclosure Mediation Program
850-219-0082, ext. 101

Miami | Tallahassee | Sarasota | St. Petersburg

www.collinscenter.org