January 2014

# "Pennies on the Dollar": Reallocating Risk and Deficiency Judgment Liability

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**"PENNIES ON THE DOLLAR":**
**REALLOCATING RISK AND DEFICIENCY JUDGMENT LIABILITY**

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*Many homeowners are unaware that they face the prospect of crushing personal financial liability if they default on their mortgage loans. While owners may appreciate that they can lose their homes to the lender if they fail to make payments in accordance with their loan terms, many do not fully comprehend that the exposure they have under such circumstances does not end with relinquishing the financed property. In what are known as recourse states, if the lender forecloses and the foreclosure sale does not yield an amount sufficient to cover the borrower's outstanding debt balance, the lender may file for a deficiency judgment against the borrower to make-up the difference. Whereas in the past, in many jurisdictions, lenders have resorted to this remedy sparingly, there are signs that this lax approach is being abandoned. First and second mortgagees and private insurance companies are increasingly opting to aggressively pursue foreclosed homeowners for fear of leaving money on the table. To make matters worse, even in those situations where lenders determine that it is not economical for them to follow-up on collecting the debt from mortgagors where a deficiency exists, they are selling the deficiency judgment or the claim to debt collectors for pennies on the dollar. Looking at a representative sample of mortgage laws and practices in California, Illinois, and Florida, this paper argues for the prohibition of deficiency judgments in the residential mortgage loan context. The Article also offers a proposal for anti-deficiency legislation. Homebuyers and lenders are not equal players in the mortgage loan transaction. The disadvantages of homeowners are particularly apparent in times of severe economic crisis, like the current Great Recession. Excising the option of deficiency judgments from the loan negotiation will help to address the glaring inequities between parties.*



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"The economic interests of the state may justify the exercise of its continuing and dominant protective power notwithstanding interference with contracts."[1]

## I. INTRODUCTION

Purchasing a home is risky business. One major risk is that the lender will foreclose on a homeowner's property if the homeowner defaults on his mortgage payments.[2] How the risks should be allocated is a matter of great contention.[3] Should mortgage loan borrowers[4] exclusively bear the risk for housing market fluctuations? Is it appropriate to place a disproportionate share of the risk on borrowers? This paper responds to the questions posed by arguing that the risks are misallocated in states that permit lenders to obtain personal liability judgments against borrowers if they default on their mortgage loans—namely, recourse states[5]—and in certain non-recourse states where the protections are too

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1. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 437 (1934).

2. *See* RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.2 (1997).

3. *Compare* Joseph W. Singer, *Foreclosure and the Failure of Formality, or Subprime Conundrums and How to Fix Them*, 46 CONN. L. REV. 497, 506 (2013) (arguing for the relaxation of rigid mortgage law requirements to protect vulnerable borrowers), *with* James B. Hughes, Jr., *Taking Responsibility: A Different View of Mortgage Antideficiency and Redemption Statutes*, 39 ARIZ. L. REV. 117, 120 (1997) (arguing that borrowers should bear risk in proportion to the benefits received through lenders' financing).

4. The terms "borrower," "mortgagor," "buyer," and "homeowner" are used interchangeably in this Article. The terms "mortgagee" and "lender" are also used interchangeably.

5. *See* Mark Cappel, *State Anti-Deficiency Laws & Non-Recourse Laws*, BILLS.COM (July 16, 2014), http://www.bills.com/anti-deficiency/ (listing and categorizing states by whether they allow lenders to pursue deficiency judgments); *see also* Debra Cassens Weiss, *Ex-Homeowners Face "Foreclosure Hangover" as Banks Pursue Deficiency Judgments*, A.B.A. J. (Oct. 3, 2011), http://www.abajournal.com/news/article/ex-homeowners_face_foreclosure_hangover_as_banks_pursue_deficiency_judgment/ (stating that banks are escalating their pursuit of deficiency judgments).

circumscribed.[6] The risks should be redistributed to fall more heavily on lenders for several reasons. Lenders can better evaluate the risks of the market than borrowers. Lenders are an integral part of the industry that produces deficiencies.[7] Lenders are more easily able to absorb the losses of loan defaults and foreclosure than individual borrowers.[8] This paper takes a position at odds with the conventional freedom to contract principle in asserting that governmental intervention in residential mortgage loan contracts is warranted where there is an industry whose members function as dominant parties and who (1) are in a superior position with respect to having pertinent knowledge relative to the contemplated transaction, (2) have the exclusive power to structure the transaction by setting the terms and deciding who is an acceptable counterparty, (3) are incentivized by the prevailing legal and economic regime to maximize the gains of the members to the substantial detriment of the other party even when the overall effect on the industry or the economy is negative, and (4) have the ability to more adroitly manage and absorb the losses associated with the intervention.

By examining deficiency judgments solely in the context of residential properties, this Article highlights the inequitable risk allocation between borrowers and lenders[9] and argues for the broad adoption of anti-deficiency legislation. The deficiency judgment remedy is not new,[10] and neither is the practice of lenders vigorously pursuing such judgments in times of economic crisis. Even with this extensive history, the debate over whether deficiency judgments are an appropriate and efficient remedy is far from resolved.[11]

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6. For example, California's statutes fail to provide sufficient protection to defaulting borrowers in that there is no retroactive protection afforded to refinanced residential loans entered into prior to January 1, 2013. *See* CAL. CIV. PROC. CODE § 580b(c) (West 2011 & Supp. 2014).

7. *See, e.g.*, Singer, *supra* note 3, at 501–02 (arguing that American banks deceived borrowers when they sold subprime mortgages to families who could not afford them).

8. *See, e.g.*, John Mixon, *Deficiency Judgments Following Home Mortgage Foreclosure: An Anachronism that Increases Personal Tragedy, Impedes Regional Economic Recovery, and Means Little to Lenders*, 22 TEX. TECH L. REV. 1, 11 (1991) ("Mortgage lenders as a class have more money and power than borrowers.").

9. *See* John Mixon & Ira B. Shepard, *Antideficiency Relief for Foreclosed Homeowners: ULSIA Section 511(b)*, 27 WAKE FOREST L. REV. 455, 460 (1992) (citing Requirements for Single Family Mortgage Instruments, 54 Fed. Reg. 27,596, 27,608 n.6 (June 29, 1989)) ("Home mortgage documentation ordinarily assigns the entire risk of market decline . . . to the buyer.").

10. The widespread use of the deficiency judgment remedy to the detriment of depression era homeowners was one of the motivating factors for the California anti-deficiency statutes introduced in the 1930s. *See* Cornelison v. Kornbluth, 542 P.2d 981, 988–90 (citations omitted) (providing a history of anti-deficiency legislation in California).

11. *See, e.g.*, Grant Nelson & Gabriel D. Serbulea, *Strategic Defaulters Versus the Federal Taxpayer: A Brief for the Preemption of State Anti-Deficiency Law for Residential Mortgagees*, 66 ARK. L. REV. 65, 91–97 (2013) (citations omitted) (arguing that the federal government should adopt recourse legislation to stymie what they view as the growing frequency of strategic defaulters); Rachel D. Godsil & David V. Simunovich, *Protecting Status: The Mortgage Crisis, Eminent Domain, and the Ethics of Homeownership*, 77 FORDHAM L. REV. 949, 951 (2008)

Indeed, the federal government and various states are simultaneously exploring whether they should implement more extensive measures to protect consumers in their transactions with ordinary and predatory lenders, or whether broad recourse legislation should be adopted as a necessary antidote to strategic defaults.[12] This piece takes the position that mortgagors should be shielded from deficiency judgments. The impetus for this work is several-fold. The character and depth of the Great Recession has exposed the vulnerability of the mortgage consumer,[13] and the economic crisis highlights that federal and state laws are

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(arguing that government intervention is necessary to preserve homeownership and to protect consumers).

12. *See* OFFICE OF INSPECTOR GENERAL, FEDERAL HOUSING FINANCE AGENCY, AUD-2013—001, FHFA'S OVERSIGHT OF THE ENTERPRISES' EFFORTS TO RECOVER LOSSES FROM FORECLOSURE SALES (2012), [hereinafter FHFA Report] *available at* http://origin.www.fhfaoig.gov/Content/Files/AUD-2013-001.pdf. The FHFA Report concludes:

> Recovering losses from strategic defaulters and others who have the ability to repay their financial obligations—e.g., real estate investors and vacation home owners—presents an opportunity for the Enterprises to strengthen their financial positions and to reduce the need for future taxpayer support.
>
> *Id*. at 14. The FHFA Report also recommends:
>
> 1. Routinely obtain deficiency-related information, such as the size of the Enterprises' deficiencies, their effectiveness in targeting for deficiency collection defaulting borrowers who continue to have the ability to repay their loans, the number or amount of their collection referrals, and their recovery rate.
>
> 2. Based on an analysis of deficiency data from Recommendation 1, incorporate deficiency management into FHFA's supervisory review process.
>
> 3. Issue written guidance to the Enterprises on managing their deficiency collection processes, including at a minimum whether they should be pursuing the same type of defaulted borrowers and pursuing collections in the same states.

*Id*. at 15. *See also* Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X), 78 Fed. Reg. 10,696, 10,696 (Feb. 14, 2013) (to be codified at 12 C.F.R. pt. 1024); Mortgage Servicing Rules Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 10,902, 10,902 (Feb. 14, 2013) (to be codified at 12 C.F.R. pt. 1026) (providing an official interpretation of regulations implementing provisions of the Dodd-Frank Act); Lew Sichelman, *Fannie Mae, Freddie Mac to Go After More Strategic Defaulters*, CHI. TRIB., Oct. 13, 2013, http://www.chicagotribune.com/business/bizwrap/la-fi-lew-20131013-story.html (discussing recommendations by the Office of the Inspector General at the Federal Housing Agency for Fannie Mae and Freddie Mac to pursue deficiency judgments more aggressively).

13. *See* Singer, *supra* note 3, at 501 ("The banks made huge amounts of money marketing mortgages to people who could not afford to pay them back while offloading the risks of such deals onto hapless third parties.").

inadequate to protect mortgagors.[14] Government's failure to implement legislation that addresses the relative disadvantages of the mortgage consumer in the context of a loan transaction has repercussions for the financial well-being of the country.[15] This Article is prompted by a concern that the lending industry will continue to vigorously pursue collecting on deficiency judgments thereby effectively incapacitating borrowers who are financially strained. Rather than ignoring the danger that the secondary market in deficiency judgments will flourish, which will contribute to the widening gap between the lending industry and the practical realities and issues confronting borrowers, this Article seeks to intervene to propose a more efficient approach towards the attendant risks of the residential mortgage loan. Finally, this piece seeks to offer an alternative to recent scholarship advocating for the government's adoption of recourse as the default for all residential mortgages.[16] The scholarship maintains that bold moves like nationwide enactment of recourse laws are necessary in order to discourage mortgagors who strategically suspend making payments on their mortgage loans and leave their properties even though they have the financial means to continue paying the loan debt.[17] These scholars argue that despite casting a wide net that will likely capture borrowers who do not have the financial resources to pay, their approach is necessary in order to protect federal taxpayers who ultimately shoulder the financial burden when the government acts to protect defaulting borrowers from foreclosure and personal liability judgments.[18] Recognizing that defaulting mortgagors are also taxpayers, this Article draws a different conclusion, that mortgage consumers need more protection, not less. There are other measures that can be implemented by banks and governments to manage the risk of strategic defaults.[19]

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14. *See id.* at 503 ("The bankers appear to have assumed that subprime mortgages were lawful because no law specifically prohibited them.").

15. *See id.* at 510.

16. *See* Nelson & Serbulea, *supra* note 11 and accompanying text.

17. *See, e.g.*, *id.* at 91 ("Strategic defaulting has the potential to make matters much worse . . . Congress should preempt state law and make all residential mortgages recourse.").

18. Drawing upon the empirical research of Andra Ghent and Marianna Kudlyak, regarding the responsiveness of borrowers in certain income brackets to the threat of deficiency judgments, Grant S. Nelson and Gabriela D. Serbulea argue that Congress should enact a recourse statute that should be retroactive to the time the legislation goes into effect. *See id.* at 68; *see also id.* at 98 ("Where there has been intervention by states in the mortgage crisis, it has largely been regulatory and, in the long run, arguably financially counterproductive for federal taxpayers . . . [because] such legislation creates a transfer payment from lenders to defaulting borrowers in the form of free rent for the moratoria period." (quoting Grant S. Nelson, *Confronting the Mortgage Meltdown: A Brief for the Federalization of State Mortgage Foreclosure Law*, 37 PEPP. L. REV. 583, 609 (2010))).

19. *See, e.g.*, Debra Pogrund Stark, *Unmasking the Predatory Loan in Sheep's Clothing: A Legislative Proposal*, 21 HARV. BLACKLETTER L.J. 129, 130–31 (2005) (proposing a mortgage counseling law); Hughes, *supra* note 3, at 145 (proposing that lenders "refrain from entering into mortgage transactions with borrowers who fail to demonstrate the requisite ability to comprehend the lender's disclosures"); William N. Eskridge, Jr., *One Hundred Years of Ineptitude: The Need for Mortgage Rules Consonant with the Economic and Psychological Dynamics of the Home Sale and*

This paper references mortgage laws in California, Florida, and Illinois to help clarify the type of anti-deficiency legislation needed.[20] These geographic regions represent a range of possibilities regarding real estate characteristics, buyers, and markets. California, as a non-recourse state and pioneer in anti-deficiency legislation, serves as an interesting point of contrast to the recourse states for several reasons, such as its size and share of the residential real estate market. The inflated real estate values of the California market also provide important source material in terms of the monetary amount of the deficiencies for situations in which lenders have been permitted to recover personal judgments— for example, on refinanced loans. California serves as a critical source of information regarding whether the presence of anti-deficiency legislation invites strategic defaults in noticeable excessive margins as compared to those states that don't have anti-deficiency statutes. Florida, as the site of a substantial increase in deficiency judgment activity, presents an interesting case study.[21] While Florida has some protections in place for mortgagors, they are not extensive enough.[22] Due to its warm climate, Florida is an attractive location for an eclectic mix of potential loan defaulters, such as second home vacation purchasers, retirees, first time home purchasers, longstanding homeowners, and investors.[23] The proposal to apply anti-deficiency laws to this diverse home buying population raises the question of whether the profile of the homebuyer should factor in the decision of granting non-recourse protection. Illinois is included not only because of its location in the Midwest, but also because this state contains one of the most expensive real estate markets—that is Chicago—as well as regions with lower real estate values.[24] The state encompasses agricultural land and urban areas and has been the site of significant industrial development.[25] Further, recent occurrences in Illinois suggest that a shift is underway from protecting mortgage loan consumers judicially, rather than legislatively.[26] Although Illinois does not have an anti-deficiency

*Loan Transaction*, 70 VA. L. REV. 1083, 1165 (1984) (proposing federal disclosure requirements that "more accurately reflect the total costs and risks of the loan").

20. *See* CAL. CIV. PROC. CODE § 580b (West 2011 & Supp. 2014); FLA. STAT. ANN. § 45.031 (West 2006 & Supp. 2014); 735 ILL. COMP. STAT. 5/15 (2012).

21. *See* Jessica Silver-Greenberg, *House is Gone but Debt Lives On*, WALL ST. J., Oct. 1, 2011, at A1.

22. Florida has a fair value statute. *See* FLA. STAT. ANN. § 45.031(7) (West 2006 & Supp. 2014).

23. *See* Silver-Greenberg, *supra* note 21.

24. Caitlin Wilson, *The Average Illinois Home Price is Very . . . Average*, REBOOT ILLINOIS (June 9, 2014) *available at* http://www.rebootillinois.com/2014/06/09/editors-picks/caitlinwilson/illinois-home-price/10073/.

25. *See id*.

26. *See* The Honorable Mathias W. Delort, Assoc. Judge, Cook Cnty. Cir. Ct. Keynote Address at the University of Northern Illinois Law Review Symposium: The Mortgage Foreclosure Crisis (Apr. 20, 2012); *see also* Andra C. Ghent & Marianna Kudlyak, *Recourse and Residential Mortgage Default: Evidence from U.S States*, 24 REV. OF FINANCIAL STUD. 3159, 3179 (2011) (stating "a judge may opt not to confirm the sale on grounds that 'justice was not otherwise done. In

statute,[27] judges have historically[28] engaged in the practice of routinely "denying" or discouraging motions for deficiency decrees. There is evidence to suggest that Illinois judges are moving away from this practice.[29] California, Florida, and Illinois have some of the highest foreclosure rates in the nation.[30] These states would benefit from either the adoption of anti-deficiency legislation or an expansion of the legislation that is already in place.

In making the case for anti-deficiency legislation, this Article proceeds in the following manner. Section II provides background information on deficiency judgments and the problems they pose. Section III examines the state of the law in California, Illinois, and Florida and gives historical background on anti-deficiency measures. Section IV presents arguments in favor of enacting anti-deficiency legislation in those states that don't currently have such protective measures and expanding the coverage of the law, where needed, in those states that do. Section V analyzes and critiques the main arguments that have been offered against providing anti-deficiency protection to borrowers. The counterarguments fall into several categories. Opponents of pro-consumer mortgage laws emphasize the sanctity of the contract and argue that imposing remedies that were not bargained for undermine the loan contract[31] as a reliable vehicle to structure relationships and outcomes, thereby causing instability in the market—for example, an increase in strategic defaults—and in future

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practice, this means that the granting of a deficiency judgment is at the discretion of the judge and judges rarely grant deficiency judgments on residential property").

27. *See* 735 ILL. COMP. STAT. 5/15-1101 to -1706 (2012).

28. The Honorable Mathias W. Delort, Assoc. Judge, Cook County Circuit Court in Chicago, Keynote Address at the University of Northern Illinois Law Review Symposium: The Mortgage Foreclosure Crisis (Apr. 20, 2012).

29. *Id.*

30. A legislative report to the recent bill amending Florida's foreclosure statute notes that at the close of 2012 "[s]even out of the top 10 highest foreclosure markets in the nation [were] in Florida," and there were approximately "305,766 properties in some stage of foreclosure or bank-owned." FLA. H.R. STAFF ANALYSIS: MORTGAGE FORECLOSURES, H.B. 87, at 2 (2013) (citing *1.8 Million Properties with Foreclosure Filings in 2012*, REALTYTRAC (Jan. 14, 2013), http://www.realtytrac.com/content/foreclosure-market-report/2012-year-end-foreclosure-market-report-7547). In Illinois, "at the end of 2010 there were 70,000 pending foreclosure cases in Cook County . . . . At the end of January [2013], there were 77,000 cases pending in Cook County Circuit Court." Mary Ellen Podmolik, *New Rules to Govern Illinois Foreclosures*, CHI. TRIB. (Feb. 22, 2013), http://articles.chicagotribune.com/2013-02-22/business/ct-biz-0222-mortgage-rules--20130222_1_illinois-foreclosures-mortgage-servicers-foreclosure-process.

31. *See, e.g.*, Melissa B. Jacoby, *Home Ownership Risk Beyond a Subprime Crisis: The Role of Delinquency Management*, 76 FORDHAM L. REV. 2261, 2267 (2008) ("Building a society of home owners generally requires mortgage market development, which in turn is premised on a reliable system of contract enforcement against borrowers who default."); Eric L. Talley, *Contract Renegotiation, Mechanism Design and the Liquidated Damages Rule*, 46 STAN. L. REV. 1195, 1196 (1994) (noting the dissolution of contractual freedom in judicial non-enforcement of liquidated damages clauses); Mixon, *supra* note 8, at 9 (pointing out that "[t]raditional analysis holds the obligation to repay the mortgage is absolute, and the mortgaged property is merely pledged to ensure repayment").

transactions.[32] They maintain that from a moral and ethical standpoint, individuals should be held accountable for the deals they make and should be required to follow the terms of a transaction without variation regardless of any intervening factors, such as job loss, financial crises, or illness.[33] They reason that because borrowers are responsible for assessing the risks associated with their home purchases they should bear the losses just as they enjoy the benefits.[34] Rather than resorting to non-recourse legislation, which limits the remedies available to lenders, this camp promotes other consumer protective approaches.[35] Finally, challengers to anti-deficiency laws maintain that placing restrictions on the lender's ability to recover outstanding debt encumbers the foreclosure process making it inefficient[36] and leads to substantial increases in the price of mortgage loan products, which in turn effectively prohibits certain segments of the population—for example middle and lower income classes—from obtaining financing.[37] In short, lenders will be discouraged from providing mortgage loans to those groups. Section VI offers a proposal for drafters of anti-deficiency legislation and argues that the statute should be applied retroactively to those residential mortgage loans entered into starting January 1, 2006.[38]

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32. *See, e.g.*, Mixon, *supra* note 8, at 46 (noting that mortgagees favor maintaining the option of deficiency judgments, even when collecting on those judgments often produces no significant economic benefit, because of the perception that they serve as an effective deterrent to potential strategic defaulters).

33. *See, e.g.*, Hughes, *supra* note 3, at 141 ("If we relieve individuals of the obligation to stand by their commitments, we diminish the individual and we diminish the collective strength of our society by eliminating our ability [to] prudently to rely upon each other for the mutual fulfillment of promises.").

34. *See id.* at 120–21 (citing Robert M. Washburn, *The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales*, 53 S. CAL. L. REV. 843, 873 (1980)).

35. *See, e.g.*, Stark, *supra* note 19, at 130–31 (advocating a "mortgage counseling law" to offset the practices of predatory lenders).

36. *See, e.g.*, James Geoffrey Durham, *In Defense of Strict Foreclosure: A Legal and Economic Analysis of Mortgage Foreclosure*, 36 S.C. L. REV. 461, 482 (1985) ("A mortgagee's ability to recover a deficiency judgment against the mortgagor . . . affects . . . the efficiency of foreclosure by sale.").

37. *But see* Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 VA. L. REV. 489, 490 n.4 (1991) ("Mortgagor protection laws may redistribute income from wealthy and middle-income homebuyers to those who are less fortunate.").

38. While there are conflicting opinions and data regarding the "beginning" of the financial crisis, January 1, 2006, was selected because the weight of evidence suggests that certain risky residential lending practices became more prevalent during 2006. This justifies the date as a reference point for the retroactive period of the proposal advocated herein. *See* Chairman Ben S. Bernanke, Bd. of Governors of the Fed. Reserve Sys., Speech at the Federal Reserve System Conference on Housing and Mortgage Markets (Dec. 4, 2008), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm ("Delinquency rates for subprime mortgages—especially those with adjustable interest rates—began to climb steeply around the middle of 2006."); *see also* Carol Necole Brown, *Women and Subprime Lending: An Essay Advocating Self-Regulation of the Mortgage Lending Industry*, 43 IND. L. REV. 1217, 1217–18 (2010) ("Subprime mortgages as a share of the total number of loan originations were twenty percent in 2006, up from only nine percent in 1996." (citing Katalina M. Bianco, The Subprime

## II. DESCRIPTION OF THE PROBLEM

### A. *What is a Mortgage Loan Deficiency?*

If a borrower defaults and the lender or holder of the note chooses to sue on the note or chooses to foreclose on the security, that is the borrower's house, the total obtained by placing a levy on the borrower's assets or the resulting foreclosure sale may yield an amount that is less than what the borrower owes on his mortgage.[39] This difference is referred to as a deficiency.[40] In the latter scenario, if the borrower is not living in a non-recourse state and if there is no anti-deficiency statute in place, the lender may pursue the defaulting borrower by obtaining a personal judgment for the deficiency including any expenses the foreclosing mortgagee has incurred in connection with the foreclosure.[41] For example, if the borrower owes $200,000 on his mortgage loan and the mortgaged property sells for $100,000 at the foreclosure sale, then—assuming there are no restrictions imposed by the state's laws or in the terms of the loan—the lender can obtain a deficiency decree in the amount of the $100,000 difference. If the lender chooses to take this course of action, it often results in a set of economically disadvantageous consequences for the borrower. In general, because deficiency judgments are related to an expensive asset relative to personal income and other property an individual is likely to acquire in his lifetime, deficiency judgments are often financially unmanageable for the average person.[42] A foreclosure already damages the defaulted borrower's credit.[43] When a personal liability judgment is added to this circumstance, it often results in the borrower filing for bankruptcy in order to obtain relief.[44] A deficiency judgment can impact the amount of take home pay that the debtor has at his disposal because his wages may be garnished in some jurisdictions by as

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Lending Crisis: Causes and Effects of the Mortgage Meltdown, CCH 1, 6 (2008), http://business.cch.com/bankingfinance/focus/news/subprime_wp_rev.pdf)).

39. *See generally* RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8 (1997).

40. *See* DENISE L. EVANS & O. WILLIAM EVANS, THE COMPLETE REAL ESTATE ENCYCLOPEDIA 125 (2007) (defining "deficiency" as "[t]he amount due on a mortgage loan after adding all expenses of foreclosure and accrued interest to the principal balance of the loan and then deducting the sale price or lender-bid price for the property.").

41. *See* RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.4 (1997).

42. The Wall Street Journal reports that $100,000 was the "average amount" of the deficiency in seven states examined. Silver-Greenberg, *supra* note 21, at A1.

43. John Murphy, *Deficiency Judgments—Another Blow to the Housing Market in the Future*, JOHN MURPHY REPORTS (Apr. 4, 2011), http://johnmurphyreports.com/2011/04/04/deficiency-judgments-another-blow-to-the-housing-market-in-the-future.

