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Lisa Herbold
Leg, RES Principal Reduction
November 20, 2013
Version #4~~3a~~

CITY OF SEATTLE
RESOLUTION 31495

A RESOLUTION exploring mortgage principal reduction and other foreclosure prevention programs for low-income homeowners in order to support and revitalize communities impacted by the foreclosure crisis.

WHEREAS, since 2006, nearly five million families nationally have lost their homes to foreclosure, nine million Americans have lost their jobs, and ten million families now owe more on their mortgages than their homes are worth; and

WHEREAS, in response, the Seattle City Council passed Resolution 31434 to "explore all legal options to assist low-income homeowners who continue to suffer from the foreclosure crisis" and commissioned a report on "the circumstances and causes of foreclosures and the foreclosure methods and practices of lenders, including reviewing any apparent inequities people in Seattle may face when lender foreclosure proceedings occur;" and

WHEREAS, according to the "Hockett Report," the loss of wealth and density of foreclosures in several Seattle zip codes is high; and

WHEREAS, in 2012 estimates of homeowners who were underwater on their mortgages ranged from 24,000 to 42,000 with homeowners owing on average $65,900 to $131,800 more on their mortgage than their homes are worth; and

WHEREAS, to date in 2013, there are 1,765 homes in the City that have had Notices of Trustee Sales issued, which is the initial step in the foreclosure process; and

WHEREAS, foreclosures in the City have adversely impacted communities of color in Seattle with nearly 8% of Seattle's African-American and Latino homeowners foreclosed upon to date as compared to 4.5% for white homeowners; and

WHEREAS, the rates of homelessness among children in Washington has risen fifty percent since the housing bubble burst and the Seattle School District reports that nearly 2,000 of its 49,000 students are homeless with 47% of them being African American; and

WHEREAS, the City of Seattle has provided relief to struggling homeowners in the past with a Foreclosure Prevention Program that helped forty homeowners with financial and mortgage counseling, assistance in negotiating loan modifications, and "stabilization loans" of up to $5,000; and

1
2 WHEREAS, because mortgage debt overhang is one of the primary drags on economic recovery and, at one point nationally, an estimated $1 trillion more was owed than our nation's
3 homes were worth, principal reduction on underwater homes may aide in our economic recovery.
4
5 NOW, THEREFORE,

6 **BE IT RESOLVED BY THE CITY COUNCIL OF THE CITY OF SEATTLE, THE**
7 **MAYOR CONCURRING, THAT:**
8
9 Section 1. The City Council will form an Interdepartmental Team (IDT) to explore
10 principal reduction and other foreclosure prevention programs that can help low-income
11 homeowners who have significant negative equity and may be at risk of losing their homes due
12 to foreclosure. The IDT shall be led by Council Central Staff and departments requested to
13 participate on the IDT include the Law Department, the Office of Housing, and the Budget
14 Office.
15
16 Section 2. By March 15, 2014, the IDT will report to the City Council Finance
17 Committee and the Housing Committee on, at minimum, the following elements:
18 a) The financial and legal implications of the three principal reduction programs
19 proposed in the Hockett Report (Attachment 1),including information on current
20 legal challenges related to the implementation of these programs, as well as, any
21 negative financial impacts for municipalities implementing any of these programs.
22 b) A review of the Hockett Report summary (pages 11-21) , as well as, other new
23 and existing programs and state laws, including, but not limited to, the
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1 Washington Foreclosure Fairness Act, that specifies the types of low-income
2 homeowner mortgages that are eligible for various program specific assistance.
3 b)c) A recommendation onf which of these programs and alternative
4 approaches to reducing the risk of foreclosure are the most promising to pursue.
5
6 Section 3. Based on the IDT's recommendation for a particular principal reduction
7 program or other foreclosure prevention programs, by June 1, 2014, the IDT will provide a
8 secondary report to the City Council Finance Committee and Housing Committee that will, at
9 minimum, provide the following elements:
10
11 a) The characteristics of low-income homeowner mortgages that might qualify for
12 participation in a principal reduction program or other foreclosure prevention
13 program , including an estimate of the number of loans and the average benefit to
14 borrowers and the attendant economic benefit to the community.
15 b) A strategic plan for the development of a principal reduction program or other
16 foreclosure prevention program including a timeline and program development
17 deliverables.
18 c) A list of the potential partners with whom the city could work to fund a principal
19 reduction program or other foreclosure prevention program and the potential cost
20 of such a program.
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Adopted by the City Council the ____ day of ____________________, 2013, and signed by me in open session in authentication of its adoption this________ day of ______________________, 2013.

____

President ___________of the City Council

THE MAYOR CONCURRING:

____

Michael McGinn, Mayor

Filed by me this ____ day of ________________________, 2013.

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Monica Martinez Simmons, City Clerk

(Seal)

Attachment 1: Post-Bubble Foreclosure-Prevention and Mitigation Options in Seattle

Post-Bubble Foreclosure-Prevention and -Mitigation Options in Seattle

Robert Hockett*

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I. Introduction

American residential real estate prices plunged nationwide in 2006-07, bringing a catastrophic end to a decade-long housing price bubble fueled by excess credit and often predatory nonprime lending. Since then, trillions of dollars in wealth has been lost, and 11 to 13 million Americans have been left "underwater" on mortgage debt: their homes are worth less – often *much* less – than they owe on their loans.[1] This has proved devastating to investing and home-owning families, their communities, and the nation's economy at large.[2]

Communities of color have been particularly hard hit. Because they were heavily targeted by subprime and other "alternative" mortgage originators pursuant to a practice that has since come to be known as "reverse redlining," these communities were steered disproportionately into home loans that were especially prone to go bad once home prices turned south and then plummeted. A telling indicator is the percentage of African American nonprime borrowers who actually qualified for prime

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* Professor of Financial Law, Cornell Law School; Consulting Counsel, International Monetary Fund (while on sabbatical during the 2012-13 academic year); Resident Scholar, Federal Reserve Bank of New York, 2011-2012

[1] See Robert Hockett, *Paying Paul and Robbing No One*, 19 (5) CURRENT ISSUES IN ECONOMICS AND FINANCE 1, Federal Reserve Bank of New York (2013), available at http://www.newyorkfed.org/research/current_issues/ci19-5.html; Robert Hockett, *It Takes a Village*, 18 (1) STANFORD JOURNAL OF LAW, BUSINESS, & FINANCE 121 (2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2038029; and Robert Hockett, *Six Years On and Still Counting: Sifting Through the Mortgage Mess*, 9 (1) HASTINGS BUSINESS LAW JOURNAL 1 (2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2029262. Fuller elaboration of some of the non-Seattle-specific points made below can be found in these articles.

[2] See, e.g., Federal Reserve Board, *The U.S. Housing Market: Current Conditions and Policy Considerations*, White Paper, January 4, 2012, at 3. Also William C. Dudley, 'Housing and the Economic Recovery,' Remarks at the New Jersey Bankers Association Economic Forum, January 6, 2012, available at http://www.newyorkfed.org/newsevents/speeches/2012/dud120106.html.

loans but were steered into subprime by loan originators looking for high subprime fees. The current estimate is that this number is 35%.[3]

Against this backdrop, it is not difficult to understand why so many American cities, and especially communities of color, are now in difficult straits. Deeply underwater home mortgage loans are exceedingly difficult to stay current on, often impossible to refinance, and accordingly prone to default in high numbers.[4] This brings widespread foreclosure and consequent homelessness, blight, and slow growth or slump to economic activity and employment. The latter, in turn, feed back into further depressed home values and yet more difficulty among homeowners in keeping current on mortgage loan payments. This is why cities with heavy concentrations of underwater loans – and heavily nonwhite neighborhoods in such cities in particular – are the most blighted and prone to go bankrupt of all of the nation's communities.[5]

While in some states the crisis appears to be partly abating, for now, as foreclosure rates slow somewhat from recent record high levels, in other states foreclosures continue at high rates or even to rise.[6] Washington is one of those states, and Seattle is one of its harder hit cities. Figure 2 breaks down current Seattle foreclosure densities by zip code. As will be noted, many are quite high by national standards.

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3 See, e.g., filings in Department of Justice (DOJ) suit against Countrywide, available at http://www.justice.gov/usao/cac/countrywide.html.

4 See sources cited supra, notes 1 and 2. See also Fannie Mae and Freddie Mac 10K data cited infra, note 34, and accompanying text.

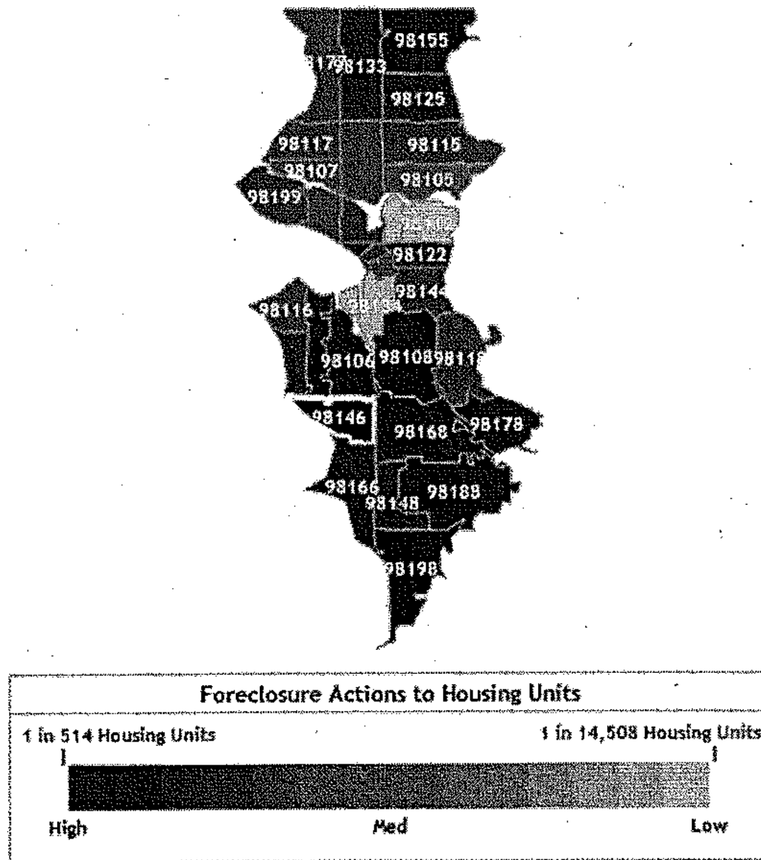
5 See sources cited supra, notes 1 and 2.

6 Although it is not the principal concern of this Report, it bears noting at least in passing that there are multiple reasons to be skeptical of claims of "recovery" in the housing markets even outside of Seattle. First, the negative equity problem, as further documented below, is highly localized in character and especially concentrated among communities of color; and these communities have seen little if any recovery in home prices – indeed quite the contrary. See, e.g., Nathaniel Popper, "California's Inland Empire Still in Housing Tailspin," *New York Times*, September 13, 2013, available at http://dealbook.nytimes.com/2013/09/13/california-inland-empire-still-in-housing-tailspin/?_r=0.

