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LARGE-SCALE DISASTERS ATTACKING THE AMERICAN DREAM: HOW TO PROTECT AND EMPOWER HOMEOWNERS AND LENDERS

MATTHEW D. EKINS*

INTRODUCTION

A barrage of high-impact storms with torrential rains and vicious winds pummeled the Gulf Coast states during the 2005 hurricane season. Hurricane Katrina alone resulted in a large-scale disaster where over 1300 lives were lost, property owners suffered approximately $75 billion in property damage, and, in particular, uncertainty erupted between homeowners and lenders.¹ The financial costs do not recede for the 1.2 million displaced and distressed homeowners, as they try to repair their homes while continuing to

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make their monthly mortgage payments. If homeowners falter in paying their mortgage debts, foreclosure is a likely result.

In 2002, one study estimated the lender foreclosure costs alone to be $58,759 per home. If only 500,000 of the affected homeowners defaulted and lenders elected to foreclose, the lender costs, in addition to the property damage estimates, could reach $29 billion—more than one-third of the estimated Katrina-caused property damage.

On a smaller scope, the average existing home value in 2004 for the southeastern United States was $182,820. If a home retained this value after the disaster, foreclosure costs would represent an estimated thirty-two percent loss in pre-disaster equity. Where the disaster caused “severe damage”—destruction of at least half of the home’s value—foreclosure would likely result in a sixty-four percent loss in the post-disaster equity. These estimates exclude consideration of the amount of mortgage indebtedness secured before the disaster, which the homeowner is still obligated to repay.

This Article examines, through a historical lens, the effects that large-scale disasters have had on the residential homeowner-lender relationship and proposes relief provisions to better miti-

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5. Brown, supra note 1, at 34.
7. See United States Housing Market, supra note 2, at 5. The Federal Emergency Management Agency estimates that 125,731 homes suffered severe damage, 179,378 homes suffered major damage, and 892,390 homes suffered minor damage. Id. at 6.
8. For example, in a worst case scenario, the financing obtained immediately before the hurricane would leave the mortgage 100% undersecured because of home damage and substantially bar recovery of lender expenses if foreclosed.
9. “Homeowner,” in this Article, inclusively refers to mortgagor, buyer, and land owner when applicable in the appropriate context.
10. “Lender,” for purpose of this Article, combines references to mortgagee, bank, mortgage broker, mortgage company, savings and loan company, and other governmental lending institutions.
gate financial loss and avoid the burden resulting from foreclosure. First, an examination of the Great Depression looks at problems that contracting parties faced, measures implemented by state and federal authorities, and lasting consequences arising from that era. Next, the Article asserts that legislatures should implement a standardized framework from which homeowners and lenders can effectively mitigate loss arising from large-scale disasters. Finally, the Article specifically addresses two measures: a workout plan and a cramdown provision. In the wake of large-scale disasters, direct loss is inevitable; minimization of the indirect, corollary loss relies upon humanity's acumen. In considering the efficacy of mitigation measures to recover from a large-scale disaster, organizing standardized relief provisions fosters the necessary post-disaster perspective for the homeowner and lender, and preserves, although not perfectly, both parties' prevailing contractual interests.

I. Historical Examination of the Great Depression

"[M]ortgages on single family homes [are] the 'backbone of the American financial system.'"11

A. Prevalent Conditions During the Depression

The Great Depression was an economic crisis in American history, which is unrivaled in scope and effect to this day.12 It affected millions of homeowners and pushed lenders toward insolvency.13 The mortgage debt totaled forty-three billion dollars, which was approximately three times the railroad debt, four times the long-term industrial debt, and comparable to the federal, state, county, and municipal debt.14 In 1932, nearly 250,000 mortgages were foreclosed upon nationwide, and, in 1933, the rate of foreclosure exceeded 1000 homes per day.15 Because of the economic circumstances that ultimately resulted in foreclosure, many proud


12. Id. at 239.
13. Id.
14. Id.
15. Id.
homeowners were reduced to being economic serfs on the land that they previously owned.\textsuperscript{16}

Many factors precipitated the harsh reality that existed during the 1930s. William Prosser noted the drastic near collapse of commodity prices that fell below the producers' break-even point.\textsuperscript{17} The inflating dollar, coupled with these circumstances, resulted in increased residential mortgage default when mortgage balloon notes, the industry standard at the time, matured.\textsuperscript{18} The inevitable default resulted in a rapid increase in the number of foreclosure sales, which depressed the market because of the surplus of foreclosed homes.\textsuperscript{19} In addition, the large inventory of foreclosed homes chilled competitive bidding at sheriff's sales, and encouraged lenders to bid nominal prices and seek a deficiency judgment for the remaining balance nearly equal to the mortgage debt.\textsuperscript{20}

Homeowners confronted this mounting crisis by implementing self-help measures. The "penny sale" was one remedial measure used in Minnesota.\textsuperscript{21} When a farmer's personal property was up for bid at the sheriff's sale, neighboring farmers would band together and purchase the property for pennies, then resell the property back to the original foreclosed farmer at a nominal price.\textsuperscript{22}

Some courts took matters into their hands by imposing an "upset price."\textsuperscript{23} The courts would establish a floor price and the foreclosed property could be sold only at or above that predetermined minimum price.\textsuperscript{24} However, these efforts alone were not enough to curb the housing crisis.\textsuperscript{25} Beginning in the early 1930s, the public


\textsuperscript{17} William L. Prosser, The Minnesota Mortgage Moratorium, 7 S. CAL. L. REV. 353, 354 (1934).

\textsuperscript{18} Id. at 345; see also Harold F. Breimyer, Agricultural Philosophies and Policies in the New Deal, 68 MINN. L. REV. 333, 334 (1983) (crisis on the farms stirred national debate for farm relief). As Prosser noted, "[a] survey of farm mortgages in Minnesota . . . indicated that, in 1930, 53.8% of the owner-operated farms in Minnesota were mortgaged." Prosser, supra note 17, at 354 n.10. For a description of a balloon note see infra note 79.

\textsuperscript{19} Amundson & Rotman, supra note 16, at 822.

\textsuperscript{20} Prosser, supra note 17, at 354-55.

\textsuperscript{21} Amundson & Rotman, supra note 16, at 822.

\textsuperscript{22} Id.

\textsuperscript{23} Id.

\textsuperscript{24} Id.

\textsuperscript{25} Id.
placed pressure on lawmakers to take steps to ameliorate the metastasizing crisis.26

B. State Legislative Response to Alleviate Increasing Foreclosures

In response to public sentiment, Minnesota lawmakers enacted a mortgage foreclosure moratorium,27 which granted some degree of relief to defaulting homeowners.28 This type of legislation expanded into other states.29 The validity of the mortgage foreclosure moratorium was premised on the legislative declaration of an economic emergency that qualified the passage of such legislation.30

The landmark case Home Building & Loan Ass'n v. Blaisdell established the mortgage foreclosure moratorium law as a valid, reasonable relief measure for homeowners facing foreclosure.31 Blaisdell involved the Minnesota Mortgage Moratorium Law (Moratorium Law), which the state’s legislature passed on April 18, 1933.32 The Minnesota Supreme Court upheld the Moratorium Law as valid,33 but its decision was appealed to the U.S. Supreme Court.34 The Court considered whether the asserted right to implement the emergency legislation modifying mortgage provisions conflicted with the Contract Clause of the U.S. Constitution prohibiting impairment of contractual obligations.35

The Moratorium Law provided that, during times of a declared economic emergency, judicial relief could extend foreclosure court proceedings, sales could be postponed for a finite period, and the redemption period could be extended.36 Where the district court granted extended foreclosure relief, the homeowner was required to pay either income generated by the property, if applicable, or a

26. Id. at 822-23.
27. Id. at 822-24. The Governor of Minnesota first acted in response to the demand of public outcry. Id. at 823. Governor Olson issued an executive order that prohibited sheriff sales until the legislature had adjourned. Id. This order was later declared unconstitutional. Id. at 824. However this was an impetus for state legislatures taking action by passing moratorium legislation. Id.
28. See Wright, supra note 11, at 240.
29. Id. at 241.
32. See id. at 415-16.
33. Blaisdell v. Home Bldg. & Loan Ass’n, 249 N.W. 893, 894 (Minn. 1933) (per curiam), aff’d, 290 U.S. 398 (1934).
34. Blaisdell, 290 U.S. at 416.
35. Id. at 425; see also U.S. Const. art. I, § 10.
reasonable rental value to the lender as determined by the court.37 The Moratorium Law included a sunset provision that limited its availability to this particular declared emergency and not beyond May 1, 1935, two years after passage.38 It was this law that impacted the Blaisdell family during the Great Depression.

