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# Fixing *the* Foundation

*Colorado lawmakers can restore order to the housing market*

**F**oreclosures are devastating the housing market in Colorado. The state was hit early and hard by the crisis, and it is projected that more than 140,000 will have their homes repossessed between 2009 and 2012.<sup>1</sup> Many more homeowners are seeing the values of their houses plummet.

Standing alone, the foreclosure crisis is troubling enough. Making matters worse, however, is the alarming number of home repossessions performed on the basis of fraud or dubious paperwork. Such fraudulent foreclosures have resulted in homeowners improperly losing their homes, casting a cloud over the entire housing market.

Fortunately, state lawmakers can take steps to put Colorado's housing market back on a strong foundation. With simple changes to Colorado law, the state's leaders can require lenders to prove their chain-of-title interest in the property and make sure paperwork is accurate before they evict families from their homes.

## THE TRADITIONAL WAY OF MAKING AND TRACKING HOME LOANS

Historically, most home loans involved a direct relationship between the borrower and the lending bank. The bank retained its interest in the loan and in the underlying property until the borrower paid off the loan. The title to the house and the bank's interest in it were filed with the county recorder to provide a public chain of title on the property.

The lender's interest in the property was represented by two documents: the promissory note and the mortgage.<sup>2</sup> The promissory note was a signed pledge by the homeowner to pay back the loan. The mortgage document granted the lender the right to foreclose on the property if the homeowner defaulted on the loan.<sup>3</sup> In some cases, the lending bank sold its interest in the property, assigning its rights to another lender and recording that assignment with the county recorder to continue showing the chain of title.

A system of establishing clear ownership is essential for maintaining a functioning housing market. A clear chain of title establishes that the bank collecting mortgage payments from a homeowner actually has a right to those payments. It also provides homebuyers with the security of knowing that the seller of the property does actually own it. When the chain of title is not maintained, however, ownership of the property falls into doubt. If this occurs on a mass level, it can wreak major havoc on the housing market overall.

## HOME LOANS BECOME BIG BUSINESS ON WALL STREET

Borrowers taking out a home loan to purchase a property still sign a promissory and a note granting the lender the right to receive payments and foreclose in event of default. However, aside from these fundamentals, the system for tracking this paperwork has changed significantly since the mid-1990s, in response to the mass proliferation of home loan securitization.

Home loan securitization involves the repackaging of home

loans into instruments to be bought and sold as investments on Wall Street. Securitization makes the paperwork underlying home loans much more complicated. Rather than buying the mortgage itself, investors purchase the right to receive a return on the home loans.

Meanwhile, the original lender may also sell its interest in the home to another entity. However, this original lender may remain the "servicer" on the home loan, sending out monthly statements to the borrower and receiving payments. Many interests in the home can be sold to multiple parties without the homeowner knowing that any interest at all has changed hands.

Mass proliferation of home loan securitization brought the U.S. economy to a halt in 2008, leading to record bank bailouts. Making matters worse, this home loan securitization was facilitated by a new and deeply flawed loan clearinghouse that bypasses the county recording system. The Mortgage Electron Registration Systems (MERS), a private corporation, now serves as a smokescreen for mortgage transfers. A mortgage may be sold again and again (and securitized) — and MERS can carry out foreclosure proceedings — with no transfer being publicly recorded,<sup>4</sup> despite MERS being rife with error.<sup>5</sup>

## PAVING THE ROAD TO FORECLOSURES IN COLORADO

To carry out foreclosures, most lenders in Colorado use an administrative process that is unique to Colorado. Lenders initiate proceedings with the state's appointed public trustees, who set the sale and mail required notices. This process bypasses the court system, involving only a limited hearing (a "Rule 120" hearing) in which the judge determines only whether the homeowner has defaulted on the loan or has a military service record rendering the homeowner eligible for relief under the Soldiers and Sailors Civil Relief Act of 1940.<sup>6</sup>

The system provides almost no legal protection to homeowners, preventing the homeowner from raising defenses related to lender wrongdoing or even challenging the lender's purported interest in the home.<sup>7</sup> However, once this limited review is complete, homeowners can be removed from their

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homes,<sup>8</sup> despite the possible invalidity of the foreclosure.