44. A deficiency judgment may be discharged in a personal bankruptcy action because the debt is unsecured. *See* Mixon, *supra* note 8 at 29. As discussed in Section V of this Article, some scholars have noted the positive aspects of bankruptcy, which can help a mortgagor who is experiencing financial difficulties keep her home or delay a foreclosure to allow sufficient time to dampen the harsh disruptive effects that can accompany it—for example, temporary homelessness.

much as twenty-five percent.[45] A deficiency judgment may also hinder the defaulting borrower's ability to secure alternative housing in the future and could affect a borrower's future job prospects if employers run a credit check and factor the state of a job applicant's credit into their hiring decisions.[46] In a worst-case scenario, a person subjected to a deficiency judgment might find himself facing prison.[47]

There are other reasons to be concerned about allowing lenders to pursue deficiency judgments. The availability of this remedy has widespread effects on the economy and on the stability of the housing market.[48] A deficiency judgment financially constrains a borrower who is already experiencing substantial financial difficulties.[49] Borrowers in this position are unable to fully participate in the economy because they do not have the economic means to do so.[50] Further, the psychological effect of deficiency judgments on borrowers may keep them out of the market.[51] If borrowers perceive that the purchase and financing of a house is a heavily rigged game that they cannot win, they will be reluctant to purchase real estate in the future.[52] For as long as the lesson that real estate is no longer a "sure bet" remains in the psyche of U.S. culture, it could impact how generations coming of age as adults—that is, potential home

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45. *See* Murphy, *supra* note 43.

46. While a consideration of a person's credit status may not be permitted under U.S. laws, it does not preclude the possibility that employers may engage in this behavior. If, in fact, the credit score of a person plays a role in a decision not to hire someone, it is difficult to prove.

47. *See* Molly McDonough, *Payday Lenders Using Courts to Create Modern-Day Debtors' Prisons in Missouri, Critics Say*, A.B.A. J. (Aug. 20, 2012), http://www.abajournal.com/news/article/payday_lenders_using_courts_to_create_modern_day_debtors_prisons/ (quoting Jim Gallagher, *Payday Lenders Use Courts to Create Modern Debtors' Prison*, ST. LOUIS POST-DISPATCH (Aug. 19, 2012, 5:52 PM), http://www.stltoday.com/business/local/payday-lenders-use-courts-to-create-modern-debtor-s-prison/artcle_f56ca6aa-e880-11e1-b154-0019bb30f31a.html); Megan McArdle, *America's Modern-Day Debtor's Prison*, THE ATLANTIC (Nov. 23, 2011, 12:15 AM), http://www.theatlantic.com/business/archive/2011/11/americas-modern-day-debtors-prison/249043/ (quoting Jessica Silver-Greenberg, *Debtor Arrests Criticized*, WALL ST. J. (Nov. 22, 2011), http://online.wsj.com/news/articles/SB10001424052970203710704577052373900992432#printMode). To be clear, a jail sentence would likely be imposed because of the individual's failure to appear in court on the matter of payment of his debt and not because of the actual failure to pay the debt. If the debtor refused to appear, the court may choose to issue a body attachment order. Nonetheless, given that a substantial number of defaulting borrowers are in a precarious financial condition, the imposing force of the collector and the sense of doom a borrower may experience when being summoned to court by their creditor may lead some to make the unwise decision to ignore the summons because they cannot pay. Thus, one can conclude that there may be a disturbing relationship between the new rise in debtor's prisons and deficiency judgments obtained in connection with mortgage foreclosures.

48. *See* Murphy, *supra* note 43.

49. *See id.*

50. *See id.*

51. *See* HART RESEARCH ASSOC., HOW HOUSING MATTERS: AMERICANS' ATTITUDES TRANSFORMED BY THE HOUSING CRISIS & CHANGING LIFESTYLES 3 (2013) (finding that buying a home has become less appealing for more than half of adults surveyed).

52. *See id.*

purchasers—view the house asset.[53] Society has often privileged homeownership as a premier wealth accumulation vehicle.[54] While recent events suggest that rethinking the privileged place of homeownership in the American economy and psyche is warranted,[55] it is important not to automatically abandon the house as a vehicle for individuals to accumulate wealth over time[56] particularly since there are no apparent suitable alternatives.[57] Instead, it is necessary to reevaluate the positioning of mortgage consumers in relation to lenders to ensure that the former are well informed before entering into a mortgage loan and that the risks they are undertaking, given the cost of the property, are not unduly assigned to them. If states continue to allow deficiency judgments, the remedy can have rippling negative effects on the U.S. economy impacting the construction, purchase, and sale of houses.[58]

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53. Conversely, one could assert that as long as housing prices and financing is relatively low compared to the cost of renting, many people will make the decision to purchase homes even if there is a risk that they may default, lose their home, and face a judgment of personal liability for any outstanding loan debt that is not covered by the foreclosure sale proceeds.

54. *See* William M. Rohe & Harry L. Watson, *Introduction: Homeownership in American Culture and Public Policy*, *in* CHASING THE AMERICAN DREAM: NEW PERSPECTIVES ON AFFORDABLE HOMEOWNERSHIP 1, 4–5 (William M. Rohe & Harry L. Watson eds., 2007).

55. Substantial scholarship reevaluating home ownership has already been initiated. *See, e.g.*, Stephanie M. Stern, *Reassessing the Citizen Virtues of Homeownership*, 111 COLUM. L. REV. 890, 938 (2011) (arguing that alternatives to homeownership do not have a detrimental effect on citizen values); Stephanie M. Stern, *Residential Protectionism and the Legal Mythology of Home*, 107 MICH. L. REV. 1093, 1096–97 (2009) (arguing that ownership of property is not a prerequisite to human flourishing); Jacoby, *supra* note 31, at 2262 (pointing out that commitment to homeownership should not be taken lightly); Lee Anne Fennell, *Homeownership 2.0*, 102 NW. U. L. REV. 1047, 1049 (2008) (discussing the downsides of concentrating on homeownership as a primary investment strategy); D. Benjamin Barros, *Home as a Legal Concept*, 46 SANTA CLARA L. REV. 255, 255 (2006) (analyzing differences in treatment between "homes" and other types of property).

56. *See* Godsil & Simunovich, *supra* note 11, at 953 (arguing for the preservation of homeownership provided that policy and laws are revised to take into account larger economic issues).

57. Some may argue that the stock market is an acceptable alternative, but the market also carries substantial risks that many people do not appreciate. There is nothing comparable to the multi-functional aspects of the home, which provides individuals with a place to live and gives them an investment that may allow them to preserve their money, and the potential for their wealth to grow.

58. According to a recent study, commissioned by the MacArthur Foundation, on individual attitudes towards housing, the economic crisis has led to significant changes in how individuals perceive homeownership. The study reveals that "seven in 10 (69%) believe it is less likely for families to build equity and wealth through homeownership today compared with two or three decades ago . . . [and] four in five (81%) saying that it is more likely today for banks to foreclose on homeowners than it was 20 or 30 years ago." HART RESEARCH ASSOC., supra note 51, at 10. While the increased awareness of individuals regarding the possibility of foreclosure is positive because it indicates that people are more accurately assessing the risks accompanying homeownership, there are potential negatives to discouraging individuals from purchasing homes. If the disincentives to homeownership prevail, this climate creates a crisis with respect to the current structure that is in place, which is dependent upon individuals continuing to buy homes. Will there be enough buyers for current homeowners who wish to sell? There will be growing pains if indeed the United States is transitioning from a homeownership society to a rental one. The move away from real property

### *B. Types of Foreclosure and Deficiency Judgments*

The three types of foreclosure procedures available to mortgagees in the United States are judicial sale;[59] power of sale, also known as non-judicial sale;[60] and strict foreclosure.[61] A common method of foreclosure in many states, including California,[62] Florida,[63] and Illinois[64] is by judicial sale.[65] A judicial sale foreclosure is the procedure according to which a mortgagee can file an action for a "court-ordered sale of the mortgaged property after a default by the

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residential ownership leaves a void regarding available pathways to advance economically within society. On the other hand, borrowers may be more resilient than this trend suggests. There is some evidence that even those borrowers who have been stung by the financial downturn, losing their homes to foreclosure, have rebounded in some states and opted to enter the home buyer's market again. These so-called "boomerang" buyers are contributing to the escalation of home prices in Phoenix and California; although, investors are the primary force behind the rise of prices in those states. Catherine Reagor, *Phoenix Housing Market Sees "Boomerang Buyers" Sooner Than Expected*, ARIZ. REPUBLIC (July 14, 2014, 1:14 AM), http://www.azcentral.com/business/realestate/articles/20130709phoenix-housing-market-boomerang-buyers.html. This phenomenon can largely be explained by the continuation of historically low interest rates, depressed home prices, and some forgiving lenders who are willing to make credit available. In some markets the entry of new groups—for example, immigrant communities—has also helped to spark growth. *See* John Feinblatt & Jason Marczak, *Immigrants Are Driving the Housing Recovery*, CNN (July 13, 2013, 8:53 AM), http://www.cnn.com/2013/07/19/opinion/feinblatt-housing-immigration/.

59. *See* GRANT S. NELSON ET AL., REAL ESTATE TRANSFER, FINANCE, AND DEVELOPMENT: CASES AND MATERIALS 612 (8th ed. 2009). ("The most pervasive method [of foreclosure] is judicial foreclosure in equity accompanied by a judicial sale. This type of foreclosure is available in every state, and in many states it is the only type of foreclosure permitted.").

60. Under a power of sale foreclosure, a mortgagee is permitted to "force a sale of the mortgaged property without bringing a judicial action." Durham, *supra* note 36, at 477–78. For a detailed explanation of the power of sale foreclosure method, *see* GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW 633–36 (5th ed. 2007) (citations omitted). Not all jurisdictions authorize mortgagees to use the power of sale method. Illinois, for example, does not allow power of sale foreclosures. *See* 735 ILL. COMP. STAT. 5/15-1405 (2012) ("No real estate within this State may be sold by virtue of any power of sale contained in a mortgage or any other agreement, and all such mortgages may only be foreclosed in accordance with [the Illinois Mortgage Foreclosure Law]).

61. *See* NELSON ET AL., *supra* note 59, at 612–13 ("Under [the strict foreclosure method,] foreclosure is in court, but there is no judicial sale. Instead the defaulting mortgagor is given a period of time by the court to pay the mortgage debt. Failure to do so within that time period will result in the mortgaged property vesting in the mortgagee without sale."). Of the three states that this Article examines, only Illinois provides for strict foreclosure. *See* 735 ILL. COMP. STAT. 5/15-1403 (2012) ("Nothing in this Article shall affect the right of a mortgagee to foreclose its mortgage by a common law strict foreclosure as in existence in Illinois on the effective date of this Article.").

62. *See* CAL. CIV. PROC. CODE § 726 (West 1980 & Supp. 2014).

63. *See* FLA. STAT. ANN. § 702.01 (West 1994 & Supp. 2014).

64. In Illinois, mortgagees are required to utilize judicial foreclosure. *See* 735 ILL. COMP. STAT. 5/15-1404 (2012).

65. Approximately forty percent of the states use the judicial foreclosure method. *See* NELSON ET AL., *supra* note 59, at 614; *see also* Durham, *supra* note 36, at 476 ("Judicial foreclosure is the primary method of foreclosure in at least twenty-five states." (citing G. OSBORNE, G. NELSON & D. WHITMAN, REAL ESTATE FINANCE LAW § 7.11 at 446 (1979))).

mortgagor."[66] Given the popularity of judicial sale foreclosures, its use in the jurisdictions this Article highlights, and the restrictions that are often placed on deficiency judgments if mortgagees opt to pursue foreclosure via one of the other procedures,[67] this paper focuses on the judicial sale.[68] If the mortgagee chooses this popular mechanism, and the jurisdiction's laws otherwise permit, the mortgagee has the option of suing for a deficiency judgment if the foreclosure sale price does not cover the full amount of the borrower's outstanding debt.[69]

### *C. Scope of the Problem*

The threat of a lender or other collector obtaining a deficiency judgment is a viable one that merits attention.[70] A majority of states provide for a deficiency judgment remedy in connection with judicial foreclosures.[71] In 2011, "64% of the 4.5 million foreclosures since the start of 2007 have taken place in states that allow deficiency judgments."[72] This statistic means that there is potential for a substantial rise in deficiency judgment suits. Although the circumstances under which a deficiency judgment will be granted may be limited, if the mortgagee[73] chooses to rely upon the judicial foreclosure process, the deficiency judgment remedy is available in California,[74]

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66. Durham, *supra* note 36, at 476.

67. *See* NELSON ET AL., *supra* note 59, at 615 (noting that "in some jurisdictions, deficiency judgments are unavailable after power of sale foreclosure"). California does not permit the mortgagee to obtain a deficiency judgment if power of sale is the method of foreclosure. *See* CAL. CIV. PROC. CODE § 580(d) (West 2011 & Supp. 2014). In Illinois, after a decree has been awarded to a lender through strict foreclosure, the lender may not pursue a deficiency judgment. *See* Debra Pogrund Stark, *Facing the Facts: An Empirical Study of the Fairness and Efficiency of Foreclosures and a Proposal for Reform*, 30 U. MICH. J.L. REFORM 639, 647–48 (1997).

68. While this Article does not analyze the alternative procedures in depth, the arguments pertain equally well to those jurisdictions that allow the mortgagee to pursue deficiency judgments when using the other methods of foreclosure.

69. *See, e.g.*, FLA. STAT. ANN. § 702.06 (West 1994 & Supp. 2014) (allowing request for deficiency judgment in foreclosure); 735 ILL. COMP. STAT. 5/15-1504(f) (allowing a limited right to sue for deficiency). The deficiency judgment is limited in California. *See* CAL. CIV. PROC. CODE § 580(b) (West 2011 & Supp. 2014).

70. *See* Sichelman, *supra* note 12; Silver-Greenberg, *supra* note 21, at A1, A12; Les Christie, *You Lost Your House, but You Still Have to Pay*, CNNMONEY.COM (Feb. 3, 2010, 3:21 PM), http://money.cnn.com/2010/02/03/real_estate/foreclosure_deficiency_judgement/.

71. *See* Durham, *supra* note 36, at 482 & n.135 (citations omitted).

72. Silver-Greenberg, *supra* note 21, at A1.

73. In addition to lenders bringing personal liability deficiency actions against mortgagors, private mortgage insurers and government-controlled entities, such as Fannie Mae or Freddie Mac, and debt collectors—investors who have purchased the debt—may also pursue foreclosed borrowers for deficiencies where the jurisdiction or the loan instruments allow them to do so. *See* Sichelman, *supra* note 12 (noting that Fannie Mae and Freddie Mac can pursue borrowers for deficiency); *see also* Silver-Greenberg, *supra* note 21, at A12 (describing debt investors pursuing deficiency judgments).

74. CAL. CIV. PROC. CODE § 726 (West 1980 & Supp. 2014).

Illinois,[75] and Florida.[76] Some may argue that because lenders secure deficiency judgments in only a relatively small number of the cases in which they are legally entitled to do so,[77] the positives of having this remedy available to them to exercise at their discretion outweigh the negatives of when they opt to rely upon the remedy. While the number of deficiency judgments obtained in connection with foreclosures over the past five years, from 2008–2013, may not have reached epidemic proportions, there is compelling evidence to suggest that a disturbing trend is emerging according to which lenders are relying more heavily upon this remedy.[78] Florida has experienced a noticeable increase in deficiency judgment activity. According to one report:

> In 2010, [Lee County, Florida] courts granted more than 270 deficiency judgments to lenders in a county that includes hard-hit Cape Coral and Fort Myers. That's five times more than in 2008. This year [2011] is promising to be even more active, with 33 deficiency judgments granted in February, more than double the number from a year earlier.[79]

Apparently, lenders are utilizing this remedy against both perceived strategic defaulters—that is, borrowers who have the financial means to continue paying their mortgages but choose not to[80]—and judgment proof borrowers—that is, borrowers who do not have the financial resources to pay their mortgage loan obligation.

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75. 110 ILL. COMP. STAT. 15/112 (2012); *see also* Bank of Benton v. Cogdill, 454 N.E.2d 1120, 1126 (Ill. App. Ct. 1983) (citing Emerson v. LaSalle Nat'l Bank, 352 N.E.2d 45, 49 (Ill. App. Ct. 1976); *In re* Folksdorf's Estate, 26 N.E.2d 660, 662 (Ill. App. Ct. 1940)) (stating that "[t]he right to secure such a deficiency judgment in any foreclosure proceeding is clear, provided the mortgagee receives only one full satisfaction").

76. FLA. STAT. ANN. § 702.06 (West 1984 & 2014).

77. In reporting on the results of her 1993–1994 empirical study on foreclosures in Illinois, legal scholar Debra Stark comments that, "[o]f the approximately 25% of the judicial sales cases in which a deficiency occurred, the lender pursued the deficiency in only 28.2% of such cases in the 1993 sample and 12.9% of such cases in the 1994 sample." Stark, *supra* note 19, at 664; *see also* Silver-Greenberg, *supra* note 21, at A12 ("Lenders still sue for loan shortfalls in only a small minority of cases where they legally could.").

78. *See* Silver-Greenberg, *supra* note 21, at A12. Silver-Greenberg states that there was a thirty-four percent increase in the number of deficiency judgments entered on the court records in 2011 in Lee County, Florida, as compared to the previous year, for a total of 172 deficiency judgments in the first seven months of 2011. *Id*.; *see also* Camillo T. Melchiorre, *A New Weapon in Default Servicing*, MORTGAGE BANKING, Feb. 1, 1995 ("[L]enders, private mortgage insurers and government-sponsored enterprises have recognized that the practice of deficiency recoveries should be a routine part of conventional residential mortgage servicing.").

79. Kris Hundley, *Deficiency Judgments Let Creditors Haunt Borrowers*, ST. PETERSBURG TIMES (Mar. 28, 2011), http://www.tampabay.com/news/business/deficiency-judgments-let-creditors-haunt-borrowers-for-up-to-20-years/1160128.

80. Section V of this Article addresses in more detail arguments regarding strategic defaulters as a justification for maintaining the deficiency judgment remedy.

Lenders are increasingly relying upon the remedy of deficiency judgments.[81] The likely reason for this shift is that the deficiencies remaining after a foreclosure sale are substantially greater due to the larger amounts that borrowers obtained to finance their purchases.[82] The crisis of this decade is due, in substantial part, to the reckless practices of lenders who liberally extended large loans to home purchasers while simultaneously relaxing their underwriting requirements.[83] As a result, more borrowers were able to receive complete financing, rather than placing the standard down payment of twenty to twenty-five percent on their intended home purchase.[84] Consequently, if those borrowers who relied on the lender to finance 95 to 100 percent of their purchases defaulted, the lender has to contend with greater shortfalls.[85] Another factor may be the type of institution that is confronted with deficiencies. According to one news article, "[c]redit unions and smaller banks"[86] are frequently making the calculated choice to seek recourse from a borrower on a defaulted loan. Given some of the typical characteristics of these lending institutions, for example, duties to members in the case of the credit unions, responsibility to be more risk averse, less capitalized, not as many avenues for spreading their risk as big commercial lenders, the connection between the bank's solvency and community development, and the smaller scale of lending in which they engage,[87] it makes sense that these institutions would conclude that it would be a financially unsound decision not to obtain personal liability judgments against borrowers when confronted with sizeable deficiencies following foreclosures. However, if credit unions are dedicated to providing services and loans to people who cannot readily obtain such resources from larger banks (e.g. lower-income communities), the fact that these institutions are

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81. *See* Silver-Greenberg, *supra* note 21, at A1.

82. *See id*. at A1.

83. *See* Singer, *supra* note 3, at 507–08 (citing Adam J. Levitin & Susan M. Wachter, *Explaining the Housing Bubble*, 100 GEO. L.J. 1177, 1180–82 (2012)); *The Origins of the Financial Crisis: Crash Course*, THE ECONOMIST (Sept. 7, 2013), http://www.economist.com/news/schoolsbrief/21584534-effects-financial-crisis-are-still-being-felt-five-years-article; Steve Dening, *Lest We Forget: Why We Had a Financial Crisis*, FORBES (Nov. 22, 2011), http://www.forbes.com/sites/stevedenning/2011/11/22/5086/; Barry Ritholtz, *What Caused the Financial Crisis? The Big Lie Goes Viral*, WASH. POST (Nov. 5, 2011, 11:28 AM), http://www.washingtonpost.com/business/what-caused-the-financial-crisis-the-big-lie-goes-viral/2011/10/31/gIQAXlSOqM_story_1.html.

84. *See* Silver-Greenberg, *supra* note 21, at A1.

85. *See id*. at A1.

86. *Id*. at A12.

87. *See generally* J. CARROLL MOODY & GILBERT C. FITE, THE CREDIT UNION MOVEMENT ORIGINS AND DEVELOPMENT 1850 TO 1980 (2d ed. 1984) (providing a history of the credit union movement); Scott E. Hein, Timothy W. Koch & Scott MacDonald, *On the Uniqueness of Community Banks*, FED. RES. BANK OF ATLANTA ECON. REV., First Quarter 2005, at 15–36 (discussing the community bank model, and the role of community banks); William Keeton, Jim Harvey, & Paul Willis, *The Role of Community Banks in the U.S. Economy*, FED. RES. BANK OF KANSAS CITY ECON. REV., Second Quarter 2003, at 15–43 (providing an overview of community banks in U.S.).

more likely to seek deficiency judgments against this same group means there is a danger that the people who are least likely to be able to manage a deficiency judgment are getting saddled with personal liability.[88]

*D. The Secondary Market*

An even more disturbing trend is the burgeoning secondary market in deficiency judgments.[89] Debt collection companies are buying deficiency judgments for approximately "two cents on the dollar."[90] Investors in this type of debt are pursuing two courses of action. Under one scenario, the lender obtains the deficiency judgments, and the investors buy the judgments to pursue on their own timetable capped only by state statutes.[91] In other cases, investors acquire the note and obtain the deficiency judgment on their own.[92]

Investors are willing to pay pennies on the dollar for deficiency judgments even if some of the judgments purchased are against judgment proof borrowers.[93] Their strategy is to defer acting on the judgments, for as long as the state's statute of limitation permits, with the intention of collecting at a later date when the debtor is in a better financial position.[94] The typical twenty-year period that a mortgagee has to collect on the deficiency, once a personal liability judgment is issued,[95] allows more than enough time for a defaulted mortgagor's financial state to drastically change for the better. When the investors factor in the interest that can accumulate over time on the debt,[96] they deem the acquisition of this type of debt a bet worth making. However, for the mortgagor-debtor, the weight of the debt is overwhelming. For this reason, it is imperative that anti-deficiency laws be enacted to help dismantle this growing market.

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88. This argument assumes that the credit unions are obtaining judgments against borrowers from traditionally underserved lower-income communities.

89. *See* Silver-Greenberg, *supra* note 21, at A12.

90. *Id.*

91. *See id.* (explaining that investors sometimes buy deficiency judgments from lenders and noting the long time frame states allow for collecting on such judgments).

92. *See id.*

93. *See id.* (noting that one debt investor interviewed will buy bad mortgages, get deficiency judgments, and hold the judgments, even if borrowers are not currently in a position to pay).

94. *See id.*

95. With the recent passage of H.B. 87 in Florida, the time period for obtaining deficiency judgments has been substantially shortened for foreclosures after July 1, 2013. Kerri Ann Panchuk, *Florida Governor Signs Bill to Speed up State's Foreclosure Process*, HOUSING WIRE (June 7, 2013, 5:51 PM), http://www.housingwire.com/articles/florida-governor-signs-bill-speed-states-foreclosure-process. For a discussion of lenders' practices in Florida prior to the enactment of the new law, *see* Hundley, *supra* note 79 (discussing deficiency judgment practices in Florida).

96. For example, in Illinois the interest rate on judgments is 9 percent per annum and runs from the date the judgment is entered until it is satisfied. *See* 735 ILL. COMP. STAT. 5/2-1303 (2012).

## III. THE STATE OF THE LAW IN CALIFORNIA, ILLINOIS, AND FLORIDA

### A. *California and the History of Anti-Deficiency Statutes—What Purposes Do the Statutes Serve?*

Anti-deficiency legislation emerged in the depression era of the 1930s.[97] California serves as an important source of information regarding the impetus and rationales for this type of legislation because it is a forerunner in crafting pro-mortgagor laws.[98] As with today's recession, during the 1930s depression, borrowers had to contend with falling property values, the lack of readily available credit, and a dearth of potential homebuyers.[99] This confluence of factors created an unfair advantage for mortgagees in three essential ways. First, borrowers were not able to easily refinance their properties to reduce their payments by trading their higher interest loans for lower interest ones.[100] Second, borrowers who found themselves in financial trouble were not able to sell their homes to avoid foreclosure.[101] Third, in the event of foreclosure, because of the absence of a ready market of buyers, mortgagees could succeed in obtaining a "double recovery" by acquiring the mortgagor's property at the foreclosure sale for a relatively insignificant amount compared to what the mortgagor paid, and then pursue the mortgagor for the difference between the foreclosure sale price and the outstanding debt.[102] California implemented protective legislation for borrowers in recognition of the severe economic conditions that placed mortgagors in dire straits.[103] California's anti-deficiency statutes serve several specific goals:

> (1) to prevent a multiplicity of actions, (2) to prevent an overvaluation of the security, (3) to prevent the aggravation of an economic recession

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97. *See* Talbott v. Hustwit, 78 Cal. Rptr. 3d 703, 705 Ct. App. 2008) ("California's statutes, . . . enacted during the depression, limit or prohibit lenders from obtaining personal judgments against borrowers where the lender's sale of real property security produces proceeds insufficient to cover the amount of the debt."); *see also* Cornelison v. Kornbluth, 542 P.2d 981, 988–90 (Cal. 1975) (citations omitted) (noting that California's antideficiency statutes were passed during the Great Depression).