The Blaisdell family owned a fourteen-room home encumbered by a mortgage lien held by Home Building & Loan Association.39 The Blaisdells' subsequent default resulted in a foreclosure sale on May 2, 1932, where the lender purchased the residence for $3700.98, while the reasonable market value was $6000.40 The Blaisdell family would lose all equity and the right to redeem one year later on May 2, 1933.41

The Supreme Court quoted Justice Olsen of the Minnesota Supreme Court who stated:

"The present nation wide and world wide business and financial crisis has the same results as if it were caused by flood, earthquake, or disturbance in nature. It has deprived millions of persons in this nation of their employment and means of earning a living for themselves and their families; . . . it actually has resulted in the loss of their homes by a number of our people and threatens to result in the loss of their homes by many other people in this state . . . ."42

In upholding the Moratorium Law, the Supreme Court found that the statute did not impair the integrity of the remaining mortgage debt, and that interest continued to accrue.43 Further, it found that the Moratorium Law did not disturb the lender’s right to foreclose and seek a deficiency judgment. The only redemption condition altered was time, which was extended.44 The rental value paid applied to taxes, insurance, and interest.45

37. Id. at 416-17.
38. Id. at 416.
39. Id. at 419-20. The extra rooms provided income when the family used them for room and board. Id. at 420.
40. Id. at 419. The Blaisdell family argued that, in addition to the loss of their home, they would also lose the equity in the home. Id. The foreclosure sale covered all outstanding debt and arrearage fees. Id. at 419-20.
41. Id. at 419.
42. Id. at 423 (quoting Blaisdell v. Home Bldg. & Loan Ass'n, 249 N.W. 334, 340 (Minn. 1933) (Olsen, J., concurring), aff'd, 290 U.S. 398 (1934)).
43. Id. at 425.
44. Id.
45. Id.
The Supreme Court's ruling rested upon five essential elements. First, the existence of an emergency was reason to protect vital community interests. Second, the legislation addressed "a legitimate end," which was the "protection of legitimate social interest." Third, relief was based on appropriate and reasonable conditions. Fourth, conditions to extend the redemption period could not be unreasonable and must consider the interest of homeowner and lender. Fifth, the moratorium legislation was limited in duration, not lasting beyond the emergency.

Blaisdell suggests that in a time of crisis, the Constitution should be interpreted to "comfort" citizens, rather than "pinch" them. The Moratorium Law provided a mere modification of the remedy available to the lender, while upholding the homeowner's legal obligation of repayment. It afforded the comfort, in terms of time needed to cure the problem, rather than having the homeowner feel the pinch of a valid contractual obligation upheld in extreme circumstances. In this way, the law recognized that the victims were not at fault and placed in circumstances beyond their control and afforded assistance where possible.

C. Federal Response to the Great Depression

In addition to state legislative response, the federal government sought to ameliorate the growing crisis with administrative measures. The federal government first used its financial might by injecting money into the mortgage industry to correct the housing disaster. However, the opening of the federal coffers had a de minimis impact on the housing crisis.

46. Id. at 444-47; see also Amundson & Rotman, supra note 16, at 825-26.
47. Blaisdell, 290 U.S. at 444.
48. Id. at 445.
49. Id.
50. Id. at 445-46.
51. Id. at 447.
53. See Amundson & Rotman, supra note 16, at 819.
55. Wright, supra note 11, at 241.
56. Id.
57. Id. Of the estimated 1.8 million applications for the federal HOLC, over half were either rejected due to lack of security or withdrawn before final review. Id. at 247. Only one in ten residential home owners received relief from foreclosure. Id. Although the Federal Home Loan Bank Board sought to infuse money into the banking
1. Quashing the Crisis with Policy

The federal government also implemented a policy approach that significantly reversed the housing market's foreclosure rate. One of the first executive actions taken by newly elected President Franklin D. Roosevelt was to provide relief to homeowners reeling from external market forces beyond their control. Two months after taking office, President Roosevelt signed the Home Owners' Loan Act into law. This Act created the Home Owners' Loan Corporation (HOLC). The fundamental premise of the program was to "(1) protect small homeowners from foreclosure, (2) relieve them of part of the burden of excessive interest and principal payments incurred during a period of higher values and higher earning power, and (3) declare that it was national policy to protect home ownership." 

The HOLC operated by providing federally backed HOLC bonds in exchange for defaulted home mortgages. The bonds generally had a lower interest rate than residential mortgage rates, and the HOLC guaranteed principal and interest payments. The HOLC refinanced approved homeowners, consolidating all arrearages, fees, and back taxes. The refinanced loan interest payments, subject to the HOLC's approval, could be delayed up to three years, thereby providing relief from the threat of foreclosure until the economy improved.

To the mortgage industry's detriment, Congress included limiting measures on the HOLC's lending practices. Financial limitations included total funding of $4.75 billion in bonds during three years, interest rates no greater than four percent, and a loan maturity limit of eighteen years. Other binding provisions required that

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58. Id. at 246.
59. Id. at 242.
61. Wright, supra note 11, at 242.
62. Id.
63. Id.
64. Id.
65. Id. at 242-43.
66. Id. at 243.
67. Id.
68. Id.
the value of residential property exceed $20,000 and the loan amount be no greater than eighty percent of the appraised value.\textsuperscript{69}

On average, homeowners who qualified for the HOLC assistance were in default for two years on the original note and mortgage and nearly three years behind on property tax payments.\textsuperscript{70} Even though the HOLC helped many homeowners, foreclosures still occurred on 2.5% of all of the HOLC’s loans.\textsuperscript{71} However, two-thirds of foreclosures resulted from the homeowner’s unwillingness to cooperate with the HOLC when it estimated that the homeowner had the ability to pay.\textsuperscript{72}

2. Policy and Rulemaking Response

One year after signing the Home Owners’ Loan Act, President Roosevelt successfully lobbied for the National Housing Act of 1934 (Housing Act).\textsuperscript{73} The Housing Act did not allocate aid—rather, it laid the foundation for indirect administrative measures to accelerate recovery.\textsuperscript{74} The Housing Act created the Federal Housing Administration (FHA), which served as a catalyst to implement policy tailored to revive the ailing mortgage industry.\textsuperscript{75}

The FHA implemented revolutionary standards in the mortgage industry. It offered deficiency insurance of up to twenty percent of the loan amount so long as the private lender met federally mandated criteria.\textsuperscript{76} Borrowers paid a one-half percent fee in addition to the standard interest rate, which the FHA deposited into a reserve fund used to cover mortgage deficiencies.\textsuperscript{77} The FHA also

\textsuperscript{69}. Id. The HOLC molded the way in which appraisals were done and how the lending institutions utilized this developing discipline. Id. The end result was a greater standardization of the real estate appraisal. Id. The change also resulted in the redlining of more “risky” neighborhoods. Id.

\textsuperscript{70}. Id. at 249.

\textsuperscript{71}. Id. When the borrower defaulted, the HOLC exercised broad restraint in filing a deficiency judgment against the borrower, unless the borrower was clearly able to pay, or state law mandated that the HOLC seek a deficiency judgment to protect its property interest. Id. at 250.

\textsuperscript{72}. Id. at 249.

\textsuperscript{73}. Id. at 251.

\textsuperscript{74}. Id.

\textsuperscript{75}. See Adam Gordon, The Creation of Home Ownership: How New Deal Changes in Banking Regulation Simultaneously Made Homeownership Accessible to Whites and Out of Reach for Blacks, 115 YALE L.J. 186, 193 (2005) (“[T]he federal government enabled lenders to provide home mortgage credit without any risk of loss—a vital guarantee given how much money those lenders had lost in the foreclosures of the early Depression.”).

\textsuperscript{76}. Wright, supra note 11, at 251.

\textsuperscript{77}. Gordon, supra note 75, at 193.
progressively lowered the standard requirement for down payment. In exchange, the lender offered borrowers fully self-amortized loans with a high loan-to-value ratio, typically eighty percent. One of the more important benchmarks of the Housing Act was the fact that it did not require a large amount of federal funding. Instead, borrowers paid for the program by paying a mortgage insurance premium integrated into the monthly principal and interest payments.

The same authority that permitted the FHA to insure mortgages emboldened the FHA to stipulate construction standards like setbacks, cul-de-sacs for residential neighborhoods, and separate zoning for commercial and residential property. The FHA clamped down on usurious interest rates on second mortgages and limited lender and builder fees. The FHA requirements made borrowing for residential homeowners less expensive and less risky, and demand for new homes and new capital grew.

In response to the residential industry crisis of the Great Depression, systemic changes occurred in legislation, administrative

78. Id. However, these changes were not completely for the better. While a lower down payment allowed younger homeowners access to mortgage funds, it also increased the likelihood of loss in default. Id. at 193-94. Where little equity exists in the home and there is a dramatic drop in property value, the borrower has little incentive to keep the house and is likely to walk away. Id. at 194.

79. Wright, supra note 11, at 251. Before the mortgage industry changed during the Great Depression, most mortgages were short-term—between three and five years. Id. at 246; see Nelson & Whitman, supra note 3, at 2. Moreover, the loans were not amortized. Id. This type of loan is commonly referred to as a balloon loan. Id. The balloon loan was problematic during the Great Depression because homeowners were frequently unable to refinance the mortgage when the mortgaged “ballooned” at the end of the term. Wright, supra note 11, at 246. The HOLC offered fifteen-year amortized loans, a drastic change from the industry standard. Id. The belief was that as equity grew, the likelihood of default decreased. Id. An amortized loan spreads principal and interest payments over the life of the loan. See Nelson & Whitman, supra note 3, at 2-3. The monthly payment is fixed with the payment ratio of principal to interest incrementally increasing with each pay period. See id.

