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The *Ibanez* decision and the foreclosure business

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Last week, in a Massachusetts Land Court decision, Judge Long issued a Memorandum and Order denying the motions to vacate the previous judgments that he had entered in the consolidated cases of *U.S. Bank National Association v. Ibanez* and *Wells Fargo Bank v. Larace* (both referred to hereinafter as the "*Ibanez*" decision). Effectively, Judge Long thereby reaffirmed his earlier decision in *Ibanez,* which invalidated the foreclosure sales because the foreclosing entities were not the mortgage holders "at the time" of the foreclosure, nor did they have a valid assignment of the mortgage pursuant to Massachusetts law. Judge Long rejected the banking industry's arguments in favor of a strict construction of the requirements that need to be followed by a foreclosing party under M.G.L. c. 244 Section 14 (hereinafter referred to as the "Massachusetts Foreclosure Procedure Act"). The banking industry had argued that (1) "post-sale mortgage assignments to the successful bidder, even if backdated should suffice", (2) that the foreclosing entities should be "statutorily deemed to be the "present holder" of the mortgage" because they possessed the note, a blank mortgage assignment, and a series of off-record assignments by which they were entitled to a mortgage assignment in recordable form", and (3) that the foreclosures initiated by the foreclosing entities were "valid because they were done at the direction of the actual mortgage holder."

To understand the industry ramifications the *Ibanez* decision may have, a detailed look at the facts and issues of the case is necessary.

Although there were several issues under consideration in *Ibanez*, the primary and most important issue was whether the foreclosing entities had "the right . . . to foreclose the subject mortgage in light of the fact that the assignment of the foreclosed mortgage . . . was ***not executed or recorded*** until ***after*** the exercise of the power of sale."

It had become common in the mortgage industry, that in order to create the volume in the money supply that the market was demanding, mortgage loans were sold

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into a trust, packaged into pools based upon their credit quality, and then syndicated to qualified investors in a private or public offering underwritten by Wall Street banks.

This is precisely the situation that occurred in *Ibanez*.

Specifically, a home buyer needing financing would take out a loan from a bank. Once the loan closed and funded, the lending bank, needing to free up as much of its capital as possible to make more loans, would sell the loan to an "Originator." This Originator, who would often also act as the servicer of the loan, would then sell the loan to a large Wall Street Bank, such as a Lehman Brothers (the "Investment Bank"), and in doing so would endorse the note in blank, making it payable to bearer, and would execute an assignment of the mortgage in blank, which, while possibly acceptable in other states, is not legally sufficient, and does not create a recordable assignment in Massachusetts.

Interestingly, the syndication documents themselves expressly stated that the assignment needed to be "in recordable form" in the jurisdiction in which the property is located.

The syndication process would then roll on, with the Investment Bank selling the loan to a Depositor, which was typically one of their subsidiaries. The Depositor would in turn sell the loan into a Trust, managed by a Trustee, who was usually a different financial institution. The documents in the Trust would all be held by a Custodian, often a different entity altogether. All these entities along the way were earning fees based upon these purchases and/or assignments.

The Trust would then group all the loans it purchased into a pool and would issue certificates, which were purchased by the Investment Bank itself. The Investment Bank would then sell the certificates to qualified investors in a private or public offering.

Therefore, at various points in the syndication process, the mortgages were sold and assigned to as many as 4 or 5 different entities, and each time, **although the syndication documents themselves required each mortgage to be assigned in recordable form**, these assignments were not completed, were not recorded, and were not in the correct form to be recorded in Massachusetts.

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The resulting fact was that, when an underlying mortgage went into default and a foreclosure action was initiated, it was done so in the name of the Trust, or the Trustee acting on behalf of the Trust, whereas, according to the Registry, the actual mortgage itself was still owned by the Originator.

Correspondingly, the requirements of the Massachusetts Foreclosure Procedure Act that the foreclosing entity was required to complete, were therefore, completed by a party that did not actually own the mortgage in the legal sense at the time that it was foreclosing on the mortgage.

