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A Lawyer's Perspective

Foreclosure debate

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Well, the election is over. So now you can kick back and read the Press, watch your favorite TV shows, and listen to the radio without the constant drone of political candidates, or pundits, debating the issues of the day. Right? Wrong! Until the issue is resolved, you will continue to get a daily dose of debate, from Main Street to Wall Street, on what the country should do about the foreclosure crisis.

Several weeks ago, we discussed how basic economic principles affect housing prices. Let's use some Press market area illustrations to see why that issue has now been picked up in the national debate. Then, let's talk about two other key principles in that debate.

When I was the Housing Planner in the Atlantic City Planning Department in the late 1970s, our market saw the effect of increased demand while supply stayed constant. Each new casino-hotel created a surge of demand as that facility ramped up hiring for its opening. There were few large scale housing developments in the pipeline so supply could not grow as quickly as demand. Existing home prices and land values increased dramatically, as a result.

During the mid-1990s, demand in the Press area was considered constant because there are no new casino openings and the industry saw stable growth. In those years before law school, I practiced as an MAI real estate appraiser. Increases in housing supply from numerous new subdivisions in Egg Harbor and Galloway townships resulted in minimal increases in the value of existing homes, such as the 25-year-old home that I then owned in Absecon.

As a result of the post-9/11 shift of capital from the stock market to the real estate market, demand outstripped supply. When increased supply was created in response, historically low interest rates turned upward to dampen inflation. From the beginning of 2006 to the beginning of 2008, our market held steady notwithstanding such increased supply. Then there were the psychological effects of the precipitous slide in Western U.S. housing prices. Listings burgeoned here because buyers were waiting for prices to similarly drop and sellers decided to wait out the storm.

Fear of recession and the financial crisis has now caused even more listings. Many 2004-2007 buyers are unable to sell the property at a figure to cover their mortgage. Some walk away. Some are granted short sales. Some properties are foreclosed by lenders. All of this adds more supply, which depresses prices.

The more foreclosures, the greater the effect on the value of your home. Your neighbor's foreclosure will affect your property value because every foreclosure creates more supply in an already oversupplied market. That's why economic principles are becoming the heart of the debate about foreclosures.

On the flip side of economic principles are two other principles. Public policy, as evidenced in U.S. foreclosure law has generally supported the contractual mortgage agreement between the borrower and the lender. There are three pages of definitions of various types of mortgages in Black's Law Dictionary (West Publishing, 8th Ed.). Duty, performance and obligation to the contract are the key concepts throughout. In New Jersey, the state's Supreme Court has determined that a mortgage "confers on the mortgagee (the lender) a lien on the property that secures the debt", another concept derived from contract law.

A mortgage in this state is typically secured by a Mortgage Note, which is a legal instrument in which the borrower unconditionally promises to repay to the order of the lender the fixed principal, along with interest, incurred by the mortgage on real property, within a stated time period. In practical terms, a recourse Mortgage Note enables the lender to go after the borrower personally if the mortgaged real property does not pay off the debt incurred by the mortgage.

The amount typically due in a mortgage foreclosure includes past due payments, penalties, legal fees and the cost of sale, such as a sales commission. And, that's in a good market. In today's market, the mortgage balance may be greater than the value of the property. So, in addition to the normal costs of a foreclosure, you then add the difference between the foreclosed mortgage amount and the proceeds received from a foreclosure sale. The result is a judgment against the borrower for the total amount not satisfied by the sale of the property. In a market like this, many judgments are effectively uncollectable.

The final principle is fairness. Is it fair for you to pay your mortgage when your neighbor gets a government "bailout" through a taxpayer subsidized mortgage workout? Is it any more, or less, fair when you are the one receiving that assistance? What if your investment property has no tenant and you are months behind in mortgage payments, and your home is the additional collateral securing the investment property mortgage? What if your investment property is rented, your mortgage is current, a speculator snapped up the adjoining property at a foreclosure sale for a song and is now soliciting your tenant to move when the lease is up?

Stabilization of the housing market is said to be the key to economic recovery, but how can that be done taking into account these three principles? Over the next several weeks, we will talk with experts involved in the foreclosure debate. Stay tuned. Just like the presidential election, you never know what will happen next.

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