At one time, Colorado law afforded homeowners greater protection in the foreclosure process. In 1989, the Colorado Supreme Court ruled that homeowners had a right to challenge a bank's ownership interest in the home it was seeking to repossess.<sup>9</sup> However, in 2002 and 2006, Colorado's foreclosure law was amended to undermine this protection. Lenders would no longer be required to show original mortgage documents before foreclosing. Instead, they can show an affidavit from a lawyer stating that the lender owns the notes and obtained them legally.<sup>10</sup>

Now, according to the *Denver Post*, "to question a bank's entitlement to a foreclosure, consumers ... must file expensive and often time-consuming private lawsuits that aren't likely to yield a result until long after the house is auctioned."<sup>11</sup> Meanwhile, banks can rely on a lawyer's signature rather than original documents to claim they have a right to the house they are repossessing.

Just as troubling as the substance of these changes is the process by which they were adopted. For both bills, the state's public trustees collaborated with mortgage lenders' lawyers to develop legislation to present to lawmakers. According to the *Denver Post*, it appears that the banks' lawyers inserted a provision into the 2006 bill eliminating the requirement that the bank show original loan transfer documents.<sup>12</sup> Grand County public trustee Christina Whitmer explained to the *Post* that the "lawyers were very powerful and they, in my opinion, put in a lot of stuff that should not have happened. And it was to benefit their lender clients, absolutely."

## FRAUDULENT FORECLOSURES

Since the collapse of the housing market, lenders have been foreclosing on millions of homes. These foreclosures have been rife with abuse. In February 2012, an audit by San Francisco County officials found that 84 percent of foreclosures involved clear violations of law. The audit found instances in which interests in a home had been transferred to more than one lender, as well as instances in which entities had acquired homes through foreclosure without having an interest in those homes. It also found that, in 58 percent of cases, owners of loans listed in the MERS database did not match names in public records.<sup>13</sup>

The audit provides startling new support to reports of abuses that came into the public spotlight in 2010, when it was revealed that loan servicers had been misapplying payments, fabricating documents, and ignoring the requirement of assessing homeowners for alternatives to

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— *The Denver Post*

foreclosure.<sup>14</sup> Employees at the foreclosure mills were "robo-signing" hundreds of documents, prompting nationwide investigation by state attorneys general.<sup>15</sup> According to the *New York Times*, the San Francisco audit "contradict(s) the contentions of many banks that foreclosure improprieties did little harm because the borrowers were behind on their mortgages and should have been evicted anyway."<sup>16</sup>

The failure of banks to properly maintain and record documents is at the center of this crisis. Without clear chain of title, a borrower cannot be certain that the lender demanding payment and foreclosing on the home has any right at all to that home. However, this uncertainty has not stopped lenders from foreclosing. According to the Center for Responsible Lending, "It is becoming more and more apparent that servicers falsify court documents not just to save time and money, but because they simply have not kept the accurate records of ownership, payments and escrow accounts that would enable them to proceed legally."<sup>17</sup>

In February 2011, state attorneys general and the Obama Administration reached an agreement with the country's largest home lenders, including J.P. Morgan Chase and Bank of America, settling claims related to robo-signing. As of February 2012, the specific terms of this agreement had not been made public. Again, given the relatively narrow scope of the settlement, much more remains to be done to provide homeowners — and the housing market — with a secure foundation of documentation.

Fortunately, state lawmakers have tools at their disposal to begin building this foundation. For example, recent legislation in Nevada takes steps to improve that state's foreclosure law, barring enforcement of mortgage assignments that have not been properly recorded and tightening requirements as to which parties have standing to foreclosure, among other

changes.<sup>18</sup> Colorado lawmakers can join states like Nevada in restoring balance to foreclosure law.