Only after the foreclosure had taken place, in fact, sometimes up to a year after the foreclosure had taken place were these assignments correctly drafted, signed by the necessary parties and recorded (a procedure referred to as "backdating") when in fact the law requires that these procedures be completed at the time of the foreclosure. The only exception that could cure such assignments would be where the lender would assign the mortgages it was selling to an agent on behalf of the mortgage holder, such as the Mortgage Electronic Registration Service ("MERS"), rather than to the Originator itself. In the *Ibanez* case, however, this was not the case, so this exception was not applicable.

The right to foreclose on a mortgage is contained in the "statutory power of sale" provision.

In Massachusetts, the power of sale can only be invoked by the mortgage holder or an assignee of the mortgage holder. To assign a mortgage in Massachusetts, the assignment must identify the assignee and the assignor, and the Massachusetts Foreclosure Procedure Act requires that the foreclosing entity must hold the mortgage or a valid assignment in "recordable form" at the time of the foreclosure.

During the syndication process, these assignments were not properly made, and the mortgages were foreclosed upon by a party that did not have a valid assignment at the time of the foreclosure.

Therefore, the Massachusetts foreclosure procedures were not followed correctly. In fact, the foreclosure notices identified the wrong party as the owner of the mortgage. Based on these procedural violations, Judge Long invalidated the foreclosures.

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The banking industry claimed in its motions to reverse the Court's decision, that these procedural violations were mere technicalities, but evidently, Judge Long does not agree with that contention.

The Court's position was that in a foreclosure, because you are dealing with people's homes, their equity in those homes, and the possibility of the former homeowner being liable for a deficiency judgment to the lender in addition to losing their home, strict construction of the foreclosure procedures was warranted.

In fact, the suggestion the Court seems to be making is that, because lenders will foreclose on a person's home relying only upon the four corners of the documents signed by the borrowers and those documents alone, without consideration of exigent circumstances, and, as lenders are notoriously reluctant to modify the terms of the mortgages they hold, they cannot ask the Court to look the other way and allow them to complete a procedure that neither complies with the laws of the Commonwealth, nor their own documentation.

It was also not lost on the Court that the banking industry itself brought these actions to obtain a declaratory judgment of the interpretation of the law. They framed the issue themselves in their court filings, and then, when they didn't like the decision cried foul.

It is actually very ironic that lenders asked a Court to approve the foreclosures at issue based upon an incomplete set of documents mandated by their own syndication documents; documents that breached their own covenants by failing to secure a valid assignment in recordable form at each step in the securitization process, and which thereby were in non-compliance with the Massachusetts foreclosure procedure, by making an argument that these were technical violations. It's almost a perverted version of the too-big-to-fail argument. Analogizing that argument to Main Street, it is hard to envision a homeowner, down on his luck, and in default of his mortgage, successfully arguing that a Court should keep him in his house by ignoring the mandated terms of the mortgage document by which the lender seeks to use to foreclose on his property.

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Judge Long, in my opinion, quite correctly states that what the banking industry wants and **needs, is a change in the law**, which is something that the Legislature needs to take up, and **not** the Massachusetts Land Court.

So, the banking industry messed up, and its legal arguments were trashed, but what does that mean for the Massachusetts mortgage market:

The ramifications of the *Ibanez* decision in Massachusetts means that any other foreclosures on syndicated mortgages like the *Ibanez* mortgage, other than those that could claim the MERS exception, could be invalidated. Moreover, people who have already purchased homes through the foreclosure process may not have clear title to their properties. This could cause a chilling effect on both institutions needing to foreclose on a mortgage, as well as on purchasers, or potential purchasers of a property through a foreclosure auction, as well as on the ability or desire of title insurance companies to deal with this "break" in the chain of title, and issue a title insurance policy to a buyer and their lender.

The Legislature or the State's highest court will have to clarify the issue, but until then, short sales and modifications, rather than foreclosing, may become more palatable to banks, and foreclosure purchases may become lengthier due to the title uncertainties raised by the *Ibanez* decision. Inevitably, buyers, even though faced with increased legal fees and title costs, may be able to get better deals from banks wanting to offload their distressed properties. On the flip side, as banks still need to fund these purchases, and if they tighten their underwriting standards, as happened with investor purchases (vs. owner-occupied properties), institutional buyers like Distressed Asset Funds, rather than individual purchasers may become bigger buyers of distressed properties.

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