80. Wright, supra note 11, at 251.
81. See id.
82. Id.
83. See Gordon, supra note 75, at 193.
84. Wright, supra note 11, at 257.
85. Id.
86. See id. at 260; see also Gordon, supra note 75, at 194. Much pressure also came from developers, builders, and other related business that were hit hard by the Depression. Id. These entities relied heavily on the housing market and available capital.
87. Wright, supra note 11, at 260.
rulemaking, and in the private lending system. Generally, foreclosure moratorium laws expanded beyond Minnesota and provided legal delays in foreclosure proceedings. In addition, balloon note usage was replaced by the amortization of principal and interest over the life of the loan and government regulators integrated new requirements to stabilize the housing market.

II. STANDARDIZED FRAMEWORK FOR EFFECTIVE MITIGATION

A. Introduction

Empowering contracting parties in disaster recovery is essential. The previous historical analysis exemplified what was less effective—congressional funding of lending institutions. It also illuminated what was more effective—rules and guidelines giving direction to homeowners and lenders. This knowledge is paramount in developing modern measures to address disaster recovery. The comparison exhibits a valuable predictive function of what will hedge against loss and hasten recovery.

The current pervasive notion is that homeowners must make all mortgage payments on time or the lender will foreclose on the property. In reality, the industry is not so absolute. We—society, local, and national governments—should resist the routinely ingrained response to solely give financial assistance. Instead, we should enact a framework that empowers those affected by large-scale disasters. The difficult balance is to respect the contracting parties' rights while attempting to assist both parties. Consideration of less-effective and more-effective mitigation measures will manifest workable standardized relief provisions that will create the

88. Id. at 250.
89. Id.
90. As the book of Acts illustrates: a lame man sat before the temple asking for alms and Peter said, “Silver and gold have I none, but such as I have give I unto thee. In the name of Jesus Christ of Nazareth rise up and walk.” Acts 3:1-7. The lame man immediately received strength in his feet and ankles, arose, and walked. Id. at 3:7-8. Peter helped this man by a blessing of health, not by fleeting monetary aid.
91. See infra text accompanying notes 134-135.
92. Id.
93. See generally Robert R. Rosenthal, The Role of Courts of Equity in Preventing Acceleration Predicated upon a Mortgagor's Inadvertent Default, 22 SYRACUSE L. REV. 897, 898-99 (1971) ("[S]tability of contract obligations must not be undermined by judicial sympathy,' and . . . ‘the interests of certainty and security in real estate transactions forbid us, in the absence of fraud, bad faith or unconscionable conduct, to recede from the doctrine that is so deeply imbedded in equity.’") (quoting Graf v. Hope Bldg. Corp., 171 N.E. 884, 885 (N.Y. 1930)).
necessary post-disaster perspective for the homeowner and lender while modifying pre-disaster contractual rights and obligations.

B. A Forward-Looking Standardized Response

Consistent, standardized relief provisions will improve the mitigation of financial loss arising from a large-scale disaster, and increase lender profit.\textsuperscript{94} Like the FHA’s success during and after the Great Depression, rulemaking for standardized relief provisions will do more to recover from a large-scale disaster than simply opening the federal and state coffers to cure the ailment.\textsuperscript{95} Standardized relief provisions are a starting point that do not exist in many mortgage forms, and are feasible mitigation tools that diminish clouds of uncertainty that abruptly appear after a catastrophe. Equity and loan conditions may be changed, in favor of both parties, to accommodate new circumstances resulting from a catastrophe.

If circumstances arising from a catastrophe cause homeowners to stumble into default and foreclosure results, the lenders’ direct financial losses are significant.\textsuperscript{96} Furthermore, indirect foreclosure costs accumulate: Homeowners incur expenses during foreclosure, home values in corresponding neighborhoods become depressed, and state and local governments lose tax revenue.\textsuperscript{97} The cumulative estimated costs total $73,300 per foreclosure.\textsuperscript{98} The ripple effect may also extend to municipal services and school systems that rely on property tax revenues.\textsuperscript{99} Having standardized relief provisions in place before disaster strikes will successfully mitigate post-disaster loss, in particular, keeping foreclosure at bay. All this can be done at no or negligible direct costs to state or federal governments.

\textsuperscript{94} Cf. Cutts & Green, \textit{supra} note 4, at 13.
\textsuperscript{95} See Gordon, \textit{supra} note 75, at 192-94.
\textsuperscript{96} See \textit{supra} text accompanying note 5. With the possibility of a wave of foreclosure looming, Washington lawmakers are determining whether or not the government should intervene and rescue the struggling mortgage industry. Edmund L. Andrews, \textit{In Washington, Measuring a Lifeline}, N.Y. TIMES, Aug. 28, 2007, at C1. Interestingly, the wave is estimated to hit close to the elections, thus providing more incentive for politicians to take a closer look at the situation. \textit{Id.} Some Democrats are hoping for changes that will shift the balance of power between borrowers and lenders. \textit{Id.}
\textsuperscript{98} \textit{Id.} at 3 (breaking down costs of a foreclosure as follows: homeowner, $7200; lender, $1500; servicer, $1100; FHA-HUD, $26,500; city, $27,000; and neighbors, $10,000).
\textsuperscript{99} See \textit{id.} at 2-3.
C. Inefficient Disaster Response Happens

On January 17, 1994, a 6.7 magnitude earthquake struck the densely populated community of Northridge, California.100 The Northridge quake left Sondra Sutherland’s Northridge residence uninhabitable and she was forced to vacate her premises while major repairs were performed.101 As a result of the earthquake’s damage, the home’s value plummeted to approximately $51,000.102 Sutherland had purchased this condominium in 1992 for $105,000 and had executed a mortgage for $101,000, which was transferred to Barclays American/Mortgage Corporation for servicing.103

Sutherland communicated with a lender representative three days after the earthquake and they agreed to “stop” the account while she rented an apartment during the repairs.104 The stop consisted of no monthly payments due, no notices of default, and no reporting to credit agencies.105 Sutherland relied upon this oral agreement for a three-month stop and reallocated her funds to pay for earthquake-related costs during the period of the stop.106

Contrary to Sutherland’s belief that the postponed payments would be added to the end of the loan period, the lender billed Sutherland for all outstanding back payments along with the current monthly payment.107 The lender threatened foreclosure if Sutherland failed to bring the mortgage current.108 Subsequently, Sutherland brought an action for a declaratory judgment to clarify the oral agreement and to enjoin the lender from foreclosing.109

The confusion arising from the ambiguity of the terms of the oral “stop” agreement resulted in default by the borrower, costly litigation fees for both parties, and near foreclosure on Sutherland’s condominium.110 These problems would have been averted had a standardized framework been in place before the earthquake. A standardized framework fosters certainty in communication, facilitates more efficient and quicker responses to a vital community in-

101. Id.
102. Id. at 617 n.1.
103. Id. at 617.
104. Id.
105. Id.
106. Id.
107. Id.
108. Id. at 618.
109. Id. at 619-20.
110. Id. at 618.
terest, and forbears impending foreclosure proceedings to give homeowners the opportunity to get back on their feet. The framework gives homeowners and lenders a better chance to mitigate loss and shorten recovery time.

D. Standardization Is Necessary

Standardization of disaster response for lenders and homeowners provides controlled flexibility during catastrophes, instead of requiring parties to navigate the complex existing laws that are not structured to respond to such disasters. A standardized response plays a critical role in protecting and preserving the legitimate social interest of homeownership by mitigating loss without requiring additional allocation of taxpayers' dollars. Large-scale disasters give rise to unforeseen financial burdens flowing from circumstances beyond the homeowner's control. Providing uniform measures for homeowners to retain possession encourages them to repair and maintain the home that serves as collateral for the mortgage debt, instead of homeowners complacently allowing foreclosure for twenty or fifty cents on the dollar. The value of lenders' collateral is retained and lenders avoid costly foreclosure proceedings. Moreover, foreclosures can lead to greater long-term loss due to declining home prices and abandonment of homes. Individually and collectively, the mortgage industry avoids a depressed housing market. Standardized relief measures will "enable these families to remain on the land they love and in the communities that they have been a part of for generations."

111. 131 Cong. Rec. 16,928 (1985) (statement of Rep. Gunderson). The flexibility will make it more likely that the family farmer can keep the farm. Similarly, flexibility will help the homeowner's likelihood of retaining the home. Cf. id.

112. Id. at 16,924 (statement of Rep. Synar). Congress found these arguments persuasive when passing the Chapter 12 bankruptcy relief provisions in response to the financial crisis farmers were facing in the 1980s. See generally 8 COLLIER ON BANKRUPTCY ¶ 1200.01[2] (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2007) (discussing the reasons behind passing Chapter 12).


114. See generally U.S. Small Bus. Admin., Federal Agency Regulatory Response to Hurricane Katrina, http://www.sba.gov/advo/reg_katrina.html (last visited Sept. 9, 2007) ("The Department of Housing and Urban Development has instructed all FHA-approved lenders to provide foreclosure relief to FHA-insured families who are affected by Hurricane Katrina. The relief includes a special 90-day moratorium on all foreclosures of FHA-insured properties in the declared disaster areas.").


