Large-scale Disasters Attacking the American Dream: How to Protect and Empower Homeowners and Lenders

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I. **Introduction**

A barrage of high impact storms with torrential rains and vicious winds pummeled the Gulf Coast States during the 2005 hurricane season. Hurricane Katrina alone resulted in a large-scale disaster where over 1,300 individual lives were lost, property owners suffered approximately $75 billion in property damage, and, in particular, uncertainty erupted between homeowners and lenders.\(^1\) The financial costs do not recede for the 1.2 million displaced and distressed homeowners, as they try to repair their homes while continuing to make the monthly mortgage payments.\(^2\) If homeowners falter in paying the mortgage indebtedness, foreclosure is a likely result of non-payment.\(^3\)

In 2004 industry experts estimated the lender foreclosure costs alone to be $58,759 per home.\(^4\) If only 500,000 of the effected homeowners defaulted and lenders elected to foreclose, the lender costs, in addition to the property damage estimates, could reach $29 billion—nearly one-third of the estimated Katrina-caused property damage.\(^5\)

On a smaller scope, the average existing home value in 2004 for the southeastern United States was $182,820.\(^6\) If a home retained this value after the disaster, foreclosure at above stated costs would represent an estimated 32 percent

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\(^2\) OFFICE OF POLICY DEVELOPMENT AND RESEARCH, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, **UNITED STATES HOUSING MARKET CONDITIONS 1ST QUARTER 2006 5** (2006).


\(^5\) Brown, *supra* note 1, at 34.

loss in pre-disaster equity. Where the disaster caused “severe damage,” up to half of
the home’s value, foreclosure would likely result in a 64 percent loss in the post-
disaster equity.7 These estimates exclude consideration of the amount of mortgage
indebtedness secured before the disaster, which the homeowner is still obligated
to repay.8

This article examines, through a historical lens, the effects large-scale
disasters have had on the residential homeowner9-lender10 relationship and proposes
relief provisions to better mitigate financial loss and avoid the burden resulting from
foreclosure. First, an examination of the Great Depression looks at problems the
contracting parties faced, measures implemented by state and federal authorities, and
lasting consequences arising from that event. Next, the article asserts legislatures
should implement a standardized framework from which homeowners and lenders
can effectively mitigate loss arising from large-scale disasters. Finally, the article
specifically addresses two measures: a workout plan and a cramdown provision. In
the wake of large-scale disasters, direct loss is inevitable; minimization of the
indirect, corollary loss relies upon humanity’s acumen. In considering less-effective
and more effective mitigation measures to recover from a large-scale disaster,
organizing standardized relief provisions fosters the necessary post-disaster

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7 See supra note 2, at 5. The Federal Emergency Management Agency estimates that 125,731 homes
suffered severe damage, 179,378 homes suffered major damage, and 892,390 homes suffered minor
damage.
8 In a worst case scenario, the financing obtained immediately before the hurricane of 100 percent
would leave the mortgage undersecured because of home damage and substantially no recovery of
lender expenses if foreclosed.
9 Homeowner in this article inclusively refers to mortgagor, buyer, and land owner when applicable in
the appropriate context.
10 Lender for purpose of this article combines reference to mortgagee, bank, mortgage broker,
mortgage company, savings & loan, and other governmental lending institutions.
perspective for the homeowner and lender, and preserves, while not perfectly, both parties’ prevailing contractual interests.

II. Historical Examination of the Great Depression

“The backbone of the American financial system is the single family residential mortgage industry.”11—Franklin D. Roosevelt

A. Prevalent Conditions During the Depression

The Great Depression was an economic crisis in American history that is unrivaled in scope and effect to this day. The mortgaged debt totaled $43 billion dollars which was approximately three times the railroad debt, four times greater than long-term industrial debt, and comparable to the combined federal and state debt.12 In 1932, nearly 250,000 homes were foreclosed nationwide, and in 1933 the rate of foreclosure exceeded 1,000 homes per day.13 Because of the economic circumstances that ultimately resulted in foreclosure, many proud homeowners were reduced to economic serfs on their previously owned land.14 Many factors precipitated the harsh reality that existed during the 1930s.

Concerning the Great Depression, William Prosser noted the drastic, near collapse of commodity prices that fell below the producer’s break-even point. The inflating dollar, coupled with these circumstances, resulted in increased residential mortgage default when mortgage balloon notes, the industry standard at the time,

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12 Id. at 239.
13 Id.
matured. The inevitable default resulted in a rapid increase in the number of foreclosure sales, which depressed the market because of the surplus of foreclosed homes. In addition, the large foreclosing inventory chilled competitive bidding at the Sheriff’s Sale, and encouraged lenders to bid nominal prices and seek a deficiency judgment for the remaining balance nearly equal to the mortgage debt.

Homeowners confronted this mounting crisis by implementing self-help measures. The “penny sale” was one remedial measure used in Minnesota. When a farmer’s personal property was up for bid at the Sheriff’s Sale, neighboring farmers would band together and purchase the property for pennies, then resell the property back to the original foreclosed farmer at a nominal price.

