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# Foreclosures Hit a Snag for Lenders

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A federal judge in Ohio has ruled against a longstanding foreclosure practice, potentially creating an obstacle for lenders trying to reclaim properties from troubled borrowers and raising questions about the legal standing of investors in mortgage securities pools.

Judge Christopher A. Boyko of Federal District Court in Cleveland dismissed 14 foreclosure cases brought on behalf of mortgage investors, ruling that they had failed to prove that they owned the properties they were trying to seize.

The pooling of home loans into securities has been practiced for decades and helped propel real estate prices in recent years as investors sought the higher yields that such mortgage trusts could provide. Some \$6.5 trillion of securitized mortgage debt was outstanding at the end of 2006.

But as foreclosures have surged, the complex structure and disparate ownership of mortgage securities have made it harder for borrowers to work out troubled loans, in part because they cannot identify who holds the mortgage notes, consumer advocates say.

Now, the Ohio ruling indicates that the intricacies of the mortgage pools are starting to create problems for lenders as well. Lawyers for troubled homeowners are expected to seize upon the district judge's opinion as a way to impede foreclosures across the country or force investors to settle with homeowners. And it may encourage judges in other courts to demand more documentation of ownership from lenders trying to foreclose.

The ruling was issued Oct. 31 by Judge Boyko, and relates to 14 foreclosure cases brought by [Deutsche Bank](#) National Trust Company. The bank is trustee for securitization pools, issued as recently as June 2006, claiming to hold mortgages underlying the foreclosed properties.

On Oct. 10, Judge Boyko, 53, ordered the lenders' representative to file copies of loan assignments showing that the lender was indeed the owner of the note and mortgage on each property when the foreclosure was filed. But lawyers for Deutsche Bank supplied documents showing only an intent to convey the rights in the mortgages rather than proof of ownership as of the foreclosure date.

Saying that Deutsche Bank's arguments of legal standing fell woefully short, the judge wrote: "The institutions seem to adopt the attitude that since they have been doing this for so long, unchallenged, this practice equates with legal compliance. Finally put to the test, their weak legal arguments compel the court to stop them at the gate."

A spokesman for Deutsche Bank declined to comment on the ruling. But the inability of Deutsche Bank, as trustee for the pools, to produce proof of ownership at the time of the foreclosures will fuel borrowers' concerns that they are being forced out of their homes by entities that may not even hold the underlying loans.

"This is the miracle of not having securities mapped to the underlying loans," said Josh Rosner, a specialist in mortgage securities at Graham-Fisher, an independent research firm in New York. "There is no industry repository for mortgage loans. I have heard of instances where the same loan is in two or three pools."

The process of putting together a mortgage pool begins when a home loan is originated by a bank or mortgage lender. That loan is typically sold to a Wall Street firm that pools it with thousands of others. Once a pool is packaged, it is sold to investors in different slices, based on risk. A trustee bank oversees the pool's operations, ensuring that payments made by borrowers go to the appropriate investors.

Lawyers who represent troubled borrowers complain that trustees overseeing home loan pools often do not produce proof, usually in the form of a mortgage note, that their investors own a foreclosed property. And a recent study of 1,733 foreclosures by Katherine M. Porter, an associate professor of law at the [University of Iowa](#), found that 40 percent of the creditors foreclosing on borrowers did not show proof of ownership. Such proof gives a creditor standing to foreclose against a borrower and is required by law.

"The big issue in all these cases, whether we are dealing with a bankruptcy court, a state court or a federal court, is who really owns the mortgage note, and that is allegedly what they securitized," said O. Max Gardner III, a lawyer who represents borrowers in foreclosure in Shelby, N.C. "A collateral question is, has that mortgage note really been transferred and assigned to the securitization trust? If not, then they really don't have standing. It's Law School 101."

When a loan goes into a securitization, the mortgage note is not sent to the trust. Instead it shows up as a data transfer with the physical note being kept at a separate document repository company. Such practices keep the process fast and cheap.

Because most foreclosures proceed without challenges from borrowers, few judges have forced trustees like Deutsche Bank and [Bank of New York](#) to prove ownership by producing a mortgage note in each case.

Borrower advocates cheered Judge Boyko's ruling.

The plaintiff's argument that "Judge, you just don't understand how things work," the judge wrote, "reveals a condescending mindset and quasi-monopolistic system where financial institutions have traditionally controlled, and still control, the foreclosure process." The cases could be filed again in state court, however.

April Charney, a consumer lawyer at Jacksonville Area Legal Aid in Florida, who has been practicing foreclosure law since the late 1980s, said she rarely sees proof of ownership in cases involving securitization trusts. Her group has 30 to 50 such cases and not one of the lenders' representatives has produced proof of ownership predating the foreclosure action.

"We see a trend toward judges having enough of this trampling of the rules and procedure and care and reverence with which lawyers and litigants and participants in the judicial process should comply," Ms. Charney said. "Hopefully this will convince everybody that the time to work out these home loans is now."