

## **Governmental Intervention into Private Loan Mortgage Transactions May Ultimately be Harmful**

*By: James J. Eischen, Jr.*

“Foreclosure” is not a nice word. Charles Dickens’ fictional literary character “Scrooge” foreclosed on borrowers’ homes in the classic “A Christmas Carol” before ghosts of Christmas past, present, and future led Scrooge to a change of heart. Today people still struggle to balance lenders’ rights to strict loan enforcement with distaste for foreclosure’s aftermath. Current United States presidential candidates unveil and debate proposed national plans to help avoid residential home loan foreclosures. But lenders fear governmental intervention changing loan terms and undermining real estate market stability.

What is a “foreclosure” and how does it work? Assume someone borrows money from a lender to purchase a California residence. The residential real estate secures the debt because the borrower signs a document recorded in the office land records called a “trust deed” (in other states, a “mortgage”). The trust deed states that the residential real estate secures that lender’s loan, and if the borrower fails to timely pay and “defaults” the trust deed trustee may sell the residence at a non-judicial foreclosure sale. The lender does not (and may not) file a lawsuit to enforce the residential purchase money trust deed. If the non-judicial foreclosure complies with all applicable trust deed terms and California law (such as mandated notice and time to cure), the foreclosure sale transfers title from the borrower to the foreclosure sale purchaser via a “trustee deed.” The foreclosing lender generally cannot further seek purchase money repayment. The non-judicial foreclosure was the lender’s “one-action” on the loan. If the borrower then refuses to leave the residence, the new owner may institute an unlawful detainer action to evict the former owner. No wonder Charles Dickens’s Scrooge character appeared something less than generous as a foreclosing and evicting lender. But is that the whole story?

The subprime residential loan meltdown—the inability of borrowers who secured residential loans with unproved income or lower credit ratings to perform—triggers tighter residential lending criteria, investor losses (world-wide) for those who invested in securities backed by subprime loans, and increased foreclosure activity. Non-judicial foreclosures intended to allow lenders to enforce loan rights without a lawsuit now trigger increased litigation among borrowers, lenders, and brokers over who is to blame for sub-prime loan losses.

California’s non-judicial foreclosure process allows predictable trust deed enforcement without litigation. Purchase money lenders must accurately value real estate collateral as the lender’s sole recourse, so real estate markets are relatively stable. Purchase money lenders may charge less interest and allow long-term repayment (thirty years or even longer) while by comparison credit card lenders generally charge much higher interest rates. But when litigation and legislation undermine loan term certainty and enforcement, lenders may tighten purchase money loan terms and availability such that only the wealthy qualify.

Even after the ghosts of Christmas depart, there are no easy solutions to residential foreclosures’ painful disruptions. Nevertheless, governmental intervention into the stable, predictable home mortgage transaction process may ultimately be harmful.

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