Some courts took matters into their hands by imposing an “upset price.” The courts would establish a floor price and the foreclosed property could be sold only at or above that pre-determined minimum price. These efforts alone were not enough to curb the housing crisis. Beginning in the early 1930s, public rhetoric increased for lawmakers to take steps to ameliorate the metastasizing crisis.

15 Amundson & Rotman, supra note 14, at 822 n.96, citing Prosser, The Minnesota Mortgage Moratorium, 7 S. CAL.L.REV. 353, 353-54 (1934); see also Breimyer, Agricultural Philosophies and Policies in the New Deal, 68 MINN.L.REV. 33, 334 (1983) (crisis on the farms stirred national debate for farm relief). Prosser noted that “[a] survey of farm mortgages in Minnesota... indicated that, in 1930, 53.8% of the owner-operated farms in Minnesota were mortgaged.” Prosser, supra, at 354 n.10. For a description of a balloon note see infra note 72.
16 Id. at 822.
17 Id.
18 Id.
19 Id.
20 Id.
21 Id. at 822.
22 Id.
B. State Legislative Response to Alleviate Increasing Foreclosures

In response to public sentiment, Minnesota lawmakers turned to mortgage foreclosure moratorium law,\(^\text{23}\) which granted some degree of relief to defaulting homeowners.\(^\text{24}\) This type of legislation expanded into other States. Validation of mortgage foreclosure moratorium law relied on the policy that the legislative declaration of an economic emergency qualified the passage of such legislation.\(^\text{25}\)

The landmark case *Home Building & Loan Association v. Blaisdell* established mortgage foreclosure moratorium law as a valid, reasonable relief measure for homeowners facing foreclosure.\(^\text{26}\) On April 18, 1933, the Minnesota State Legislature passed the Minnesota Mortgage Moratorium Law (“Moratorium Law”), which later came up on appeal before the Minnesota Supreme Court.\(^\text{27}\) The Minnesota Supreme Court upheld the Moratorium Law as valid, which subsequently went on appeal before the U.S. Supreme Court.\(^\text{28}\) This constitutional challenge considered whether the conflict between the asserted right to implement the emergency legislation modifying mortgage provisions and the Contract Clause of the United States Constitution prohibiting impairment of contractual obligations.\(^\text{29}\)

The Moratorium Law provided that judicial relief could extend foreclosure court proceedings; sales could be postponed for a finite period; and the redemption

\(^\text{23}\) Amundson & Rotman, *supra* note 14, at 823-824. The Governor of Minnesota first acted in response to the demand of public outcry. Governor Olson issued an executive order that prohibited Sheriff Sales until the legislature had adjourned. This order was later declared unconstitutional. However this was an impetus for state legislatures taking action by passing moratorium legislation.

\(^\text{24}\) Wright, *supra* note 11, at 240.

\(^\text{25}\) Amundson & Rotman, *supra* note 14, at 824.

\(^\text{26}\) Home Building & Loan Ass’n v. Blaisdell, 290 U.S. 398 (1934).

\(^\text{27}\) *Id.* at 415-416. Chapter 339 of the Laws of Minnesota of 1933, p. 514, approved April 18, 1933, called the Minnesota Mortgage Moratorium Law.

\(^\text{28}\) *Id.* at 416.

\(^\text{29}\) *Id.* at 425, see also U.S. CONST. art. I, § 10.
period could be extended.\textsuperscript{30} Where the court granted extended foreclosure relief, the homeowner was required to pay income generated by the property, if applicable, or reasonable rental value to the lender as determined by the court.\textsuperscript{31} The Moratorium Law included a sunset provision that limited moratorium law availability only during the declared emergency and not beyond May 1, 1935, two years after passage.\textsuperscript{32}

The Blaisdell family owned a fourteen-room home encumbered by a mortgage lien held by Home Building & Loan Association.\textsuperscript{33} The Blaisdells’ subsequent default resulted in a foreclosure sale on May 2, 1932, where the lender purchased the residence for $3,700.98, while the reasonable market value was $6,000.\textsuperscript{34} The Blaisdell family would lose all equity and the right to redeem one year later on May 2, 1933.\textsuperscript{35}

The U.S. Supreme Court cited Justice Olsen of the Minnesota Supreme Court who stated:

\begin{quote}
[t]he present nationwide and world wide business and financial crisis has the same results as if it were caused by flood, earthquake, or disturbance in nature. It has deprived millions of persons in the nation of their employment and means of earning a living for themselves and their families…. It has actually resulted in the loss of their homes by a number of our people, and threatens to result in the loss of their home by many other people in this state.\textsuperscript{36}
\end{quote}

\begin{flushleft}
\textsuperscript{30} Id. at 416.
\textsuperscript{31} Id. at 416-417.
\textsuperscript{32} Blaisdell, 290 U.S. at 416.
\textsuperscript{33} Blaisdell, 290 U.S. at 420. The extra rooms provided income when the family used them for room and board.
\textsuperscript{34} Id. at 419. Blaisdell argued that in addition to the loss of their home, they would also lose the equity in the home. The reasonable market value was $6,000 and the foreclosure sale was for only $3,700.98, which covered all outstanding debt and arrearage fees. The equity lost by the Blaisdells would have been approximately $2,300.
\textsuperscript{35} Id. at 420.
\textsuperscript{36} Blaisdell, 290 U.S. at 423.
\end{flushleft}
In upholding the Moratorium Law, the U.S. Supreme Court found the statute did not impair the integrity of the remaining mortgage debt; interest continued to accrue; the Moratorium Law did not disturb the lender’s right to foreclose and seek a deficiency judgment; the only redemption condition altered was the extension of time; and rental valued paid applied to taxes, insurance and interest.37