E. Triggers for Disaster Relief Assistance

Disaster relief for the homeowner should be made available when circumstances substantially impair the homeowner’s capacity to make short-term mortgage payments.\(^\text{117}\) A less effective alternative trigger is to award relief only when “equitable and just to do so.”\(^\text{118}\)

A relief trigger may take various forms.\(^\text{119}\) First, the contracting parties can simply include contract terms that trigger mutually agreed upon disaster relief measures, which is similar to an acceleration remedy.\(^\text{120}\) Second, lawmakers can pass legislation declaring the application and availability of assistance to disaster victims.\(^\text{121}\) Third, courts can order the disaster relief be made available.\(^\text{122}\) Finally, a gubernatorial proclamation\(^\text{123}\) or a presidential declaration can enable relief measures via state and federal agencies, specifically for victims located in disaster areas.\(^\text{124}\)

Historically, some courts and agencies have looked at particular factual circumstances to determine whether the homeowner has an involuntary inability to pay, thus triggering relief measures.\(^\text{125}\) Factors considered were significant property damage or depreciation, economic shock from a disaster, unemployment, underemployment, illness, and death of a family member.\(^\text{126}\) The test has


\(^{118}\) Amundson & Rotman, supra note 16, at 831 n.156.

\(^{119}\) The scope of what will trigger disaster relief should be dynamic enough to address a single residence flooded by a storm or an entire region devastated by a barrage of hurricanes. The test should be a substantial impairment of the homeowner’s ability to make short-term payments that is a result of circumstances beyond the homeowner’s control.

\(^{120}\) See U.S. CONST. art. I, § 10; see also Freddie Mac, Mortgage Uniform Instrument, Louisiana, Single Family (Form 3019) [hereinafter Freddie Mac, Mortgage Uniform Instrument], available at http://www.freddiemac.com/uniform/unifsecurity.html (follow the “Form 3019: Louisiana Mortgage” hyperlink). The mortgage provides conditional clauses controlling default, acceleration, and cure. Id. at 13. This form could expressly provide disaster remedies and identify under what conditions assistance can be made available to the homeowner in the event of a disaster. Id.

\(^{121}\) See, e.g., Amundson & Rotman, supra note 16, at 824.

\(^{122}\) See Wright, supra note 11, at 240 (noting that one form of mortgage moratorium legislation gave the courts the authority to delay foreclosure proceedings).


\(^{125}\) See Amundson & Rotman, supra note 16, at 831-33.

\(^{126}\) Id.
not been a bright-line rule; rather, the decision maker has had the discretion to balance the facts and consider the circumstances.

The "equitable" approach is vague, uncertain, and its results lack uniformity. It relies on political sentiments and notions of extraordinary relief. The "inability" approach quantifies parameters, and can be readily ascertained between homeowner and lender. It works better on a case-by-case basis, rather than broadly addressing large numbers of mortgages.

Once the cumulative effects substantially impair a homeowner's ability to meet short-term obligations, the relief measures should be triggered. Foreknowledge of disaster response triggers will allow lenders and homeowners to better gauge when relief measures will apply in the wake of an unforeseen disaster and when to implement such measures in a uniform manner.

F. Standardized Workout Plan

While no statutory requirements currently exist for lenders and homeowners to use a workout plan to aid hurricane victims, Fannie Mae has encouraged servicers to use relief provisions. Using such relief provisions will protect the residential housing market, which President Franklin D. Roosevelt viewed as the "wheel within the wheel to move the whole economic engine."

A workout plan is a tool used between a lender and a defaulting homeowner to ensure repayment of the mortgage, but in terms

127. See generally HENRY L. MCCLINTOCK, HANDBOOK OF THE PRINCIPLES OF EQUITY 47-49 (2d ed. 1948) (stating the historical reasons that equitable relief is used only when the remedy at law is inadequate).
128. See generally id. (discussing how equitable relief is "extraordinary" not "ordinary").
130. See supra text accompanying note 117.
131. The interest rate basically consists of two parts: the base and the amount of risk. NELSON & WHITMAN, supra note 3, at 2. The base is set by the market and the interest exceeding the base reflects what the company hopes to make and what the risk is worth to the lender. Id.; see also Koopmans v. Farm Credit Servs. of Mid-Am., 102 F.3d 874, 876 (7th Cir. 1996).
132. Letter from Pamela S. Johnson, Senior Vice President, Fannie Mae, to All Fannie Mae Single-Family Mortgage Sellers and Services (Feb. 14, 2006) [hereinafter Fannie Mae Letter, Feb. 14, 2006], available at http://www.efanniemae.com/sf/guides/ssg/annltrs/pdf/2006/10106.pdf (reminding mortgage sellers and servicers of relief provisions that should be used: forbearance, foreclosure moratorium, deed-in-lieu of foreclosure, and limited circumstances for foreclosure). Fannie Mae also encouraged waiver of any prepayment penalty if the mortgage was to be paid off by insurance proceeds. Id.
133. Wright, supra note 11, at 250.
alternative to the original note.\textsuperscript{134} Notably, this malleable tool seeks to overcome a pervasive paradigm regarding residential mortgages: Either the homeowner is current with all payments or one missed payment results in a lender's absolute right to foreclose.\textsuperscript{135} The mortgage industry is in the beginning stages of overcoming this stigma as evidenced by empirical data on the success rate of workout plans used to prevent foreclosure. Workout plans resulted in an eighty percent reduction in the probability of home loss among all loans and a sixty-eight percent reduction in loss for low- and moderate-income homeowners.\textsuperscript{136} Concerning the 2005 Gulf Coast hurricanes, Fannie Mae has utilized workout agreements consisting of forbearance for a determined period of time, foreclosure moratorium on residences located in the hardest hit counties, and refraining from reporting delinquencies to credit bureaus.\textsuperscript{137}

Legislation requiring workout plans may not be necessary. The parties have the ability to modify the contract and some lenders have offered workout plans on their own volition.\textsuperscript{138} Some states permit lenders to begin foreclosure seven months after acceleration of the loan, which may be adequate time for homeowners to resolve their problems.\textsuperscript{139} Some may even argue that legislated workout agreements should not occur because such legislation violates the sanctity of contract.\textsuperscript{140}

While lenders and homeowners may modify the agreement, the lender maintains superior bargaining power because the mort-

\begin{enumerate}
\item \textsuperscript{134} Cutts & Green, supra note 4, at 5-6.
\item \textsuperscript{135} Id.
\item \textsuperscript{136} Id. at 21, 23.
\item \textsuperscript{137} Fannie Mae Letter, Feb. 14, 2006, supra note 132.
\item \textsuperscript{138} See Jason Scott Johnston, The Return of Bargain: An Economic Theory of How Standard-Form Contracts Enable Cooperative Negotiation Between Businesses and Consumers, 104 Mich. L. Rev. 857, 870 (2006) (describing the relation between the standard-form contract and parties' power to bargain and that the form is crucial to maintain the relationship).
\item \textsuperscript{139} To sell a house in Illinois, for example, one must wait the longer of seven months from the date of filing or three months from the date of judgment. 735 Ill. Comp. Stat. 5/15-1603 (West 2006). Similarly, in Vermont:

No sale of a dwelling house of two units or less when currently occupied by the owner as his or her principal residence may take place within seven months of service of the foreclosure complaint, unless the court finds that the occupant is making waste of the property or the parties mutually agree after suit to a shorter period.

\item \textsuperscript{140} See, e.g., Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 448-82 (Sutherland, J., dissenting) (arguing an advancing gradual encroachment upon the sanctity of private and public contracts).
\end{enumerate}
gage is an adhesion contract. Moreover, the lender is currently not required to offer any workout agreement. The lender-homeowner relationship is analogous to the railway worker-railroad company relationship. Congress recognized the significance rail transportation had on the economy. The Railway Labor Act (RLA) reflected Congress's effort to foster economic peace between railroad labor and management. Harm from railway disputes reverberated throughout the economy. Just as the RLA provided regulatory stability to a vital area of the economy, standardized relief provisions offer similar stability to the residential housing industry by providing better mitigation of loss incurred from a large-scale natural or economic disaster.

Justice Holmes rightly declared that "'experience'" is the "'life of the law,'" and no experience is greater than crisis or emergency. Times of crises demonstrate certain formalities of the law inevitability yield practical solutions to human problems. In fact, lenders increasingly use workout agreements to avoid additional loss. Lenders voluntarily turned to workout plans for 155,495 delinquent mortgages in 2004; and in the first quarter of 2005 alone recognized a significant increase to 89,741, approximately a forty-three percent increase. While lenders are making efforts to manage the current stream of delinquent loans, current number of


145. Levinson, supra note 52, at 726 (quoting OLIVER WENDELL HOLMES, THE COMMON LAW 1 (1881)).

146. Id. at 727.

147. E.g., Amundson & Rotman, supra note 16; Cutts & Green, supra note 4; Johnston, supra note 138.

workouts is just a trickle compared to the massive delinquent reservoir from which they flow.\textsuperscript{149}

Overall, the workout plans implemented by legislation need to be consistent and sufficiently flexible in dealing with the legitimate social interest of homeownership.\textsuperscript{150} Measures discussed below can function individually or be combined with others to mold the mitigation response to each fact-sensitive situation. Ultimately, the workout plan should seek to balance the lender's contractual rights with the homeowner's interest to fulfill the contractual obligations and retain the home.\textsuperscript{151}

G. \textit{No- and Low-Cost Mitigation Measures}

A potential challenge to any mitigation measure is that a party may want to retain the initial contractual rights that were enjoyed prior to a catastrophe.\textsuperscript{152} The mitigation measure, by its very application in post-disaster relief, changes the balance, mostly against a lender's interest. Some measures are easily implemented with insignificant costs; but other measures have substantial financial consequences for lenders. The lender's burden could be justified by the benefit to society of avoiding unconscionable results.\textsuperscript{153} Another view is that such measures discussed below are nominal in cost and do not impact a lender's right and ability to eventually receive repayment of the indebtedness.