Second, much of such price recovery as there has been in some of the nation's local markets is attributed by financial market watchers to speculative purchases of foreclosed homes by investment banks aiming to convert these to rental properties – an aim greatly facilitated, for now, by continued quantitative easing on the part of the Federal Reserve and a consequent "search for yield" on the part of high end investors. To tell, e.g., residents of the west coast who used to own their homes that they will now be able to rent their "recovering" homes from, say, Goldman Sachs, and to tell them that this is "recovery" would seem premature if not facetious. A more telling number where real housing "recovery" is concerned is the rate of homeownership among American families, which has just declined to its lowest level in 18 years. See, e.g., Prashant Gopal & Clea Benson, "American Dream Slipping as Homeownership at 18 Year Low," *Bloomberg*, July 30, 2013, available at http://www.bloomberg.com/news/2013-07-30/american-dream-erased-as-homeownership-at-18-year-low.html.

Finally third, it should be noted that true, sustainable recovery is in a certain sense impossible by definition absent principal-reduction. For mortgage debt overhang left over from the bubble's bursting can only be eliminated by some combination of eliminating the debt or inflating prices back toward their bubble-era highs. Since a return to the latter would be neither desirable nor sustainable, it would seem to follow virtually by definition that true, sustainable recovery awaits principal-reduction.

Figure 1: Seattle Foreclosures by Zipcode
(Source: RealtyTrac)



Some analysts believe that foreclosures have been delayed in Washington and some other states, such as New Jersey, because they are states that were proactive relatively early on in the crisis, enacting legislation and implementing programs that worked to delay default and foreclosure. Washington was one of these "early intervention" states thanks to its Foreclosure Fairness Act and other programs discussed below.

Now, however, Washington's still underwater loans are again falling into foreclosure – precisely because, as we shall see, principal-reduction is by definition the only way to eliminate the debt overhang that acts as the principal predictor of default and foreclosure on severely underwater homes. This underscores the necessity of permanent solutions that target negative equity as such like those discussed further below, as distinguished from that mere "delay of the inevitable" which mediation and refinance options provide.

This Report aims to make the case for new, more effective means of trimming back negative equity in Seattle. It first provides a brief overview of the foreclosure crisis in Seattle, in both its quantitative and qualitative dimensions (Part II). The Report then turns to the range of foreclosure-prevention and -mitigation options currently on offer, highlighting and accounting for the modesty of

these programs' accomplishments to date (Part III). The Report then lays out potential solutions that have yet to be considered in Seattle (Part IV) – solutions that target negative equity as such, rather than merely lowering interest rates or extending the terms of indebtedness. The Report then concludes with specific recommendations of policy solutions that are likely to show the greatest efficacy in arresting and reversing Seattle's ongoing foreclosure problem (Part V).

II. Overview of Seattle's Underwater Loan and Foreclosure Profile

We start by taking the measure of Seattle's and King County's underwater mortgage loan and foreclosure problems, beginning with the latter. As we shall see, in both cases the problem appears to be worse than that of the nation at large, notwithstanding that the latter is itself still widely recognized to be operating as the principal drag upon post-bust national economic recovery.[7]

A. Types of Underwater Loans

Before proceeding, we should note two preliminary points. The first is that underwater mortgage loans divide into three salient types, with each type benefitting more by some kinds of foreclosure-prevention or -mitigation measures than by others.

The first type comprises loans that are held in their entireties, as so-called "whole loans" or "portfolio loans," by banking and other depository institutions. Next come loans that are held by one or another of the government-sponsored enterprises ("GSEs"), principally Fannie Mae or Freddie Mac. These are the so-called "GSE loans." Finally come loans held by private label securitization ("PLS") trusts, which issue mortgage-backed securities ("MBS") that a variety of individual and institutional investors hold as investment securities entitling them to the proceeds of loan payments received by the trusts. These are the so-called "PLS" loans.

The second preliminary point to note is that information on *raw numbers* of underwater portfolio, GSE, and PLS loans is difficult to come by; one must derive "educated guesses," via one or more competing methodologies, on the basis of other forms of information which are themselves subject to considerable uncertainty and variation. This is (a) partly because much of the raw data on point is proprietary, (b) partly because most information, be it proprietary or publicly available, is not categorized in a manner that tracks the cross-product of the salient categories mentioned above – underwater and above water loans on the one hand, portfolio, GSE, and PLS loans on the other hand – and (c) partly because all of these forms of information, be they proprietary or publicly available, are themselves derived by providers using differing methods of data-collection and -analysis.[8] What is true of portfolio, GSE, and PLS loans as categories, moreover, is all the more true of loans categorized according to income or ethnic status of borrowers; the best that one can do by way of quantifying underwater loan totals according to the income or ethnic status of their borrowers is to track the loans

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7 See sources cited supra, notes 1 and 2, and infra, note 9.

8 See infra, note 17, for more on the perils of negative equity and foreclosure estimation.

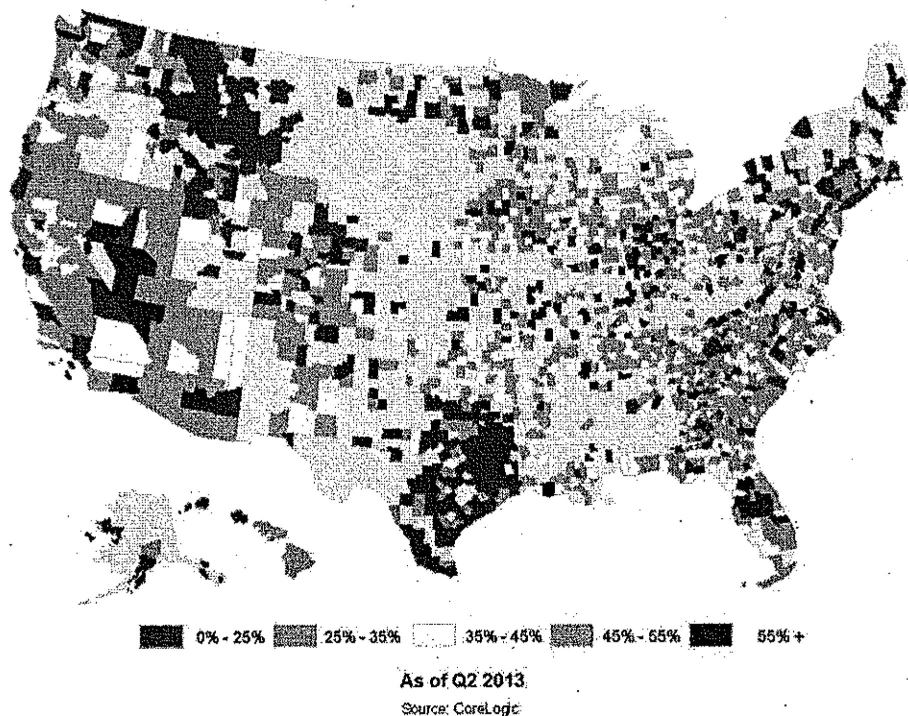
by Zip Code as is done below and then endeavor as best as one can to get a read on the income and ethnic concentrations within those Zip Code areas.

Notwithstanding all of these caveats, it is possible to derive *ranges* of certain *likely* numbers from such publicly available numeric and statistical information as is available, then to test at least some of those derived numbers against such proprietary information as one can lay hold of. We proceed in that manner here.

B. Negative Equity in King County

Turning now to our brief overview of underwater mortgage loans in King County, the first thing to note is that the nation's underwater mortgage loan problem, although national in its significance, is nevertheless highly localized in its origins and continuing character.[9] The following map, on which redder patches represent localities with higher concentrations of negative equity and bluer patches represent localities with higher concentrations of positive equity, affords a helpful pictorial snapshot.

Figure 2: Negative Equity Share by County



The next thing to note is that the State of Washington in general and King County in particular have suffered substantially even if not as dramatically as, say, the "sun" and "sand" states in the nation's southwest and southeast; they include noticeable "yellow" and "hot pink" zones on the map. At the time of this writing, Zillow suggests that average single family home value in the County, at $329,500,

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9 See sources cited supra, note 1, for more on the localized character of the nation's ongoing negative equity problem. See also Robert Hockett & John Vlahoplus, *A Federalist Blessing in Disguise: From National Inaction to Local Action on Underwater Mortgages*, 7 HARVARD LAW & POLICY REVIEW 253 (2013).

lingers some 24% below peak (circa 2006).[10] Per the same source, approximately 26% of County homeowners are in consequence underwater on their mortgage loans, with an average loan-to-value (LTV) ratio between 120 and 140%.[11] Ten percent of these loans, moreover, are "seriously delinquent" – that is, three or more months in arrears.[12] This suggests that King County could have a good many more foreclosures to come unless it acts soon to prevent them.

The foregoing figures appear to be worse than the national average in one case, while appearing more or less to match it in the other: somewhere between one-fifth and one-quarter of the nation's approximately 50 million outstanding mortgage loans are underwater, while about ten percent of these in turn are in some stage of delinquency or foreclosure.[13]

It should also be noted, before turning from the County to the City, that the picture in King County's *neighboring* counties likewise is bleak, meaning that recovery cannot be expected to find its way into King County from nearby. Again per Zillow, Pierce County home prices linger at 33% below peak, for example, with 45% of loans underwater, an average LTV between 140 and 160%, and 12% of loans seriously delinquent.[14] The comparable figures for Snohomish County are 30% below peak, 40% underwater, an average LTV of about 180%, and 11% of loans seriously delinquent.[15]

Other nearby counties – Gray's Harbor, Island, Kitsap, Mason, and Thurston, not to mention Lewis and points further south – lie between King on the one hand, Pierce and Snohomish on the other along all salient dimensions.[16] They are faring a bit worse even than King, while somewhat better than very hard hit Pierce and Snohomish. A final point to be noted is that census tract data reveals that there are parts of Seattle with foreclosure rates as dramatic as those of Pierce and Snohomish Counties, as we shall see in the next subsection upon turning to data disaggregated by city and zip code rather than by county.

C. Negative Equity in Seattle

Turning now to Seattle in particular, note first that, per the most recent available data, Seattle has as many as 42,000 underwater loans encumbering homes located within its jurisdiction, per higher-end estimates, and likely no fewer than 24,000 such loans, per lower-end estimates.[17] The higher figure,

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[10] For this and for further King County and neighboring county data elaborated immediately below, see Zillow, The U.S. Housing Crisis: Where Are Home Loans Underwater, "infographic" available at http://www.zillow.com/visuals/negative-equity/#4/39.98/-106.92. Note also that, as discussed further infra, Zillow figures tend in general to be lower than comparable figures provided by competing data-providers, meaning that the estimates here provided are likely conservative.

[11] Idem.

[12] Idem. There are no figures for numbers of delinquent loans shy of "seriously" delinquent.

[13] See sources cited supra, notes 1 and 9.

[14] Idem.

[15] Idem.

[16] Idem.