98. *See Cornelison*, 542 P.2d at 988–90; *see also* CAL. CIV. PROC. CODE. § 580b (West 2011 & Supp. 2014) (providing limitations on deficiency judgments); Carol Burns, Comment, *Will Refinancing Your Home Mortgage Risk Your Life Savings?: Refinancing and California Code of Civil Procedure Section 580B*, 43 UCLA L. REV. 2077, 2081–82 (1996) (citations omitted) (discussing California's enactment of anti-deficiency legislation in the 1930s).

99. *See Cornelison*, 542 P.2d at 988.

100. *See id*. (noting the lack of money available during the Depression).

101. *See id*. (noting the lack of money available and the declining property values during the Depression).

102. *See id*. (citing Roseleaf Corp. v. Chierighino, 378 P.2d 97, 99–100 (Cal. 1963)) (noting that, in a depression-era market, mortgagees could buy foreclosed properties cheaply, and pursue debtors for a deficiency).

103. *See* Palm v. Schilling, 244 Cal. Rptr. 600, 604 (Ct. App. 1988) (citing *Roseleaf Corp*., 378 P.2d at 99; *Cornelison*, 542 P.2d at 988–90).

> which would result if [debtors] lost their property and were also burdened with personal liability, and (4) to prevent the creditor from making an unreasonably low bid at the foreclosure sale, acquire the asset below its value, and also recover a personal judgment against the debtor.[104]

One California court summarized the effect of the state's anti-deficiency laws, as properly "plac[ing] the risk of inadequate security on the purchase money mortgagee" regardless of whether this risk arises due to the mortgagee's actions of improperly valuing the security or from an economic recession that results in the critical decline of home values.[105]

The purposes served by California's anti-deficiency legislation are relevant for all mortgagors. The fundamental reasons for having these pro-consumer laws in place in California hold true today in recession prone times. There are no absolutes on which consumers can rely. The disadvantageous conditions for borrowers prevalent during the depression era enactment of California's anti-deficiency laws are still of concern today. For this reason, it makes sense for states that do not have such pro-consumer measures to adopt them. Now that the broad foundational reasons for adopting California's anti-deficiency legislation have been identified, it is necessary to examine aspects of California's statutes in more detail. While overall California's anti-deficiency laws are protective of mortgagors, they are lacking in certain respects, which are addressed in the following section.

#### 1. *Types of Anti-Deficiency Statutes*

There are numerous provisions that fall under the category of anti-deficiency legislation.[106] Generally, these laws may be categorized as statutes that prohibit deficiency judgments in certain types of loan transactions[107] or foreclosures.[108] Examples of modifications to foreclosure procedures include fair value

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104. Cadlerock Joint Venture, L.P. v. Lobel, 143 Cal. Rptr. 3d 96, 103 (Ct. App. 2012) (quoting Bank of Am. Nat'l Trust & Sav. Ass'n v. Graves, 59 Cal. Rptr. 2d 288, 290 n.3 (Ct. App. 1996)); *see also Cornelison*, 542 P.2d at 990 (Cal. 1975) ("[P]rimary purpose of section 580b [barring deficiency] is, 'in the event of a depression in land values, to prevent the aggravation of the downturn that would result if defaulting purchasers lost the land and were also burdened with personal liability.'" (quoting Bargioni v. Hill, 378 P.2d 593, 594 (Cal. 1963)).

105. Crookall v. Davis, 77 Cal. Rptr. 2d 250, 255 (Ct. App. 1998).

106. For a detailed discussion of various types of anti-deficiency laws, see Grant S. Nelson, *Deficiency Judgments After Real Estate Foreclosures in Mississippi: Some Modest Proposals*, 47 MO. L. REV. 151, 152–154 (1982) (citations omitted).

107. California prohibits deficiency judgments in purchase money transactions. *See* CAL. CIV. PROC. CODE § 580b(c) (West 2011 & Supp. 2014); *see also* Schill, *supra* note 37, at 494 (discussing different types of limits on deficiency judgments).

108. *See* Schill, *supra* note 37, at 494–95.

limitations[109] and one-action rules.[110] The statutes provide varying degrees of protection and relief to mortgagors. While the laws that fall short of an outright prohibition on deficiency judgments help to insulate borrowers to some degree, this Article argues that given the financial resources and adaptability of lenders and the inequities inherent to the mortgage loan transaction, deficiency judgments should be precluded from residential loan transactions. They should not be part of the contractual terms bargained for by residential mortgagors and mortgagees.

### 2. *Aspects of California's Provisions*

Value and price are linked, but they are not the same.[111] Yet, the foreclosure sale price in relation to the outstanding mortgage loan balance is typically the measure used to determine whether there is a deficiency.[112] According to the foreclosure laws in many states,[113] the foreclosure sale price is the indicator of the value of the property. This approach is problematic because there can be substantial gaps may exist between the price that is given in the context of the artificial foreclosure sale market and the value of a property as shaped by a wider range of factors, such as better market conditions, improvements made to the property, the overall condition of the property, and its location.[114] The value is

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109. *See, e.g.*, CAL. CIV. PROC. CODE § 580a (West 2011 & Supp. 2014) (placing a limit on the amount of a deficiency judgment based upon fair-market value of property); CAL. CIV. PROC. CODE § 726 (West 1980 & Supp. 2014) (limiting deficiency judgment based upon fair value of property).

110. *See, e.g.*, CAL. CIV. PROC. CODE § 726 (codifying California's one-action rule).

111. *See* NELSON ET AL., *supra* note 59, at 731 (stating that foreclosure sales, "even under stable economic conditions, normally will not bring a price that will reflect the reasonable market value of the property if it were marketed outside the foreclosure context").

112. This measurement is in accordance with the common law rule. The Reporter's Note to The Restatement Third of the Law Comment a states:

> Several states continue to adhere to the common law rule that when a foreclosure sale does not yield at least the amount of the mortgage obligation, the mortgagee is entitled to a deficiency judgment measured by the difference between the foreclosure price and the mortgage obligation. Under this approach, the foreclosure sale price is the conclusive measure of the amount to be applied to the obligation unless the mortgagor can prove that the foreclosure process itself was defective.

RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.4 (1997).

113. *See, e.g.*, TENN. CODE ANN. § 35-5-118(b) (Supp. 2013) ("The creditor shall be entitled to a rebuttable prima facie presumption that the sale price of the property is equal to the fair market value of the property at the time of the sale."); Resolution Trust Corp. v. Holtzman, 618 N.E.2d 418, 424 (Ill. App. Ct. 1993) (noting that Illinois courts should uphold the foreclosure sale and grant the deficiency judgment petition unless there is evidence of fraud, that the sale was unconscionable, or "justice was otherwise not done" (citing 735 ILL. COMP. STAT. 5/15-1508(b) (2012))).

114. *See, e.g.*, San Paolo U.S. Holding Co., Inc. v. 816 S. Figueroa Co., 73 Cal. Rptr. 2d 272, 276–77 (Ct. App. 1998) (citing CAL. CIV. PROC. CODE § 726) (discussing "factors which should be considered in determining 'fair value'").

likely to be higher because it encompasses additional factors, whereas the price may not fully credit these items. One approach for addressing the potential gap between value and price is implementing a corrective provision like the fair value limitation. California has two fair value statutes,[115] one that pertains to judicial sale foreclosures and another that governs power-of-sale foreclosures. Typically, the foreclosure sale price is used as the measure to determine whether anything remains due and owing to the lender, after subtracting any fees and costs that the lender has incurred from the sale proceeds, and then applying the remainder to the loan balance.[116] In contrast, under California's judicial sales statute, the remainder amount is the difference between the fair value of the property and the outstanding amount.[117]

Fair value limitations have functioned to discourage lenders from causing a deficiency by entering a low bid on the foreclosed property.[118] Given that the mortgagee is often the only bidder at a foreclosure sale and is allowed to bid up to the amount of the outstanding debt, without actually having to pay money out of pocket,[119] the mortgagee has an incentive to bid less than the fair value of the property, knowing that in those jurisdictions that permit it to do so, the mortgagee can pursue a deficiency judgment for any amount of the loan balance that was not covered by the sale proceeds.[120] With the growing secondary market in mortgage loan deficiency collections, mortgagees may also be thinking that they can sell the deficiency judgment to a debt collector and make some

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115. Section 580a of the California Code of Civil Procedure provides for a fair value limitation in power of sale foreclosures. *See* CAL. CIV. PROC. CODE § 580a (West 2011). Section 726(b) provides for a fair value limitation in judicial sale foreclosures. *See* CAL. CIV. PROC. CODE § 726(b) (West 1980 & Supp. 2014). Section 726(b) provides in relevant part:

> In the event that a deficiency is not waived or prohibited and it is decreed that any defendant is personally liable for the debt, then upon application of the plaintiff filed at any time within three months of the date of the foreclosure sale and after a hearing thereon at which the court shall take evidence and at which hearing either party may present evidence as to the fair value of the real property or estate for years therein sold as of the date of sale, the court shall render a money judgment against the defendant or defendants for the amount by which the amount of the indebtedness with interest and costs of levy and sale and of action exceeds the fair value of the real property or estate for years therein sold as of the date of sale. In no event shall the amount of the judgment, exclusive of interest from the date of sale and of costs exceed the difference between the amount for which the real property or estate for years therein was sold and the entire amount of the indebtedness secured by the mortgage or deed of trust.

*Id.*

116. *See* NELSON ET AL., *supra* note 59, at 731.

117. *See* Nelson, *supra* note 106, at 154 & n.12 (explaining that several states have fair value statutes, including California).

118. *See* NELSON ET AL., *supra* note 59, at 731–32.

119. *See* Stark, *supra* note 19, at 663–64.

120. *See id.* at 664.

additional money on the loan if it is not worth their time and effort to pursue the foreclosed mortgagor.[121] Unless a higher bidder is present at the foreclosure sale, the mortgagee has little incentive not to adopt the foregoing strategy.[122] The logic of the fair value statutes is that mortgagees will be motivated to bid a fair price if they know that they cannot, in essence, "create" a substantial deficiency by taking note of the outstanding debt and bidding lower than the fair value of the property, thereby ensuring there will be a notable gap between the remaining indebtedness amount and the foreclosure sale price.

While fair value limitations are likely to be more protective of a mortgagor's equity[123] than relying upon the foreclosure sale price, they do not address the circumstance of dealing with a real estate market that has suffered a precipitous drop in value. In this instance, the fair value of the property may be more than what the bidder offered at the foreclosure sale, but it remains likely, depending upon when the buyer made the purchase, that the fair value will still be substantially lower than what the buyer paid and borrowed to finance the purchase. Under this circumstance, the mortgagor will still have to contend with the prospect of a hefty deficiency judgment.[124]

A second aspect of California's anti-deficiency provisions is the scope of the protective coverage. There are two categories of particular concern: borrowers who refinance their mortgages and guarantors of the mortgage loan. After years of uncertainty regarding whether borrowers who refinanced their purchase money mortgages were entitled to anti-deficiency protection,[125] a recent amendment to California's Section 580b clarifies that such protections are extended under those circumstances.[126] California's amendment provides much

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121. *See generally* Silver-Greenberg, *supra* note 21, at A12 ("The increase in deficiency judgments has sparked a growing secondary market," where a debt investor "buys banks' soured mortgages and goes to court itself to get judgments for debt that remains after foreclosure sales.").

122. The inherent unfairness of this scenario is unlikely to be a sufficient deterrent to mortgagees.

123. In some jurisdictions, if the fair value produces an excess of the amount owed to the lender and the lender is the purchaser at the foreclosure sale, the lender would not be able to benefit from any excess. *See, e.g.*, N.D. CENT. CODE § 32-19-10 (2010) ("[I]f there is any surplus, it must be brought into court subject to the order of the court. If the surplus is less than one thousand dollars and an application to receive the surplus is not filed with the court within sixty days after deposit, the court shall order the funds forfeited to the general fund of the county.").

124. *See* Burns, *supra* note 98, at 2095–2103 (citations omitted) (discussing the uncertainty in case law regarding whether borrowers were entitled to anti-deficiency protection).

125. See Silver-Greenberg, *supra* note 21, at A1.

126. *See* SB-1069 Deficiency Judgments 2012 Cal. Legis. Serv. Ch. 64 codified as amended at CAL. CIV. PROC. CODE § 580b (Supp. 2014)). The amended Section 580b provides in relevant part:

> (a) No deficiency judgment shall lie in any event for the following:
>
> (1) After a sale of real property or an estate for years therein for failure of the purchaser to complete his or her contract of sale.
>
> (2) Under a deed of trust or mortgage given to the vendor to secure payment of the balance of the purchase price of that real property or estate for years therein.

needed clarity to the term "purchase money mortgage," which was not adequately defined under the original statute.[127] Prior to the amendment, the lack of specificity deterred borrowers from operating in a logical, economically-efficient manner. Rather than acting to take advantage of prevailing lower interest rates or to replace an unconventional mortgage with a more conventional one, borrowers were motivated to stay in higher priced and, perhaps, riskier loans for fear of losing their protected non-recourse loan status.[128]

The changes to California's Section 580b are positive but they do not go far enough. Amended Section 580b only applies to "credit transactions that are executed on or after January 1, 2013."[129] In contrast to California's section 580b, this Article's proposal, as discussed in Section VI, offers retroactive coverage that would encompass borrowers who entered into residential mortgage loan contracts and refinancing loan contracts on January 1, 2006. Moreover, the amendments to California's anti-deficiency laws do not address the vulnerable position of guarantors of residential loans.[130] A guarantor is defined as "one who

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> (3) Under a deed of trust or mortgage on a dwelling for not more than four families given to a lender to secure repayment of a loan which was in fact used to pay all or part of the purchase price of that dwelling, occupied entirely or in part by the purchaser.
>
> (b) For purposes of subdivision (c), a loan described in paragraph (3) of subdivision (a) is a "purchase money loan."
>
> (c) *No deficiency judgment shall lie in any event on any loan, refinance, or other credit transaction (collectively, a "credit transaction") which is used to refinance a purchase money loan, or subsequent refinances of a purchase money loan*, except to the extent that in a credit transaction, the lender or creditor advances new principal (hereafter "new advance") which is not applied to any obligation owed or to be owed under the purchase money loan, or to fees, costs, or related expenses of the credit transaction. Any new credit transaction shall be deemed to be a purchase money loan except as to the principal amount of any new advance. For purposes of this section, any payment of principal shall be deemed to be applied first to the principal balance of the purchase money loan, and then to the principal balance of any new advance, and interest payments shall be applied to any interest due and owing. The provisions of this subdivision shall only apply to credit transactions that are executed on or after January 1, 2013.

*Id.* (emphasis added).

127. *See* NELSON ET AL., *supra* note 59, at 743; *see also* Union Bank v. Wendland, 126 Cal. Rptr. 549, 554 (Ct. App. 1976) (holding that refinanced mortgages are not the same as purchase money mortgages and therefore do not fall within the standard of 580b); Burns, *supra* note 98, at 2080 (providing an in-depth analysis of section 580b and the meaning of "purchase money mortgage"); Palm v. Schilling, 244 Cal. Rptr. 600, 609 (Ct. App. 1988) ("The explicit language of section 580b brooks no interpretation other than that deficiency judgments are prohibited by a purchase money mortgagee so long as a purchase money mortgage or deed of trust is in effect on the original real property.").

128. *See* Burns, *supra* note 98, at 2106–07.

129. CAL. CIV. PROC. CODE § 580b(b) (Supp. 2014).

130. *See* Cal. Bank & Trust v. Lawlor, 166 Cal. Rptr. 3d 38, 43 (Cal. Ct. App. 2013) ("' [T]he protections afforded to debtors under the antideficiency legislation do not directly protect guarantors from liability for deficiency judgments . . . . [I]f a guarantor expressly waives the protections of the antideficiency laws, a lender may recover the deficiency judgment against the guarantor even

promises to answer for the debt or perform the obligation of another when the person ultimately liable fails to pay or perform."[131] California courts have interpreted the guarantor's obligation as a separate promise, external to the debtor's transaction and, therefore, outside the scope of coverage of the state's anti-deficiency protections.[132] However, without a clear extension of protection to guarantors, mortgagees can avoid the prohibition on deficiency judgments either by requiring guarantors on all residential mortgage loans as a condition for their approval, or by including waiver language in the guaranty.[133] If lenders require guarantors on residential mortgage loans, it would mean that the risks formerly placed on the mortgagor under a permissive deficiency judgment regime would then be shifted to the guarantor. Excluding guarantors from the anti-deficiency protective fold makes it too easy for lenders to circumvent one of the clear goals of the statutes, which is to inject a measure of equity into the mortgage loan transaction.

### *B. The State of the Law in Florida*

Recent amendments to Florida's mortgage foreclosure statute,[134] known as H.B. 87, exemplify the compromise legislators tend to make regarding balancing the interests of lenders and borrowers. The new law, which became effective on July 1, 2013, is titled Florida's Fair Foreclosure Act ("Foreclosure Act").[135] The state's interest in dealing with the heavy backlog of foreclosures prompted changes to Florida's mortgage foreclosure laws.[136] The primary goal of the Foreclosure Act is to accelerate the foreclosure process.[137] The Foreclosure Act helps lenders by imposing certain monetary requirements on borrowers in order

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though the antideficiency laws would bar the lender from collecting that same deficiency from the primary obligor.'" (quoting Cadle Co. II v. Harvey, 100 Cal. Rptr. 2d 150, 154 (Ct. App. 2000))).

131. Talbott v. Hustwit, 78 Cal. Rptr. 3d 703, 705 (Ct. App. 2008) (citing CAL. CIV. CODE § 2787 (West 2012)).

132. *See, e.g.*, *id.* at 705 ("Since section 580a has to do solely with actions for recovery of deficiency judgments on the principal obligation [it] has no application to an action against a guarantor." (quoting Mariners Sav. & Loan Ass'n v. Neil, 99 Cal. Rptr. 238, 240 (Ct. App. 1971))); *see also* Seth Weissman, *Law of Intended Consequences?*, BUS. L. NEWS 2010, at 59, 60, *available at* http://www.jmbm.com/docs/ sethweissmanlawofintendedconsequences.pdf ("A guarantor's obligations are generally regarded as separate and distinct from those of the Borrower. . . .").

133. Some measure of protection is given by California courts' decisions holding that they will not recognize so-called "sham-guaranties." *See Cal. Bank & Trust*, 166 Cal. Rptr. 3d at 43 ("'[T]he protections afforded to debtors under the antideficiency legislation do not directly protect guarantors from liability for deficiency judgments.'" (quoting *Cadle Co. II*, 100 Cal. Rptr. 2d at 154)). An outright prohibition on deficiency judgments is more reliable, than relying upon the judiciary to ferret out these circumventions.

134. H.B. 87, 2013 Leg., 115th Sess. (Fla. 2013).

135. 2013 Fla. Laws ch. 2013–137.

136. *See* Gary Blankenship, *Foreclosures in Florida Dip*, FLORIDA BAR NEWS (Oct. 1, 2013), http://www.floridabar.org/DIVCOM/JN/JNNews01.nsf/RSSFeed/82A9ECE4B8E6CCA685257BE F0043F02C.

137. *See* FLA. STAT. ANN. § 702.015(1) (West 1994 & Supp. 2014).

to defend against foreclosure actions and by instituting procedures that impact the borrower's ability to exercise redemption rights.[138] The Foreclosure Act does not eliminate the deficiency judgment remedy.[139] Instead, it substantially reduces the permissible period for obtaining a deficiency judgment from five years to one year; the time period for collecting on the deficiency judgment is left unchanged.[140] The change helps borrowers in that it restricts the window of uncertainty regarding whether the lender will secure a personal liability judgment following foreclosure. However, the amendment fails to adequately address the borrower's need for finality so that the borrower can plan the borrower's future financial moves more effectively without being concerned that there is a likely bankruptcy filing in this individual's future. The Foreclosure Act only applies to foreclosure actions "commenced on or after July 1, 2013."[141] Consequently, the new law will not protect the numerous individuals who have already experienced foreclosure and have personal liability judgments entered against them.

Mortgagees may bring an action for a deficiency judgment in Florida in accordance with Section 702.06 of the state's foreclosure law.[142] The Foreclosure Act amends this section to limit the deficiency amount to "the difference between the judgment amount, or in the case of a short sale, the outstanding debt, and the fair market value of the property on the date of sale" if the property is owner-occupied[143] and residential.[144] The restriction regarding the deficiency calculation should not be limited to owner-occupied dwellings. Rather, it should extend to all residential mortgage loans, as argued in Sections IV through VI. The Florida House of Representatives Staff Analysis to H.B. 87 concludes that the additions to Section 702.06 "appear[] to codify the current practice of the courts when rendering a deficiency judgment."[145] Under current practice, Florida courts look to Section 45.031(8), which—like California's mortgage statute—is a civil procedure statute that provides guidance on

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138. *See* FLA. STAT. ANN. §702.036 (West 1994 & Supp. 2014) (relating to the finality of the foreclosure).

139. *See* H.B. 87, 2013 Leg., 115th Sess. (Fla. 2013).

140. H.R. 87, 2013 Leg., 115th Sess. (Fla. 2013) (amending FLA. STAT. ANN. § 95.11 (West 2014)). The limitations period begins to run on "the day after the certificate is issued by the clerk of court or the day after the mortgagee accepts a deed in lieu of foreclosure." H.R. 87, 2013 Leg., 115th Sess. (Fla. 2013). Once a deficiency judgment is obtained in Florida, it is money judgment with a 20-year life.

141. H.B. 87, 2013 Leg., 115th Sess. (Fla. 2013) (amending FLA. STAT. ANN. § 95.11(5)(h) (West 2014)).

142. FLA. STAT. ANN. § 702.06 (West 1994 & Supp. 2014).

143. FLA. H.R., *supra* note 30, at 6–7.

144. H.R. 87 § 5, 2013 Leg., 115th Sess. (Fla. 2013) (amending FLA. STAT. ANN. § 702.06 (West 1994 & Supp. 2014)).

145. FLORIDA HOUSE OF REPRESENTATIVES STAFF ANALYSIS, H.B. 87, at 6 (2013) (citing Trustees of Cent. States Se. & Sw. Areas, Pension Fund v. Indico Corp., 401 So. 2d 904 (Fla. Dist. Ct. App. 1981)), http://www.myfloridahouse.gov/Sections/Documents/loaddoc.aspx?FileName=h0087zl.CJS.DOCX&DocumentType=Analysis&BillNumber=0087&Session=2013.

determining whether a deficiency will be realized in a judicial foreclosure sale.[146] Section 45.031(8) of the Florida Civil Procedure Code allows the judge to consider a number of factors to determine whether a deficiency exists.[147] Those factors include the "amount bid"—that is, the foreclosure sale price—and evidence introduced by the mortgagor based upon, *inter alia*, property taxes, their own assessment of the property's value, or the assessment of an expert appraiser.[148] Because the judge has latitude[149] and the foreclosure sale price is not the absolute determinant of the value of the property that will be used to assess whether a deficiency exists, some have characterized Section 45.031(8) as a fair value statute.[150] Section 45.031(8), however, has actually caused considerable confusion amongst courts.[151] As Nelson and Whitman note, there is conflicting case precedent as to whether looking to the foreclosure sale price is the rule that only should be departed from if there is evidence of "fraud or other inequitable conduct." [152] The differing interpretations of the statute raise questions as to whether Florida is in fact a true fair value state.[153] The Foreclosure Act requires that the outstanding balance and the fair market value are the measures that should be used, but that still leaves room for the judge to determine fair market value.[154]

Regardless of how Florida's law is ultimately characterized, Florida's mortgage laws do not fully address the issues that are raised by the availability of the deficiency judgment remedy. While limiting the period to obtain a deficiency judgment benefits borrowers along with the "fair market value" measure, Florida's mortgage laws, nonetheless, fall short of providing borrowers

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146. Section 45.031(8) provides in relevant part: "If the case is one in which a deficiency judgment may be sought and application is made for a deficiency, the amount bid at the sale may be considered by the court as one of the factors in determining a deficiency under the usual equitable principles." FLA. STAT. ANN. § 45.031(8) (West 2006 & Supp. 2014).

147. *See id*.

148. Nelson and Whitman comment, "[T]here is some evidence that Florida trial courts allow mortgagors to introduce evidence of the fair market value of foreclosed real estate and that those courts use their determination of value, rather than the foreclosure sale price, to calculate the amount of the deficiency judgment." NELSON & WHITMAN, *supra* note 59, at 718.

149. *Id*. (quoting McCollem v. Chinese, 832 So. 2d 194, 196 (Fla. Dist. Ct. App. 2002); Hamilton Inv. Trust v. Escambia Developers, Inc., 352 So. 2d 883, 884 (Fla. Dist. Ct. App. 1977)); *see also* First Union Bank of Fla. v. Goodwin Beach P'ship, 644 So. 2d 1361, 1362 (Fla. Dist. Ct. App. 1994) (holding that the trial court had discretion to consider unpaid delinquent taxes in calculating the fair market value of the foreclosed property); FDIC v. Hy Kom Dev. Co., 603 So. 2d 59, 60 (Fla. Dist. Ct. App. 1992) (citing FLA. STAT. ANN. § 702.06 (West 1994 & Supp. 2014) Savers Fed. Sav. & Loan Ass'n v. Sandcastle Beach Joint Venture, 498 So. 2d 519, 521 (1986) (holding the entry of a deficiency judgment following a foreclosure is within the discretion of the trial judge); Carlson v. Becker, 45 So. 2d 116, 116 (1950).