Pragmatically speaking, the homeowner should give something in return for the benefit of mitigation measures in post-disaster relief. A simple way is to predetermine the value of a relief provision, associate a dollar amount with it, and apply the relief cost to the balance of the loan upon implementation. The cost can be a flat fee or a percentage of the loan.\textsuperscript{154} A percentage-based fee is a better option because it addresses the degree of risk the lender faces—the larger the loan, the more the lender may lose. The flat-fee scheme makes it more difficult to assess the value from loan to loan and more arbitrary to determine an amount. Similar to a common prac-

\textsuperscript{149} The volume of mortgage originations in 2004 was $2.7 trillion. 2007 \textit{Reporter Fact Book}, \textit{supra} note 6, at 35.

\textsuperscript{150} Cutts & Green, \textit{supra} note 4, at 13; see also Wright, \textit{supra} note 11, at 242.


\textsuperscript{152} Rosenthal, \textit{supra} note 93, at 897, 912.

\textsuperscript{153} \textit{Id.} at 909.

\textsuperscript{154} See \textit{supra} text accompanying note 131.
tice to pay points or fees at closing to reduce an interest rate, a percentage-based relief provision bases the fee on the outstanding principal balance at the time of implementation. For some of the mitigation measures outlined below, it would be appropriate for the homeowner to pay for the relief option, rather than forcing the lender to shoulder the costs alone.

1. Notice of Rights

Some lenders currently use workout plans at their discretion. However, most homeowners have no notice or knowledge of the availability of such measures. Legislation should place an affirmative duty on lenders to notify homeowners in disaster areas of what rights or options they have to manage a mortgage obligation in the wake of a crisis. Notice overcomes a real problem that unsophisticated homeowners face: not knowing what can be done after the disaster. Many homeowners fail to consider contingencies when signing financing documents. Lenders are in a better position to understand workout plans and educate customers.

Legislation, however, may not be necessary since some lenders already communicate relief provision to homeowners. The contractual agreement states obligations, rights, and remedies. The homeowner has a similar availability to communicate with the lender. Additional notice may be viewed as unnecessary because the contract already outlines remedies. Yet, mortgage terms and business practices are likely to vary within the industry and can be better managed by legislation.

Notice overcomes the homeowner’s mindset that lenders demand each monthly payment without modification. The cost to lenders is insignificant, and the party’s contractual obligations remain intact and unencumbered with such a simple term. Mandatory notice to a homeowner that the lender may discuss the

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156. Amundson & Rotman, supra note 16, at 849. Initially, the 1985 Minnesota moratorium law did not require that the homeowner be notified of statutory relief provisions. Id. However, this was subsequently modified by the Minnesota Legislature in 1986. See 1987 Minn. Laws ch. 292, § 36 (repealing Minn. Stat. §§ 583.01-.12, Minnesota’s moratorium on mortgage foreclosures).
158. Cf. Cutts & Green, supra note 4, at 6, 13 (stating that Fannie Mae strongly encouraged servicers to contact borrowers and determine their status of rebuilding, payoff indebtedness, or abandonment).
159. See supra text accompanying note 120.
160. Cutts & Green, supra note 4, at 3-4, 13.
modification of contract terms is a straightforward mitigation measure that needs no additional fees to implement.

2. Credit Reporting Hold

The industry lending practice is for lenders to report late or missed payments to credit bureaus. Another no-cost measure to mitigate loss would be for a lender to refrain from reporting missed payments due to a disaster to credit agencies. A hold on credit reporting acknowledges the impact of circumstances that exist beyond a homeowner’s control and avoids creating an inaccurate representation of the homeowner’s credit fitness.

While lenders generally reserve the right to report delinquent mortgage payments as leverage for repayment, this provision is not essential to the obligation for the homeowner to repay principal and interest. In the context of a disaster, a damaged credit rating decreases the likelihood that homeowners will obtain subsequent financing, rental housing, or other services based on credit ratings. Thus, the homeowner’s financial fitness and character is under additional strain, and the inability to prevent foreclosure increases. A hold on reporting a mortgage payment delinquency is likely to avoid this result. This relief provision can readily be implemented with little cost to the lender. Thus, the homeowner should not be required to pay fees for such relief.

3. Forbearance

Forbearance is a relief measure that many lenders have utilized in response to the 2005 Gulf Coast hurricanes. Forbearance of mortgage payments can be a short-term suspension (one-to-three month) or long-term (four-to-twelve month) of mortgage payments. Repayment of the suspended payments may occur (1) at

162. Id.
163. See generally 2007 REPORTER FACT BOOK, supra note 6, at 19-20 (discussing the options that homeowners have for nonpayments).
164. Id. at 22-24.
165. See Freddie Mac, Mortgage Uniform Instrument, supra note 120 (indicating that forbearance may be appropriate).
166. Amundson & Rotman, supra note 16, at 843 (stating that delayed payments can be amortized back into the loan to reflect the homeowner’s arrearages). Short-term repayment can be made at the end of the forbearance period, long-term payments can
the end of the forbearance period as a "balloon" payment or (2) after the maturity date is extended to the extent of the forbearance period. Government Security Enterprises (GSE) like Fannie Mae and Freddie Mac have strongly encouraged mortgage partners to temporarily forbear collection of principal and interest payments to those affected by Hurricane Katrina.

A temporary delay in a mortgage-indebtedness payment is a financial risk to the lender. The delay in payment, in effect, shifts the short-term recovery costs to the lender even though many mortgage agreements leave the onus for payment on the borrower. While rarely recognized by courts, another risk a lender faces is forbearance acting as a waiver of the acceleration clause.

This "shock absorber" approach is unique because during forbearance the "middle man" protects mortgage investors and homeowners at no additional government expenditure. Forbearance is a highly viable relief measure because of the elasticity provided by securitization in the secondary mortgage market. GSEs have the capacity to absorb a large amount of non- or partial payments with no additional government funding, as illustrated by the current lender response to the 2005 hurricane season. This type of relief provision is more suited to charge a homeowner a percentage-based fee, which helps offset the strain on the lender resulting from the temporary stoppage of payments.

4. Reverse Mortgages

A reverse mortgage is another measure to provide relief to lenders and homeowners and to mitigate loss deriving from a disaster. This mortgage tool has historically been used for elderly

be amortized back into the loan or paid in full at the end of the period and, lastly, the loan can be negotiated and permanently modified in terms that the homeowner can afford. United States Housing Market, supra note 2, at 6.

168. Silverman, supra note 163; Freddie Mac, Mortgage Uniform Instrument, supra note 120.

169. Freddie Mac, Mortgage Uniform Instrument, supra note 120 ("Borrower shall pay when due the principal of, and interest on, the debt.").
172. See supra text accompanying note 137.
homeowners who have a low debt-to-equity ratio. The "cash-rich" home serves as collateral for the mortgage, and the lender makes monthly payments to the "cash-poor" homeowner by charging the payment against the home's equity. All the fees to implement this measure can be lumped into the loan when reversed. At the end of the loan period, the homeowner must pay the indebtedness in full or modify the loan terms.

One drawback is the possibility of a sharp reduction in the home's equity caused by a disaster. Lenders require that the collateral meet specific equity levels for this type of financial tool to be feasible. Without the equity cushion, the lender would shoulder an unreasonable amount of the risk.

However, in the cases where sufficient equity remains, temporary application of reverse mortgage principles ensures that full and timely payments are made to the lender and the homeowner does not default on the contractual obligation. The reverse mortgage is beneficial when the homeowner faces economic inability to make payments. An example would be if the homeowner's employer's business is destroyed or delayed and the homeowner has no income to pay the mortgage. The reverse mortgage avoids the high cost of government grants and regulatory oversight. Even though a reverse mortgage increases the lender's risk with a higher loan-to-value ratio, the lender will receive monthly installments that would be in doubt without the application of the reverse mortgage. With

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174. Amundson & Rotman, supra note 16, at 844. This measure is ideal for economic disasters where the homeowner is cash-poor and house-rich. Id. at 845.

175. Id. at 844. For each transfer the loan balance will grow that amount of principal and interest will be charged on that amount. Id.

176. United States Housing Market, supra note 2, at 6. Nearly three-quarters of homes impacted by Hurricane Katrina suffered a loss in equity of up to half of the pre-disaster value. Id.