[17] For reasons to accept the higher-end estimates, see Saqib Bhatti, *The Wall Street Wrecking Ball*, White Paper, United Black Clergy and Washington Community Action Network (May, 2013) (employing data derived primarily from Catalist, RealtyTrac, and Zillow), available at http://washingtoncan.org/wordpress/wp-

taken from a recent Report using data compiled mainly by Catalist, would lie in the neighborhood of 40% of Seattle's approximately 100,000 mortgage loan total, a remarkable statistic, while the lower figure, derived by the present author employing a conservative estimation methodology and national data from early in the summer of 2013, would lie in the neighborhood of one quarter of the total. Either

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content/uploads/2013/05/SeattleHomeWreckers_ClergyFinalpm.pdf. As for the lower-end estimates, these were derived in an earlier draft of the present Report prepared early in the summer of 2013 by the present author, taking Seattle to be representative of the nation as a whole. Treating Seattle's population as a percentage of that of the nation as a whole, then on that basis conservatively assigning to Seattle a pro rata share of the national figures on mortgage loans outstanding and percentages of loans underwater, that early draft arrived at a figure of some 24,000 underwater loans.

a brief word on loan-estimation methodology will be in order. As suggested earlier in the text, estimating mortgage loan figures is nearly as much art as it is science. Different datasets compiling distinct kinds of data are maintained by distinct parties, all of whom differ both in respect of what they are gathering their data for and in respect of how willing they are either to provide or to sell their data to others. Add to this consideration the fact that differing methods, each with their own advantages and disadvantages, are available for extrapolating larger truths from smaller datasets, and it is easy to appreciate why one must speak in terms of "plausible *ranges*" of "*likely or possible*" values rather than of "*the* correct" value when speaking of city-wide, county-wide, state-wide or nationwide numbers of loans, numbers or percentages of underwater loans, average negative equity amounts, ethnicity or and income status of borrowers, and the like.

Speaking now more generally, there are five major providers of mortgage loan and/or foreclosure data on an aggregated basis: Catalist, CoreLogic, ListSource, RealtyTrac and Zillow. All of these vendors employ *modeling* formulae to *estimate* underwater loan and/or foreclosure numbers rather than aggregating data from actual loan-by-loan document inspections, which would be neither logistically practicable nor legally permissible. There tend in consequence to be wide variations among estimates provided by these data-aggregators. For example, at the time that the *Wrecking Ball* report was composed, the overall national underwater figures entailed by Catalist's and Zillow's data were both 13 million, while that estimated by CoreLogic was 10 million. In 2011, these variations were yet wider, with Zillow's data implying a figure of 16 million underwater homes nationwide and CoreLogic's implying a figure of 11 million.

At local rather than national levels, variations tend to be more dramatic still, presumably owing to smaller available sampling sizes. Hence some cities show significantly higher figures than others per some reports, while showing significantly lower figures than those others per other reports. For example, while Catalist's Q4 2012 Zip Code by Zip Code data implied a figure of some 42,000 underwater home loans in Seattle as noted above, ListSource data entailed a figure of about 31,000, the present author estimated the number at some 24,000 earlier in the summer, and some Zillow personnel suggested orally in early September (though Zillow has not claimed this via its publicly available negative equity reports) that the figure might be as low as 17,000.

A final point to be noted is that underwater loan and negative equity figures fluctuate significantly with home prices on a seasonal basis each year. See *Paying Paul*, supra note 1, for more on this. In consequence negative equity figures are quite season-sensitive, such that discrepancies between differing reports' estimates always are attributable in part to the *intra-year time periods* with which the reports are concerned. Sales numbers and hence prices typically improve each year at the tail end of the spring and summer "buying seasons," for example, then worsen again in the autumn and winter. A given city's Q1 or Q4 data will accordingly differ substantially from its Q3 data, for example – and all the more so when different data-aggregators' differing datasets and estimation methodologies are employed between quarters. One must, then, again think in terms of likely ranges rather than particular numbers when taking the measure of particular cities' negative equity and foreclosure problems. Regardless of the plausible range of data estimating the amount of underwater mortgages, one should keep in mind that we are still looking at a problem that affects tens of thousands of Seattleites.

figure would likely place Seattle above the national average, which has ranged between one-fourth at the high and one-fifth at the low end since the crash and nearer the latter in recent studies.[18]

Assuming, conservatively, that Seattle's negative equity problem is representative of King County's as described conservatively above, average negative equity on Seattle's underwater homes would be approximately .30 x $329,500 = $98,850. Were Seattle instead at the low end of the King County negative equity range while its home values were still representative of the County's, then its average negative equity would be approximately .20 x $329,500 = $65,900, while the comparable figure at the high end would be .40 x $329,500 = $131,800. Both the middle and high-end figures, which would seem more consistent than the low-end figure with the color-coded maps provided above, would significantly exceed the comparable state and national figures of approximately $73,000.[19]

It should finally be noted that Seattle's negative equity problem is not evenly distributed across City Zip Code areas. Areas 98104, 98106, 98121, 98148, 98168, and 98178, for example, have underwater home mortgage loan concentrations of 43%, 38%, 39%, 42%, 44%, and 40%, respectively.[20] Insofar as these areas are primarily communities of color, the observations above on the ethnic composition of the ongoing underwater loan crisis are corroborated in Seattle. The crisis is not solely, but certainly is largely, a crisis borne by communities of color.

Seattle's foreclosure statistics bear this out.[21] Nearly 8% of Seattle's African American and Latino mortgagors have been foreclosed upon to date, as compared to a 4.5% figure for whites. African American families are 76% more likely than whites to experience foreclosure. One upshot of all of this foreclosure activity is rising rates of homelessness, once again disproportionately affecting communities of color. The rate of homelessness among Washington's children, for example, has risen 50% since the housing price bust.[22] The Seattle School District reports that nearly 2000 of its 49,000 students – over 4% - are now homeless, with 47% among them being African American.[23] Not accidentally, then, we find the greatest wealth losses, the highest negative equity incidences, the highest foreclosure rates, and the highest homelessness rates among those communities of color who were most heavily targeted by subprime PLS lending.

1. PLS Loans

We now disaggregate Seattle's underwater loans according to the salient categories elaborated above, beginning with the PLS loans that are most associated with nonprime, predatory lending – especially so-called "reverse redlining" of communities of color. We begin with these because they are

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[18] See idem, and sources cited supra, notes 1 and 9. See also George Erb, "About 28% of Seattle Homeowners Underwater: Zillow Report," *Puget Sound Business Journal*, August 28, 2013, available at http://www.bizjournals.com/seattle/news/2013/08/28/about-28-of-seattle-homeowners-remain.html. The same Zillow study cited in the latter story estimated the U.S. rate at 23.8%.

[19] Idem.

[20] Idem.

[21] See supra, note 3, for source of statistics cited in this paragraph.

[22] See http://www.wsws.org/en/articles/2011/01/wash-j25.html.

[23] Idem.

both (a) the most troubled in terms of percentages underwater, aggregate negative equity, and payment turbulence on the one hand, and (b) the least eligible for assistance under current loan modification and refinance programs on the other hand. We'll then turn to GSE and portfolio loans.

As the term "private" in "private label" might lead one to expect, information concerning PLS loans is largely proprietary and, therefore, difficult to assemble absent direct or indirect access to proprietary databases. As it happens, the author of the present Report does have indirect access to two such databases, the information from which proves more or less consistent with the calculations he is able to perform on certain classes of publicly available information.

To begin with the latter, then, note first that it is estimated that PLS loans constitute nearly or approximately 40% of the total number of mortgage loans outstanding nationwide.[24] Projecting that figure onto Seattle's underwater loans would yield a total of 16,800 underwater PLS loans at the 42,000 loan "high-end" estimate noted above, and a total of 8,400 such loans were we conservatively to knock down our estimate to 21,000 underwater loans in total. This procedure in all likelihood significantly underestimates the magnitude of Seattle's underwater PLS problem, however, owing to (a) PLS trusts' disproportionate share of speculative non-prime loans, which go delinquent and default at higher rates than prime loans;[25] (b) PLS loans' suffering more impediments to voluntary modifications as discussed below;[26] and (c) PLS loans' not qualifying for the federal modification programs discussed below. Staying with the 16,800 or 8,400 figures, then, will be to stay with conservative PLS estimates relative to the high-end 42,000 or low-end 21,000 underwater loan baseline.[27]

This observation finds support, we should note, in a recent Congressional Budget Office (CBO) report on the nation's underwater mortgage loan portfolio.[28] According to this report, while Fannie and Freddie owned or guaranteed about 28.5 million, or 59%,[29] of the nation's outstanding single family

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24 This and counterpart figures for GSE and portfolio loans are derived partly from informal polling of industry professionals known by the author, partly from federal regulatory reports cited at appropriate points infra. The figures are inherently uncertain, for reasons akin to those adduced supra, note 17.

25 See sources cites supra, notes 1 and 9, as well as discussion below.

26 Idem.

27 The author of this Report has secured indirect access to two proprietary databases of underwater loans whose creditor and debtor parties could be located immediately by the City were it to wish to move forward quickly on a modification program aimed at raising the values of PLS loans by writing down principal in order to diminish default risk. The first such database has been assembled by [*temporarily redacted*]. It includes data on some 2,320 underwater PLS loans secured by single family owner-occupied homes. Of these, 1,532 are current, 276 are seriously delinquent but not yet foreclosed, and 362 are in foreclosure. The current market value of properties securing these loans is about $639 million, while the outstanding principal owed on the loans that these properties secure is approximately $765 million. (The average property value is $276,000, while the average principal owed is $330,000.) This yields an average LTV of about 120%. It should also be noted that some 280 of these loans have LTVs exceeding 150%. The second proprietary database has been assembled by [*temporarily redacted*]. It includes data on 2,070 underwater PLS loans secured by single family owner-occupied homes. Of these, 1,288, or 62%, are current, and 782, or 38%, are either seriously delinquent or in foreclosure.

28 See http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/122xx/doc12213/06-02-gses_testimony.pdf.

29 Because these figures are recent, they are to some degree distorted. The reason is that private mortgage loan financing has all but disappeared, for the time being, in the wake of the 2006-07 housing price crash. In

home mortgage loans as of the last quarter of 2012, they held only about 27% of the *underwater* loans within that total.

2. Portfolio and GSE Loans

We can derive plausible estimates of Seattle's underwater GSE and bank portfolio loans via the same procedure employed above for PLS loans.[30] First, since about 10-15% of the national pre-crash home mortgage loan portfolio comprises first lien bank portfolio loans, we might initially estimate that at most some 42,000 x .15 = 6,300 of Seattle's underwater home mortgage loans would be underwater bank portfolio loans at the high end, or 21,000 x .15 = 3,150 such loans would be underwater portfolio loans at the low end. Because bank asset portfolios are regulated strictly in manners to which PLS trusts are not subject, however, this figure in all likelihood significantly overestimates the number of underwater portfolio loans just as the figure above in Subsection 1 *under*estimates the number of underwater *PLS* loans.[31]

Next, since approximately 50% of the national pre-crash home mortgage loan portfolio comprises GSE loans, [32] one might initially estimate that as many as half of Seattle's underwater loans could be underwater GSE-held loans. That would mean 21,000 loans were we to assume the high-end estimate of 42,000 underwater loans in total, or 10,500 loans were we conservatively to assume a lower end estimate of 21,000 underwater loans in total. Either way, this figure too will in all likelihood be a great deal higher than the actual figure inasmuch as GSE portfolios, like bank portfolios, are strictly regulated in manners to which PLS pools are not subject. As noted above, for example, the aforementioned CBO Report estimates that GSE loans comprise only 27% of the nation's underwater loan total. Applying that latter percentage to the 42,000 Seattle figure yields 11,300 instead of 21,000 underwater GSE loans, while applying it to the more conservative 21,000 Seattle figure yields 5,650 instead of 10,500 underwater GSE loans.

Weighing this data we estimate that at least 50% and probably rather more of Seattle's 21,000 to 42,000 underwater loans are PLS loans. This proves significant when we turn to assessing the success rates of currently available loan modification programs below, since none of them work on PLS loans.

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consequence some 86% of new mortgage financing is done by the GSEs, the Federal Housing Administration ("FHA"), and the Veterans' Administration ("VA"). In the period during which Seattle's now troubled mortgage loans would have been originated, the GSEs would have accounted for a smaller percentage – some 50% or less – of the total. Idem.