150. *See* NELSON & WHITMAN, *supra* note 59, at 717–18 (citing FLA. STAT. ANN. § 45.031(8) (West 2006 & Supp. 2014)).

151. *See id*. at 717 (quoting R.K. Cooper Constr. Co. v. Fulton, 216 So.2d 11, 13 (Fla. 1968)).

152. *Id*. at 718.

153. *See id*.

154. H.B. 87 § 5, 2013 Leg., 115th Sess. (Fla. 2013).

with adequate relief. Sections IV through VI make the case for why deficiency judgments should be eliminated altogether.

### *C. The State of the Law in Illinois*

The Illinois Mortgage Foreclosure Law provides that mortgagees may seek a deficiency judgment in a judicial sale foreclosure under the following circumstances: "[i]f the sale of the mortgaged real estate fails to produce a sufficient amount to pay the amount found due, the plaintiff may have a personal judgment against any party in the foreclosure indicated as being personally liable therefor and the enforcement thereof be had as provided by law."[155]

Mortgagors in Illinois do not have all of the protections that are available to borrowers in California and Florida. For example, Illinois has neither a one-action rule nor a fair value statute.[156] Yet, it is clear that anti-deficiency laws are needed because mortgagees have resorted to seeking deficiency judgments against Illinois borrowers in the past.[157] In lieu of a fair value statute, Illinois has a provision that pertains to the price paid for the foreclosed property, which can affect whether there is a deficiency.[158] A party to a foreclosure may seek to have the special matter relating to establishing an agreed minimum price for the property, also known as an upset price, applied to the judgment.[159] Section 5/1506(g) of the Illinois statute provides:

> If all of the parties agree in writing on the minimum price and that the real estate may be sold to the first person who offers in writing to purchase the real estate for such price, and on such other commercially reasonable terms and conditions as the parties may agree, then the court

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155. 735 ILL. COMP. STAT. 5/15-1504(f) (2012). Section 5/15-1508(e) provides that:

> In any order confirming a sale pursuant to the judgment of foreclosure, the court shall also enter a personal judgment for deficiency against any party (i) if otherwise authorized and (ii) to the extent requested in the complaint and proven upon presentation of the report of sale in accordance with Section 15-1508. Except as otherwise provided in this Article, a judgment may be entered for any balance of money that may be found due to the plaintiff, over and above the proceeds of the sale or sales, and enforcement may be had for the collection of such balance, the same as when the judgment is solely for the payment of money.

735 ILL. COMP. STAT. 5/15-1508(e) (2012); *see also* 735 ILL. COMP. STAT. 5/15-1511 (2012) ("[F]oreclosure of a mortgage does not affect a mortgagee's rights, if any, to obtain a personal judgment against any person for a deficiency.").

156. *See* 735 ILL. COMP. STAT. 5/15-1101 to -1706 (2012).

157. Debra Stark reports that, [i]n 11 of 39 judicial cases in 1993 with a deficiency (28.2%), the lender sought a deficiency judgment (in 4 of the 39 cases this information was not available). In 4 of the 31 judicial sales cases in 1994 with a deficiency (12.9%), the lender sought a deficiency judgment." Stark, *supra* note 67, at 671 n.143.

158. 735 ILL. COMP. STAT. 5/15-1506(f)(14), (g) (2012).

159. 735 ILL. COMP. STAT. 5/15-1506(g) (2012).

> shall order the real estate to be sold on such terms, subject to confirmation of the sale in accordance with Section 15–1508.[160]

This upset price provision serves several purposes. It can operate as a check on the mortgagee who may otherwise be motivated to bid the lowest amount possible for the real estate knowing that the mortgagee can file for a personal deficiency judgment against the mortgagor to cover the difference between the amount bid and the loan balance. This section also may be viewed as working along with the statutory right of redemption, to encourage mortgagees to bid an amount that is closer to the fair market value of the real estate.[161] It allows the mortgagor some input into the outcome of the foreclosure sale and provides a measure of control for the mortgagor to protect her equity and to minimize or avoid the possibility of a resulting deficiency. If the final foreclosure sale price is high enough, then the outstanding loan balance will be satisfied. If the price is higher than the outstanding balance, plus any fees to which the mortgagee is entitled, the mortgagor will be able to claim the excess—that is, capture some of her equity. While it is beneficial to Illinois mortgagors that Section 5/1506(g) exists, according to one study of foreclosures for 1993 and 1994 in Illinois, mortgagors generally did not file a motion with the court to utilize the special matters in their foreclosures.[162] The study attributes the failure of distressed borrowers to rely upon the equalizing measures to the borrowers' unawareness of the availability of the special matters.[163]

Several conclusions can be drawn from this information. First, the Illinois Special Matters minimum price provision does not go far enough in protecting mortgagors—it is optional.[164] Consequently, there is a risk that borrowers will not take advantage of the provision because they do not know about it. Further, it is unlikely, if mortgagees are operating in their own best interests, that they will bring the provision to the attention of the borrower, prior to the foreclosure proceeding. Second, the parties may not be able to "agree in writing on the minimum price" for the sale of the property.[165] Mortgagees have an interest in

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160. *Id*.

161. Typically, the statutory right of redemption functions to discourage the lender from bidding low in that it provides a period of time during which the defaulted mortgagor may pay the foreclosure sale price plus any fees to reclaim the property. If the lender bids too low, it gives the defaulted borrower an opportunity to reclaim the property at the low bid price. *See* Catherine A. Gnatek, Note, *The New Mortgage Foreclosure Law: Redemption and Reinstatement*, 1989 U. ILL. L. REV. 471, 476–77 (1989). Under the Illinois statute, the mortgagor may redeem the property for "[t]he amount specified in the judgment of foreclosure, which shall consist of (i) all principal and accrued interest secured by the mortgage and due as of the date of judgment" plus all costs allowed under the law. 735 ILL. COMP. STAT. 5/15-1603(d) (2012). In Illinois, the statutory redemption period runs "3 months from the date of entry of a judgment of foreclosure." 735 ILL. COMP. STAT. 5/15-1603(b) (2012).

162. *See* Stark, *supra* note 19, at 670–71.

163. *See id*. at 671.

164. *See id*. at 670.

165. *Id*. at 654 (quoting 735 ILL. COMP. STAT. 5/15-1506(g) (2012).

getting real estate off their books due to ongoing carrying costs.[166] The fact that cost operates as a strong motivating factor to sell is especially true in recessionary times when there are high rates of foreclosure and a lender has a lot of inventory. Trying to deal with the high inventory levels becomes unmanageable after a while. If this is the prevailing state, it is to a lender's advantage to sell the property as quickly as reasonably possible, and obtain a deficiency judgment to cover any differences between the outstanding loan balance and the foreclosure sale price.

Mortgagors in Illinois are also in need of anti-deficiency protection because there is evidence that Illinois courts are moving away from the local practice of denying or discouraging a deficiency judgment request in connection with the order confirming the judicial sale.[167] It strengthens the mortgagor's position to prohibit deficiency judgments outright, rather than relying upon an optional special matters provision or upon the foreclosure judge's sense of fairness and discretion regarding whether a deficiency judgment should be granted. For these reasons, the state legislature of Illinois should adopt an anti-deficiency statute prohibiting deficiency judgments in residential mortgage transactions in accordance with the proposal offered in Section VI.

## IV. THE CASE IN FAVOR OF ANTI-DEFICIENCY LEGISLATION: WHY ANTI-DEFICIENCY LAWS ARE NEEDED

While the present economic situation instigated this review of anti-deficiency laws and public policy, it is important to clarify that, regardless of the economic climate, government should take action to prohibit deficiency judgments for residential mortgage loans.[168] The prevailing conditions of a crisis, like the Great Recession, merely serve to accentuate the dire need for widespread reform in this area. The convergence of economically debilitating events[169] places mortgagors in a precarious position. But even absent a crisis, residential mortgagors are always at a disadvantage—relative to lenders.[170] The crisis conditions have resulted in an unprecedented number of foreclosures

166. *See id*. at 666–67.

167. Remarks of various panelists presented at Judge's panel at University of Northern Illinois College of Law's Foreclosure Symposium (April 2012); *see also* 735 ILL. COMP. STAT. § 15-1508 (2012) (allowing discretion to judges on whether to grant deficiency judgment); Ghent & Kudlyak, *supra* note 26, at 3179 n.9. (stating that in Illinois: "a judge may opt not to confirm the sale on the grounds that 'justice was not otherwise done.' In practice, this means that the granting of a deficiency judgment is at the discretion of the judge and judges rarely grant deficiency judgments on residential property.")

168. *See* Singer, *supra* note 3, at 549.

169. *See* Bernanke, *supra* note 38 (discussing series of factors contributing to the Great Recession).

170. *See* Hughes, *supra* note 3, at 122.

across the nation.[171] This Article builds upon the existing body of scholarship, which offers suggestions on how the foreclosure wave can be stemmed, and on how those in danger of being foreclosed upon can best be served by the law,[172] by articulating a way to alleviate the predicament of the mortgagor in the aftermath of foreclosure.

Several arguments weigh in favor of adopting anti-deficiency legislation for residential mortgage loan borrowers and strengthening the protections in states, like California, where there are notable gaps in the protective measures. Lenders should assume a larger proportion of the accompanying risks of residential mortgage loans for several reasons. Lenders are instrumental in creating loan products.[173] Lenders are better situated to appreciate and monitor economic markets and downturn risks in relation to their loan products.[174] The sophisticated banking industry, of which lenders are a part, is the central driver producing deficiencies and profits.[175] Lenders can more easily absorb the losses associated with loan defaults and foreclosure.[176]

### A. *Lenders are in a Better Position than Borrowers to Evaluate the Risks of the Market*

Lenders are in a better position to appreciate the many risks associated with lending and home ownership.[177] Lenders are skilled in or work with professionals who are trained in the practice of assessing risk.[178] In particular, they engage in the practice of evaluating the risks associated with the mortgage loan transaction.[179] Borrowers, as a group, do not fit this description.

Risk is made up of several factors. Many borrowers do not fully appreciate the risks associated with purchasing a house.[180] First, the expectations of the

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171. *See* Amy Hoak, *Top 10 Cities Where Foreclosure Rates Are Highest*, MARKETWATCH (Jan. 27, 2011, 12:01 AM), http://www.marketwatch.com/story/top-10-cities-where-foreclosure-rates-are-highest-2011-01-27; *see also* Ryan Allen, *Who Experiences Foreclosures? The Characteristics of Households Experiencing a Foreclosure in Minneapolis, Minnesota*, 26 HOUSING STUD. 845, 845–46 (2011) (stating that residential properties in the foreclosure process more than tripled from 1 percent to 3.3 percent).

172. *See generally* Melissa B. Jacoby, *The Value(s) of Foreclosure Law Reform*, 37 PEPP. L. REV. 511 (2010) (providing a helpful summary and review of the traditional foreclosure law scholarship).

173. *See* Singer, *supra* note 3, at 502 (stating that the bankers are responsible for issuing loan documents).

174. *See id*.

175. *See id*. at 501.

176. *See id*. at 537.

177. *See id*. at 501, 507 (citing Alan M. White, *Losing the Paper—Mortgage Assignments, Note Transfers and Consumer Protection*, 24 LOY. CONSUMER L. REV. 468, 471 (2012)).

178. *See id*. at 508 (citing KATHLEEN C. ENGEL & PATRICIA A. MCCOY, THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS 50 (2011)).

179. *See id*. (citing ENGEL & MCCOY, *supra* note 178, at 48).

180. *See* Stark, *supra* 19, at 134.

borrower and the mortgage lender are an intangible part of the mortgage loan.[181] The borrower has expectations that either the value of the house purchased will remain constant or rise over the life of the loan.[182] Generally, the homebuyer is not contemplating the possibility that the U.S. economy will experience a severe economic crisis along with a widespread decrease in home values.[183] The housing market industry fosters this belief.[184] That is, brokers, lenders, appraisers, and the government promote the idea that "you can't lose with home ownership because the home is a stable, tangible asset that will appreciate in value over time," and the widely held belief that "you would be a fool not to purchase a home to take advantage of the ever rising housing values."[185] There was also the view that if one was renting one was throwing away one's money because at the end of one's rental term one would have no asset to show for it.[186] To the extent that this network of real estate professionals and the government are complicit in creating the perception that there is very little at stake in homeownership,[187] the devastating losses that result when the bubble bursts should fall more heavily on the lending industry. Prohibiting deficiency judgments in residential mortgage loan transactions will place some of the risk associated with such loans on lenders, where it belongs.

Second, the risk calculation also includes the likelihood of being able to refinance or modify the loan. If a loan will be packaged along with other mortgage-backed securities and sold, the borrower's ability to refinance may be severely restricted.[188] If the borrower needs to negotiate with the entity that

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181. *See* Singer, *supra* note 3, at 558–59.

182. *See id*. at 507–08 (citing ENGEL & MCCOY, *supra* note 178, at 10).

183. *See id*. at 502.

184. *See id*.; *see also* Christopher L. Peterson, *The Political Economy of Consumer Credit Securitization: Comparing Predatory Lending in Home Finance in the US, UK, Germany and Japan*, *in* CONSUMER CREDIT, DEBT AND BANKRUPTCY: COMPARATIVE AND INTERNATIONAL PERSPECTIVES 32, 47 (Johanna Niemi et al. eds., 2009) (illustrating the deceptive tactics and "unrealistically underwritten" financial plans lenders used on buyers that helped sustain the housing bubble and an "aggregate illusion of appreciation"); Denning, *supra* note 83 (providing a brief background of the 2008 financial crisis).

185. The hypothetical quotes are analogous to typical statements a lender would make to a borrower to promote homeownership. *See* Peter W. Salsich, Jr., *Homeownership–Dream or Disaster?*, 21 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 17, 25–27 (2012) (citations omitted) (discussing the promotion of homeownership in U.S. housing policy over decades); *see also* Godsil & Simunovich, *supra* note 8, at 956–57 (providing a historical outline of the federal government encouraging and subsidizing homeownership). *See generally* Lawrence J. Vale, *The Ideological Origins of Affordable Homeowership Efforts*, CHASING THE AMERICAN DREAM: NEW PERSPECTIVES ON AFFORDABLE HOMEOWNERSHIP *supra* note 54, at 15–40 (providing an assessment of the origins of affordable homeownership efforts and goals).

186. *See* Godsil & Simunovich, *supra* note 11, at 970 (citing IRENE HARDILL, GENDER, MIGRATION AND THE DUAL CAREER HOUSEHOLD 48 (2002)).

187. *See* Salsich, *supra* note 185, at 25–27 (citations omitted) (pointing out instances of federal support for homeownership).

188. *See* Amy Feldman, *Foreclosure Nation*, COLUMBIA L. SCH. MAG., (Summer 2011), http://www.law.columbia.edu/magazine/5994/foreclosure-nation (discussing the limitations when relying upon mortgage servicers to modify existing loans).

holds the note, the borrower will not be able to because the lender will state that it is just the servicer, without any authority to renegotiate the loan terms.[189] To the extent that lenders have the ability to either grant the request to renegotiate the loan terms or facilitate the process of mortgagors renegotiating terms with third parties, lenders can more effectively guard against the occurrence of loan defaults.[190] Lenders have participated in perpetuating certain narratives about the loan process, such as the ease of refinancing or modifying a loan, and what the loan experience will be over the course of a loan.[191] For example, if the loan with which a borrower starts is not as favorable as the borrower wishes, lenders and mortgage brokers cultivate the belief that the "starter loan" is not immutable and can be exchanged for a loan with more favorable terms, such as a one with a lower fixed interest rate.[192] Related to this narrative is the idea that not only will it be possible to make an exchange but it will be fairly quick and painless to do so—that is, not expensive and not unduly burdensome, in terms of completing the paperwork necessary to accomplish the goal. The mortgagee might go even further in attempting to discourage the mortgagor from pursuing any means of modifying the loan.[193] This inflexibility is part of the risk that many mortgagors do not fully appreciate but of which mortgagees are well aware because they are

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189. *See id*.

190. There is no guarantee that lenders would be successful in assisting in the renegotiation of the terms of mortgage loans on behalf of mortgagors even if they were willing to do so. However, if the mortgage loan has been sold into the secondary market, lenders have a better chance at renegotiating the terms than mortgagors who have no access to the investors of their loans.

191. *See* Singer, *supra* note 3, at 502–503; *see also* Peterson, *supra* note 184, at 47 ("Brokers commonly encouraged debtors to buy debts with teaser pricing, explaining away any concerns with the rationale that 'you can just refinance later.'"); Ruth Simon & James R. Hagerty, *Mortgage Mess Shines Light on Broker's Role: Job-Hopping Mr. Shaikh Left Trail of Lawsuits, Failed License Exams*, WALL ST. J., July 5, 2007, at A1, *available at* http://online.wsj.com/news/articles/SB118360072311457784 ("As business surged, some brokers put borrowers into loans they didn't understand, couldn't afford or were otherwise ill-suited for, one reason defaults have skyrocketed.").

192. While perhaps not all lenders and brokers engaged in this practice leading up to the 2007 economic crisis, there is sufficient evidence to suggest that the practice was widespread throughout the lending industry. *See* Antje Berndt, Burton Hollifield, and Patrik Sandas, *The Role of Mortgage Brokers in the Subprime Crisis*, (Nat'l Bureau of Econ. Research, Working Paper No. 16175, 2010) *available at* http://www.nber.org/papers/w16175; s*ee* Simon & Hagerty, *supra* note 191, at A12; Alistair Barr, *Subprime Crisis Shines Light on Mortgage Brokers*, MARKETWATCH (Apr. 10, 2007, 11:30 AM), http://www.marketwatch.com/story/subprime-crisis-shines-spotlight-on-mortgage-broker-practices (noting that many home mortgage brokers failed to disclose important and costly details of the new loan.

193. A number of scholars have analyzed the impediments to the refinance and loan modification processes. *See* Schill, *supra* note 37, at 520. In some situations the modification either does not provide adequate relief—for example, the interest rate on the debt is still too burdensome for the mortgagor—or the mortgagor is not granted a loan modification even when it is in the interest of the lender because of a failure of the mortgagor to abide by some technicality. *See generally* Feldman, *supra* note 188.

dictating the terms.[194] Mortgagors have no control over whether they will in fact have an opportunity to undertake the aforementioned types of foreclosure preventative measures.[195] Despite any promises made in connection with the initial loan transaction and the mortgagor's reliance upon those statements, the mortgagor may find that in times of financial crisis the comforting words offered by the lender and broker were just empty promises rather than loan terms. If a borrower facing substantial financial difficulties with no other access to capital is unable to refinance or modify his loan it means that the risk of foreclosure is elevated.

A third aspect of risk concerns the mortgage loan products themselves. Lenders are instrumental in developing and promoting loan products—such as adjustable rate mortgages, subprime mortgages, and negatively amortized loans—which lenders and mortgage loan brokers then peddle to potential borrowers.[196] Borrowers are more likely to default on these loans.[197] Lenders have a sense of the costs and benefits of the loans, and their potential to perform in the mortgagee's favor because they created them. The mortgagor, on the other hand, is likely to be someone who is new to the loan products, and, therefore, may be tempted to rely upon the lender's or broker's explanation of the unconventional loans.[198]

Another aspect of risk in the home loan context is that the lender, at times, is betting that the borrower, ultimately, will not be able to pay the loan the lender is willing to advance.[199] How many mortgagors enter into their loans considering

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194. *See* John W. Schoen, *Bank of America Former Employees: 'We Were Told to Lie'*, NBCNEWS.COM (June 17, 2013, 3:29 PM), http://www.nbcnews.com/business/suit-bank-america-paid-bonuses-foreclosures-6C10351458 (reporting on allegations that bank employees routinely denied qualified borrowers the chance to modify their loans); *see also* Shaila Dewan, *Monitor Finds Mortgage Lenders Still Falling Short of Settlment's Terms,* N.Y. TIMES (June 19, 2013), http://www.nytimes.com/2013/06/20/business/economy/monitor-finds-lenders-failing-terms-of-settlement.html?pagewanted=all&module=Search&mabReward=relbias%3As%2C%7B%222%22%3A%22RI%3A12%22%7D&_r=0 (reporting that four of the five major mortgage lenders are still failing to communicate with borrowers and therefore creating frustrations the loan modification process).

195. *See* Schoen, *supra* note 194 (reporting on allegations that bank employees routinely denied qualified borrowers the chance to modify their loans).

196. *See* Singer, *supra* note 3, at 502–03; *see also* Christopher L. Peterson, *Predatory Structured Finance*, 28 CARDOZO L. REV. 2185, 2214–15 (2007) (citing Michael D. Larson, *It's Buyer Beware When You're Shopping for a Subprime Loan*, BANKRATE (Feb. 2, 2001), http://www.bankrate.com/brm/news/mtg/20000420.asp (explaining how subprime mortgage lenders have more leeway in dictating the terms of their instruments resulting in "predatory lending").

197. *See* Jacoby, *supra* note 31, at 2269 (discussing the availability of empirical research establishing a connection between the type of mortgage loan and delinquency rates).

198. These loans are unconventional in that they depart from the standard fixed-rate 30-year mortgage.

199. Debra Stark notes that in the predatory loan context, a lender may advance a loan even if in the lender's estimation the borrower will not be able to repay it but "the lender is counting on the borrower's equity in the property to become whole after the borrower defaults (commonly referred to as "equity stripping")." Stark, *supra* note 19, at 134. Stark explains this practice of why a lender, essentially, would position itself against the borrower as follows:

that potential factor? If mortgagors viewed their transaction from this perspective, they might discount more heavily the statements that a lender or broker makes to them regarding their loans.

Given that lenders are in a stronger position to assess the range of risks that accompany real estate transactions, particularly in this era of sophisticated real estate vehicles and real estate-backed securities markets that interact on a global level, the risks should fall more heavily on lenders. Placing the lion's share of the risk on lenders is in accordance with addressing moral hazard. Moral hazard refers to the"[l]ack of incentive to guard against risk where one is protected from its consequences."[200] Scholars and commentators have raised concerns about moral hazard in connection with lenders and borrowers.[201] Some economists propose, as a way to address moral hazard, that risk should be allocated to the "low cost risk avoider" who is defined as "the party who is better able to reduce the probability or cost of losses."[202] As this piece argues in the following sections, lenders satisfy the low cost risk avoider definition in all respects.

### *B. Lenders are an Integral Part of the Industry that Produces Deficiencies*

The burdens of the mortgage loan transaction should fall more heavily on lenders because lenders are an integral part of the machinery that helps to produce deficiencies.[203] Lenders control capital.[204] Their decisions and actions

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> The answer relates to the 'atomization' of loans over the past ten years. Most loans today are arranged by mortgage brokers who earn their fees when the loans close. The mortgage brokers are not affected when the borrower defaults on some date after the loan has closed, and so they will continue to market unaffordable loans as long as they keep making money from such borrowers. The lender who initially makes the loan usually sells the loan to a mortgage loan pool and will not face the consequences of a likely future default. Even the ultimate assignee of the loan pool is protected, since the loan was given to a borrower with sufficient equity in the property so that when the assignee forecloses it can recover the principal paid and retain all of the higher interest paid prior to the default.

*Id*. at 138 n.39.

This analysis assumes that the overextended borrower will make enough payments on the loan to have equity in the property. *See* Peterson, *supra* note 184, at 47.

200. OXFORD DICTIONARIES, http://www.oxforddictionaries.com/us/definition/american_english/moral-hazard (last visited Sept. 11, 2014).

201. *See Inside the Meltdown* (Frontline television broadcast Feb. 17, 2009), *available at* http://www.pbs.org/wgbh/pages/frontline/meltdown/view/.

202. Scott Masten, Professor, Univ. of Mich. Ross Sch. Of Bus., Agency Costs, Transaction Costs, and the Theory of the Firm, Presentation at Twenty-Ninth Economics Institute for Law Professors (July 15–16, 2013), at 23 (discussing contract design).

203. This Article does not claim that lenders are wholly responsible for market fluctuations leading to rapid declines in home prices. There may be numerous factors that contribute to borrowers defaulting on their mortgages.

204. *See* Mixon, *supra* note 8, at 9.

impact the probability that losses will occur in the housing market.[205] In order for an individual to acquire financing from a lender, the potential borrower must satisfy the conditions determined and imposed by the lender.[206] As part of the underwriting process, the lender is positioned to evaluate the borrower and the real estate that will serve as collateral for the loan.[207] As part of their assessment, lenders routinely require appraisals of the properties for which borrowers seek financing.[208] The appraisers must typically be selected from a lender-approved appraiser list.[209] Lenders participate in the network of professionals assigned to valuing property, and they have a deeper understanding of home pricing and valuation methods.[210]

Unless an individual is an appraiser, is in a business related to the valuation of real estate, or is a knowledgeable real estate speculator, it is unlikely that the individual will be schooled in the "science" of valuing property. Individuals, most likely, will have available to them comparable sales information provided by their real estate broker, and, perhaps, the seller's broker; anecdotal information about sale prices of properties in the area; anecdotal information about how a property has performed over time as an asset that serves both the functionality component of providing a place to live and the economic goal of allowing for wealth accumulation if the asset appreciates over time; information available from the media about neighborhoods and property values; and their own subjective views based upon their observations of the neighborhood and its amenities—for example, quality of schools, location, and condition of the structures in the area.[211] Buyers may draw upon this information, but they will also be evaluating it from the emotional standpoint of having identified a property that they like and want to buy. Often the emotional component will

205. In 2008, Federal Reserve Chairman Ben Bernanke remarked:

> Because housing and mortgage markets are tightly interlinked with the rest of the economy, actions to strengthen financial markets and the broader economy are important ways to address housing issues. By the same token, steps that stabilize the housing market will help stabilize the economy as well.