177. Amundson & Rotman, supra note 16, at 844.

178. Id. at 845. Legislation or the parties would need to establish a minimum amount of equity necessary. Id. This base could be the amount needed for the homeowner to resume payment or remedy the default. Id. For example, twelve months for a disaster small in scope where recovery is quicker and twenty-four months for a large-scale disaster where relief is slow. Victims of Hurricane Katrina would generally fall under the twenty-four month period.

179. Id.

180. See generally Wright, supra note 11. The HOLC response to the Great Depression was to make a large amount of monies available for loans and the FHA implemented regulation on the mortgage industry to improve the impoverished housing market. Id. Since Hurricane Katrina, the federal government has allocated $11.5 billion dollars in reconstruction efforts: $6.2 billion for Louisiana and $5.058 billion for Mississippi. Department of Defense Appropriations Act of 2006, Pub. L. No. 109-148, 119 Stat. 2680, 2779-80 (2005); Brown, supra note 1, at 51.
the homeowner remaining in the home, the collateral is protected.181 The homeowner could simply petition the court for statutory exercise of the reverse mortgage, which avoids the increased burden of out-of-pocket mortgage payments during efforts to repair the home and provide alternative housing.182

5. Disaster Default Insurance

Mandatory mortgage default insurance is another possible measure to mitigate loss resulting from a disaster.183 Conceptually, default insurance is where an insurer continues to pay the monthly mortgage payments to the lender and the homeowner does not become delinquent on the loan. In contrast to hazard insurance, it does not insure against loss to the physical structure, just payment for mortgage payments to prevent delinquency. This measure would insure against the homeowner’s inability to pay the monthly mortgage payment due to circumstances beyond his control arising from a large-scale disaster.184 The homeowner would pay the premium along with the monthly payment of principal, interest, property taxes, and hazard insurance.185 After a crisis, the homeowner would file a claim and the third-party insurer would pay the lender monthly mortgage payments, on behalf of the homeowner, for a predetermined period of time. Thus, lenders would receive their monthly mortgage payments, while homeowners could apply available resources to recovery efforts without becoming delinquent on the loan.

181. Amundson & Rotman, supra note 16, at 845. Essentially the fictional transfer from the lender to the homeowner serves as rent. Id.

182. E.g., Sutherland v. Barclays Am. Mortgage Corp., 61 Cal. Rptr. 2d 614, 617 (Cal. Ct. App. 1997). If repairs are necessary, the homeowner’s burden doubles: paying rent while fulfilling the obligation to make existing mortgage payments. All this is done while paying costs associated with the disaster: repairs, replacement of lost personal property, or additional travel expenses. Id. at 617-18.

183. Generally, hazard insurance issues fall outside the purview of this Article.

184. Homes & Communities, U.S. Dep’t of Hous. & Urban Dev., 203(b) Mortgage Insurance, http://www.hud.gov/offices/hsg/sfh/sfns/sfh203b.cfm (last visited Feb. 16, 2007). If the mortgage enters default and the home is sold for less than the remaining mortgage debt, then the private mortgage insurance covers the shortage and the borrower has no deficiency judgment looming.

In theory, default insurance spreads the risk of loss across a greater base, thus, lessening the financial impact. The premiums paid by the homeowner would likely be minimal and provide relief to each policyholder at a critical juncture that would facilitate recovery for both individuals and the housing industry. In practice, however, this mitigation measure will ultimately fail. Historical experience with the hazard insurance industry teaches that insurance is too small a tool to deal with large-scale disasters.

While insurance appears on its face to be a reasonable loss-mitigation measure, disasters have exposed a flaw of home hazard insurance: magnitude. For example, in 1992, Florida's hazard insurance claims from Hurricane Andrew exceeded some insurance companies' ability to cover the $17 billion in insured damage. As a result, policyholders "submitted 280,000 claims and recovered [only] $11 billion or 65 percent of total insured loss," while seven smaller insurers became insolvent. Florida's legislative response to the insurance failure created the state-run Residential Property and Casualty Joint Underwriting Association and the Florida Hurricane Catastrophe Fund, which yield significant hope to mitigate the financial loss caused by future disasters.

However, the underlying problem remains: the magnitude of large-scale disasters. Because of this issue, many insurance companies have already exited the industry. If private insurers offer disaster default prevention policies, premiums are likely to be cost prohibitive. The state-run insurers have a finite fiscal capacity. At this time there is not a third line of defense against astronomical economic loss, leaving the insurance industry vulnerable. If a state institution is to shoulder the over-burdensome economic loss, government insolvency is a distinct possibility.

The 1994 California Northridge earthquake resulted in $12.5 billion in residential damage and overwhelmed insurers' financial


187. Id. at 167-69 (outlining the disastrous results of Hurricane Andrew, the largest natural disaster to date).

188. Id. In 1992, Florida property insurers collected $1.5 billion in premiums. Claims paid out were ten times greater than premiums paid. Id. at 168.

189. Id. at 167-68. Of the 300 insurers providing coverage before Hurricane Andrew, thirty-four gave notice to state insurance regulators of the intent to withdraw permanently and twenty-nine insurers reduced their coverage options in Florida. Even the reinsurance companies limited coverage offered to Florida residents. Id. at 168.

190. Id. at 167.
capacity to respond to the policyholders' claims.\textsuperscript{191} This natural disaster resulted in ninety-three percent of earthquake insurers either drastically reducing hazard insurance or refusing to underwrite policies completely.\textsuperscript{192} Not only were Northridge earthquake claims on shaky ground, but reduction in participating insurers threatened the viability of the housing market and efforts to emerge from the current economic recession.\textsuperscript{193}

Some insurance companies in the California residential industry exited the market and the state government responded by creating a state-run insurance program.\textsuperscript{194} In 1996, California responded by organizing the California Earthquake Authority (CEA) as a privately funded, publicly managed program to insure against future earthquake loss.\textsuperscript{195} California, as a result of the autonomous CEA, is the largest residential earthquake insurer in the world.\textsuperscript{196}

Hurricane Andrew and the Northridge earthquake resulted in unpaid or partially paid claims and essentially left the residential insurance market with few willing participants. One study estimated that another hurricane, with the same force in the same location as Andrew, would cause damages close to $70 billion—nearly double the 1992 figure.\textsuperscript{197} State government is now the insurer, and it is unclear whether the state insurance programs can satisfy future natural disaster claims. Should an exorbitant number of claims be submitted, who will bail out the state governments' insurance implosion? State-sponsored social welfare policies should not extend to include this kind of insurance program because its sustainability is unproven. Homeowners living in risk-prone areas should shoulder the risk when it arises, rather than requiring persons at much lower risk levels to assume heavy financial costs.

For large-scale disasters, default insurance is a less effective mitigation measure. This type of insurance will fail to meet the

\begin{itemize}
\item \textsuperscript{191} California Earthquake Authority, http://www.earthquakeauthority.com (last visited Feb. 16, 2007).
\item \textsuperscript{192} Id. To remedy the inability or exit of insurers, state government established state-run insurance programs with the caveat that once existing reserves are exhausted, no more relief is available. CAL. INS. CODE § 10089.30 (West 2005).
\item \textsuperscript{193} California Earthquake Authority, supra note 191.
\item \textsuperscript{194} FARBER & CHEN, supra note 186, at 197.
\item \textsuperscript{195} CAL. INS. CODE §§ 10089.5-.54.
\item \textsuperscript{196} California Earthquake Authority, supra note 191. This only took two years. The CEA was created in 1995 and in 1997 it became one of the largest earthquake insurers. Cal. Earthquake Authority, History, http://www.earthquakeauthority.com/index.aspx?id=7&#pid=1 (last visited Aug. 15, 2006).
\item \textsuperscript{197} FARBER & CHEN, supra note 186, at 168.
\end{itemize}
overwhelming demand of claims filed by policyholders. In addition, insurance companies tend to limit coverage or withdraw from the insurance market after disasters, resulting in numerous and costly claims, thus leaving the homeowner, housing markets, and general economic health exposed and vulnerable.

III. THE HEAVY HAND OF CRAMDOWN LEGISLATION

A. Introduction

Historically, farmers have been afforded financial relief by means of a forced debt reduction. Lawmakers have often compared the plight of farmers with that of homeowners. Homeowners, in the wake of Hurricane Katrina, suffered rapid home depreciation and undersecured debt just as farmers during the 1980s experienced notable depreciation of land that led to undersecured mortgage debt.

The Chapter 12 cramdown bankruptcy provision made available for family farmers should also be available for homeowners. Many perceive farmers as the backbone of America. Similarly, the residential mortgage industry, in the view of many, is essential to the American economy. During times of disaster and despair, public outcry has rung in the ears of lawmakers to assist the farmer and to assist the homeowner. A high number of farm foreclo-

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199. FARBER & CHEN, supra note 186, at 161.


201. Geyer, supra note 151, at 333.

202. Id.; see Brown, supra note 1, at 34.


205. Wright, supra note 11, at 242.

206. See Amundson & Rotman, supra note 16, at 822-23 (describing the public sentiment for the governor and legislatures to help ailing farmers); Wright, supra note
sures depresses equity of adjoining farms, just as a high number of home foreclosures depresses equity in the residential community.\footnote{207} Congress should give the same degree of deference to homeowners recovering from a devastating catastrophe that it has offered to distressed family farmers.