[30] In these cases, however, it is not possible for individuals to lay hold of raw numbers to corroborate the estimates. The City, however, as a government entity, might well be able to obtain such information via formal request made to the Federal Housing Finance Agency ("FHFA") as regulator and, since August 2008, conservator of the GSEs, and to the Office of the Comptroller of the Currency ("OCC") as primary regulator of those nationally chartered banking firms that hold the bulk of bank portfolio loans.

[31] It should also be noted that, because banks are not subject to the same collective action and other impediments to value-maximizing loan write-downs, all discussed below, to which PLS trusts are subject, there is yet more reason to infer that portfolio loans now represent a smaller portion of the underwater loan total.

[32] See supra, note 29, for the significance of "pre-crash" here.

III. Existing Foreclosure-Prevention Approaches: Modest Successes and Failures to Date

There is a potentially bewildering array of means available to at least *some* underwater homeowners in Seattle by which to ease the burden entailed by their status and thereby, in a few cases, avoid foreclosure. There are three vitiating weaknesses shared by nearly all of these means, however, which the numbers below reveal to be preventing their making much more than a dent in Seattle's foreclosure problem. That means in turn that some alternative or alternatives, including an eminent domain plan of the kind to be sketched below in Part V, will likely be necessary to address Seattle's problems more fully. It will be well for the reader to be aware of these weaknesses in advance, in order the better to appreciate why the numbers of beneficiaries we find below are so small.

The first weakness among currently available options is that they do not concentrate upon mortgage principal-reduction, meaning that they do nothing about the *underwater* status of underwater mortgage loans – which is, again, the principal predictor of default and foreclosure – at all. Instead they rely upon temporary forbearance, term-extension, or interest rate reduction. Though these are all modestly helpful, no adequate approach to the foreclosure problem can afford to avoid principal reduction, which is both (a) by definition, the only way to eliminate the ultimate *source* of the foreclosure crisis, which is mortgage debt overhang (i.e., negative equity, underwater status); and (b) for that very reason, widely recognized among leading economists as being the only longterm solution to the crisis.[33]

The second weakness of the currently available options is that they are *voluntary* from the *creditor's* point of view. That is problematic not because creditors lack in appreciation of their own enlightened self-interest or in desire to do the right thing, but because where there are structural or contractual barriers to principal reduction, as we shall see there are here in abundance, even *creditor-benefiting* such changes cannot occur on an adequate scale. Creditors are very often unable to do what benefits themselves and homeowners alike, meaning that voluntary programs are virtually useless.

Finally, the third weakness that the options discussed here suffer is that they do not extend to underwater *PLS* loans, which, as seen above, constitute the great bulk of troubled mortgage loans; they are in general available only to GSE and bank portfolio loans. The reasons for this, in turn, are essentially two. The first is that most PLS loans, which disproportionately comprise non-prime loans, are simply ineligible for assistance under the programs elaborated below. The second is that PLS loans, as we'll see, are especially, even if not uniquely, subject to the structural and contractual impediments to efficient writedowns mentioned above, meaning in turn that voluntary programs cannot help even the relative few that are eligible.

All three of these weaknesses are visible in the surprisingly small numbers of beneficiaries we'll find below in connection with all programs currently on offer. It will be helpful, in proceeding now to

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[33] See again sources cited supra, note 1. See also Robert Hockett & Richard Vague, *Debt, Deflation, & Debacle: Of Private Debt Write-Down and Public Recovery*, Global Interdependence Center, Federal Reserve Bank of Philadelphia, available at http://www.interdependence.org/wp-content/uploads/2013/04/Debt-Deflation-and-Debacle-RV-and-RH1.pdf.

those programs, first to offer a few observations concerning "spontaneously" creditor-offered debtor relief, which as noted above can be as helpful to creditors as it is to debtors. This affords opportunity to elaborate on the structural and contractual barriers to such relief mentioned a moment ago, a good understanding of which is necessary to appreciate why existing programs, voluntary as they are, tend not to be helpful – particularly where principal reduction is concerned.

A. Voluntary Writedowns

As noted in the Introduction, significantly underwater home mortgage loans are subject to significant default risk. A look at the expected default rates on Fannie Mae's underwater 2006 vintage loans, by way of one example, provides some hint of the magnitude of the problem. Subprimes default at a 71% rate, alt-A's at a 67% rate, and even 30-year fixed-rates default at a remarkable 40% rate.[34] When we factor in the costs of foreclosure and resale of foreclosed properties – particularly in an already depressed market – we can see straightaway why writing down principal can be a financially winning proposition not only for debtors, but for creditors as well.

At least partly for this reason, "spontaneous" voluntary principal write-downs occur at nontrivial and still growing rates among bank portfolio loans, while they do not thus occur in such numbers among GSE or PLS loans (for reasons to which we'll return). Evidence compiled by Laurie Goodman of Amherst Securities over the last several years, for example, suggests that portfolio loans have experienced steadily growing rates of voluntary principal reduction, to the point that we now see upwards of 27% of these loans being written down.[35] If Seattle is representative of the nation at large, this would suggest that over a quarter, or 1000 to 1,500 of its at most 4-6,000 underwater first lien bank portfolio mortgage loans have seen principal reductions already, while more will presumably see the same going forward.

GSE loans ought, in theory at least, to be experiencing principal reduction at rates comparable to what we find in the case of bank portfolio loans. The GSEs and their conservator FHFA, after all, have the same value-salvaging reasons to write-off negative equity and its attendant default risk as do banking institutions. The obstacle in this case appears to emanate from the current leadership at FHFA.[36] Notwithstanding in-house analysis showing that principal reduction could help up to 500,000 homeowners and save taxpayers as much as $1 billion, FHFA leaders warn that writing down the principal balances of some loans "could give borrowers who are current on their mortgages a message that the government endorses forgiving a portion of mortgage debt if hardship can be demonstrated, creating a very broad incentive for underwater borrowers to seek ways to become eligible."

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[34] See, e.g., Fannie Mae 10K data at http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2012/10k_2012.pdf, page F-42.

[35] See, e.g., Laurie Goodman et al., *Amherst Mortgage Insight: Non-Agency MBS – Decomposing the Returns*, September 27, 2012; Barry Ritholtz, 'Fascinating Mortgage and Housing Data Points,' June 17, 2012, available at http://www.ritholtz.com/blog/2012/06/fascinating-mortgage-housing-data-points/; and Testimony of Laurie S. Goodman, Amherst Securities Group, to the U.S. Senate Subcommittee on Housing, Transportation, and Community Development, March 15, 2012, available at http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=0f96e0ff-8500-41a5-a0f2-0139d0df2e07.

[36] See sources cited supra, notes 1 and 33.

PLS loans would be just as financially rational to write down as are portfolio and GSE loans. They do not experience write-downs at anything near portfolio rates however, owing to certain structural and contractual features of the mortgage securitization arrangements that proliferated over the course of the 1990s and after.[37]

For one thing, the ultimate creditors to securitized lending arrangements are numerous and scattered across the globe. This means that they cannot decide upon financially rational write-downs in the same manner as can unitary portfolio loan holders and as could FHFA or the GSEs.

For another thing, the pooling and servicing agreements ("PSAs") pursuant to which PLS loans are securitized, drafted as they were during the bubble years when few anticipated nationwide housing price drops on the scale the nation experienced, typically either prohibit or effectively prevent pool trustees and servicers from writing down loans on a large enough scale to end the crisis. They also prohibit or effectively prevent sales of these troubled loans, out of their trusts, to parties able to write them down.

Ambiguities in the Internal Revenue Code further buttress these impediments. So do conflicts of interest on the part of loan servicers, which often are banking institutions that hold consumer-credit-securing second liens on the same properties whose first lien loans they are servicing.

In addition to all of this, the contractual compensation arrangements for servicers of PLS loans typically make it more remunerative for servicers to oversee long-drawn delinquencies and foreclosure proceedings than to work out even value-salvaging loan modifications.

For all of these reasons, PLS loans might not be salvageable in adequate numbers unless Seattle resorts to new means of addressing them outlined below in Part V.

A final, again structural, point bears noting in connection with voluntary write-downs of underwater loans. It is that write-downs are unlikely to occur in optimal numbers even among bank portfolio loans not subject to the current opposition noted in connection with GSE loans or the contractual and other structural impediments noted in connection with PLS loans. The reason is quite simple, even if subtle: because, as is well documented, foreclosure on one property diminishes the value of neighboring properties, there is a first-mover value advantage realized by creditors who foreclose early relative to those who foreclose late – rather as those at the front of the queue in a bank run fare better than those behind them. For the properties taken in foreclosure by early foreclosers are worth more than those taken by later foreclosers.

But the same principle operates in reverse: an early principal-reducer, by lessening the likelihood of foreclosure on her debtor, effectively increases the value of neighboring properties too and thereby lessens the likelihood of default and necessary foreclosure on those properties. There is accordingly a "*last* mover" advantage where writedowns are concerned, meaning in turn that even bank

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[37] The structural and contractual factors briefly catalogued in the next seven paragraphs are all discussed at full length in *Six Years On and Still Counting*, supra note 1. They are also discussed, somewhat more briefly, in the other two sources cited supra, note 1.

portfolio loans are unlikely to be voluntarily written down in optimal numbers and to optimal degrees. Those who can afford to wait often will. This affords further argument in favor of the new methods of securing loan writedowns discussed below in Part IV.

B. Publicly Encouraged Debt Relief

Most of the best known federal, state, and local programs aimed at preventing mortgage-debt-caused foreclosure and homelessness seek to provide additional incentives, over and above the value-salvaging that can be had by preventing default and foreclosure, to creditors and their agents to cut debtors slack. While these are all of course helpful, they are unable to do anything about structural and contractual barriers to voluntary debtor relief. What is more, were those barriers to be surmountable, the "incentives" would likely be rather less necessary; the value that creditors can salvage through writedowns could be incentive enough.

1. HAMP

The best-known program available to troubled mortgagors is probably the federal Home Affordable Modification Program ("HAMP"), part of the Making Home Affordable ("MHA") program authorized by Sections 101 and 109 of the Emergency Economic Stabilization Act of 2008 and amended by Section 7002 of the American Recovery and Reinvestment Act of 2009.[38]

HAMP is available for mortgages originated before 2009 with principal balances of $729,750 or less, provided that (a) the borrower's required monthly mortgage payment amounts to 31% or more of her gross monthly income and (b) the borrower's loan is either owned or guaranteed by a GSE or is serviced by a HAMP participant. For loans that are eligible per these criteria, HAMP makes payments to participating servicers to incent them into voluntarily lowering monthly mortgage payments by (a) lowering interest charges, (b) extending the duration over which the borrower will be making monthly payments, (c) reducing principal, or some combination thereof.

HAMP is not aimed directly at reducing mortgage principal as such; its focus is on monthly payments. A later added "HAMP Principal Reduction Alternative" ("HAMP PRA") program, introduced in October 2010, aims at principal reduction more directly,[39] but thus far there have been few takers, primarily because the program is voluntary and affords no means of overcoming structural and contractual barriers of the sort noted above. To date, there have been only 128,000 HAMP modifications involving principal reduction nationwide.[40] The comparable figure for Seattle would be (42/13,800 = .003) x 128,000 = 384 loans in total to date, assuming the high-end estimate of 42,000

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[38] See http://www.makinghomeaffordable.gov/programs/lower-payments/Pages/hamp.aspx.