Ben S. Bernanke, *supra* note 38.

206. *See* Hughes, *supra* note 3, at 128 (explaining that lenders have certain conditions a borrower must satisfy in order for the lender to have a secure loan).

207. *See id.* ("[A] more obvious incentive for the lender would be to negotiate for and lend at the lowest possible loan-to-value ratio.").

208. *See id.* at 128 n.73 (quoting Washburn, *supra* note 34, at 843).

209. *See id.* (quoting Washburn, *supra* note 34, at 843).

210. *See* Mixon, *supra* note 8, at 52 n.198 (noting that "[t]he lender is the professional and knowledgeable party in the transaction who protects itself by requiring the borrower to pay for an appraisal that must meet the lender's requirements. The lender will refuse to lend if the appraisal does not justify the loan").

211. *See* Karen M. Gibler & Susan L Nelson, Consumer Behavior Applications to Real Estate 20 (Apr. 1998) (paper presented at the American Real Estate Society meeting).

have substantial sway over the buyer's decision to purchase.[212] Regarding the other information, the buyer is likely to rely, to some extent, upon the interpretation of the pricing data offered by real estate professionals.[213]

Lenders also will have an arsenal of information available to them, which overlaps with that of the buyer's, save perhaps the anecdotal and personal view information. In contrast to buyers, however, lenders will assess this information from the professional vantage point of being in the business of making loans to finance the acquisition and disposition of real estate. Lenders engage in the professional actions of making determinations, not only about the creditworthiness of individuals requesting mortgage loans, but also the value-worthiness of the property.[214] While lenders also can make mistakes regarding their evaluations of the payment performance of individuals and the value of properties, the losses should nonetheless fall more heavily on them because they have the final say regarding whether to advance a loan for the property being contemplated for purchase. This powerful position means they are responsible for making sound determinations as to the "worthiness" of the property.[215] The lender is interested in making money.[216] Therefore, the lender's evaluation of the information regarding whether to finance a real estate purchase will not be from an emotional viewpoint, but from an objective one. Presumably, from this objective vantage point, the flaws regarding the valuation of the property and market conditions will be more apparent than they would be to a potential borrower. Also, as noted in the previous section, lenders sometimes make an accurate assessment about the real estate and the borrower—that is, that the

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212. *See* Karl E. Case & Robert J. Schiller, *Is There A Bubble in the Housing Market?*, 2:2003 BROOKINGS PAPERS ON ECON. ACTIVITY 299, 314 (2004) (concluding in connection with surveys of homebuyers regarding a 1988 housing bubble "that emotion and casual word of mouth played a significant role in home purchase decisions"). *See generally* Gibler & Nelson, *supra* note 211, at 314 (providing analysis on consumer behavior in real estate transactions).

213. *See* Gibler & Nelson, *supra* note 211, at 5 (citing James R. Bettman & Mita Sujan, *Effects of Framing on Evaluation of Comparable and Noncomparable Alternatives by Expert and Novice Consumers*, 14 J. CONSUMER RES., 141, 142 (1987) (concluding that "[f]irst time buyers are more susceptible to external influences determining what criteria they use during decision-making").

214. Who the lender is investing in when making a decision to advance a residential real estate loan has been a matter of contention. Scholar James Hughes takes the position that the lender invests in the purchaser of the real estate not in the real estate itself and, therefore, if the real estate declines in value and the purchaser suffers a financial setback and is unable to continue paying the mortgage, the purchaser should shoulder the losses not the lender. *See* Hughes, *supra* note 3, at 132 (citing Provident Bldg. & Loan Ass'n v. Pekarek, 3 N.E.2d 983, 984 (Ohio Ct. App. 1936)). In contrast to Hughes, this Article takes the position that lenders are investing in both the purchaser and the property. The lender's request for an appraisal and the requirement that the lender approve the appraisal suggests that the lender is taking steps to verify that the amount advanced for the loan is reasonable in light of the value of the property. This suggests that the lender is making a calculated investment in the property not just the person applying for the loan.

215. *See id*. at 127 (stating that risk shifting statutes are justified to "prevent mortgagees from intentionally lending more money than the value of the mortgagor's property would justify").

216. *See* Singer, *supra* note 3, at 507, 514–15, 559.

borrower will likely default on the loan—but they choose to advance the financing anyway.

Lenders are the drivers in setting the underwriting standards.[217] In the period leading up to the present financial crisis, many mortgagees were lax in adhering to the underwriting standards in place.[218] They routinely failed to question improbable property valuations.[219] Lenders offered loans based upon higher valuations, possibly ignoring data that they had available on properties and geographic regions.[220] Borrowers relied upon those valuations and accepted the loans.[221] As the market began to collapse, many lenders changed course and resorted to following stricter standards in their request for and review of property appraisals.[222] In following these stringent standards, lenders often denied requests to refinance by claiming that property values have fallen. The lenders' involvement in ratifying the values of the appraisers impacts a whole chain of events. If the property does not appraise for a certain amount, the lender is unlikely to permit the borrower to structure a lower monthly payment through refinancing.[223] The inability to refinance could lead to the borrower's default, which would be followed by the mortgagee foreclosing on the property. The foreclosure then places the borrower in the position of potentially having to deal with a deficiency if the foreclosure sale price does not satisfy the outstanding balance. In this chain, it is evident that lenders are instrumental in helping to produce deficiencies. Judging from the current Great Recession, lenders played

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217. *See id.* at 509.

218. *See id.* at 509–10; *see also* Peterson, *supra* note 196, at 2214 (citing Larson, *supra* note 196) (discussing how there were certain underwriting standards in place and certain mortgagees were not following them).

219. *See* Singer, *supra* note 3, at 510–11.

220. *See* Mixon, *supra* note 8, at 52 n.198 (explaining that "[l]enders have knowingly participated in (and even encouraged) sale-facilitating inflation of housing prices to include loan discounts, brokerage fees, and other costs that reflect cost of financing an do not add to (or even reflect) the value of a house in a cash market").

221. *See* Singer, *supra* note 3, at 537.

222. In commenting on housing markets and the weak economy, Federal Reserve Chairman Ben Bernanke remarked that, as residential mortgage delinquencies become more prevalent in 2006, "lenders tightened standards on higher-risk mortgages as secondary markets for those loans ceased to function." Bernanke, *supra* note 38.

223. Chairman Ben Bernanke explained how lenders' actions served to further deepen the economic crisis:

> When house prices were rising, higher-risk borrowers who were struggling to make their payments could refinance into more-affordable mortgages. But refinancing became increasingly difficult as many of these households found that they had accumulated little, if any, housing equity. Moreover, lenders tightened standards on higher-risk mortgages as secondary markets for those loans ceased to function.

*Id.*

an integral role in creating the problem.[224] Consequently, they should not be able to reap the benefits of the crisis at the expense of borrowers. Adopting an anti-deficiency law is a positive step towards preventing a crisis that imperils homeowners in the way described.

### *C. Lenders Can Better Absorb the Losses of a Declining Housing Market*

Lenders are better able to absorb the losses of a declining housing market than borrowers.[225] If lenders know that deficiency judgments are not a viable option to recuperate portions of the outstanding loan balance, they will take whatever precautions necessary to account for the loss of the remedy.[226] The lending industry will devise a means to address the loss.[227] Lenders, as a group, have access to more capital and broader markets—for example, sector markets such as insurance and international markets—than individual borrowers.[228] This access to other economic sectors provides opportunities to spread the costs for losses.[229] As a sophisticated group, lenders should be able to figure out the best price points to keep mortgage loans affordable so that they will be available to a broad range of individual borrowers.[230] For these reasons, lenders are the low cost risk avoiders.

## V. ANALYSIS AND CRITIQUE OF ARGUMENTS AGAINST ANTI-DEFICIENCY LAWS

The positions advanced in this paper challenge the conventional contract law model which holds freedom of contract sacred. The functions of the contract are to "shift risk" to the "low-cost risk bearer," "align . . . incentives," and "reduce various costs of transacting . . . in transactions supported by relationship-specific investments."[231] The arguments against deficiency judgments assert that anti-deficiency laws interfere with these primary contract functions and do not result in the most efficient outcomes.[232] The main arguments are that: (i) permitting remedies that the parties failed to negotiate undermines the contract as an efficient and reliable tool for encapsulating parties' obligations to each other and

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224. *See generally* Singer, *supra* note 3, at 506–10 (citations omitted) (providing background on the actions of subprime mortgage lenders which led to the housing crisis).

225. *See* Emily Gildar, Comment, *Arizona's Anti-Deficiency Statutes: Ensuring Consumer Protection in a Foreclosure Crisis*, 42 ARIZ. ST. L.J. 1019, 1024 (2010).

226. *See* Mixon & Shepard, *supra* note 9, at 462–63.

227. *Id.*

228. *See* Gildar, *supra* note 225, at 1025–26.

229. *Id.*

230. *Id.*

231. Scott E. Masten, *Contractual Choice*, *in* 3 ENCYCLOPEDIA OF L. AND ECON. 25, 26–27 (Boudewijn Bouckaert & Gerrit De Geest ed., 2000), *available at* http://encyclo.findlaw.com/4100book.pdf (citations omitted).

232. *See* Hughes, *supra* note 3, at 117.

the projected economic outcomes of their exchange;[233] (ii) the borrower's failure to follow through on the borrower's promises is morally and ethically wrong;[234] (iii) mortgagors should bear any losses associated with their purchases just as they reap the benefits of any appreciation in their property values because they are charged with assessing the risks of their purchase;[235] (iv) there are better alternatives available to protect consumers that are less costly and burdensome to lenders;[236] and (v) enacting anti-deficiency legislation will ultimately hurt middle and low income home purchasers because lenders will increase the price of mortgage loans to provide some cushion to protect themselves from the possibility that borrowers will walk away when their home values fall below the balance of their mortgage loans ("underwater borrowers").[237]

As the following discussion demonstrates, anti-deficiency laws serve the goals of the contract in that the protection is geared toward better and more efficient outcomes for borrowers and lenders.

### *A. Contracts and Anti-Deficiency Legislation*

The first argument against anti-deficiency laws is rooted in the view that contracts are an effective and stable means for structuring exchanges.[238] Scholars in this camp espouse the view that freedom of contract without government interference should be promoted because it permits those who are most knowledgeable about their positions and interested in the outcomes of their interactions to negotiate the terms of their agreement.[239] Legal scholar Richard Posner, writing from a law and economics perspective, asserts that "[t]he most important function of contract law is to provide a legal remedy for breach in order to enhance the utility of contracting as a method of organizing economic activity."[240] Governmental interventions, such as anti-deficiency laws, rarely if ever, should be permitted because allowing remedies for which the contractual parties did not negotiate for weakens the contract instrument as a vehicle to structure the contours of an exchange.[241] Anti-deficiency legislation is viewed as

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233. *See* Talley, *supra* 31, at 1196.

234. Hughes, *supra* note 3, at 117.

235. *Id*. at 129

236. *See id*. (arguing that bankruptcy is an appropriate alternative to anti-deficiency legislation).

237. Todd J. Zywicki & Joseph D. Adamson, *The Law and Economics of Subprime Lending*, 80 U. COLO. L. REV. 1, 29 (2009) (discussing the strength of the incentive to walk away in states with anti-defencieny legislation).

238. Richard Posner, *The Law and Economics of Contract Interpretation*, 83 TEX L. REV. 1581, 1582 (2005) ("The main purpose of contracts is to enable performance to unfold over time without either party being at the mercy of the other as would be the case if, for example, a buyer could refuse to pay for a custom-built house for which there were no alternative buyers at or above the agreed price.").

239. *See* Hughes, *supra* note 3, at 146–47.

240. *See* Posner, *supra* note 238, at 1582.

241. *See* Hughes, *supra* note 3, at 120.

counter to the public policy goal of deterring individuals from breaching their contractual obligations because it signals to borrowers that there are no serious consequences to their actions.[242] In order to ensure that contracts have integrity and discourage mortgagors from engaging in this conduct, lenders argue that contractual terms must be strictly enforced and the remedies available to lenders to motivate compliance should not be curtailed.[243] Adopting this approach fosters society's willingness to rely on the contract by providing assurance that the terms that have been so carefully negotiated will be adhered to by the parties.[244] This Article challenges the foregoing position. As argued in the following sections, when the government offers consumers financial protection in the form of anti-deficiency laws, rather than undermining contracts, it helps to address the inherent inequities of mortgage loan transactions and permits borrowers to make rational choices regarding their loans in good times and in times of severe economic downturn.

### *B. Strategic Defaults and Anti-Deficiency Laws*

A troubling prospect to staunch freedom of contract advocates is that anti-deficiency statutes are likely to encourage strategic defaulters.[245] Strategic defaulters are individuals who walk away from their payment obligations in times of economic crisis and substantially declining home values.[246] Lenders maintain that they need deficiency judgments as a disincentive to strategic defaults.[247]

#### *1. There are already Deterrents in Place to Discourage Strategic Defaults*

As an initial matter, it is necessary to explain the term "strategic defaulter" in more detail. A strategic defaulter is a borrower who has the financial resources to continue making his monthly mortgage loan payments but chooses, once the market value of the mortgaged property falls below the mortgage loan amount, to stop making payments, thereby defaulting on his loan.[248] Strategic

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242. *See id.*

243. *See id.* at 147.

244. Jacoby, *supra* note 31, at 2267 (commenting on the current mortgage lending structure and the expectations that there is "a reliable system of contract enforcement against borrowers who default.").

245. Zywicki & Adamson, *supra* note 237, at 29.

246. *See* Dov Solomon & Oelia Minnes, *Non-Recourse, No Down Payment and the Mortgage Meltdown: Lessons from Undercapitlization*, 16 FORDHAM J. CORP. & FIN. L. 529, 531 (2011).

247. Salsich, *supra* note 185, at 30 (discussing lenders' choice to pursue foreclosure with all of its attendant rights, rather than opting to agree to the cheaper alternatives of deeds in lieu of foreclosure or short sales, in order to discourage strategic defaults).

248. Mortgagors in this position are alternatively referred to as "underwater borrowers" or borrowers who have negative equity in their homes. Legal scholar Grant Nelson notes that banks

defaulters sometimes engender less empathy because "technically" they can afford to pay but decide not to.[249] Lenders highlight this group as the reason why deficiency judgments and rigorous contractual enforcement are necessary.[250] The detractors fail to appreciate that there are rational reasons to support a borrower's choice to stop paying on his mortgage loan.[251] Some of the reasons include the borrower's desire to rededicate capital toward saving for the borrower's children's education, or for retirement, or for elder care. The borrower may wish to invest in better performing wealth accumulation instruments. The borrower's frustration regarding the inability to refinance his loan to receive a lower rate and the borrower's calculation regarding the house's current value in comparison with the loan amount and the likely time period needed for the property to climb back to its value at the time of the borrower's purchase are also likely to factor into a decision to default.[252] The borrower makes this strategic decision, surrendering the asset of the house, in the hope that this will serve to bring finality to the settling of his debt with the mortgagee.[253] This is a rational choice, given the circumstances.

Disregarding the reasons a mortgagor may choose to default on his mortgage, opponents of anti-deficiency laws emphasize that the strategic defaulter willingly entered into an arms-length contract with a lender, agreed to the terms established, and has the financial wherewithal to continue fulfilling the contract but simply opts not to do so.[254] From their view, if society fails to penalize this person it is equivalent to saying that one's contractual promises don't matter.[255] This Article disagrees for equity and efficiency reasons. Property law has, at times, departed from strict adherence to the terms of a real estate transaction, relying instead upon equity to address the inherent unfairness

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have precisely defined the term "strategic defaulters" as borrowers who abruptly change from being current on their mortgage to 180-days late "'while staying current on *all* their non-real estate debt obligations, 6 months after they first went 60 [days late] on their mortgage.'" Nelson & Serbulea, supra note 11, at 66 n.6. (quoting Brent T. White, *Take This House and Shove It: The Emotional Drivers of Strategic Default*, 63 SMU. L. REV. 1279, 1284 (2010). The definition of strategic defaulter matters. Just because a borrower manages to continue paying on his other debts after defaulting on his mortgage loan does not mean that he has the financial resources to make ongoing loan payments. A plausible reading of a borrower who behaves in this manner is that he is trying to honor his debt obligations to the best of his ability with the financial resources he has available to him.

249. *See id*. at 67 (citing James R. Hagerty & Nick Timiraos, *Debtor's Dilemma: Pay the Mortgage or Walk Away*, WALL ST. J., Dec. 17, 2009, at A22).

250. *See* Sichelman, *supra* note 12.

251. *See id*.

252. *See* White, *supra* note 248, at 1291–95.

253. *See id*. at 1308–09.

254. *See* Hughes, *supra* note 3, at 120.

255. *See id*. at 123 (citing MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY (10th ed. 2002), *available at* http://www.merriam-webster.com/dictionary/mulligan) (arguing that consumer protections (e.g. statutory redemption or antideficiency measures) that are external to the contract entered into by parties are "'mulligans' which permit mortgagors to avoid some of the negative consequences of bad luck, their own faulty decision making, or irresponsibility").

of a situation.[256] There are already penalties that the property owner suffers in defaulting on the mortgage loan. Relinquishing one's house comes at significant cost to the mortgagor.[257] The costs include the loss of the asset, the loss of the possibility of recovering any equity the mortgagor has in the property, potential federal tax liability, the emotional aspects of losing one's property, the costs of relocation for those who were occupying the relinquished asset, and the costs to one's credit score.[258] These costs already operate as deterrents to walking away from an underwater property.[259] Imposing additional costs on borrowers eclipses their ability to be active consumers.[260] Ultimately, this outcome negatively impacts lenders who would benefit from stable economies and financially engaged consumers, who are willing and able to purchase homes.[261] In the face of the disincentives, if a mortgagor decides that it makes more sense to turn the asset over to the mortgagee than to continue paying on a property that is unlikely to ever return to the price level the mortgagor purchased it at, then should not society support this type of rational decision? American society permits businesses to engage in the rational behavior of the efficient breach of contracts in the business context.[262] Applying this logic to residential mortgage loans, it makes sense to have a law that permits mortgagors to engage in rational conduct that leads to more efficient results.

#### 2. *Targeting Strategic Defaulters in Setting Policy Results in a Misallocation of Risk*

The empirical evidence available does not establish that anti-deficiency laws lead to a higher rate of defaults.[263] According to the evidence, no particular category of borrowers—that is, non-recourse or recourse—are more likely to default when their home values fall below the amount owed on their mortgage

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256. *See* Bean v. Walker, 464 N.Y.S.2d 895, 897–98 (N.Y. App. Div. 1983) (citing N.Y. REAL PROP. ACTS. LAW § 1301–91) (following the equity maxim, "equity deems done that which ought to be done" and holding that despite the language of the contract that provides for remedies allowing the seller on a land installment contract to terminate the contract, keep the payments made by vendee to date, and reclaim possession of the property, equity requires that the seller institute foreclosure proceedings in order to extinguish the buyer's equitable interest).

257. *See* Mixon & Shepard, *supra* note 9, at 464–65.

258. *See id.*

259. *See* Brent T. White, *Underwater and Not Walking Away: Shame, Fear, and the Social Management of the Housing Crisis*, 45 WAKE FOREST L. REV. 971, 972 (2010).

260. *See id.* at 1022.

261. *See id.* at 1020–21.

262. Black's Law Dictionary defines "efficient breach" as a strategy that "allow[s] [a party] to breach a contract and pay damages, if doing so would be more economically efficient than performing under the contract." BLACK'S LAW DICTIONARY 592 (9th ed. 2009). *See* Robert Birmingham, *Breach of Contract, Damage Measures, and Economic Efficiency*, 24 RUTGERS L. REV. 273, 284–86 (1970) (quoting Addison Mueller, *Contract Remedies: Business Fact and Legal Fantasy,* 1967 WIS. L. REV. 833, 835. *See also* Lake River Corp. v. Carborundum Co., 769 F.2d 1284, 1289 (7th Cir. 1985) (discussing efficient breaches).

263. Ghent & Kudlyak, *supra* note 26, at 3140.

loans.[264] Scholars Andra Ghent and Marianna Kudlyak acknowledge that "[u]nconditionally, there is no difference between the default rates in recourse and non-recourse states" and that "[r]ecourse does not have a statistically significant effect on the default rate."[265] Another study draws a similar conclusion that the threat of a deficiency judgment does not result in a decrease in the number of defaults and foreclosures.[266] In deciding on the appropriate policy, one cannot draw sound conclusions merely by comparing foreclosure rates in California (non-recourse) and Illinois (recourse). There is a high foreclosure rate in California,[267] which has anti-deficiency laws, but there are also high foreclosure rates in other states, such as Illinois,[268] which do not have anti-deficiency statutes. Based upon that data alone, it does not follow that a greater percentage of the foreclosures in California are attributable to so-called strategic defaults, rather than to circumstances under which people could not afford to continue making their mortgage payments and, as a result, ended up defaulting.

Deficiency judgments and strategic defaulters are presently the focus of significant research activity.[269] The heightened attention can be explained, in part, by lenders and their lobbyists seeking concrete evidence to establish that changing mortgage laws in a way that benefits borrowers will invite massive defaults in times of economic crisis because there is no penalty in place to

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264. Luisi Guiso, Paola Sapienza, & Luigi Zingales, *Moral and Social Constraints to Strategic Default on Mortgages*, 3 (Nat'l Bureau of Econ. Research, Working Paper No. 15145, 2009) ("assuming that a homeowner [in a non-recourse state] will default as soon as his home equity becomes negative is clearly wrong."). Ghent & Kudlyak, *supra* note 26, at 3140.

265. Ghent & Kudlyak, *supra* note 26, at 3140. Ghent and Kudlyak note that "states that allow recourse for lenders do not have fewer defaults." *Id.* at 3149.

266. *See* Feldman, *supra* note 188, at 41.

267. For example, Riverside-San Bernadino, California was "fifth highest among the nation's 20 largest metro[]" areas with the highest foreclosure rates in October 2013, with "one in every 531 housing units with a foreclosure filing." *U.S. Foreclosure Activity Increases 2 Percent in October Driven By Continued Rise in Judicial Auctions*, REALTYTRAC (Nov. 12, 2013), http://www.realtytrac.com/content/foreclosure-market-report/october-2013-us-foreclosure-market-report-7934.

268. According to RealtyTrac, Illinois numbered among the five states with the highest foreclosure rates in October 2013 with "one in every 552 housing units" in some state of foreclosure. Chicago "rank[ed] third highest among the 20 largest metro areas nationwide" in that same month with one "in every 427 Chicago-area housing units" experiencing "a foreclosure filing [in October]." *Id*. Florida had the highest foreclosure rate in the nation in October 2013 with "one in every 332 housing units" having foreclosure filings totaling approximately "26,962 Florida properties." *Id*.

269. *See* Michael Wilkerson, Mortgage Default in Southern California: Examining Distressed Borrower's Decision Making and Market Contagion, (Ph.D dissertation, Claremont College), (2012) *available at* http://scholarship.claremont.edu/cgu_etd/35; Christopher J. Mayer, Edward Morrison, Tomasz Piskorski, & Arpit Gupta, *Mortgage Modification and Strategic Behavior: Evidence from a Legal Settlement with Countrywide* 2 (Nat'l Bureau of Econ. Res., Working Paper No. 17065, 2011); Ghent & Kudlyak, *supra* note 26, at 3139. Guiso et al., *supra* note 264, at 2. *See also* David Streitfeld, *With No Help in Sight, More Homeowners Walk Away*, N.Y. TIMES, Feb. 3, 2010, at A1.

dissuade such behavior.[270] Identifying who is a strategic defaulter is not an easy task.[271] Nonetheless, there have been recent innovations in this area relying upon different strategies for designing an accurate model to extract data[272] or drafting a survey to capture the behavior of mortgagors. Researchers Ghent and Kudlyak conducted a study that is garnering attention.[273] They recognize that for *all* borrowers there is some point at which they will default on their loans if the value of their homes as compared to the outstanding loan balance drops to a certain level.[274] They then group borrowers according to the range of their home appraisal amounts—for example, $300,000–$500,000 or $500,000–$750,000.[275] Ghent and Kudlyak use "the appraisal amount . . . as a proxy for both the lender's amount of recourse and the borrower's financial means in general."[276] Based upon their study, they conclude that "recourse decreases borrowers' sensitivity to negative equity, i.e., recourse deters some borrowers with negative equity from defaulting."[277] They further conclude that:

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270. *See* Colin Robins, *Expansion of California's Anti-Deficiency Laws Means More Litigation for Creditors*, DSNEWS (Feb. 19, 2014, 10:01 AM), http://dsnews.com/news/02-19-2014/expansion-of-californias-anti-deficiency-laws-means-more-litigation-for-creditors/.