\section*{B. Congressional Cramdown Precedent}

Secured-debt intervention dates back to the Depression era with the Frazier-Lemke Act.\footnote{208} From 1935 to 1949, this legislation enabled the adjustment of farmers' debt by extension of repayment periods, moratorium on creditors' collection rights, and redemption of farms at current appraised values.\footnote{209} In 1986, farmers received debt assistance under Chapter 12 which allowed bifurcating undersecured debt into secured debt (the actual value) and unsecured debt (loan amount less the present value).\footnote{210}

The farming credit crisis of the 1980s is another instance where lawmakers codified cramdown provisions.\footnote{211} Nearly forty percent of owners' equity evaporated through land value depreciation from 1981 to 1985.\footnote{212} During this time, farm commodity prices were below the cost of production, unemployment levels were near record highs, the dollar was strong, exports were weak, and interest rates were extremely high, leaving farmers in grave risk of losing their farms through foreclosure.\footnote{213}

Even though lawmakers conditioned Chapter 12 with a sunset provision, Congress has consistently renewed the provision so that cramdown relief is still available to family farmers.\footnote{214} Congress

\begin{itemize}
\item \cite{207} Farm Bankruptcy Hearing, supra note 204, at 32 (statement of Rep. Michael Synar).
\item \cite{208} Geyer, supra note 151, at 334.
\item \cite{209} Id.
\item \cite{210} Id.
\item \cite{211} White, supra note 200, at 1-2.
\item \cite{212} 131 Cong. Rec. 16,927 (1985) (statement of Rep. De La Garza); Farm Bankruptcy Hearing, supra note 204, at 83 (statement of Ewen M. Wilson, Deputy Assistant Secretary for Economics, U.S. Department of Agriculture).
\item \cite{213} See Wright, supra note 11, at 806.
continues extending cramdown provisions as a viable option for family farmers even though the general conditions present at the time of the initial passage no longer exist. Therefore, the cramdown is a tested and trusted means to protect a vital community interest and to give family farmers a fighting chance to recover from economic disaster. This protection should be available to qualified homeowners who are affected by natural or economic disasters.

In response to the 2005 Gulf Coast hurricanes, Congress once again considered cramdown provisions. In the 2005 Baker Bill, which did not pass due to its complexity and efforts to acquire hurricane damaged properties, the House considered offering the cramdown provision as a part of recovery efforts to Hurricane Katrina. Concededly, Congress’s action to forego the Baker Bill indicates less inclination to give homeowners the same benefits as farmers. However, the cramdown provision is still of interest to other politicians. Louisiana state lawmakers are debating whether to enact similar cramdown measures for their citizens participating in the Louisiana Homeowner Assistance Program.

C. Basic Structure of Cramdown

Chapter 12 permits “bifurcation of undersecured debt into secured and unsecured debt.” The secured amount is the post-cramdown appraised value and the unsecured amount is the...
original mortgage amount less the secured post-disaster value.\textsuperscript{221} Some terms, such as the amortization period and interest rate, may be changed under Chapter 12.\textsuperscript{222} The principal and interest payments are revised and based only on the secured debt.\textsuperscript{223}

The potent cramdown provision is not a remedial measure for all, especially those who are highly leveraged.\textsuperscript{224} The cramdown already passes a large unbargained-for loss to the lender. For highly leveraged financing, the lender takes a greater loss than a lower loan-to-value ratio would sustain. The highly leveraged homeowner has less incentive to recapture equity owing to the lender. However, Congress, in its wisdom, made this provision available to family farmers even though it deprives the creditor from having the power to foreclose the land.\textsuperscript{225}

Reducing principal and interest payments based solely on secured mortgage debt is a practicable solution that lessens the monthly payment burden on the homeowner and preserves the lender's share of future asset appreciation.\textsuperscript{226} Thus, foreclosure is less likely to occur because the lender's security is preserved and likely to appreciate while the homeowner continues making payments against the mortgage indebtedness.

One drawback of the Chapter 12 cramdown provision is that it fails to recognize and secure any postcramdown appreciation of the collateral that appears under Chapter 11 of the Bankruptcy Code.\textsuperscript{227} While appreciation is likely to be gradual, any increase must be recognized and secured.\textsuperscript{228} With time and effective resources, most homeowners can regain pre-disaster equity, and this equity growth should be shared with the lender in the form of cor-

\begin{footnotes}
\item 221. Id. The rewriting of the debt does not unconstitutionally impinge upon the lender's property rights because the reduced debt is what the lender would have received from the foreclosure sale. Id. at 338.
\item 222. Id. at 334.
\item 223. Id. at 335.
\item 224. Farm Bankruptcy Hearing, supra note 204, at 49 (statement of Richard F. Stagmen). If the farmer has exceeded sixty percent debt-to-asset ratio, the cramdown provision is not an appropriate remedy. Id.
\item 225. White, supra note 200, at 17. In this case, the lender's right to foreclose, for practical purposes, is not allowed under Chapter 12 cramdown. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 425 (1934) (upholding a Minnesota moratorium statute that was partially based on the reasoning that the right to foreclose was not eliminated).
\item 226. See Geyer, supra note 151, at 335-37 (noting that Chapter 12 merely provides the creditor the right to “request an equitable share of future asset appreciation”).
\item 227. White, supra note 200, at 8-9.
\item 228. Geyer, supra note 151, at 335.
\end{footnotes}
relating secured security interests. Mortgage cramdown is a more effective relief provision.

D. Rationale for the Residential Mortgage Cramdown

Reducing the secured debt and payments to pragmatic amounts reasonably and effectively balances both parties' interests. From the lender's perspective, the amount recovered at a foreclosure sale would, in theory, equal the post-disaster value of the home, but would include administrative and legal costs to realize the sale. The cramdown measure reduces the secured debt to the level that the lender would recover at a foreclosure sale and avoids most administrative fees. Some costs arise in implementing the cramdown. Therefore, the secured debt maintains the lender's interest in the value it would have received from foreclosure and costly foreclosure costs are not realized. The cramdown measure places the lender in a similarly situated position as an executed foreclosure action. In addition, home values are not decreasing, which results in larger profits from interest rates based on larger loan amounts. If lenders do foreclose, they remove their lender hat and begin to wear their property manager hat. Generally, however, lenders are not in the business of maintaining properties, assuming property liabilities, and disposing homes.

From the homeowner's perspective, he retains ownership and a vested interest to rebuild and recover. A reduced mortgage payment facilitates the homeowner's ability to make monthly payments and, as a result, his financial well-being remains largely intact. Society benefits because greater loss in home values is avoided. The difficult situation is dealt with between the parties and does not require societal financial assistance. Also, tax revenues are preserved because the property tax based on home values is not further reduced during the post-disaster period.

Traditionally, lenders hold superior bargaining power over the homeowner by maintaining the threat of foreclosing on the security interest. In some instances the threat of foreclosure leads to the

\[229. \text{The argument made by creditors is that a debtor will use the cramdown provision when the market is depressed and then sell the land for a substantial profit when market prices increase. White, supra note 200, at 8-9.}
230. See Geyer, supra note 151.
231. Id. at 335.
232. Id.
233. White, supra note 200, at 18-19.]
forced sale of the home, giving credibility to the threat.234 In practice, the lender does not have or exercise superior bargaining power over homeowners because foreclosure threats made by lenders are seldom carried out.235 Moreover, the idea of sustaining the lender's threat of foreclosure is minimized because the existing industry paradigm is that homeowners must pay the mortgage; if not, the lender will foreclose.236

The cramdown measure efficiently mitigates loss because crippling foreclosure costs are not realized. Home value appreciation is more likely where the homeowner remains in the home with the incentive to repair and maintain the premises.237 Moreover, the appreciation directly reduces or eliminates the problem of the mortgage being undersecured.238

Another reason why a cramdown is efficient mitigation is that the lenders may adjust the interest rate according to risk when initially extending credit.239 Courts and legislators recognize that “[m]arket rates of interest measure the real risks of nonpayment and the costs of collection.”240 Lenders are in the business of calculating risk and charging borrowers accordingly. The downside is that less credit is likely to be made available to homeowners, thus reducing homeownership affordability. In response to the family farmer crisis during the 1980s, lenders with knowledge of cramdown measures kept interest rates at comparable levels and implemented more conservative lending practices for future loans.241 The codification of the cramdown measure did not cause interest rates to spike like the lenders clamored it would.242 The farmers faced the same problem that confronts homeowners who would benefit from the cramdown: lenders extending less credit. A fewer number of homeowners would qualify for mortgage financing.

234. Id.
236. Id. at 2.
237. Geyer, supra note 151, at 337. When a homeowner retains possession, taxes are likely to be paid, which generates revenue for local government and schools. Further, home values are not depressed by low foreclosure sales. In addition, homeowners have incentive to work, which helps economic recovery.
238. Id. at 334-35. Many are critical of the Chapter 12 structure that prohibits the lender to recognize the appreciation of the collateral. If this fixed base line was removed, then the undersecured problem would be minimized.
239. See generally Koopmans v. Farm Credit Servs. of Mid-Am., 102 F.3d 874, 876 (7th Cir. 1996).
240. Id.
242. Id.
Most large-scale disasters expose the reality between those who have more and those who have less. Historically, society has collectively taken efforts to extend a helping hand to those who fall victim to such disasters. As noted above, during the Great Depression, allocating congressional funds was a less effective means to recover from a catastrophe. Rules and regulations have worked better to create a more effective recovery system. Overall, the cramdown measure extends assistance to disaster victims at nominal cost to governments, businesses, and individuals.