[39] See http://www.makinghomeaffordable.gov/programs/lower-payments/Pages/pra.aspx.

[40] See http://www.treasury.gov/initiatives/financial-stability/reports/Documents/April%202013%20MHA%20Report%20Final.pdf .

underwater Seattle mortgage loans in total.[41] Assuming the lower-end estimate, the total number of HAMP-benefitted loans would be correspondingly lower, at 192.

Principally owing to (a) its eligibility criteria, (b) its voluntariness, and (c) its accordingly not offering means past the structural and contractual impediments noted above, HAMP and HAMPR PRA have brought comparatively few significant principal reductions to troubled mortgage loans (see previous paragraph), while 97% and 62%, respectively, have brought only interest rate reductions or term extensions.[42] The Programs are expected by termination at the end of 2015 to bring modifications of any sort to only about one in four applicants, yielding a total of about one million permanent modifications nationwide.[43]

Assuming that Seattle's rates are representative of the national rates, and assuming the higher-end estimate of Seattle's underwater loan total mentioned earlier, this means that it will see approximately 1 million x 42/13,800 = 3,000 modifications by the time HAMP and HAMP PRA are phased out. Assuming, in the alternative, the lower-end underwater loan estimate of 21,000, we would be talking no more than 1,500 modifications. Either way we would be speaking of merely 7% of Seattle's underwater mortgage loans. If Seattle is representative of the nation as a whole, about 97% (2,910 at most, 1,455 at least) of these would involve interest rate reductions, while 62% (1,860 at most, 930 at least) would involve payment term extension.

Seattle might, however, not be quite representative of the nation as a whole, even if it is close. According to Treasury numbers, the State of Washington accounts for about 2.1% of national HAMP activity. Since the State's population, at 6.9 million, constitutes 6.9/314 = about 2.2% of the national population, it would seem that its HAMP activity amounts to a bit less than its pro rata share of the national population.

It should finally be noted that the U.S. Department of Treasury and the Department of Housing and Urban Development ("HUD") estimate numbers of HAMP-associated loan modifications rather higher than do academic sources.[44] Its numbers are approximately double those of the academic sources. If these numbers are credible, then we are looking at about 2 million mortgage loans

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[41] Calculated as follows: Beginning with the higher-end estimates cited above, Seattle has 42,000 underwater loans, while the nation as a whole has 13,800,000. Seattle's underwater loan total accordingly comes to .003 of the national total. Assuming that Seattle has benefited by HAMP in a manner proportional to the nation at large, 384 Seattle loans would have benefited. Essentially the same result is reached if we calculate 128,000/13,800,000 = .01, or 1% of underwater loans nationally benefiting by HAMP, then project that onto Seattle's 42,000 underwater loans, yielding a total of 389 loans. (The difference of 5 between the two figures is the product of rounding.) The *lower alternative* figures result simply from halving the higher figures, since the lower-end estimate of Seattle's underwater loan total with which we are dealing here is 21,000.

[42] Idem.

[43] See http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2138314. Also http://www.gao.gov/products/GAO-12-296.

[44] See, e.g., http://www.treasury.gov/connect/blog/Pages/Another-Look-at-the-Numbers-on-HAMP.aspx; http://portal.hud.gov/hudportal/documents/huddoc?id=MayNat2013_Scd_FINAL.pdf; and http://www.nationaljournal.com/magazine/the-white-house-s-housing-fumbles-20120322.

nationwide and 6,000 (3,000 assuming the lower underwater loan total) – or 14% of its 42,000 (21,000 assuming the lower figure) total – for Seattle. About 5,820 (2,910 assuming the lower underwater loan total) of these would involve interest rate reductions, while 4,736 (2,368 assuming the lower underwater loan total) would involve term-extension.

2. HARP

The Home Affordable Refinance Program ("HARP"), introduced by FHFA in early 2009 and revised later that year and then again in late 2011, is aimed specifically at refinancing existing mortgage loans into new loans with lower interest rates – an option not typically available in private markets for homes that are worth less than what's owed on their mortgage loans.[45]

HARP is available only to loans owned or guaranteed by one of the GSEs since the first of June 2009 or earlier, and to borrowers who (a) are current on their loans, (b) have not been more than 30 days late on more than one monthly payment during the previous 12 months, (c) have not been late on any such payments during the previous 6 months, and (d) have income sufficient to support continued payment at the new interest rate. In its first months, it applied only to loans with LTVs of 105 or lower. With its first revision later in 2009, the LTV maximum rose to 125% - which, it will be recalled, is a bit higher than Seattle's average for underwater loans. Finally, per the so-called "HARP 2.0" revisions of late 2011, the LTV cap was removed.

Notwithstanding these program expansions, HARP's remaining eligibility criteria and focus on interest rate reductions alone have resulted in its bringing fewer loan term changes even than HAMP – at least to underwater loans. The national figure at about this time last year was about 1.32 million loans nationwide, of which 1.15 million were above water. Only about 158,000 benefitting loans had LTVs of 105-125, and a mere 11,000 had LTVs greater than 125.[46]

The counterpart figures for Seattle, if it is representative of the nation as a whole, would be (158,000 + 11,000 = 169,000) x (42/13,800 = .003) = about 507 refinancings of significantly underwater loans under HARP as of summer 2012, assuming the higher-end 42,000 underwater loan estimate for Seattle, or 254 such refinancings assuming the lower-end 21,000 underwater loan estimate. If we, say, charitably double the number in estimating the cumulative total to date in recognition of the facts that (a) significantly underwater loans only became eligible in later 2009 and (b) programs take time to "get up to speed," we would still arrive at a modest figure of about 1014 HARP refinancings for significantly underwater home loans in Seattle assuming the 42,000 underwater loan total, or 507 assuming the 21,000 underwater loan total. Either way, this would suggest that about 2% of the total have benefitted thus far.

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45 See http://www.makinghomeaffordable.gov/programs/lower-payments/Pages/pra.aspx.

46 See http://portal.hud.gov/hudportal/documents/huddoc?id=MayNat2013_Scd_FINAL.pdf; and http://www.calculatedriskblog.com/2012/07/report-harp-refis-increase-signficantly.html; also http://www.nationaljournal.com/magazine/the-white-house-s-housing-fumbles-20120322.

3. Miscellaneous Specialized HAMP Analogues

In addition to HAMP and HARP, the federal government administers more particularized HAMP- and HARP-analogues for discrete constituencies such as veterans and "family farmers." Examples include the Department of Veterans Affairs ("VA") and the Federal Department of Agriculture ("FDA").[47] The federal Government Accounting Office estimates ("GAO") that these programs, combined, approximately double the HAMP numbers. If so, that would mean another one million loans nationwide, and another 3,000 (or 1,500) – just over 7% – of Seattle's 42,000 (or 21,000) underwater mortgage loan total.

4. FHA Short Refinance Program

For underwater mortgage loans that are not already insured by the Federal Housing Administration ("FHA"), certain credit-worthy borrowers who are current on their mortgage loans and do not have total debt exceeding 50% of their monthly gross income can qualify for refinancing into a new, FHA loan that involves lower monthly payments.[48] The program was introduced by FHA in September of 2010.[49]

As with HAMP and HARP, the FHA "Short Refi" program is entirely voluntary. No creditor or mortgage servicer is required to participate in the program. This means in turn that the structural and contractual impediments that prohibit or effectively prevent PLS loan modifications are unaffected by the program. At least partly for this reason, mortgagors who had benefited by the FHA Short Refi program numbered only about 1,500 nationwide as of this time last year.[50] If, say, we charitably double that number in estimating the cumulative total to date in recognition of the facts that (a) the program commenced a bit under three years ago and (b) programs take time to "get up to speed," we would still arrive at a modest figure of about 3,000 nationwide to date. The comparable figure for Seattle then would be (42/13,800 = .003) x 3,000 = 9 underwater loans in total given 42,000 underwater Seattle loans, and about 5 such loans assuming the lower-end 21,000 underwater Seattle loan total.

5. Home Affordable Foreclosure Alternatives ("HAFA") Program

The Home Affordable Foreclosure Alternative ("HAFA") program is essentially a federally condoned and facilitated "strategic default" program that enables underwater mortgagors to surrender their homes to their creditors without suffering the adverse credit rating consequences of foreclosure.[51] In essence, anyone who meets the HAMP or HARP eligibility criteria, and also (a) can document a financial hardship while (b) not having purchased a home within the previous 12 months, can either hand her deed over to the creditor and leave the home (a "deed in lieu [of foreclosure]"), or sell the

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47 See generally http://www.gao.gov/products/GAO-12-296.

48 See http://www.makinghomeaffordable.gov/programs/lower-rates/Pages/short-refinance.aspx.

49 See http://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2010/HUDNo.10-173.

50 See http://www.sigtarp.gov/Quarterly%20Reports/July_25_2012_Report_to_Congress.pdf.

51 See http://www.makinghomeaffordable.gov/programs/exit-gracefully/Pages/hafa.aspx.

home and discharge her debt to the creditor by transferring the proceeds of the sale to the creditor ("short sale"). In some cases, the beneficiary of the program may also qualify for up to $3000 in "relocation assistance."

HAFA is obviously a rather draconian "solution" to underwater mortgage debt, one that affords formal recognition to the fact that blood cannot be squeezed from turnips by nevertheless squeezing all that can indeed be squeezed and then handing it over to the creditor. While such a "solution" might be warranted in some extreme circumstances, it is difficult to imagine any municipality's viewing it anything other than a last resort means of addressing its foreclosure problems. Even in such circumstances, moreover, the program's usefulness is limited, in that, like HAMP, HARP, and FHA Short Refi, it is voluntary in the case of non-GSE loans. The only servicers who take part in the program are those that elect to do so without added government incentive.

Presumably for these reasons, the number of U.S. mortgagors thus far to have successfully availed themselves of HAFA is 154,000 individuals.[52] The counterpart figure for Seattle would be (42/13,800 = .003) x 154,000 = 462 mortgagors assuming the higher-end 42,000 underwater Seattle loan total, or 231 mortgagors assuming the lower-end 21,000 underwater Seattle loan total.

6. "Hardest Hit" Fund & Program

Since early 2010, the U.S. Department of Treasury has made $7.6 billion available to certain states in the nation that have been particularly hard hit by the housing price bubble and bust.[53] These moneys are meant to enable benefiting states and municipalities to fund particularly innovative means of addressing their foreclosure crises – e.g., by securing principal reductions, by providing bridge loan assistance to temporarily un- or underemployed homeowners, by buying-out second lienholders, or by transitioning homeowners not up to the task of owning into rental properties. Thus far, 18 states and the District of Columbia have been designated "Hardest Hit" beneficiary jurisdictions. At present, the State of Washington is not among them, hence there are no Seattle beneficiaries of the program.

7. HOPE NOW Alliance

The earliest federal intervention into the housing price crash took the form of a "voluntary alliance" between federal agencies, creditor groups, and home-ownership-preservation groups introduced by the Bush administration in late 2007.[54] The aim of the "Alliance" was and remains to facilitate voluntary mortgage loan modifications. Some – generally about 20% – of these modifications are funneled through one or another of the federal programs discussed above. The remaining 80% are "proprietary," meaning that they are done by bank portfolio loan holders on their own.

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52 See http://www.treasury.gov/initiatives/financial-stability/reports/Documents/April%202013%20MHA%20Report%20Final.pdf.