271. Determining whether a person is a strategic defaulter is not an easy assessment to make. As economists, Luisi Guiso, Paola Sapienza, Luigi Zingales, note:

> It is difficult to study the strategic default decision, because it is de facto an unobservable event. While we do observe defaults, we cannot observe whether a default is strategic. Strategic defaulters have all the incentives to disguise themselves as people who cannot afford to pay and so they will appear as non-strategic defaulters in all the data.

Guiso et al., *supra* note 264, at 4.

272. Without undertaking an extensive empirical study exploring what led each defaulted mortgagor to walk away from his property, it is difficult to say whether prohibiting deficiency judgments gives rise to more strategic defaults. To initiate such a study, it would be necessary to identify a pool of mortgagors who have defaulted on their mortgage loans. The researcher would need to examine each person's finances or rely upon survey responses to make the determination that the person could have paid but chose not to because there was no penalty attached to walking away beyond losing the house and the sunk costs that the individual put into the house via his down payment, past mortgage loan payments, and improvements. Guiso, Sapienza, and Zingales, constructed a survey based on hypothetical questions to ascertain what motivates a homeowner to default on his mortgage loan even though he has the financial ability to continue meeting his debt obligation. *See id*. As they observe, their study is not based upon what people have actually done, but upon what they say that they would do in certain situations. *See id* at 6. Their empirical study does not address the question of whether the absence of the deficiency judgment remedy leads to more strategic defaults as compared to states in which deficiency judgments are permitted.

273. *See generally* Ghent & Kudlyak, *supra* note 26.

274. *See id*. at 3154.

275. *See id*.

276. *Id*. at 3177.

277. *Id*. at 3140. Specifically, the authors present "estimates of the probabilities of default in recourse and non-recourse states:"

> At the mean value of the default option at the time of default and for homes appraised at $300,000 to $500,000, borrowers in non-recourse states are 81% more likely to default

> [the] results indicate that some borrowers choose not to default when the lender has recourse, which indicates that they are capable of continuing to make payments . . . . Our results regarding the differential effect of recourse by the mortgaged property's appraisal amount indicate that at least some defaults on high and moderately priced homes are strategic.[278]

Prompted by the substantial economic costs the federal government is shouldering as a result of the mortgage crisis, and the results of the Ghent and Kudlyak study, scholars Grant Nelson and Gabriel Serbulea conclude that, "we need a uniform recourse law."[279] Specifically, Nelson and Serbulea advocate Congress' adoption of legislation modeled on the Restatement (Third) of Property on Mortgages.[280] This approach, which is addressed in Section VI, would make recourse the default for all states.[281] This Article takes a position counter to that conclusion. Non-recourse should be the default for residential mortgage loans. While it is important to be attentive to the costs that various policies may impose on the government, this paper argues that the costs associated with retaining the deficiency judgment remedy outweigh the costs of eliminating it. Further, the Ghent and Kudlyak study raises several issues that could impact the conclusions and meaning of the data. The assumption that houses falling within a particular price range signals that the homeowner's income must be at a certain level should be questioned, especially given the lax underwriting practices of some lenders that permitted borrowers, who clearly did not have the income, to qualify for substantial loans to purchase high-priced houses.[282] Rather than assuming that defaulting borrowers can pay because they continue to meet their other debt obligations,[283] or because in a recourse state they will not default within a certain time frame but borrowers in non-recourse states within the same time frame will,[284] a more thorough study would include

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> than borrowers in recourse states. For homes appraised at $500,000 to $750,000, borrowers in non-recourse states are more than twice as likely to default as borrowers in recourse states. For homes appraised at $750,000 to $1,000,000, borrowers in non-recourse states are 60% more likely to default than borrowers in recourse states.

*Id*. at 3162.

278. *Id*., at 3177.

279. Nelson & Serbulea, *supra* note 11, at 91.

280. *Id*. at 92. Nelson and Serbulea reason that "[b]ecause the federal government is engaged in a massive underwriting of lender losses and acquiring ownership of millions of mortgages and mortgage-backed securities, it is ultimately the federal government that will bear the financial consequences from foreclosure delay." *Id*. at 98 (quoting Nelson, *supra* note 18, at 608–09).

281. *Id*. at 91–92.

282. *The Origins of the Financial Crisis: Crash Course*, *supra* note 83; Denning, *supra* note 184.

283. *See* Nelson & Serbulea, *supra* note 11, at 66 (discussing a definition of "strategic defaulter" adhered to by some lenders).

284. Ghent & Kudlyak, *supra* note 26, at 3143–44.

examining how much money defaulting borrowers have left after meeting their other obligations and what purchases—for example, medical—they are foregoing to make the mortgage payment.

The focus on strategic defaulters to justify retaining the deficiency judgment remedy is misplaced. This Article's proposal intentionally does not include a carveout for wealthy individuals who default on their mortgages. The rationale is that if such a carveout were included, lenders will find a way to exploit it. Banks could choose to look to the home appraisal amount as a measure of the borrowers' net worth, adopting the approach of the Ghent and Kudlyak study.[285] Banks could also make the determination of who falls within the carveout based upon whether the borrowers "qualify" for a certain loan amount. In this instance, lenders would control the outcome because they have the final say as to who qualifies for a loan and for how much they qualify.[286] Under either one of the scenarios, individuals who do not necessarily have the means to pay and who are not necessarily high net worth individuals will be captured within the carveout and lenders will be able to pursue them. Further, even wealthy individuals could experience financial setbacks that make paying their mortgage loans impossible.[287] As it stands now in recourse states, it is left to the discretion of the lender whether to obtain a personal liability judgment against a defaulting borrower.[288] Some argue that economics will prompt lenders to seek the remedy only where there is a high probability of recovery.[289] If, however, the past behavior of lenders is any indication of whether they will act in ways that result in the most economically beneficial outcomes across the board, the answer is clearly "no."[290] Similarly, secondary market investors in deficiency judgments are unlikely to be careful in exercising discretion.[291] Government needs to impose measures of restraint.[292]

Borrowers in recourse states do not receive lower rates on their mortgage loans than borrowers in nonrecourse states.[293] One could view the circumstance of recourse borrowers entering into loans that "cost" the same as loans in non-recourse states as recourse borrowers hedging against the possibility that they

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285. *Id*. at 3159.

286. *See* Tracie R. Porter, *The Field Between Lions and Zebras . . . Evening the Playing Field Between Lenders and Borrowers: Conflicts of Interest and Legal Obligations in the Residential Mortgage Transaction*, 30 QUINNIPIAC L. REV. 623, 676–77 (2012).

287. *See* Ghent & Kudlyak, *supra* note 26, at 3159.

288. *See id*. at 3140.

289. *See* Nelson & Serbulea, *supra* note 11, at 90 n.142 (citing Ghent & Kudlyak, *supra* note 26, at 3140.

290. *See* STEVEN A. RAMIREZ, LAWLESS CAPITALISM: THE SUPRIME CRISIS AND THE CASE FOR AN ECONOMIC RULE OF LAW 39–40 (2013) (critiquing law and economics views and the failure to regulate).

291. *See* Nelson, *supra* note 211, at 585–86.

292. *See* Nelson & Serbulea, *supra* note 11, at 97–98 (quoting Nelson, *supra* note 18, at 608–09).

293. Ghent & Kudlyak, *supra* note 26, at 3174 ("In no appraisal category do we see evidence that borrowers in recourse states enjoy lower interest rates.").

may default in the most cost effective manner—that is, by paying more for the loan upfront. This perspective is in accord with Lee Anne Fennell's approach of putting some control back into the hands of the homeowner by allowing the owner to "compensate an investor to take on off-site downside risk . . . who can hold it as part of a diversified portfolio."[294] The deficiency judgment remedy is inequitable and inefficient because it does not take into account that when borrowers in recourse states pay the same amount for their loans as borrowers in non-recourse states, lenders have already been compensated for the risk of a deficiency.[295]

The fact that every mortgagor, non-recourse and recourse alike, does not default at the moment when the borrower's house appraisal value falls below the amount of the purchase price or below the amount owed on the mortgage loan provides additional support to the argument that deficiency judgments can be eliminated without creating a moral hazard for borrowers.[296] That is, the removal of this remedy will not incentivize all mortgagors to default.[297] Empirical research does not support the conclusion that the punitive incentive of the deficiency judgment is necessary to discourage the majority of borrowers from defaulting in times of economic distress.[298]

Lenders seek deficiency judgments against both strategic defaulters and judgment-proof borrowers.[299] Given this indiscriminate policy, regardless of whether anti-deficiency laws operate to encourage strategic defaulters in times of housing market declines, this Article maintains that relying upon the bludgeoning instrument of the deficiency judgment as a deterrent to potential strategic defaulters places an undue burden on all mortgagors.

### *C. Moral Arguments Against Anti-Deficiency Legislation*

Those who make moral arguments against anti-deficiency statutes maintain that they foster a norm of unaccountability and irresponsibleness.[300] This

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294. LEE ANN E. FENNELL, THE UNBOUNDED HOME: PROPERTY VALUES BEYOND PROPERTY LINES 197–98 (2009) (defining "off-site downside risk" as "occurrences, events, and conditions beyond the four corners of the parcel, such as housing market fluctuations").

295. *Id.* at 198.

296. *See* White, *supra* note 259, at 972.

297. *See id.* Moral hazard is a term used by economists to refer to "the reduction in incentives to reduce or avoid risk when individuals do not bear the risk." Masten *supra* note 202, at 23.

298. Guiso et. al., *supra* note 264, at 3 ("Assuming that a homeowner will default as soon as his home equity becomes negative is clearly wrong.").

299. Silver-Greenburg, *supra* note 21, at A12; Hundley, *supra* note 78.

300. *See* Hughes, *supra* note 3, at 120. Hughes argues that anti-deficiency laws operate to the "moral detriment of individual mortgagors" in that they "relieve[] [mortgagors] of an obligation to conduct their business affairs in what might be characterized as the 'right way.'" *Id.* These arguments may be rooted in the logic of the Contract Clause of the United States Constitution, Article I, Section 10. The Contract Clause provides: "No state shall . . . pass any . . . Law impairing the Obligation of Contracts." U.S. CONST. art. I, § 10, cl. 1. Chief Marshall expounded upon this logic in the case of *Ogden v. Saunders*, which upheld a state's bankruptcy law applying to contracts

position adopts a narrow focus regarding what is entailed in the residential mortgage loan transaction, which involves individual borrowers and an industry of lenders.[301] There is an inequity in bargaining power as the potential homebuyer begins the process of attempting to secure a mortgage loan.[302] In entering this market, the potential borrower is at a distinct disadvantage because the individual cannot actually negotiate the terms of a mortgage loan contract.[303] Lenders utilize the Fannie Mae/Freddie Mac forms. Where those uniform terms are more beneficial to the mortgage lending industry, individuals who wish to purchase a house can do little to avoid accepting them if they need financing.[304] Being able to shop for rates does not do much to address the fundamental imbalances in power that exist.[305]

The moral argument frames the mortgage loan contract as an equitable contract that must be adhered to because it is the product of even-handed negotiations between the home purchaser and the lender.[306] From this vantage point, both parties entered into the loan with a mutual appreciation and deep understanding of the complexities of the mortgage loan documents and the protections, or lack thereof, provided by them.[307] This view is not an adequate representation of the mortgage loan transaction. The power differential between

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entered after the adoption of the legislation as not being in violation of the United States Constitution's Contract Clause. Marshall noted that:

> The power of changing the relative situation of debtor and creditor, of interfering with contracts, a power which comes home to every man, touches the interest of all, and controls the conduct of every individual in those things which he supposes to be proper for his own exclusive management, had been used to such an excess by the state legislatures, as to break in upon the ordinary intercourse of society, and destroy all confidence between man and man. This mischief had become so great, so alarming, as not only to impair commercial intercourse, and threaten the existence of credit, but to sap the morals of the people, and destroy the sanctity of private faith. To guard the continuance of the evil, was an object of deep interest with all the truly wise, as well as the virtuous, of this great community, and was one of the important benefits expected from a reform of the government.

*Saunders*, 25 U.S. at 354–55. The arguments relied upon to affirm the importance of carefully scrutinizing state laws that modify private law contracts have relevance for debtors. Because of the tactics of lenders over the course of the Great Recession and in the immediate years prior, debtors are incited to question the fairness of the entire residential mortgage loan transaction. It is also important to note that unlike the circumstances that factored into the drafting of the Contract Clause—that is, that powerful individuals would use their status to nullify their financial contractual obligations—this Article advances arguments in favor of the relatively disempowered individuals who enter into residential mortgage loan contracts.

301. Hughes, *supra* note 3, at 120.

302. Mixon, *supra* note 8, at 88.

303. *Id.*

304. *Id.*

305. Mixon, *supra* note 8, at 87 n.292.

306. *See* Hughes, *supra* note 33, at 122.

307. *See id.*

lenders and borrowers means that the best terms will not emerge in the "negotiation" between borrowers and lenders.[308] There is no meaningful possibility of negotiating the terms of the mortgage loan contract.[309] Instead, the contracts function more as form documents.[310] Richard Posner argues that if consumers are not paying attention to the terms that seem to be inflexible or unimportant, they will not shop for contracts that have the best provisions, thus the efficient terms will not appear through exchange.[311] In treating the loan documents as forms, mortgagors will not shop for loan contracts that do not have the deficiency judgment remedy.[312] Even if they tried to shop for this type of contract in a recourse state, it is unlikely they would be able to exert enough pressure on lenders to turn their recourse loans into non-recourse ones.[313] For this reason, the idealized representation should not serve as the basis for a state's refusal to adopt anti-deficiency measures. Borrowers already recognize the importance of abiding by the mortgage loan contract, especially with respect to the central obligation of making monthly mortgage payments.[314] There is evidence to support that even borrowers who encounter financial difficulties go to extraordinary lengths to meet their obligations.[315] Borrowers have depleted their retirement accounts or other financial reserves and have attempted to renegotiate the terms of their loans so that they can continue making payments at a more manageable level.[316] If borrowers are unsuccessful in their efforts to preserve their homes, they should not suffer the additional punishment of having a personal liability judgment entered against them. The loss of the real property is punitive enough. Penalizing individuals by subjecting them to personal liability does not result in individuals of stronger moral fiber. Instead, it underscores the inflexibility and bias of the mortgage lending system.

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308. Mixon, *supra* note 8, at 88.

309. *Id*.

310. *See id*. at 22 (discussing mortgage documents as form documents).

311. Posner, *supra* note 238, at 1585.

312. *Id*.

313. *See id*. at 1586.

314. Salsich, *supra* note 185, at 29.

315. *Id*. at 29 (citing Heather Hill Cenoch, *Survey: 60% of Americans Frown on Mortgage Abandonment*, DSNEWS.COM (Apr. 6, 2011), http://www.dsnews.com/articles/survey-60-of-americans-frownonmortgage-abandonment-2011-04-06) (indicating that a majority of the individuals polled believe that it is morally unacceptable to default on a mortgage if the individual has the financial means to continue paying); *see also* White, *supra* note 259, at 4–5 (citing Guiso, et al., *supra* note 264, at 1) (asserting that other factors beyond negative equity drive homeowners to default).

316. *See* Salsich, *supra* note 185, at 29; *see also* White, *supra* note 259, at 4–5 (citing Guiso, et al., *supra* note 264, at 1) (stating that only one-fourth of defaults are strategic).

### *D. Borrowers Should Bear Losses because they are Responsible for Assessing the Risks Associated with their Home Purchases*

Another argument against anti-deficiency legislation asserts that losses related to home values are properly placed upon mortgagors because they are responsible for making determinations regarding the riskiness of their home purchases.[317] If their assessment of the risk is incorrect, it is not the fault of the lender, so the lender should not be penalized.[318] Further, because borrowers reap the benefits of homeownership—appreciation in home value, mortgage interest deductions, etc.—they should also be required to shoulder the burdens associated with it.[319]

This argument ignores that both lenders and borrowers are engaged in the process of assessing the risks associated with the purchase of real estate.[320] Proponents of this view discount the realities of the valuation process for the home purchase.[321] The lender requires an appraisal of the house that the borrowers intend to purchase.[322] The appraiser is usually selected from an approved list provided by lenders.[323] Borrowers are not typically schooled in the mechanics of appraising property; thus, they are susceptible to relying upon the appraiser's valuations regardless of whether they are sound.[324] Under this process, borrowers can fall victim to properties that have inflated valuations because of either improper appraisal methods or appraisals that have not been thoroughly vetted by the lender.[325] Lenders are in a stronger position to detect overvaluations, because they are more skilled in processing valuation information.[326] As part of the underwriting process, lenders could make the determination that, regardless of the appraisal, there appears to be a discrepancy between the value of the home and the appraisal value.[327] During times of accelerated increases in home prices over a three to six month period, a lender's further inquiry is warranted.[328] For example, prior to the recession, in the nascent period of the housing boom, potential buyers of new construction housing were enticed by pricing alternatives of preconstruction pricing, phase I

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317. Hughes, *supra* note 3, at 129.

318. *Id.*

319. *See id.*

320. Mixon, *supra* note 8, at 88.

321. *Id.*

322. *Id.*

323. J. Kevin Murray, Note, *Issues in Appraisal Regulation: The Cracks in the Foundation of the Mortgage Lending Process*, 43 LOY. L.A. L. REV. 1301, 1308 (2010).

324. Mixon, *supra* note 8, at 52 n.198.

325. *Id.*

326. *Id.*

327. *See id.*

328. *See id.*

pricing, and phase II pricing.[329] In Chicago, the value of a home in a new development could increase from $200,000 to $275,000 and then to $320,000, all within the expanse of a year.[330] Lenders do not appear to have intervened in markets such as Chicago or cities in California to question whether the valuations were sound or sustainable.[331] To the extent that lenders have failed to question valuations, particularly prior to this current economic crisis, they should bear the burden of any so-called "deficiencies."[332]

A positive result of having an anti-deficiency statute may be that lenders will be more careful in assessing whether appraisers' valuations are skewed. Lenders will be motivated to be more vigilant in making sure that properties are not overvalued and they will be less likely to encourage, indirectly or directly, overvaluations.

### *E. There are Better Measures than Anti-Deficiency Statutes to Protect Borrowers that are Less Intrusive and Burdensome to Lenders*

Some opponents of anti-deficiency laws argue that there are better, less intrusive, alternatives that can accomplish the goal of protecting borrowers without unduly burdening lenders.[333] The alternatives identified often include stricter disclosure requirements,[334] mortgage counseling,[335] personal bankruptcy,[336] and disqualification of potential borrowers at the outset if they fail to signal that they appreciate the accompanying risks.[337]

#### *1. Stricter Disclosure and Mortgage Counseling Requirements*

Imposing stricter disclosure and mortgage counseling requirements on lenders are positive suggestions. Such requirements could help to strengthen the

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329. *See* Douglas J. Short, Comment, *Use Versus Abuse: A Comprehensive Analysis of Nonbinding Reservation Agreements and Real Estate Developers' Ability to Freely Rescind*, 30 CAMPBELL L. REV. 201, 209 (2007).

330. *See* Shawn Tully, *Welcome to the Dead Zone*, CNNMONEY (May 5, 2006, 12:14 PM), http://money.cnn.com/2006/05/03/news/economy/realestateguide_fortune/.

331. The Ohio Attorney General has investigated the alleged improper "collusion" between lenders and appraisers in determining housing values. *See* Press Release, Office of the Ohio Attorney Gen. (June 7, 2007) (on file with author).

332. Mixon, *supra* note 8, at 52.

333. *See* Jacoby, *supra* note 31, at 2264 (discussing some of the alternatives); *see also* Hughes, *supra* note 3, at 128 (suggesting lenders negotiate for and lend at lower loan-to-value ratios).

334. William N. Eskridge, *supra* note 19, at 1215–17.

335. Stark, *supra* note 19, at 131.

336. Jacoby, *supra* note 31, at 2264.

337. Hughes, *supra* note 3, at 145 (advocating to have lenders "refrain from entering into mortgage transactions with borrowers who fail to demonstrate the requisite ability to comprehend the lender's disclosures").

disadvantaged position of the borrower in mortgage loan transactions.[338] Fortifying the disclosure requirements makes sense and could be effective in providing the buyer with more of the information he needs to make an intelligent decision about his home purchase and in furnishing this information sooner to the buyer so that he has time to read and process the information.[339] Federal law already mandates that lenders make certain disclosures to borrowers regarding loan terms, under the Truth in Lending Act,[340] and the fees that a borrower will be charged along with other financial items that appear on a borrower's closing statement, under the Real Estate Settlement Procedures Act.[341] These mandated disclosures are of critical importance but they are insufficient to fully protect borrowers.[342] Requirements that mortgage loan terms be more transparent and that borrowers have an extended opportunity to review loan documents and ask questions about them are useful measures that this Article endorses, but they are not acceptable substitutes for anti-deficiency legislation.[343] Rather, they should be viewed as additional measures that can serve to protect consumers. Requiring more rigorous disclosures makes sense because, as it stands now, borrowers are at a distinct disadvantage in the unfolding of the real estate loan transaction.[344] Typically, borrowers arrive at a real estate closing and are handed, for the first time, complex real estate loan documents that they are directed to sign.[345] Few borrowers read the documents in detail,[346] and even if they do, reading the terms does not guarantee comprehension.[347] Further, few actually attempt to renegotiate the terms of the documents.[348] If a borrower attempts to renegotiate, it is unlikely that the effort will be successful.[349]

There are other factors that shape the borrower's view of a mortgage loan transaction and the borrower's behavior in the context of that transaction. A borrower's understanding of the terms may be influenced by a mortgage broker's or lender's statements that the borrower can always refinance—or worst-case

338. *See* Eskridge, *supra* note 19, at 1215; *see also* Stark, *supra* note 19, at 151 (claiming that mandatory mortgage counseling would provide protection to borrowers without limiting their choices).

339. *See* Eskridge, *supra* note 19, at 1165.

340. Truth in Lending Act, 15 U.S.C. §§ 1601–1693 (1994).

341. Real Estate Settlement Procedures Act, 12 U.S.C. §§ 2601–2617 (1994).

342. Jamie Dultz, Note, *Battling Discriminatory Lending: Taking a Multidimensional Approach Through Litigation, Mediation, and Legislation*, 20 J. AFFORDABLE HOUS. & CMTY. DEV. L. 101, 140–41(2010) (citations omitted).

343. *See* Hughes, *supra* note 3, at 125 (asserting that anti-deficiency legislation is just one tool used for the protection of mortgagors).

344. *See* Eskridge, *supra* note 19, at 1086.

345. *Cf.* Stark, *supra* note 19, at 134 (explaining that certain loans are "bad" because they contain "exploitive terms that the borrower does not comprehend").

346. *See id* (explaining borrowers have trouble comprehending loan documents due to "exploitive terms").

347. *See id*.

348. *See id*. at 138 (suggesting mortgagors may need mortgage counseling to know when to negotiate better terms).

349. *See id*.

scenario modify the loan—before the higher rate for an adjustable rate mortgage goes into effect or under circumstances of financial setbacks.[350] Law Professor Debra Stark's scholarship takes into account the myriad factors that can affect borrowers.[351] Her proposal directly addresses helping the potential borrower to process all the information that is disclosed.[352] She persuasively argues that a pro-borrower mortgage counselor who has the appropriate level of financial training can make a difference by injecting more fairness into the loan process and by decreasing the number of predatory loans and foreclosures.[353] Notwithstanding these interventions of more disclosure and competent, effective counseling, anti-deficiency legislation is still needed. Requiring lenders to disclose more to their customers, highlight unfavorable terms, provide more time for document review, and provide counseling are positive steps towards leveling the playing field for mortgagors. However, these modifications are inadequate substitutes for providing the borrower with the relief of finality at the other end of a transaction, which results in foreclosure. If a deficiency judgment is not an option for the mortgagee, the mortgagor experiences some consolation in knowing the painful act of relinquishing the home will be deemed to satisfy the loan debt obligation.

#### 2. *Personal Bankruptcy*

Filing for personal bankruptcy under Chapter 7 of the United States Bankruptcy Code,[354] (or filing under Chapter 13)[355] is a viable option that can provide relief to financially distressed mortgagors who need assistance with restructuring their debt obligations.[356] In some jurisdictions filing for bankruptcy can help the mortgagor to either avoid foreclosure or, at the very least, delay it so that the mortgagor has more time to occupy the property and make alternative living arrangements before the foreclosure is final.[357] But it comes at a price.[358]

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350. *See id*. at 134 (describing the deceptive practices of predatory lenders). Stark has done some work on whether these statements are actionable or mere puffery. *See also* Jessica M. Choplin et al., *A Psychological Investigation of Consumer Vulnerability to Fraud: Legal and Policy Implications*, 35 LAW & PSYCHOL. REV. 61, 62 (2011) (explaining how consumers may be vulnerable to such practices).

351. *See generally* Stark, *supra* note 19 (advocating assistance for borrowers in handling the many facets of a mortgage transaction).

352. *Id*. at 130.

353. *Id*. Stark advocates the adoption of a federal program mandating this type of counseling. *Id*. Her approach serves to close the gap between giving the borrower access to helpful tools and ensuring that the borrower makes effective use of those tools. *Id*.

354. *See* 11 U.S.C. §§ 524(a), 727(a) (2006).

355. *See* 11 U.S.C. § 1322.

356. Hughes, *supra* note 3, at 147–48.

357. *See* Stark, *supra* note 19, at 139; *see also* Jacoby, *supra* note 31, at 2274 (citing 11 U.S.C. §362(a) (2012)) (discussing how bankruptcy helps borrowers reinstate delinquent mortgages).