Some lenders argue that a cramdown measure increases the debtor’s wealth and decreases the creditor’s equity. The right to foreclose permits the lender to elect to foreclose and recapture the home’s value at the current levels or to defer foreclosure intending to hedge for future appreciation. The cramdown measure, in its most basic form, makes the decision for the lender. The Chapter 12 scheme suspends foreclosure and destroys the lender’s right to elect whether or not to carry the mortgage, thereby allocating appreciation to the debtor. Because the post-disaster recovery period is so pivotal to both parties and decisions must be made relatively quickly, the decision to make cramdown measures available must be made long before the unfortunate circumstances rear their ugly heads.

A cramdown measure in response to large-scale disasters should integrate the concept of shared appreciation between homeowner and lender. Sharing the home’s appreciation is the most pragmatic approach to balancing each party’s interests in the wake of a cramdown. Shared appreciation minimizes transfer of wealth from the lender to the homeowner and seeks to place both parties in the position they would have been in but for the disaster. Moreover, little wealth transfers from richer citizens to poorer citizens.

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243. White, supra note 200, at 23.
244. Wright, supra note 11, at 242, 246.
245. See generally supra Part I.C.
247. White, supra note 200, at 23.
248. Id.
249. Id.
250. See Geyer, supra note 151, at 341.
because policy-based remedies cost taxpayers very little to implement this measure of disaster relief.251

Congress allocated $11.5 billion in Community Development Block Grant funds for areas impacted by Hurricane Katrina and Hurricane Rita.252 This is a patent transfer of wealth from the taxpayer who has more, to the victim who has less.253 A cramdown measure, with shared appreciation, will not redistribute the wealth from the lender to the homeowner.254

The general rule in America is that freedom to contract exists for all.255 Upon entering the mortgage obligation, one is bound to fully comply, regardless of the circumstances.256 Many homeowners take pride in ownership and in honoring their obligations to repay outstanding debt. Affording homeowners the chance to pay the debt retains their dignity and self respect, which public policy recognizes as traditional farmer and homeowner values.257

This issue is real. In one setting, the onus felt by an indebted person to repay debt strained a citizen of North Carolina into taking his life because he was unable to cope with the dire circumstances of undersecured debt and his momentary inability to meet his pecuniary obligation.258 No financial obligation, no matter the amount, is worth a person’s life. Policy and law should encourage

251. See generally Wright, supra note 11. This is one reason why the FHA was so successful in long-term recovery efforts during the Depression era.


253. Wright, supra note 11, at 242-43. The HOLC’s focus was to thrust money into the mortgage market to reverse the tightening of available credit. Id.

254. The idea of wealth transfer is difficult to quantify. It is merely a guessing game contingent on factors like appraisal value, consumer surplus, and market demand versus the property owner’s valuation. See generally White, supra note 200, at 22-29 (discussing redistribution of wealth in Chapter 12 bankruptcy cases). Lending institutions argued that a cramdown measure would result in less credit availability because banks would withdraw from the market. Furthermore, the exiting lenders would justify high lending costs and interest rates passed to the farmer. Id. at 26-27. However, over time these fears were not realized. In fact, the interest rates remained at relatively normal levels and a very small number of agricultural lenders increased their interest rate. Given the farming credit crisis, the response was expected, with or without the cramdown provision. Banks implemented more conservative lending policies such as more reliance on cash flow and decreasing loans based on security interest in collateral. Geyer, supra note 151, at 339-41.

255. See generally Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 448 (1934); White, supra note 200, at 17.

256. Id.


parties to honor financial obligations while caring for those reeling from a large-scale catastrophe.

E. Substitutes as Incentives

Where a lender is subjected to cramdown provisions and incurs financial loss from the homeowner’s delay in payments or failure to fully repay, substitutes should ameliorate the loss. The law should make certain “carrots,” as well as “sticks,” available to lenders whose secured mortgaged debt is reduced by cramdown measures. The intent of substitutes is to place the lender as close as possible to the original mortgage terms being fulfilled. Lenders are in the business to increase profit by increasing revenue or reducing costs. While substitutes are not likely to increase a lender’s revenue, they can reduce costs that lenders have in their business operations. Tax incentives and a goodwill system are discussed in turn.

One incentive for lenders would be tax incentives to those subjected to cramdowns. For example, a tax credit or deduction based on all or part of the bifurcated unsecured mortgage debt financially benefits a lender and softens the financial blow. The reduction in tax revenue, admittedly, is a detriment to the general tax base because it reduces tax revenue from lending enterprises. The lender would further benefit, in addition to the tax incentive, where the homeowner repays, in part or in full, the unsecured debt.

Creating a system to rank or standardize a lender’s recovery efforts is yet another incentive to enhance the goodwill of the lending institution. Just as borrowers are rated by a credit system, a

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260. A gap created by reduced payments and security is filled by incentives that differ in terms from the original mortgage obligation.

261. See, e.g., I.R.C. § 165(a) (2006) (“There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.”).

262. See id. Similar tax provisions can be implemented to benefit those lenders affected by the mortgage cramdown.

263. This proposed goodwill concept is analogous to the State of Washington’s or the U.S. Department of Agriculture’s (USDA) efforts to establish goodwill by means of grading apple quality. The Supreme Court upheld the Washington State Apple Advertising Commission’s efforts to keep grade labeling on apple boxes sold in North Caro-
lender can be evaluated on their efforts to help homeowners in a natural disaster. Although quantifying the value of goodwill imposed by such a system may seem complex, the benefits are substantial. The lenders’ enhanced reputation will help retain current borrowers and attract new customers. This is of particular importance in an industry where lenders are constantly seeking to retain and attract patrons.

Tax deductions and a goodwill system cannot replace the original terms of the mortgage contract. However, these incentive measures smooth over the scarring and gaps arising from the mitigation efforts that the cramdown provision affords. The incentive measures are of particular importance to the lender because cramdowns harshly reduce their valid, secured mortgage interest.

The cramdown measure is not intended to be an absolute cure; rather a tool of last resort. This stiff, but reasonable, measure gives homeowners a fighting chance to pick themselves up and continue forward with relief efforts. A looming cramdown equals the bargaining power during workout negotiations. As a result, fewer homes foreclose, fewer neighborhoods are economically depressed, lenders may receive payment in full, and the individual homeowner and community are empowered with an opportunity to overcome tremendous financial burdens.

lina, where a North Carolina statute prohibited labeling displayed on closed apple boxes. Hunt v. Wash. State Apple Adver. Comm’n, 432 U.S. 333 (1977). Washington State, the nation’s largest apple producer, has a specific agency to promote and protect the state apple industry, thereby protecting the goodwill of Washington apple farmers and sustaining their profits. Id. at 336-37. The apple industry views Washington State apples as equal or superior to those graded according to the USDA standards. Id. at 351-52. That grading system is a tool that molds public perception which in turn benefits Washington State farmers’ reputation and pocketbook. Id.

264. See Marcus, supra note 259, at 725-27.
265. Id. at 718-19.
266. White, supra note 200, at 26-27. The workout agreement is done in the shadow of the farmer’s alternative of a Chapter 12 cramdown. Id.
267. In comparing the cramdown provision to elements set forth by the Supreme Court in Blaisdell, the debate is on what is “reasonable.” Home Bldg. & Loan Ass’n v. Blaisdell, 290 U.S. 398 (1934). First, the cramdown seeks to protect a vital community interest, homeownership. Id. at 444-45. Second, the legislation implementing cramdown provisions addresses the protection of the legitimate social interest of disaster recovery and community sustainability. Id. at 445. Third, the provision is based on the appropriate and reasonable conditions of a large-scale disaster that significantly impacts lives, homes, and communities. Id. Fourth, conditions must consider both parties because appreciation in the home’s equity is recognized as secured debt and payments are based on the smaller secured debt—rather than on the original indebtedness. Id. at 445-46. Fifth, the cramdown provision is only limited to the particular disaster. Id. at 447.
Conclusion

Thus, we see that recovery costs of natural disasters alone can be enormous as demonstrated by Hurricane Katrina’s estimated property damages of $75 billion. If homeowners stumble into default and foreclosure results, the associated costs are significant for both the homeowner and lender. Furthermore, the ripple effect is widespread, impacting both communities and industries through depressed prices, lost revenues, and lost tax base.

Empowering the contracting parties for long-term success, not ephemeral monetary aid, is the appropriate action to take. A standardized framework is the means by which lenders can determine future risk and associated costs, and homeowners are afforded knowledge of and access to mitigation measures. In considering less effective and more effective mitigation measures, organizing standardized relief provisions fosters the necessary post-disaster perspective for the homeowner and lender, and preserves, while not perfectly, both parties’ prevailing contractual interests. The favorable, tangible end result is secured homeownership, diminished financial loss for the residential mortgage industry, and hastened community recovery.

268. See Brown, supra note 1, at 34.
269. Id.
270. See id.; Hatcher, supra note 97.