## CONCLUSION AND RECOMMENDATIONS

Colorado homeowners now encounter a foreclosure system stacked in favor of lenders wishing to evict families from their homes. Lenders can repossess homes without clearly establishing their interest in the property, and the court system provides little to no protection for homeowners seeking to defend themselves. As it currently stands, the law reflects the successful efforts of lenders to influence Colorado foreclosure and chain of title statutes to their benefit.

Colorado lawmakers have the power to fix the state's foreclosure law and provide security to homeowners and the housing market as a whole. To begin putting that market back on a solid foundation, Colorado lawmakers should:

- Reverse the amendment to Colorado's chain of title law that allows a foreclosure based solely upon a lawyer's signature;
- Fix burden of proof requirements so that a lender seeking foreclosure must clearly establish its valid interest in the underlying property;
- Fix the Rule 120 hearing process so that presiding judges must assess whether the lender seeking foreclosure has an interest in the property;
- Provide homeowners an opportunity to defend their right to their homes outside a limited Rule 120 hearing;
- Protect homeowners from eviction from their homes while they challenge a lender's right to foreclose.

## ENDNOTES

- 1 Center for Responsible Lending, "The Cost of Bad Lending in Colorado," updated August 2010, viewed at: <http://www.responsiblelending.org/mortgage-lending/tools-resources/factsheets/colorado.html>.
- 2 For the purposes of this report, "mortgage" includes both mortgage and deed of trust.
- 3 Nolan Robinson, "The Case against Allowing Mortgage Electronic Registration Systems, Inc. (MERS) to Initiate Foreclosure Proceedings," *Cardozo Law Review*, March 2011, pp. 105-106, viewed at: [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1791896](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1791896).
- 4 *Ibid.*, pp. 106-107.
- 5 Michael Powell & Gretchen Morgenson, "MERS? It May Have Swallowed Your Loan," *New York Times*, March 5, 2011, viewed at: [www.nytimes.com/2011/03/06/business/06mers.html](http://www.nytimes.com/2011/03/06/business/06mers.html).
- 6 Orten Cavanagh Richmond & Holmes, LLC, "Colorado Foreclosure Laws," updated March 21, 2008, pp. 2-3, viewed at: [http://www.ocrhlaw.com/library/Colorado\\_Foreclosure\\_Laws.pdf](http://www.ocrhlaw.com/library/Colorado_Foreclosure_Laws.pdf).
- 7 Aldo Svaldi, "Foreclosure hearings, called Rule 120, may be too limited to help borrowers," *Denver Post*, November 7, 2010, viewed at: [http://www.denverpost.com/news/ci\\_16539427](http://www.denverpost.com/news/ci_16539427).
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- 11 *Ibid.*
- 12 *Ibid.*
- 13 Gretchen Morgensen, "SF audit finds foreclosures riddled with errors," *New York Times*, February 16, 2012, viewed at: [http://www.msnbc.msn.com/id/46405686/ns/business-us\\_business/t/sf-audit-finds-foreclosures-riddled-errors/](http://www.msnbc.msn.com/id/46405686/ns/business-us_business/t/sf-audit-finds-foreclosures-riddled-errors/).
- 14 Julia Gordon, Center for Responsible Lending, Testimony before the Congressional Oversight Panel, October 27, 2010, p. 3, viewed at: <http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/testimony-julia-gordon-10-26-2010.pdf>.
- 15 Eric Dash & Nelson D. Short, "Bankers Ignored Signs of Trouble on Foreclosures," *New York Times*, October 13, 2010, viewed at: <http://www.nytimes.com/2010/10/14/business/14mortgage.html>.
- 16 Morgensen.
- 17 Gordon, p. 11.
- 18 Nevada Assembly Bill 284 (2011), viewed at: <http://www.leg.state.nv.us/Session/76th2011/Reports/history.cfm?ID=599>.

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