358. Mixon & Shepard, *supra* note 9, at 463.

Declaring bankruptcy comes at a high psychological price because there is a stigma associated with it.[359] Bankruptcy also results in a substantial cost to the filer's credit.[360] The bankruptcy filing may hinder a mortgagor's ability to obtain financing in the future for a home purchase even though the mortgagor's financial situation may have improved significantly.[361] After a personal liability judgment is obtained and filed in the county where the debtor has property, interest will accumulate on the outstanding amount, making an already hefty judgment an even more impossible burden to shoulder.[362] Confronted with this overwhelming debt, the mortgagor is left with little choice but to declare personal bankruptcy.[363] It is true that bankruptcy helps the foreclosed homeowner find relief from the deficiency judgment[364] as well as relief from certain federal tax obligations that can be triggered by the foreclosure sale.[365] However, it is a drastic remedy.[366] For that reason, it should not be the only option available to the defaulting borrower.

Some legal scholars argue that for foreclosed borrowers, the ability to file for bankruptcy essentially operates as "an antideficiency statute."[367] Given that borrowers have this vehicle as a means of relief from their creditors, the reasoning continues, there is no need to deny lenders the deficiency judgment remedy.[368] While personal bankruptcy provides borrowers with some relief from creditors, it is important to note that it is the deficiency judgment itself that often pushes the distressed borrower into bankruptcy.[369] There are appreciable differences between anti-deficiency laws, which intervene at an earlier moment to protect the debtor, as compared to bankruptcy.[370] Borrowers can rely upon bankruptcy at a later moment of financial impairment in order to obtain relief when no other avenues are available.[371] While a defaulting homeowner may be

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359. Mixon & Shepard, *supra* note 9, at 463; *see also* White, *supra* note 259, at 972.

360. *See* Mixon & Shepard, *supra* note 9, at 463.

361. Jean Braucher, *Counseling Consumer Debtors to Make Their Own Informed Choices—A Question of Professional Responsiblity*, 5 AM. BANKR. INST. L. REV. 165, 189 (1997).

362. Mixon & Shepard, *supra* note 9, at 464. State interest rates can vary from between 6 and 10 percent. *Id*. at 464 n.38.

363. *Id*. at 463.

364. Jacoby, *supra* note 31, at 2272.

365. *Id*. at 2288 n.140.

366. Mixon & Shepard, *supra* note 9, at 463.

367. Jacoby, *supra* note 31, at 2272; *see* Hughes, *supra* note 3, at 148 n.171.

368. *See* Hughes, *supra* note 3, at 148.

369. *See* Mixon & Shepard, *supra* note 9, at 461. This is often the case unless the borrower is filing for bankruptcy to prevent or delay the foreclosure. *See* Jacoby, *supra* note 31, at 2274 (citing 11 U.S.C. §362(a) (2012)).

370. *See* Mixon & Shepard, *supra* note 9, at 461 (showing bankruptcy often occurs *after* anti-deficiency judgments).

371. *See id*. Financially overextended debtors who opt to file for bankruptcy before foreclosure proceedings begin may be able to halt or prolong the foreclosure process. *See* Jacoby, *supra* note 31, at 2274 (citing 11 U.S.C. §362(a) (2012)). Some scholars argue that under bankruptcy, the structured plans that are set up to pay one's creditors could have a better result for cash-impaired debtors. *See id*. at 2283.

able to deal with the setback of losing his home to a mortgagee, he may not be able to manage this loss and have a hefty personal judgment that will cloud his credit for a significant period of time.[372] Removal of the deficiency judgment threat could serve to decrease the number of individuals who are essentially forced into bankruptcy because they see no other option for responding to their creditors.[373]

### *3. Disqualifying Potential Borrowers at the Outset*

The third suggestion of disqualifying potential borrowers, at the outset, from obtaining loans if they fail to demonstrate some minimum level of economic risk intelligence could result in discrimination and an undue limitation on the number of people who will be able to purchase houses. According to this proposal, the potential borrower would have to show that the borrower is capable "of comprehending the nature or the magnitude of the risks associated with default under a mortgage."[374] This approach would likely exclude borrowers who would never default on their mortgages because they have enough money to continue paying the debt obligation and avoid any financial setbacks that would make foreclosure imminent.[375] This Article advocates imposing strong underwriting requirements and making candid disclosures to individuals who are applying for mortgage loans. Beyond that, this piece does not support adopting a "test" that potential borrowers have to pass in order to show the "proper" level of understanding regarding the risk being undertaken. Implementing a mortgage loan competency test fails to strike at the fundamental problem of inequities in the loan transaction that this paper highlights. Even if a borrower demonstrates that the borrower fully appreciates the risks, it does not change the unequal bargaining positions of the lender vis à vis the mortgagor.

## *F. Anti-deficiency Statutes Will Result in Higher Costs for Borrowers and Discourage Lenders from Lending to Certain Communities*

Lenders often maintain that placing restrictions on their ability to recover outstanding debt will lead to substantial increases in the price of mortgage loans for certain segments of the population—for example, middle and lower income communities.[376] The higher prices will effectively preclude these groups from obtaining financing, or the higher costs will discourage lenders from providing

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372. *See* Mixon & Shepard, *supra* note 9, at 463.
373. *See id*.
374. Hughes, *supra* note 3, at 144.
375. *See id*. at 144–45.
376. *See* Durham, *supra* note 36, at 507–08 (explaining that a prohibition of deficiency judgments would shift the burden of increased mortgage costs to "others").

mortgage loans to them.[377] Legal scholars have advanced arguments in support of the position that prohibiting mortgagees from obtaining deficiency judgments will lead to higher mortgage loan costs and, therefore, such laws are "inefficient."[378] An important concern for those who argue in terms of efficiency is that the transaction costs are borne by all mortgagors but they only benefit those who default.[379] While it is true that the costs are spread in this way across all mortgagors as a group, this piece takes issue with the assertion that the only beneficiaries are defaulters. All borrowers benefit from knowing that such protections are in place.[380] All borrowers benefit from having peace of mind in knowing that there is a limit to the losses they will sustain in the unlikely, but possible, event that they default.[381] Further, it makes sense to spread costs in this way because it should keep the mortgage loan affordable to a wider sector of the market of potential borrowers.[382] Inoculating the borrower from personal liability by precluding deficiency judgments may also assist the borrower in making a more accurate assessment of the risks associated with home ownership.[383]

The lending landscape pre-2007 leading up to the present economic crisis included lenders and mortgage loan brokers who assured borrowers that they would be able to refinance or modify their loans, if necessary.[384] The narratives associated with home ownership related to the appreciation of real estate, not the rapid and extended decrease in housing values.[385] Even if a decline was contemplated, many homeowners in recourse states were under the impression that the worst-case scenario would be the loss of their homes to the banks, not the additional personal liability that a deficiency judgment brings.[386] Feeding into these assumptions were the prevailing practices in jurisdictions.[387] Lenders in many states were not actively pursuing deficiency judgments even when the outstanding balance was not covered at a foreclosure sale.[388]

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377. *See* Christian E. Weller, *Access Denied: Low-Income and Minority Families Face More Credit Constraints and Higher Borrowing Costs*, CTR. FOR AM. PROGRESS 1 (Aug. 2007), http://cdn.americanprogress.org/wp-content/uploads/issues/2007/08/pdf/credit_access.pdf.

378. *See, e.g.*, Durham, *supra* note 36, at 493–500 (citations omitted). In making the case for strict foreclosure, law professor James Durham defines "efficiency" as "the utilization of the best method of allocating legal rights between parties that choose to engage in the regulated activity." *Id.* at 505.

379. *See id.* at 503 (asserting that "[d]efaulting mortgagors are the only parties who actually benefit from mortgagor protection").

380. *See* Gildar, *supra* note 225, at 1025–26.

381. *See* Hughes, *supra* note 3, at 126.

382. *See id.* at 129.

383. *See* Silver-Greenberg, *supra* note 21.

384. *See* Singer, *supra* note 3, at 509; *see also* Peterson, *supra* note 184, at 47; *see also* Simon and Hagerty, *supra* note 191, at A12 (relating anecdotes regarding dishonest mortgage brokers); *see also* Barr, *supra* note 192 (discussing examples of poor disclosure by brokers).

385. *See* Singer, *supra* note 3, at 500.

386. Silver-Greenberg, *supra* note 21.

387. *See id.*

388. *See id.*

Opponents of anti-deficiency laws also argue that if deficiency judgments are not allowed, it will mean that, in some instances, mortgagees are not fully compensated for their costs, which include, *inter alia*, the costs of filing the foreclosure lawsuit and marketing the property for a foreclosure sale.[389] This assertion is an incorrect prediction of what is likely to play out on a larger scale.[390] What is likely to happen is that lenders will find a way to efficiently price their loss of the deficiency judgment into the cost of the loans.[391] If mortgagees cannot recuperate their costs on the back-end through deficiency judgments, they will charge more for their loans on the front end as a way of protecting themselves from shortfalls.[392] Lenders' reliance on this compensating strategy does not necessarily mean that mortgage loans will become "unaffordable" to the middle class.[393] For those states that are non-recourse or that have adopted anti-deficiency provisions, there is apparently no empirical evidence to suggest that mortgages are not as readily available to the middle class in those regions as compared to other states without the protections.[394] The California market may serve as an example. The existence of anti-deficiency statutes in California has not deterred lenders from lending to middle and lower income individuals within this State.[395] On the contrary, it appears that the

389. Durham, *supra* note 36, at 502–503, 506–508.

390. *See* Schill, *supra* note 37, at 496–97 (citing Mark Meador, *The Effects of Mortgage Laws on Home Mortgage Rates*, 34 J. ECON. & BUS. 143, 146) (1982). Schill focuses on the work of Mark Meador, which suggests that state laws protecting borrowers substantially raises the price of credit for consumers. Meador, *supra*, at 146. Schill counters Mark Meador's conclusion that anti-deficiency statutes have a measurable impact on the interest rate of mortgage loans by as much as "22.65 basis points." Schill, *supra* note 24, at 496–97, 497 n.29 (citing Meador, *supra*, at 146). *See also* George M. Platt, *Deficiency Judgments in Oregon Loans Secured by Land: Growing Disparity Among Functional Equivalents*, 23 WILLAMETTE L. REV. 37, 52 (1987) ("Lending institutions maintain large loan portfolios over which the risk of losses may be spread.").

391. *See* Schill, *supra* note 37, at 507. ("If mortgagor protection laws generate substantial costs, economic theory suggests that lenders in a competitive market will pass these costs along to borrowers.").

392. *Id.*

393. *See id.* at 511. ("[I]t is impossible to predict, ex ante, the expected relationship between household income and interest rates.")

394. *Cf.* Nina Liao, Note, *Cramming Down the Housing Crisis: Amending 11 U.S.C. § 1322(b) to Protect Homeowners and Create a Sustainable Bankruptcy System*, 93 MINN. L. REV. 2240, 2255 (2009) (citing *The Looming Foreclosure Crisis: How to Help Families Save Their Homes: Hearing Before the S. Comm. on the Judiciary*, 110th Cong. 196 (2007) (testimony of Henry J. Sommer, President, National Association of Consumer Bankruptcy Attorneys) (discussing a lack of evidence showing that "cram-down," a feature of bankruptcy law that is similar to anti-deficiency provisions, has affected the price and availability of mortgages)).

395. Writing in 1991, legal scholar John Mixon commented that:

> One might expect that, in a rational microeconomic system, mortgagees would require greater down payments, extract higher interest [rates] on home loans, and withhold mortgage financing in areas where the risk of market downturn is shifted to them. This appears, however, not to be the case, inasmuch as institutional lenders apply the same rates and terms to California houses as to the rest of the country.

middle-class has enjoyed extensive access to mortgage loans.[396] Regarding individuals within lower income groups, lenders have made loans available to them although not always as freely and consistently as compared to middle-income borrowers.[397] The availability of loans in the California market to a mixed range of income levels supports the position that, if lenders perceive that they can make money on providing mortgage loans, they will continue to make them available to lower, middle, and upper income individuals.[398] Although the underwriting requirements may be more stringent in certain cases, it is unlikely that lenders would lock such a large sector of the population—that is, the middle class—out of the loan market indefinitely.[399]

The conclusion that anti-deficiency protection measures do not result in mortgage loans that are priced at a prohibitively high level for the middle-income market is supported by Michael Schill's work.[400] Schill concludes that there is no substantial negative impact on mortgage loan interest rates that can be attributed to the adoption of anti-deficiency laws or other pro-debtor mortgage mechanisms.[401] Further, Schill argues that it is important to evaluate pro-debtor laws, like anti-deficiency statutes, for the effect that they have for borrowers obtaining financing at the time, and not from the perspective of any rippling after-effects of the laws.[402] Viewed from this vantage point, Schill maintains that anti-deficiency and redemption laws can be likened to "insurance" for mortgagors because the laws operate to put a cap on the amount of losses that mortgagors may suffer due to the occurrence of events that are not within their control—for example, severe economic contractions or change of life events such as divorce or illness.[403] If individuals know that their maximum amount of loss to the mortgagee in the event of their default will be the concrete asset of the house, then they are more inclined to continue participating in the housing market economy.[404] This piece shares Schill's conclusion that, because the laws

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Mixon, *supra* note 8, at 37.

396. According to the American Bankers Association, the average percentage of 1–4 family loans made to first time home buyers in 2013 increased to thirteen percent from eleven percent in 2012 and nine percent in 2011. AM. BANKERS ASS'N, 21ST ANNUAL ABA REAL ESTATE LENDING SURVEY REPORT 15 (2014).

397. *See generally* Weller, *supra* note 377 (discussing barriers to home financing for low income borrowers).

398. *See* Mixon, *supra* note 8. *See generally* AM. BANKERS ASS'N, *supra* note 227 (discussing the recent increase in loans made to first time buyers despite regulatory obstacles).

399. Mixon, *supra* note 8.

400. Schill, *supra* note 37, at 514.

401. *Id.* at 514. The results of Schill's "net present value simulation model of mortgage lending" indicate that "home mortgage loan interest rates are relatively insensitive to the existence of mortgagor protection laws and that the incremental costs of these laws are likely to be quite modest." *Id.* at 490–91.

402. *Id.* at 498.

403. *Id.* at 500 (citing Alan Schwartz, *The Enforceability of Security Interests in Consumer Goods*, 26 J.L. & ECON. 117, 125–29 (1983).

404. *Id.* at 500.

result in more predictive outcomes for mortgagors, they are more conducive to "economic efficiency."[405]

## VI. PROPOSAL FOR ANTI-DEFICIENCY LAW FOR RESIDENTIAL MORTGAGE LOANS

This Article proposes a legislative solution to the problems that deficiency judgments pose. The beginning place for the anti-deficiency law proposal is from the position that lenders should not be able to pursue deficiency judgments against residential loan borrowers. At the federal or state level, legislators should enact laws prohibiting deficiency judgments in the residential mortgage loan transaction.[406] By properly defining "residential mortgages" legislators can address any concerns that the anti-deficiency legislation will cast too broad of a net that would encompass sophisticated real estate investors who don't suffer the same disadvantages in terms of market knowledge, and who will take advantage of the protections to the detriment of lenders. Apart from the legislative action, lenders can cushion themselves against unsustainable losses related to the prohibition of this remedy by making sufficient adjustments in their underwriting requirements—for example, loan to value ratios, required down payment, etc.

### A. *Elements of the Anti-Deficiency Law Proposal*

The elements of the anti-deficiency law proposal advocated in this paper are:

1) All residential mortgage loans qualify for protection against deficiency judgment liability.

2) The borrower's cessation of occupancy or subsequent rental of the property purchased with financing that qualifies for anti-deficiency protection does not change or eliminate that protected status.

3) The refinancing of a residential mortgage loan qualifies for the same level of protection against a deficiency judgment as that of the original residential purchase money mortgage loan.

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405. *Id.* at 538.

406. For the definition of "residential," the Uniform Land Security Interest Act provides a useful one that reads:

> "Residential real estate" means, in relation to a protected party, real estate improved or to be improved, containing not more than [three] acres, not more than four dwelling units, and no nonresidential uses for which the protected party is a lessor. If a unit in a common interest community is otherwise "residential real estate," it remains so regardless of the size of, or the number of units in, the common interest community.

UNIF. LAND SEC. INTEREST ACT § 113(b) (amended 1999), 7A U.L.A. 403, 426 (1985 & Supp. 1991).

4) The guarantors of a residential mortgage loan have the same level of protection as the residential mortgage loan with respect to deficiency judgments.

5) The anti-deficiency protections are not waivable.

### *B. Distinguishing the Proposal from Some Prominent Models*

There have been previous attempts to modify the remedies that are available to lenders in conjunction with foreclosure proceedings. Two prominent models can be found in the Uniform Land Security Interest Act ("ULSIA")[407] and section 8.4 of The Restatement (Third) of the Law of Property Mortgages.[408] Neither of these models fully eradicates deficiency judgments.[409] Instead, they interpose criteria for when and how deficiency judgments may apply to a mortgagor whose property has been foreclosed.[410]

This paper articulates a proposal that differs in scope and approach from ULSIA and Restatement (Third) models for anti-deficiency protection. For the reasons stated in the following sections, those models are insufficient to fully address the unequal position of the borrower in the residential mortgage loan process. Given that this anti-deficiency proposal extends beyond models that have not enjoyed widespread adoption, it is important to acknowledge that the lukewarm reception to previous reform efforts suggests that there are substantial barriers to change. Those barriers include the powerful banking industry lobby, differences in economic policy, the inertia of legislators, and an unwillingness to change the status quo.[411] This Article recognizes the hurdles that the anti-deficiency law proposal will likely confront, but nonetheless asserts that the unequal bargaining relationship between lenders and borrowers is at a crisis point and must be addressed. At the outset of this Article, it was noted that governmental action is permissible in the realm of contracts where certain conditions prevail. Here, those conditions are satisfied given that there is a lending industry whose members function as dominant parties in residential loan negotiations: they (i) are in a superior position with respect to having pertinent knowledge relative to the contemplated mortgage loan and housing purchase transaction, (ii) have the almost exclusive power to structure the mortgage loan and decide whether to make the loan to an applicant based upon the terms they set, (iii) are incentivized by the prevailing legal and economic regime to

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407. *Id.* at §§ 501–511.

408. RESTATEMENT (THIRD) OF PROP.: MORTG. §§ 8.1–8.6 (1997).

409. *See* UNIF. LAND SEC. INTEREST ACT § 511(b) (amended 1999), 7A U.L.A. 403, 468 (1985 & Supp. 1991); RESTATEMENT (THIRD) OF PROP.: MORTG. § 8.4 cmt. a (1997).

410. UNIF. LAND SEC. INTEREST ACT § 511 cmt. 2 (amended 1999), 7A U.L.A. 403, 468–69 (1985 & Supp. 1991); RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.4 cmt. a–d (1997).

411. *See* Norman Geis, *Escape from the 15th Century: Uniform Land Security Interest Act*, 30 REAL PROP. PROB. & TR. J., 289, 316–17 (1995).

maximize their gains even if it forces defaulted mortgagors into bankruptcy and undermines their ability to be fully-engaged consumers for a substantial period of time, and (iv) have the ability to address the losses associated with the intervention.

### 1. *The Uniform Land Security Interest Act: The Limitations of ULSIA in Providing Mortgagors with Deficiency Judgment Relief*

The National Conference of Commissioners on Uniform State Laws promulgated ULSIA in 1985.[412] To date, no state has adopted ULSIA.[413] Section 511(b) contains the key language relative to deficiency judgments.[414] ULSIA, in contrast to this Article's proposal, does not prohibit deficiency judgments.[415] Rather, it delineates a protected party status.[416] If a mortgagor falls within the definition of a "protected party" then the mortgagor is shielded from deficiency judgment liability. Section 511(b) provides:

> Unless otherwise agreed and except as provided in this subsection as to protected parties, a person who owes payment of an obligation secured is liable for any deficiency. If that person is a protected party and the obligation secured is a purchase money security interest, there is no liability for a deficiency, notwithstanding any agreement of the protected party. For purposes of calculating the amount of any deficiency a transfer of the real estate to a person who is liable to the creditor under a guaranty, endorsement, repurchase agreement, or the like is not a sale.[417]

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412. *See* UNIF. LAND SEC. INTEREST ACT historical notes (amended 1999), 7A U.L.A. 403, 403 (1985 & Supp. 1991).

413. While no states have yet adopted ULSIA, some scholars have made compelling arguments in favor of its adoption across the country. *See* Patrick A. Randolph, Jr., *The Future of American Real Estate Law: Uniform Foreclosure Laws and Uniform Land Security Interest Act*, 20 NOVA L. REV. 1109, 1131–32 (1996). The reasons for the failure to adopt ULSIA are not necessarily a sign that there is no political will for nonrecourse laws statewide but, rather, may relate to several other reasons such as: (i) the powerful lobby of mortgagees are likely to resist any legislative measures that will curtail their advantage in mortgage loan transactions, and (ii) the particular idiosyncrasies of each state's current mortgage laws that may make it difficult to embrace the positives of ULSIA (*e.g.*, Section 511(b)) without some other aspect of ULSIA supplanting the positives of the state's mortgage laws. *See* Geis, *supra* note 411, at 316–17.

414. *See* UNIF. LAND SEC. INTEREST ACT § 511(b) (amended 1999), 7A U.L.A. 403, 468 (1985 & Supp. 1991).

415. Section 511(b) provides in relevant part: "Unless otherwise agreed and except as provided in this subsection as to protected parties, a person who owes payment of an obligation secured is liable for any deficiency." *Id*.

416. *Id*. § 113(a).

417. *Id*. § 511(b).

The positive aspects of ULSIA are that it recognizes the need to prohibit deficiency judgments under certain circumstances, and its protections cannot be waived.[418] Making the provision unwaivable is important because, as this article highlights, mortgagors are in a disadvantageous position relative to lenders in the real estate loan deal.[419] Borrowers, due to the failure to read all their loan documents carefully at the closing or a misunderstanding of the complicated terminology used in the documents, may waive this protection and not realize it.[420] This Article's critique of ULSIA is that it is too limited in its focus. Section 113(a) of ULSIA defines "protected party" as follows:

> (1) an individual who gives a security interest in residential real estate all or a part of which the individual occupies or intends to occupy as a residence;
>
> (2) a person obligated primarily or secondarily on an obligation secured by residential real estate if, at the time the obligation is incurred that person is related to an individual who occupies or intends to occupy all or a part of the real estate as a residence; or (3) an individual who acquires residential real estate and assumes or takes subject to the obligation of a prior protected party under the real estate security agreement.[421]

Section 113(a) has positive aspects that appropriately accord protection to individuals who should be shielded from personal liability.[422] This proposal suggests broadening the scope of protection. The goal is to provide borrowers with relief. While paragraph (1) protects those individuals who occupy or intend to occupy the mortgaged property,[423] it should be broadened so that anti-deficiency protection is extended to those individuals who, at one time, did occupy the property but relocated due to job or family related reasons. Individuals who are no longer occupying property they purchased for that purpose should still be able to take advantage of continuing non-recourse protections. This protection should be extended even if the person is no longer living in the state where the property is situated. The protection should also remain in place if the mortgagor is renting out the property. Mortgagees often reclassify property that fits the latter description as "investment property."[424]

418. *Id*. § 501(d).

419. *See* Mixon, *supra* note 8, at 88.

420. *See id*.

421. UNIF. LAND SEC. INTEREST ACT § 113(a) (amended 1999), 7A U.L.A. 403, 425–26 (1985 & Supp. 1991).

422. *Id*. § 113(a) cmt. 1–4.

423. *Id*. § 113(a)(1).

424. *Id*. § 113(b)(1). This category of "investment property" is typically subject to stricter limits and standards regarding the evaluation of the property for refinancing purposes. While it is not clear that ULSIA's protection extends to a person under all the scenarios identified above,

Instead of automatically reclassifying the property in this way, mortgagees should consider whether the purchaser initially bought the property with the intent to occupy it. While determinations of intent can be difficult and costly, the test could be reduced to some limited period of required occupancy for the purchaser.

This proposed anti-deficiency law would not disqualify individuals who had previous foreclosures from non-recourse protection. Lenders would be privy to that information because it is a matter of public record, and could make a risk assessment as to whether to extend the loan.

Paragraph (2) of Section 113(a) contemplates encompassing guarantors within its protection.[425] Under the approach put forth by this Article, guarantors of the mortgage loan also would be protected. In addition, individual guarantors, even if they are not "related to an individual who occupies or intends to occupy" the property, would be included.[426] Including guarantors under the protective umbrella of anti-deficiency statutes closes a loophole like the one that currently exists in California's anti-deficiency statutes.[427] This type of loophole invites exploitation by mortgagees in order to circumvent the purposes of the anti-deficiency laws.[428] The Restatement of the Law (Third) on Property and Mortgages also recognizes the fairness of extending to guarantors the same anti-deficiency protections that have been granted to mortgagors.[429] As the Restatement comments, "[t]o permit the mortgagee to recover a deficiency judgment against the latter persons [that is, guarantors, sureties] unrestricted by

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Section 511(b)'s reach does cover "owner-occupied fourplexes and second homes." Mixon & Shepard, *supra* note 9, at 481 (citing *id*.).