53 See http://www.makinghomeaffordable.gov/programs/unemployed-help/Pages/hhf.aspx.

54 See http://georgewbush-whitehouse.archives.gov/news/releases/2007/08/20070831-5.html; and http://www.hopenow.com/hopenow-aboutus.php.

In total, about 2.7 million mortgage loans have been thus "proprietarily" modified nationwide since 2008, albeit partly on the basis of NPV modeling techniques pioneered by the Federal Deposit Insurance Corporation ("FDIC") that year.[55] The counterpart figure for Seattle, again assuming that the City is representative of the nation as a whole, would be (42/13,800 = .003) x 2.7 million = 8,100 loans of the City's approximately 42,000 loan total, assuming the higher-end estimate of the latter, or 4,050 loans assuming the lower-end estimate of 21,000 underwater Seattle loans.

8. Washington State-Mandated Mediation

In 2011, Washington's state Legislature passed the Foreclosure Fairness Act ("FFA," "the Act"), which requires creditors to enter into good faith mediation with mortgage debtors before initiating foreclosure proceedings, provided that the borrower requests the mediation in a timely manner – i.e., within 20 days of a notice of trustee sale's being recorded.[56] The creditor must send a party authorized to modify the loan to the mediation, as well as supply loan, payment history, and value calculation documents to the mediator. The debtor must supply sundry forms of personal financial information to the mediator, and both parties must pay $200 of a $400 mediation fee. Some "small" banks and credit unions are exempt from the Act. The mediator is requested by a housing counselor or attorney, whom the debtor must contact.

Although the FFA constitutes an effective means of ensuring that mortgagors who affirmatively seek it receive a fair hearing in a neutral setting as to why loan modification or refinancing will be preferable to foreclosure, it does not require anything more than good faith participation by the creditor or its agent in a mediation process. No particular incentives, positive or negative, are afforded creditors to modify, refinance, or forbear. Insofar as HAMP and HARP afford such incentives, however, FFA can function as a helpful adjunct to those programs, as well as to the FHA Short Refi program. Of course, this does not enable HAMP, HARP, or FHA Short Refi to overcome their own limitations. That means in turn that FFA is not a significant solution to the problem of insufficient numbers of principal reductions on underwater PLS loans.

9. Seattle Foreclosure Prevention Program

The City of Seattle, in partnership with the nonprofit Urban League of Metropolitan Seattle and the nonprofit Solid Ground, administers a tripartite Foreclosure Prevention Program ("FPP," "the Program") aimed at avoiding foreclosures among Seattle residents.[57] The Program offers financial and mortgage counseling, assistance in negotiating loan modification or repayment options with creditors, and in some cases "stabilization loans" of up to $5000. (The Program website also includes links to other nonprofits that offer mortgage and financial counseling.) The first two forms of assistance would seem to constitute nice complements to both the federal and state programs discussed above. The

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55 See http://www.nationaljournal.com/magazine/the-white-house-s-housing-fumbles-20120322; also http://portal.hud.gov/hudportal/documents/huddoc?id=MayNat2013_Scd_FINAL.pdf; and http://www.housingwire.com/news/2013/05/15/hope-now-245000-loan-mods-completed-1q.

56 See http://www.skcabc.org/initiatives/Washington%20Resource%20Guide.pdf, beginning at page 34.

57 See http://www.seattle.gov/housing/buying/ForeclosurePrevention.htm.

third form might make for a very nice complement to the federal Hardest Hit Fund Program were the State of Washington at some point to come to qualify as one of the "hardest hit" states.

To date, the FPP's accomplishments, notwithstanding its innovative partnering approach to its mandate and its laudable intentions, appear to be modest. The Program purports to have assisted "more than 30 homeowners," which of course constitutes but a tiny fraction of Seattle's likely 21,000-42,000 underwater loans.

10. Seattle – King County Foreclosure Prevention and Intervention Program

The Seattle – King County Asset-Building Cooperative runs a Foreclosure Prevention and Intervention Program ("FPIP," "the Program") designed to facilitate the operation of other programs elaborated above.[58] The Program works essentially as an information-dissemination and clearinghouse mechanism, through which Seattle homeowners can learn more both about the programs elaborated above and about how to procure counseling or legal assistance from other quarters. It is not clear how many have benefited by this program, though tracked "hits" at its website might offer some indication.

11. The Attorney Generals' Settlement

In February of 2012, several states' attorneys general settled a suit they had brought against five of the nation's largest mortgage lenders for "robosigning" and related foreclosure fraud scandals. Per the terms of the settlement, the five banks (Bank of America, JPMorgan Chase, Wells Fargo, Citigroup, and GMAC) agreed to contribute $26 billon to foreclosure-prevention and -mitigation efforts. The suit was hailed as a milestone, and the settlement amount as impressive. The settlement only applies, however, to portfolio loans held by the 5 banks; it does not affect GSE loans, let alone those PLS loans which we noted above to constitute the great bulk of the underwater loan problem.

Helpful perspective is supplied, moreover, when we note that a pro rata distribution of this settlement amount over the nation's 11-13 million underwater homeowners would yield $2,400 – or about one or two monthly mortgage payments – per home. Washington State received $648 million of this settlement. $483 million of it has been designated for programs that help homeowners who are in danger of foreclosure on eligible loans, including loan modifications and principal reduction; $84 million goes to refinancing of underwater eligible loans; $24 million is used to make direct payments to foreclosure victims holding eligible loans;[59] and $45 million will be used for foreclosure relief and housing programs, disbursed in the form of grants to nonprofit and government agencies working on foreclosure prevention and increasing the supply of affordable housing in communities hard hit by the crisis. These are important programs and sums, but again, they will not reach GSE or PLS loans.

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[58] See http://www.skcabc.org/initiatives/foreclosure.html.

[59] It is estimated that Washington homeowners will receive checks for approximately $2000 under this program.

C. Summing Up: Few Beneficiaries of Existing Programs, Fewer Still Principal Reductions

We are now in a position to sum up the likely numbers of Seattle beneficiaries of foreclosure prevention programs currently available, and compare those to the likely numbers of underwater Seattle homeowners. Estimating optimistically, and assuming the higher-end estimate of 42,000 underwater Seattle mortgage loans, we would have 3,000 HAMP and HAMP PRA beneficiaries, with a mere 384 of these involving principal reductions; 507 underwater HARP beneficiaries; 3,000 VA, FDA, and other HAMP-analogue beneficiaries; 9 FHA Short Refi beneficiaries; 462 HAFA "beneficiaries;" 0 Hardest Hit Fund beneficiaries; 8,100 "proprietary" HOPE NOW beneficiaries; 30 or so Seattle FPP beneficiaries; and an unknown number of Washington FFA and Seattle FPIP beneficiaries.

Assuming the higher-end estimate of its underwater loan aggregate, this all totals to 15,069 beneficiaries, out of Seattle's 42,000 underwater mortgagors, of one or another federal, state, municipal or privately offered mitigation plan. Assuming the lower-end estimate of 21,000 underwater Seattle mortgage loans, the comparable figure would be approximately 7,535 beneficiaries out of Seattle's 21,000 underwater mortgagors. Either way, we are speaking then of a mere 36% who have benefited in any way at all by existing programs. And the overwhelmingly greater part of this percentage, it should be remembered, has received nothing in the way of principal reduction at all. Even these 36%, in other words, remain deep underwater even after enjoying the comparatively privileged status of having been cut some sort of slack by some currently available program.

IV. Programs Not Yet Considered, with Particular Attention to Modification-Resistant PLS Loans

We have noted at various points in this Report that underwater PLS loans constitute the largest unserved category of underwater loans in both Seattle and the nation. This is because they are the loans most afflicted by the structural and contractual impediments to even voluntary, creditor-friendly writedowns noted above. We also noted that even the structural impediments to such writedowns tend in large part to be rooted in now dysfunctional contract arrangements – specifically, those stipulated in the pooling and servicing agreements (again, PSAs) pursuant to which the PLS loans at root of our problems were securitized.

What this means for present purposes is that no foreclosure-prevention strategy that does not replace these contracts will be effective. But there are only two authorities by which these contracts can be overridden to the benefit of creditor and debtor alike. One is the bankruptcy-oversight authority vested in our bankruptcy courts by the federal Constitution and the federal Bankruptcy Code. The other is the eminent domain authority that our federal and state constitutions respectively confer upon our federal, state, and local governments. The first two new options that we discuss here correspond to those two contract-overriding authorities. We then address a complementary strategy, aimed at foreclosure-mitigation rather than -prevention, to complete the menu.

A. Lease Swaps

Unfortunately, the Bankruptcy Code is not yet helpful as a foreclosure-prevention tool, owing to a controversial 1993 Supreme Court decision, *Nobelman v. American Savings Bank*, which interpreted the Chapter 13 "primary residence" exclusion from bankruptcy protection in an unexpected way.[60] Chapter 13 excludes primary residences from bankruptcy protection, but it does not, by its language or legislative history, exclude overhang when prices fall below nominal debt obligations.[61] Yet that is how *Nobelman* read it, and the bankruptcy courts have chafed under the ruling ever since. Were *Nobelman* to be expressly overruled, then, either congressionally or judicially, we would have one route to mortgage debt write-downs in the form of so-called "strip down." A more plenary route to solving the problem would be to amend the Bankruptcy Code itself to remove the primary residence exclusion altogether. Some members of Congress have tried twice now and failed to do this post-2008, via the so-called "cram-down" legislation introduced in 2009 and 2010.

In the absence of legislative or judicial action to overturn *Nobleman* or legislative action to amend Chapter 13 in more plenary fashion, there is but one remaining bankruptcy-levering route to go. That is the use of what the author of this Report has proposed and advocated under the name of "lease swaps" over the past several years.[62] The idea here is for underwater home-owners in the same neighborhoods literally to swap residences under leasing contracts, then file for bankruptcy under Chapter 13 to write-down their mortgage debt overhangs. Homeowners wishing to do this could make use of the extensive "home-swapping" infrastructure that has developed on the web during the crisis years – an infrastructure that Seattle could facilitate use of simply by constructing a website with portals, accessible from its foreclosure resource website. Figure 2 shows how the arrangement would work.

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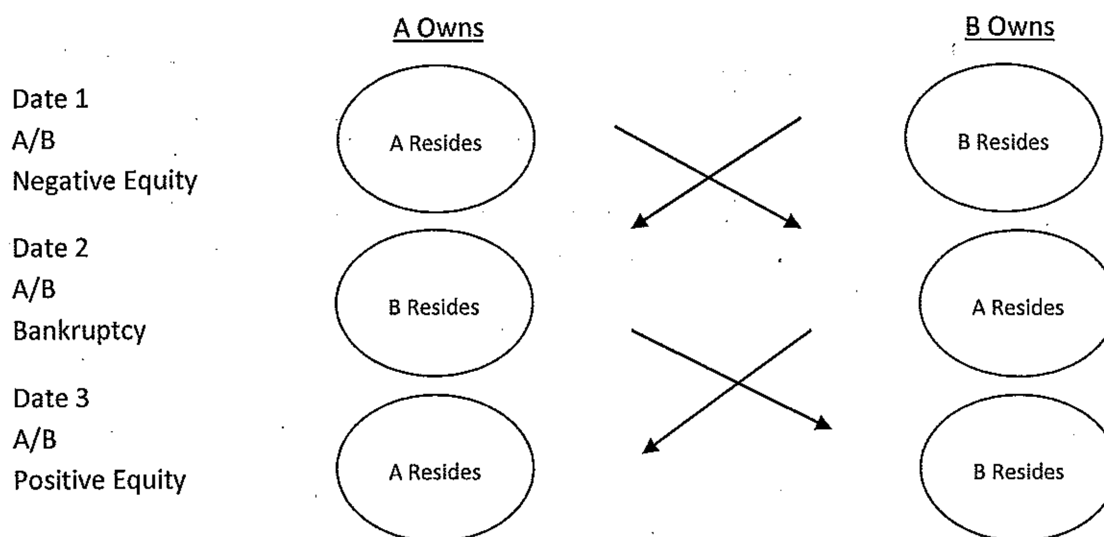
[60] See 508 U.S. 324 (1993). Also *Six Years On and Still Counting*, supra note 1.