425. UNIF. LAND SEC. INTEREST ACT § 113(a)(2) (amended 1999), 7A U.L.A. 403, 426 (1985 & Supp. 1991).

426. Section 114 of the ULSIA outlines the "related to" status. *Id*. § 114.

427. California's protections do not automatically extend to guarantors of mortgage loans, particularly if they have waived certain protections, but they should. *See* Weissman, *supra* note 132, at 59–60. *See also* Paradise Land & Cattle Co. v. McWilliams Enter., Inc., 959 F.2d 1463, 1465–66 (9th Cir. 1992) (citing Spangler v. Memel, 498 P.2d 1055, 1059 (1972); Palm v. Schilling, 244 Cal. Rptr. 600, 601 (1988)) (observing holdings that establish California's anti-deficiency statute's applicability to purchase-money obligations in real property transactions in which the obligation is secured by the purchased property, and does not apply to guarantees of such obligations)Talbott v. Hustwitt, 78 Cal. Rptr. 3d 703, 705 (2008) (quoting Mariners Sav. & Loan Assn. v. Neil, 99 Cal. Rptr. 238, 240 (1971)) ("Since section 580a has to do solely with actions for recovery of deficiency judgments on the principal obligation [it] has no application to an action against a guarantor . . . "); Kincaid v. Gomez, 274 Cal. Rptr. 539, 540 (1969) (citing Roberts v. Graves, 75 Cal. Rptr. 130, 134 (1969)); Jonathan Manor, Inc. v. Artisan, Inc., 56 Cal Rptr. 14, 16 (1967); Heckes v. Sapp, 40 Cal. Rptr. 485, 487 (1964) ("If respondent were guarantors, section 580b would not protect them."). Further, guarantors are also permitted to waive any defenses or protections that the California laws may provide. *See* Cal. Civ. Proc. Code § 2856(a)(3) (West Supp. 1984) (allowing waivers by guarantors of rights and defenses if the principal obligation is secured by real property).

428. Weissman, *supra* note 132, at 61.

429. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.4 cmt. b (1997).

the limitations of [§ 8.4] Subsection (c) would be inconsistent with the goal of preventing unjust enrichment of the mortgagee."[430]

This paper's anti-deficiency proposal also differs from ULSIA's method in the way it treats individuals who renegotiate their loan contracts. This proposal would grant continuing anti-deficiency protection to individuals who refinance. In contrast, ULSIA denies anti-deficiency protection to individuals who refinance their residential mortgage loans.[431] Only purchase money mortgages are covered by ULSIA's anti-deficiency provision.[432] Using the phrase "purchase money security interest," ULSIA refers to the security interest in relation to the "purchase money security agreement," which is defined as an agreement that is:

> (i) taken or retained by the seller of the collateral to secure all or part of its price or (ii) taken by a person other than the seller of the collateral who, by making an advance or incurring an obligation, gives value to enable the debtor to acquire the collateral.[433]

As Professor Roger Bernhardt discusses, Comment 2 to ULSIA § 511 suggests that individuals who refinance lose their protected status because the loans no longer qualify as *purchase money* security interests.[434] Yet, there are real drawbacks to excluding individuals who refinance from the protected party class.[435] In order to ensure the widest possible coverage of an anti-deficiency

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430. *Id.* Section 8.4 provides that mortgagees may request the use of fair market value, as of the date of the foreclosure sale, to calculate a deficiency rather than the foreclosure sale price. The comment refers to those instances in which the fair market value exceeds the mortgage obligation. *Id.* § 8.4 cmt. b, illus. 2–6 (1997).

431. UNIF. LAND SEC. INTEREST ACT § 511, cmt. 2 (amended 1999), 7A U.L.A. 403, 468 (1985 & Supp. 1991).

432. *Id.* § 511(b) & § 511 cmt. 2. For a discussion of some of the downsides of this limitation *see* Mixon & Shepard, *supra* note 9 at 481 (citing *Id.* § 511 cmt. 2). It is important to acknowledge that ULSIA is now more than twenty years old. While the drafters did not include individuals who refinance within the ambit of anti-deficiency protection, given the apparent problems that this group faces, it is unlikely that the drafters would exclude this category, today.

433. *Id.* § 111(18).

434. Roger Bernhardt, *ULSIA's Remedies on Default—Worth the Effort?*, 24 CONN. L. REV. 1001, 1044–45 (1992).

435. Bernhardt observes:

> If refinancing truly eliminates purchase-money status as the Commissioners believe, it would not be hard for lenders to move their loans from one category to the other when the need arises. There is also the philosophical question of why homeowners should be protected only with regard to their purchase-money loans, which may well be the most discretionary form of borrowing they undertake. Homeowners who need to refinance in order to survive a recession when the breadwinner has been laid off work may be no less deserving.

*Id.*

measure, the likelihood that borrowers will want to refinance at some point should be taken into account, and a clear statement of whether this results in a loss of their protected status should be articulated.[436] Legal scholar Carol Burns astutely argues, regarding California's anti-deficiency laws, that the rational actions of taking advantage of lower interest rates or more stable loan products—for example, a fixed rate loan instead of an adjustable rate mortgage—should not be penalized.[437] An anti-deficiency law that allows broader protection would lessen the occurrence of foreclosures because individuals would be able to make the adjustments they need in their mortgage loans in order to continue making their payments. A decrease in foreclosures is an efficient outcome that benefits the broader economy because it contributes to the stability of the housing market.[438]

### 2. *The Restatement (Third) of Law Approach*

The Restatement's approach to deficiency judgments and anti-deficiency legislation differs drastically from this proposal. The Restatement's technique for balancing the interests of borrowers and lenders is to permit deficiency judgments, but limit them in a way that reflects the value of the property rather than merely the price paid at the foreclosure sale.[439] Section 8.4, paragraph (a) of the Restatement provides: "If the foreclosure sale price is less than the unpaid balance of the mortgage obligation, an action may be brought to recover a deficiency judgment against any person who is personally liable on the mortgage obligation in accordance with the provisions of this section."[440]

As an alternative measure to modify the potential deficiency amount, the Restatement permits the foreclosed mortgagor to rely upon the reference point of "fair market value of the real estate as of the date of the foreclosure sale,"[441] rather than using the foreclosure sale price against the outstanding debt. The Restatement defines "fair market value" as "the price which would result from negotiation and mutual agreement, after ample time to find a purchaser, between a vendor who is willing, but not compelled to sell, and a purchaser who is willing to buy, but not compelled to take a particular piece of real estate."[442] If this alternative value exceeds the foreclosure sale price, the mortgagor can use the excess—that is, the difference between the fair market value and the

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436. Prior to the 2012 amendment, which clearly grants protection to those who refinance their purchase money mortgage for the same property, the lack of clarity in California's anti-deficiency provisions regarding the status of individuals who refinanced caused confusion and prompted litigation over whether such individuals are insulated from personal liability. *See* Burns, *supra* note 98, at 2080.

437. *Id*. at 2111.

438. *Id*. at 2079.

439. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.4 cmt. a (1997).

440. *Id*. § 8.4(a).

441. *Id*. § 8.4.

442. *Id*. § 8.3, cmt. b.

foreclosure sale price—to offset the deficiency amount.[443] In this respect, the Restatement's approach corresponds to the fair value limitation discussed above in Section III. Comment *a* to the Restatement describes the rationale behind this strategy:

> This approach enables the mortgagee to be made whole where the mortgaged real estate is insufficient to satisfy the mortgage obligation, but at the same time protects against the mortgagee purchasing the property at a deflated price, obtaining a deficiency judgment and, by reselling the real estate at a profit, achieving a recovery that exceeds the obligation. Thus, it is aimed primarily at preventing the unjust enrichment of the mortgagee.[444]

As argued in Section III, while the fair market value approach affords the mortgagor some protection, it has its shortcomings. First, the reliance upon fair market value, rather than the foreclosure sale price is not automatic under the Restatement's model.[445] The mortgagor has to request that the alternative measure be used.[446] Putting the onus on the mortgagor means that he has to be aware that it is his right to have another basis used to calculate the deficiency judgment. When the responsibility falls upon the mortgagor, the protective mechanism is subject to being underutilized due to a lack of knowledge about its existence. It is likely that many mortgagors will not have legal counsel.[447] Just as mortgagors who would benefit from the Illinois Special Matters provisions routinely fail to request them,[448] it is probable that mortgagors will not invoke the fair market value option, absent some requirement that the mortgagor be informed that this alternative is available. Second, the Restatement provides that

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443. Section 8.4 (d) provides:

> If it is determined that the fair market value is greater than the foreclosure sale price, the persons against whom recovery of the deficiency is sought are entitled to an offset against the deficiency in the amount by which the fair market value, less the amount of any liens on the real estate that were not extinguished by the foreclosure, exceeds the sale price.

*Id*. § 8.4(d).

444. *Id*. § 8.4(d) cmt. a.

445. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.4 cmt. b (1997). ("The fair market value determination of this section is not self-executing. Unless the deficiency defendant affirmatively requests such a determination, the foreclosure sale price, rather than the property's fair market value, will be used to compute the deficiency.").

446. *Id*.

447. *See* Rachel M. Zahorsky, *Biloxi Blues: Legal Cost Fears Have Victims of Oil Spill Sliding Out of the Middle Class*, A.B.A. J., Nov. 1, 2012, at 45, 48 (discussing increased reluctance and inability of middle-class individuals to pay for legal representation even when faced with complex legal matters).

448. Stark, *supra* note 19, at 671.

fair market value may be determined by a judge or a jury[449] by relying upon a "variety of approaches," including any of the three appraisal methods—comparable sales, income, and cost—commonly used by appraisers in property valuation.[450] While the Restatement's fair market value strategy allows for a broader view of property value that offers some protection to borrowers, it does not eliminate the possibility of a personal liability judgment. According to Comment c, the foreclosure proceeding cannot impact fair market value.[451] However, this restriction does not mean that other foreclosures, within the geographic area of the property are precluded from negatively affecting the fair market value determination. If the neighborhood has suffered multiple foreclosures or the overall region is plagued by depressed property values as a result of a recession, then using the fair market value is unlikely to provide a significant reduction in the deficiency amount.

#### 3. *An Alternative Approach: Creating a Special Insurance for Borrowers to Cover Deficiency Judgments*

Professor Schill proposes another approach to providing anti-deficiency protection to borrowers.[452] Moving beyond the analogy of anti-deficiency laws, Schill's noteworthy proposal is to implement an actual insurance program whereby borrowers can purchase insurance coverage as protection against the contingency of deficiency judgment liability.[453] This type of insurance would be different from private mortgage insurance ("PMI"),[454] for which many mortgagors pay premiums but which operate to protect the lender "against losses in the event of default."[455] Instead of insulating the borrower, the PMI just shifts a portion of the risk from the lender to the insurer but it does not eliminate the risk exposure the borrower has in the event that the borrower suffers a

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449. *Cf.* RESTATEMENT (THIRD) OF PROP.: MORTG. § 8.4, reporter's note (1997) (acknowledging that some states allow a jury to make the determination but taking no position on the issue).

450. *Id.* § 8.4 cmt c. According to the reporter's note the fair market value approach relied upon is attributable to the case *BFP v. Resolution Trust Corp*. *Id.* § 8.4 Reporter's Note (citing BFP v. Resolution Trust Corp., 511 U.S. 531, 537–538 (1994)).

451. *Id.* § 8.4(d) cmt. c.

452. *See* Schill, *supra* note 37, at 531.

453. *Id.*

454. In addition to being available from private mortgage insurers, this type of insurance is also provided by the Federal Housing Administration ("FHA") and the Veterans Administration ("VA"). As Nelson, Whitman, *et al.*, explain, with an FHA insured loan the FHA "collects insurance premiums from borrowers . . . These premiums, along with proceeds from the sale of foreclosed properties, pay for claims that FHA pays lenders as a result of foreclosures." NELSON & WHITMAN, *supra* note 59, at 951.

455. *Id.* Private mortgage insurers "will pay all the losses [of the lender] from a foreclosure up to a stated percentage of the claim amount . . . [usually] between 25 percent and 35 percent of the claim amount." *Id.*

foreclosure and there is a deficiency.[456] In contrast, the proposed consumer-focused insurance is intended to insulate the borrower from the deficiency risk.[457]

Rather than rely upon lenders to devise an efficient deficiency judgment program, Schill proposes a state-mandated "mortgage foreclosure insurance" program. Under the program, mortgagors would be required to buy mortgage foreclosure insurance to cover the deficiency amount.[458] There are positive aspects to this proposal in that insurance formalizes and quantifies borrowers' risks.[459] Requiring borrowers to purchase insurance and pay ongoing premiums should make visible and tangible for them their exposure to personal liability.[460] An insurance requirement would also mean that mortgagors who default are covered in the event that the lender obtains a deficiency judgment against them.[461] Notwithstanding the positives, making the costs of the risk of default more apparent has its downsides. Borrowers are likely to be resistant to the imposition of the insurance requirement and may campaign against it.[462] They are likely to discount their own likelihood of default, and may push to undermine any efforts to implement a mandatory insurance program.[463]

This Article advocates excluding deficiency judgments as a negotiable term in residential mortgage loan contracts over an insurance-structured approach. While an obligatory state insurance program meets some of the desired

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456. As John Mixon explains, "[b]ecause the mortgagee or mortgage insurer (or both, as their interests appear) holds the ultimate right to collect any deficiency remaining after foreclosure, mortgage insurance does not benefit the mortgagor in default." Mixon, *supra* note 8, at 19.

457. *See* Schill, *supra* note 37, at 535.

458. *Id.* (citing Louis Kaplow, *An Economic Analysis of Legal Transitions,* 99 HARV. L. REV. 509, 548–49 (1986). Schill concludes that certain consumer protective measures—for example, special deficiency judgment insurance—are best relegated to the government because lenders, left to their own devices, will not create properly priced safeguards for mortgagors to match their likelihood of default. For example, if lenders offered insurance to cover deficiency judgments for the benefit of borrowers, lenders are likely to overcharge mortgagors who are less likely to default, and undercharge mortgagors who are financially riskier. According to Schill, this discrepancy occurs because of "imperfect information" between lenders and borrowers. Lenders have information about trends of markets and defaults whereas individual borrowers have information about the specific factors—for example, handling of their household budget, spending habits and projects, and assets that impact their ability to pay. Another problem regarding pricing the insurance is that borrowers may incorrectly assess probability of defaulting on their loans. That is to say, borrowers who are less likely to default given their financial condition may be overly cautious and will purchase more insurance than they need whereas borrowers who are more likely to default, given their income, assets, and job stability, will likely purchase less insurance than they need because they are overly optimistic about their probability of defaulting. *Id.* at 523. Schill suggests that a mandatory state-directed program will ensure that there is a sustainable market for the insurance and that "the costs of mortgagor protections are borne by the mortgagors [who most need the protections] through insurance premiums." *Id.* at 537.

459. *Id.* at 536.

460. *Id.*

461. *Id.* at 535.

462. *See id.* at 536.

463. *See id.*, at 537.

objectives, the most efficient strategy that serves the public is the enactment of anti-deficiency laws.[464] An anti-deficiency law incentivizes lenders to use the mechanisms available to them, such as modifying their underwriting requirements or adjusting the pricing of their loan products, to account for any estimated losses associated with anti-deficiency protection.[465] Relying upon the legislative approach of prohibiting deficiency judgments addresses the concern that lenders will underbid the property at a foreclosure sale to create a deficiency.[466] This plan also avoids any potential issues that can arise with the administration of an insurance program. Under an insurance scheme, insurers may write contracts in a way that severely limits the ability of the insured to receive insurance proceeds—for example, the deductible may be too high. Thus, financially-strapped insureds may lose the full benefits of their coverage if they fail to stay current on their premiums, or insurers may delay the payout process to the point of the insured having to file for bankruptcy because of financial pressures.[467] This Article's proposal affords blanket protection for all residential mortgagors against deficiency judgment liability.

### C. *Scope of the Proposal—Prospective Application and Limited Retroactive Application*

The scope of this proposal differs from that of ULSIA, which has a prospective focus.[468] This proposal is not limited to prospective application. Instead, it takes into account the timing of the present recession to allow for the refinancing or modification of existing mortgage loan contracts that were entered into by January 1, 2006.[469] The retroactive aspect is even more controversial than the prospective portion and will undoubtedly raise freedom of contract concerns.[470] Judging from the severe limits imposed on recent government-

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464. Lenders are likely to mount substantial resistance to any proposal to prohibiting deficiency judgments because they will view it as an attempt to impair their right to freely contract. Nonetheless, this Article encourages the government to adopt such anti-deficiency legislation. The insurance approach should be held in abeyance as an alternative option if the proposal encounters such resistance that the adoption of anti-deficiency legislation proves impossible.

465. Dening, *supra* note 83.

466. *See* Silver-Greenberg, *supra* note 21.

467. *Id*.

468. Mixon & Shepard, *supra* note 9, at 456 (citing UNIF. LAND SEC. INTEREST ACT § 601 (amended 1999), 7A U.L.A. 403, 468 (1985 & Supp. 1991)).

469. The date, January 1, 2006, was selected based upon the ample evidence of clear moments during which numerous lenders were engaging in practices of heightened predatory lending, and lax underwriting standards that contributed heavily to the financially debilitated condition of many borrowers. *See* Bernanke, *supra* note 38. *See also* Brown, *supra* note 38, at 1217–18 (noting that subprime mortgages, as a share of total originations, increased from 9 percent to 20 percent from 1996 to 2006).

470. Article I, Section 10 of the Constitution of the United States provides: "No state shall . . . pass any . . . Law impairing the Obligation of Contracts." U.S. CONST. art. I, § 10, cl. 1.

endorsed homeowner mortgage relief programs,[471] a proposal to modify loans retroactively is likely to meet substantial resistance from the lending industry and others. Notwithstanding the hurdles, this type of drastic measure is warranted and should be given serious consideration. Further, there is precedent for it.[472] During the Great Depression era, the United States Supreme Court, in *Home Building and Loan Association v. Blaisdell*, upheld the state of Minnesota's decision to temporarily prohibit lenders from pursuing their remedies against homeowners who had defaulted on their mortgages.[473] The *Blaisdell* Court reasoned that "[economic] conditions may . . . arise in which a temporary restraint of enforcement of contracts will be consistent with the spirit and purpose of the contract clause, and thus be within the range of the reserved power of the State to protect the vital interests of the community."[474] The Minnesota State Legislature's declaration of an "economic emergency"[475] was significant to the Court's holding.[476] At present, in the United States, there is an

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471. See the requirements for the Home Affordable Refinance Program (HARP) and the two Home Affordable Modification Programs ("HAMP I" and "HAMP II"). *Questions and Answers*, HARPPROGRAM.ORG, http://www.harpprogram.org/faq.php (last visited Oct. 6, 2014); *Home Affordable Modification Program,* MAKINGHOMEAFFORDABLE.ORG, http://www.makinghomeaffordable.gov/programs/lower-payments/Pages/hamp.aspx (last updated Sept. 4, 2014). The lackluster results of the programs, which have only helped a relatively miniscule number of homeowners, suggest that bolder measures are needed to adequately tackle the crisis many mortgagors are facing. *See* Dewan, *supra* note 194.

472. In contract law, there is the good faith and fair dealing requirement that courts read into the transaction regardless of whether the parties expressly state that this is a condition to which the parties must adhere. The *Blaisdell* Court recognized the historical precedents, which allow states to look outside of the four corners of a contract and impose terms that are not expressed within.

> The reservation of this necessary authority of the state is deemed to be part of the contract . . . speaking though Mr. Justice Brewer, nearly fifty years later in *Long Island Water Supply Co. v. Brooklyn*: "But into all contracts, whether made between states and individuals or between individuals only, there enter conditions which arise, not out of the literal terms of the contract itself. They are superinduced by the pre-existing and higher authority of the laws of nature, of nations, or of the community to which the parties belong. They are always presumed, and must be presumed, to be known and recognized by all, are binding upon all, and need never, therefore, be carried into express stipulation, for this could add nothing to their force. Every contract is made in subordination to them, and must yield to their control, as conditions inherent and paramount, wherever a necessity for their execution shall occur."

Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 435 (1934) (quoting Long Island Water Supply Co. v. Brooklyn, 166 U.S. 685, 692 (1897)).

473. *Id*. at 447.

474. *Id*. at 439 (upholding a Minnesota statute that temporarily suspended mortgage foreclosures under certain circumstances and extended the period of time for redemption of property from mortgage foreclosure sale).

475. *Id*. at 422 (citing *Blaisdell v. Home Bldg. & Loan Ass'n*, 249 N.W. 334, 337 (Minn. 1933)).

476. *Id*. at 444.

economic crisis of great magnitude that has necessitated a host of federal government policies[477] intended to provide relief and reverse the downward financial spiral.[478] The case can be made that, in implementing these remedial policies, the federal government has in essence declared an economic emergency requiring the adoption of extraordinary measures. Lenders, as a group, have perpetrated a devastatingly harmful act against borrowers.[479] The court in *Blaisdell* recognized the need to intervene in existing mortgage loan contracts in order to address the unfairness of allowing lenders to proceed with foreclosures in an economic climate marked by widespread unemployment, depressed property prices, and a limited market for buyers.[480] Similar to the time of *Blaisdell*, the prevailing economic conditions of the Great Recession mandate a retroactive application of the anti-deficiency law proposed. Taking such retroactive action will address the negative outcomes—for example, elongating the timetable for individuals to re-enter the housing market[481] and restricting the ability of individuals to participate in the economy[482]—that are looming because of the less than optimal mortgage loan contracts that were produced. The terms of these recourse loan contracts, as argued in Sections IV and V, arose in part because of the power differential existing between mortgagors and mortgagees.

To the opponents of this proposal who may argue that *Blaisdell* can be distinguished in that the statute at issue in that case was temporary in nature[483] whereas this piece advocates the permanent removal of deficiency judgments as a remedy, it should be noted that both interventions have the potential to permanently affect the outcome of a foreclosure proceeding. In *Blaisdell* the statute had the potential to impact whether a mortgagor was ultimately able to keep the property because the borrower was granted more time to exercise his right of redemption, instead of having the property lost to the mortgagee-purchaser who in the pre-statute world would have had a shorter period of time before the property transfer was final.[484] Similarly, the proposal advocated herein impacts potential outcomes in the foreclosure stage. It ensures that the borrower does not have to contend with ongoing liability after relinquishing the

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477. These policies include quantitative easing, bank bailouts, low interest rates, etc. *See* RAMIREZ, supra note 290, at xiv. (discussing some of the policies).

478. *Id.* at 444.

479. These policies include quantitative easing, bank bailouts, low interest rates, etc. *See* Ramirez, *supra* note 290, at xiv.

480. *Blaisdell*, 290 U.S. at 437. (acknowledging that "[t]he economic interests of the State may justify the exercise of its continuing and dominant protective power notwithstanding interference with contracts"). States have an economic interest in ensuring that their residents are not so financially imperiled by their mortgage loan contracts that they cannot make economic contributions to their communities.

481. *See* Silver-Greenberg, *supra* note 21. (indicating that a deficiency judgment can become a "foreclosure hangover").

482. *Id.*

483. *Blaisdell*, 290 U.S. at 447 ("The legislation is temporary in question. It is limited to the exigency which called it forth").

484. *Id.* at 416.

foreclosed property, but it does not take away the lender's possibility of immediately being made whole upon the sale of the property at the foreclosure sale or, in the event that the mortgagee is the purchaser of the property, selling the property at a later date to address any deficiency.

This proposal advocates the statewide or federal adoption of a ban on deficiency judgments in residential mortgage loan transactions.[485] The particularities of each state's foreclosure statute prohibiting deficiency judgments will have an impact on the give-and-take character of the statutes. That is, in the absence of the proposed anti-deficiency law, some statutes may allow for a longer statutory redemption period but have a short window for the mortgagee to file for a deficiency judgment or have a short statute of limitations period to collect on the judgment. Adopting the proposed legislation, will affect the balancing of interests reflected in the statute that is currently in place. One likely outcome will be that lenders will lobby for a removal of the statutory redemption right or a severe limiting of the statutory period of redemption if they cannot pursue a deficiency judgment. It is important to preserve the protections afforded to mortgage consumers and to expand them where needed. Therefore, lawmakers must carefully assess any pressure exerted by lenders to curtail the existing safeguards for mortgagors in exchange for agreeing to prohibit deficiency judgments.

## VII. CONCLUSION

The residential mortgage loan transaction is rife with potential for abuse. Substantial differences in the bargaining positions of lenders and borrowers mean that the weaker party—that is, the borrower—is vulnerable to exploitation, and cannot freely negotiate contract terms. The Great Recession has highlighted the interdependency of the real estate market and the health of the national and global economies.[486] Government intervention is needed where it is clear that the banking industry is operating with an apparent shortsightedness that fails to take into account the consequences of pursuing policies which have a devastating impact on mortgage loan consumers and the stability of economic systems. This Article advocates for the elimination of deficiency judgments as a corrective measure to recourse residential mortgage loan contracts. The government's adoption of the proposal outlined should result in more efficient residential loan transactions because the proposed solution incentivizes lenders to be more rigorous in applying underwriting standards and in evaluating home appraisal values. The banking industry's vigilance in this respect will lead to less risky loans being made, less defaults, and less personal bankruptcies.

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485. This Article does not specifically address whether a federal law would be a better approach. The legislative change on a state-by-state basis may be more difficult to accomplish.

486. Bernanke *supra* note 38 ("[H]ousing and mortgage markets are tightly interlinked with the rest of the economy.")