[61] See 11 U.S.C. §1322(b)(2). See generally *Six Years On and Still Counting*, supra note 1.

[62] See, e.g., Hockett, "Home Lease Swapping as Mortgage Market Cure," *Benzinga*, October 14, 2011, at http://www.dorfonlaw.org/2011/10/post-by-bob-hockett-lease-swaps-as.html; and Hockett, "Lease Swaps as Underwater Mortgage Cure," *Dorf on Law*, October 16, 2011, at http://www.dorfonlaw.org/2011/10/post-by-bob-hockett-lease-swaps-as.html. Also Hockett & Vague, supra note 33.

Figure 3: Financial & Legal Structure of Lease Swap Plan



Note: Arrows represent residence swaps pursuant to lease contracts. Ownership in fee simple vests with original owners throughout.

The diagram, read from top to bottom, shows owners A and B residing in their own homes at Date 1, each with negative equity. At Date 2, A and B lease their homes to one another, changing "primary residences" within the meaning of Chapter 13, and file for bankruptcy in order to obtain "strip down" of mortgage debt overhang. At Date 3, if they wish, A and B resume residing in the homes that they own, no longer underwater.

B. Eminent Domain Modifications: Replacing the Contract-Bound Collective Agent with Public Agency

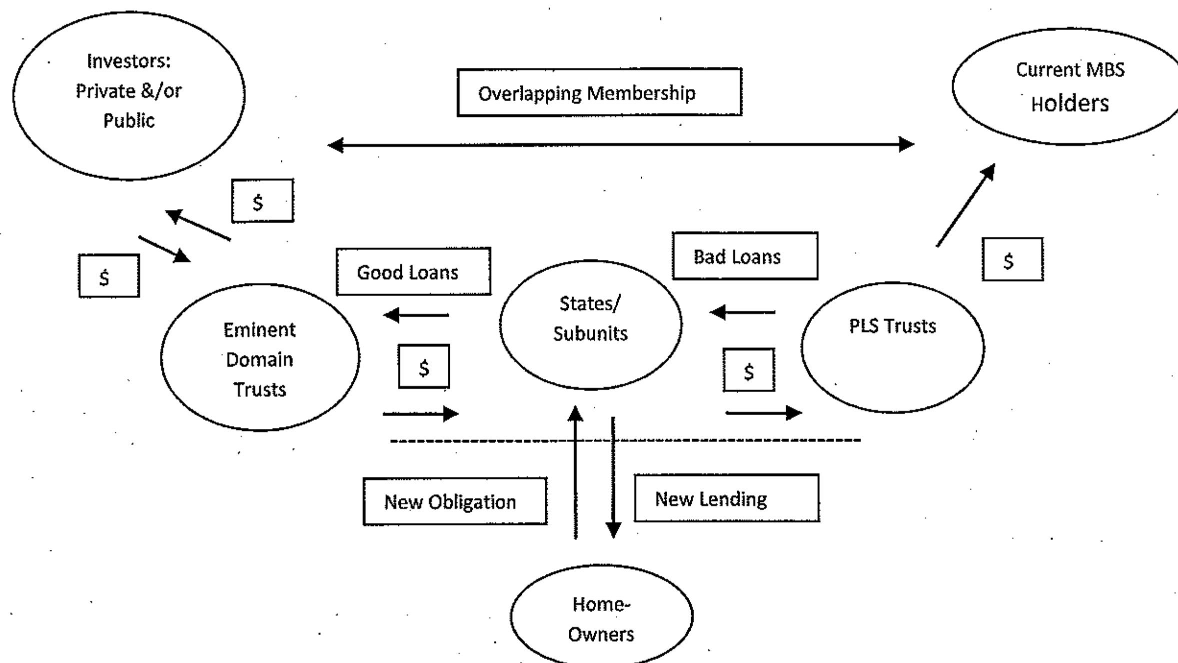
Turning now from bankruptcy and lease swaps to eminent domain, the idea here, which the author has been advocating in various forms since the foreclosure crisis commenced,[63] is for governments to sidestep the PSA contract rigidities that lie at the heart of our problem by "taking" underwater loans at fair value, then replacing them with better written loans that leave homeowners with some positive equity.[64] Because this is ultimately a way of recouping value for ultimate creditors

[63] See again *Paying Paul and Robbing No One*, supra note 1; and *It Takes a Village*, supra note 1. For earlier, more federally focused variations on the idea, see, e.g., Robert Hockett, *Treasury's Planned Bailout is FHA's Bailiwick*, DORF ON LAW, September 25, 2008, available at http://www.dorfonlaw.org/2008/09/treasurys-planned-bailout-is-fhas.html; and Robert Hockett, *Bailouts, Buy-Ins, and Ballyhoo*, 52 CHALLENGE 39 (2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1276285. See also Daniel Alpert, Robert Hockett, & Nouriel Roubini, *The Way Forward: Moving from the Post-Bubble, Post-Bust Economy to Renewed Growth and Competitiveness*, New America Foundation White Paper, October 11, 2011, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1987139.

[64] See *Paying Paul and Robbing No One*, and *It Takes a Village*, both cited supra, note 1.

themselves in addition to homeowners,[65] the ideal way to finance this operation would be with moneys supplied by the affected MBS holders themselves.[66] In effect, the latter would be "paying themselves" the fair values of the loans, then receiving the new, higher-value loans by way of payback. This two-step process would be financially identical to a single-step write-down, with the second step amounting to no more than a straightforward consequence of a government actor's having to be brought into the structure in order to get past the PSA. Figure 3 diagrams the basic structure.

Figure 4: Financial Structure of Eminent Domain Plan



Note: The double-headed arrow represents class overlap rather than a flow. The two vertical arrows crossing the dotted line represent a detour between the "bad loan" and "good loan" arrows.

[65] A numerical example might render more appreciable how the plan benefits creditors as well as debtors. Suppose a house purchased with an alt-A loan for $300,000 is now worth $200,000, meaning that the loan has an LTV of 150. Suppose that the default rate on alt-A is, as Fannie Mae and Freddie Mac report, nearly 70%. Suppose also that a foreclosure costs the foreclosing party an average of $20,000, which is the figure in California. Then in a non-recourse state the loan is worth the greater of either (.3 x $300,000 = $90,000) or ($200,000 - $20,000 = $180,000). If the loan is written down to, say, $190,000, such that the borrower now has a 5% ($10,000/$200,000) positive equity stake in the house and now negligible default risk, then both the debtor and the creditor are better off. The debtor has moved from a negative to a positive equity position. The creditor has received a $190,000 asset in exchange for a $180,000 asset. One can easily produce variations on this example by changing LTVs, default likelihoods, etc., and observe that there is a plethora of circumstances under which writedowns will be creditor- and debtor-friendly alike.

[66] See sources cited supra, note 64.

The diagram, read counterclockwise, depicts investors, including current bondholders and perhaps federal agencies and nonprofit organizations, conveying funds to eminent domain trusts operated by states or their subunits – for example, the State of Washington, King County, the City of Seattle, or some coalition of Washington counties or cities. These eminent domain trusts then purchase deeply underwater ("bad") loans from PLS trusts. The states or their sub-units, in most cases probably advised or otherwise assisted by financial professionals and/or community capital organizations, then work with homeowners to write new mortgages, replacing the negative equity loans with modestly positive equity loans—probably thirty-year fixed-rate mortgages in all cases.[67] Finally, the new ("good") loans are conveyed to the first-mentioned trusts, which convey resultant funds to the first-mentioned investors.

The sequence of steps depicted in the diagram provides only the broad outline of the plan. More is required to render any particular variation operational. There are, for example, the matters of (a) selecting and valuing appropriate loans; (b) securing government and/or private investors, if any; (c) commencing the legal proceedings necessary to exercise eminent domain authority; (d) modifying and possibly re-securitizing the loans once purchased; (e) working with homeowners throughout the foregoing; and (f) compensating investors at appropriate stages.

All of these actions can be managed in various ways.[68] And again, the government entity managing them – be it Seattle, King County, Washington, or some other grouping within the State – can be assisted by federal agency experts and/or financial professionals, including community capital or

[67] Freeing the loans from their PLS trusts, it bears noting, also renders them amenable to the HAMP PRA and FHA Short Refi programs discussed above.

[68] Briefly, on (a), the guiding criterion should be whether the loans' expected value can be raised sufficiently to offset the write-downs and associated transaction costs. A variation on this criterion, where public money is available to supplement private money, would be to include loans whose expected-value improvements fall slightly short of offsetting the write-downs and associated transaction costs, in light of the foreclosure externalities that write-downs will avoid. On (b), if federal and sub-federal units of government find merit in the plan, they can approach one another to arrange lending from former to latter. Either can also approach existing bondholders or other investors, including community capital and/or other nonprofit organizations, if desired. On (c), the State or its subunit – again, Seattle, King County, or some other substate grouping – will commence the proceedings and courts will conduct them. In the "quick take" proceedings available in most states, the taking authority places the estimated value of the loans plus some margin in escrow when filing, explains the basis of its valuations to the court's satisfaction, then takes title. Subsequent litigation, if any, concerns only whether more should be paid, not whether the taking can proceed. In most cases, governments have accurately assessed the value of the loan, often with assistance from private valuation experts, and paid adequately. This bears noting in view of popular misconceptions concerning the likelihood of protracted litigation. It should also be noted that, in view of the market failure and consequent waste stories note above as prompting this proposal, Seattle can anticipate sizable pre-trial, out-of-court agreements among state or municipal governments and bondholders on loan selection and valuation criteria, particularly if relevant federal officials facilitate. As for (d), (e), and (f), these are primarily matters for Washington or its municipalities to manage, albeit again with assistance from public or private financial professionals, ideally including community capital or other nonprofit organizations, in most cases. Washington's municipalities are best situated to approach prospective homeowner beneficiaries once qualifying loans are identified, for example. Financial advisory assistance, in turn—whether from a federal entity like FHA, from private (including community capital or other nonprofit) providers, or both—will be helpful in most cases both in restructuring loans and in arranging contributor compensation.

other nonprofit organizations. There are also multiple ways for federal agencies to play a supporting role. Fed and Treasury can facilitate municipal, homeowner, and bondholder summits on loan selection and valuation criteria, for example.[69] Treasury (principally through the OCC) and FDIC can act in a number of ways to encourage banks in both their portfolio loan holding and their loan servicing capacities to cooperate with these efforts.

Turning now to the eminent domain plan's legal aspects, the first thing to emphasize is that, although non-lawyers are not always aware of the fact, governmental authorities employ their eminent domain authority to purchase property at fair value for public use all the time. And they do so with all manner of property—tangible and intangible, contractual and realty-related alike.[70] The only legal issue that typically arises in such cases concerns the valuation of the property taken. In the "quick take" proceedings available in most states, the taking authority places the estimated value of the loans plus some margin in escrow when filing, explains the basis of its valuations to the court's satisfaction, then takes title. Subsequent litigation, if any, concerns only whether more should be paid, not whether the taking can proceed. In most cases, governments have accurately assessed the value of the loan, often with assistance from private valuation experts, and paid adequately.

Occasionally, controversy turns on whether a proper public purpose justifies the purchase, particularly after the U.S. Supreme Court's controversial *Kelo* decision. Legal challenges of this sort virtually never succeed, though, as the legal doctrine accords great deference to democratically elected officials in determining what counts as a public purpose. Blight-prevention and -reversal, moreover, such as foreclosure-prevention and -mitigation in communities with high negative equity concentrations demonstrably would constitute, is one of the most widely and frequently recognized of public purposes justifying use of the eminent domain authority.

It should also be noted that underwater mortgage loans offer two decisive grounds for exercises of local jurisdiction. First is that mortgage loans are deemed to be located at the situs of the mortgaged property. Second is that the situs of a debt is deemed to be the situs of the debtor.[71]

Washington law closely tracks all of these general truths. Article I, Section 16 of the State Constitution, the product of one of many post-*Kelo* state constitutional amendments, emphasizes the requirement of a bona fide public purpose, but does nothing to undercut the standard blight-reversal justification for eminent domain use. Revised Code of Washington (RCW) Section 35.81.080, captioned "Eminent Domain," for its part provides that

> A municipality shall have the right to acquire by condemnation, in accordance with the procedure provided for condemnation by such municipality for other purposes, any interest in real property, which it may deem necessary for a community renewal project under this chapter after the adoption by the local

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69 On this point, see in particular *Paying Paul and Robbing No One*, supra note 1.

70 For full elaboration of the legal aspects of the plan here, see in particular Part 4 of *It Takes a Village*, supra note 1.

71 Idem.

governing body of a resolution declaring that the acquisition of the real property described therein is necessary for such purpose. Condemnation for community renewal of blighted areas is declared to be a public use, and property already devoted to any other public use or acquired by the owner or a predecessor in interest by eminent domain may be condemned for the purposes of this chapter.

"Any interest in real property," as used in the statute, is understood in all states to include mortgage liens, and Washington's recognition of the traditional "community renewal of blighted areas" as a public purpose could not be more clearly stated. Washington law, then, tracks tradition, and accordingly vindicates use of the eminent domain plan by Seattle and other State municipalities.

C. Municipal Land Banks

Since the onset of the nation's foreclosure crisis six years ago, a number of cities have begun innovatively adapting municipal land banks into foreclosure-mitigation tools. These experiments offer a promising means of addressing the problems of homelessness that follow on mass foreclosure, much as the lease swap and eminent domain strategies offer means of preventing foreclosures in the first place. Adopting all three strategies, then, would offer Seattle full coverage of its pool of underwater loans – those that are current but at risk, those that are delinquent, and those that have already foreclosed or foreclose notwithstanding all efforts to prevent it.

A land bank is a public authority established by ordinance to hold, manage, and redevelop tax-foreclosed property. Through a land bank, a municipality may acquire tax-foreclosed homes and vacant land in order to prepare homes for sale or rent, or prepare land for productive public use in such forms as community gardens or green spaces. Municipal land banks are typically employed as a post-foreclosure tool to prevent neighborhood blight in the aftermath large-scale of tax-foreclosures. They have been established in cities across the country facing significant blight challenges. Examples include Flint, Michigan; Cleveland, Ohio; and most recently Chicago, Illinois.[72] These and other cities have searched for mechanisms to redevelop blighted neighborhoods and maintain property values while reducing municipal expenditures on fire-prevention, crime-reduction, and demolition of the sort often associated with foreclosed properties.

As a foreclosure-prevention tool, land banks have had only limited application. In Flint, for example, the land bank may convert a tax-foreclosed property that is still occupied by the recent owners into a rental property. The owners are then given the option to remain in the house under a rental lease agreement while the City takes formal ownership. Conceivably this could allow the former owner ultimately to regain the home under a "rent to own" arrangement, but thus far land banks have not yet been employed in this manner.

Land banks as would-be tools for foreclosure-prevention rather than -mitigation suffer from one major drawback: homes that fall subject to tax-foreclosure typically have fallen subject to loan

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[72] For Flint, see Genesee County Land Bank site, at http://www.thelandbank.org/. For Cleveland, see Cuyahoga Land Bank site, at http://cuyahogalandbank.org/. For Chicago, see Cook County Land Bank Authority site, at http://www.cookcountylandbank.org/.

foreclosure first and already reverted to lender ownership, since owners who fail to pay property taxes typically have defaulted on their mortgages before defaulting on their taxes. That means the land bank generally will receive possession only of such tax-foreclosed homes as foreclosing lenders voluntarily transfer to municipalities.

An interesting wrinkle, however, has recently been added to this picture by the city of Utica, New York.[73] Using the state's eminent domain law, Utica is foreclosing on lender-foreclosed properties that the lenders do not maintain, as a means of either (a) preventing lenders from confronting the city with heightened property-abatement costs when they do not abate their own foreclosed properties, or (b) compensating the city for those costs when lenders externalize them onto the city. This raises the interesting prospect that cities might actually "foreclose on the foreclosers" when the latter do not maintain the properties that they seize from borrowers. Were the original inhabitants then invited back into their previous homes, perhaps under "rent to own" arrangements, we might find a nice illustration of the adage that "turnabout is fair play," with owners returned to their homes and predatory lenders evicted.

V. Recommendations

Washington's twin negative equity and foreclosure crises, unlike in some parts of the country, are steadily growing worse. Seattle is particularly hard-hit, with 42,000 underwater homeowners and growing rates of homelessness among its children – especially its children of color. If the City is to staunch these continuing losses, it must adopt strategies that address the root cause of the problem rather than temporary palliatives. Those are strategies that target negative equity itself in the case of underwater homes not yet foreclosed, and strategies that find means of keeping people in, or returning people to, their dwellings in the case of already foreclosed homes. Lease-swapping and eminent domain purchases of underwater loans are the sole means of targeting negative equity, particularly in the case of PLS loans; and land banks that offer rent-to-own options and enforce abatement-foreclosure ordinances are the most promising means of retaining or restoring occupancy on the part of recently foreclosed homeowners. Between the three of them, these strategies offer means of addressing all underwater loans that are either current but at risk, delinquent, or already foreclosed upon. This Report accordingly recommends:

(1) That the City of Seattle facilitate recourse to the Lease Swap strategy by its underwater mortgagors. This it could do very simply by outlining the strategy at its Foreclosure Resource website, providing sample "boilerplate" lease agreements, and linking directly to one or more of the house swapping sites that have proliferated on the web since the crash. Members of the local bankruptcy bar, and other lawyers, realtors and others acting in a pro bono capacity, doubtless would be willing to assist, as would the author of this Report.

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[73] See *Utica Observer Dispatch*, "Utica Using Little-Known Law to Seize Abandoned Properties," at http://www.uticaod.com/news/x1379227086/Utica-using-little-known-law-to-seize-abandoned-properties.

(2) That the City of Seattle form a committee to study the Eminent Domain strategy, with a view to determining what rendition of plan would best suit the City's values and needs. Members of the committee should bear in mind that there are multiple ways to structure the plan, and multiple kinds of provider from whom to seek assistance in either designing a plan from scratch or evaluating plans offered by outside providers in response to a request for proposal (RFP). Once again local lawyers, financial professionals, and housing advocates, acting in a pro bono capacity, doubtless would be willing to assist, as again would the author of this Report.

(3) That the City of Seattle form a committee to study the prospect of establishing a municipal land bank, charged with the task of taking possession of tax-foreclosed properties and converting them to beneficial community use, and giving priority to returning recently loan-foreclosed mortgagors either to their own recent properties or to like properties, pursuant to leasing agreements with "rent to own" options embedded. Again local professionals will doubtless be willing to assist, as again would the author of this Report.

That concludes this Report. The author welcomes any follow-up questions or assignments that the City Council might wish to address to him.

Lisa Herbold
LEGPrincipalReductionReso
December 4, 2013
Version #2

Form revised: December 12, 2012

FISCAL NOTE FOR NON-CAPITAL PROJECTS

Department:	Contact Person/Phone:	CBO Analyst/Phone:
Legislative	Lisa Herbold/4-5331	N/A

Legislation Title:

A RESOLUTION exploring mortgage principal reduction and other foreclosure prevention programs for low-income homeowners in order to support and revitalize communities impacted by the foreclosure crisis.

Summary of the Legislation:
States intent to create an Interdepartmental Team (IDT) from Council staff, the City Budget Office, and the Office of Housing to review the recommendations of a Council commissioned report on options to assist low-income homeowners who continue to suffer from the foreclosure crisis and the circumstances and causes of foreclosures and the foreclosure methods and practices of lenders, including reviewing any apparent inequities people in Seattle may face when lender foreclosure proceedings occur.

The IDT will review the financial and legal implications of the principal reduction strategies proposed by the Council commissioned report as well as other foreclosure prevention programs in order to make a recommendation of what program is the most appropriate program for the City to pursue. Depending on the recommendations, the IDT will also report on possible next steps to pursue in developing a mortgage principal reduction program for low-income home owners.

Background:

Since 2006, nearly five million families nationally have lost their homes to foreclosure, nine million Americans have lost their jobs, and ten million families are estimated to now owe more on their mortgages than their homes are worth. According to the Council commissioned report, the "Hockett Report" the loss of wealth and density of foreclosures in many Seattle zip codes are higher than the national average and adversely impacts communities of color in Seattle.

Mortgage debt overhang is one of the primary drags on economic recovery and nationally $1 trillion more is owed than our nation's homes are worth, principal reduction on underwater homes as recommended by the Hockett Report may aide in our economic recovery.

Please check one of the following:

____ **This legislation does not have any financial implications.**
(Please skip to "Other Implications" section at the end of the document and answer questions a-h. Earlier sections that are left blank should be deleted. Please delete the instructions provided in parentheses at the end of each question.)

__X__ **This legislation has financial implications.**
(If the legislation has direct fiscal impacts (e.g., appropriations, revenue, positions), fill out the relevant sections below. If the financial implications are indirect or longer-term, describe them in narrative in the "Other Implications" Section. Please delete the instructions provided in parentheses at the end of each title and question.)

This legislation will have minimal financial implications as it relates to workload of staff on the IDT. The amount of time necessary for the work is comparable to other typical policy development and should be easily integrated in department workplans. If future funding needs are identified for this work, the Council can review requests via a supplemental budget allocation, budget adjustments, and/or Departmental and/or City Council Consultant budget

Other Implications:

a) **Does the legislation have indirect financial implications, or long-term implications?**
No

b) **What is the financial cost of not implementing the legislation?**
None

c) **Does this legislation affect any departments besides the originating department?**
Yes, the City Budget Office, the Office of Housing, and Finance and Administrative Services will participate in the IDT. The office directors have been notified and in some cases additional staff as well.

d) **What are the possible alternatives to the legislation that could achieve the same or similar objectives?**
N/A

e) **Is a public hearing required for this legislation?**
No

f) **Is publication of notice with *The Daily Journal of Commerce* and/or *The Seattle Times* required for this legislation?**
No

g) **Does this legislation affect a piece of property?**
No

h) **Other Issues:**
N/A

List attachments to the fiscal note below:

Hockett Report