The U.S. Supreme Court’s ruling rested upon five essential elements.38 First, the existence of an emergency was reason to protect vital community interests.39 Second, legislation addressed the “protection of legitimate social interest.”40 Third, afforded relief was based on appropriate and reasonable conditions.41 Fourth, conditions to extend the redemption period could not be unreasonable and must consider the interest of homeowner and lender.42 Fifth, moratorium legislation must be limited in duration, not lasting beyond the emergency.43

Blaisdell exhibits the sentiment that the Constitution, in time of crisis, should be interpreted to comfort, instead of pinch.44 The Moratorium Law provided a mere modification of the remedy available to the lender, while not impairing the homeowner’s legal obligation of repayment.45 Moratorium Law afforded the comfort, in terms of time needed to cure the problem, rather than having the homeowner feel the pinch of a valid contractual obligation upheld in extreme

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37 Id. at 425.
38 Id. at 444-447, see also Amundson & Rotman, supra note 14, at 825-826.
39 Id. at 444.
40 Id. at 445.
41 Id.
42 Id. at 445-446.
43 Id. at 447.
45 Amundson & Rotman, supra note 14, at 819.
circumstances. In this way the law recognized faultless victims placed in circumstances beyond their control, and afforded assistance where possible.\textsuperscript{46}

C. Federal Response to the Great Depression

In addition to state legislative response, the federal government sought to ameliorate the growing crisis by administrative measures.\textsuperscript{47} The federal government first used financial might by injecting money into the mortgage industry to correct the housing disaster.\textsuperscript{48} However, the opening of the federal coffer had a \textit{de minimus} impact on the housing crisis.\textsuperscript{49} The federal government also implemented a policy approach which significantly reversed the housing market’s foreclosure rate.\textsuperscript{50}

i. Quashing the Crisis with Money

One of the first executive actions taken by newly-elected President Franklin D. Roosevelt was to provide relief to suffering homeowners reeling from external market forces beyond their control.\textsuperscript{51} Two months after taking office, President Roosevelt signed the Home Owners’ Loan Act into law.\textsuperscript{52} This act, in part, created the Home Owners’ Loan Corporation (“HOLC”).\textsuperscript{53} The fundamental premise of the program was to “(1) protect small homeowners from foreclosure, (2) relieve them of part of the burden of excessive interest and principal payments incurred during a

\textsuperscript{47} Wright, \textit{supra} note 11, at 241.
\textsuperscript{48} Id. at 242.
\textsuperscript{49} Id. at 247. Of the estimated 1.8 million applications for the FHOLC, over half were rejected due to lack of security or withdrew the application before final review. Only one in ten residential home owners received relief from foreclosure. The Federal Home Loan Bank Board sought to infuse money in to the banking industry. Of the 41,000 homeowners that applied, only three applications were approved. Id. at 241.
\textsuperscript{50} Wright, \textit{supra} note 11, at 246.
\textsuperscript{51} Id. at 242.
\textsuperscript{52} Id.
\textsuperscript{53} Wright, \textit{supra} note 11, at 242.
period of higher values and higher earning power, and (3) declare that it was national policy to protect home ownership.\(^5^4\)

The HOLC operated by providing federally-backed HOLC bonds in exchange for defaulted home mortgages.\(^5^5\) The bonds generally had a lower interest rate than residential mortgage rates, and the HOLC guaranteed principal and interest payments.\(^5^6\) The HOLC refinanced approved homeowners, consolidating all arrearages, fees, and back taxes.\(^5^7\) The refinanced loan interest payments, subject to HOLC’s approval, could be delayed up to three years, thereby providing relief from the threat of foreclosure until the economy improved.\(^5^8\)

To the mortgage industry’s detriment, Congress included limiting measures on the HOLC’s lending practices.\(^5^9\) Financial limitations included total funding of $4.75 billion in bonds during three years, interests rate no greater than 4 percent, and loan maturity not to exceed eighteen years.\(^6^0\) Other binding provisions required residential property exceed $20,000 and the loan amount be no greater than 80 percent of the appraised\(^6^1\) value.\(^6^2\)

On average, homeowners who qualified for the HOLC assistance were in default for two years on the original note and mortgage and nearly three years behind

\(^5^4\) Id.  
\(^5^5\) Id.  
\(^5^6\) Id.  
\(^5^7\) Id.  
\(^5^8\) Wright, supra note 11, at 243.  
\(^5^9\) Id.  
\(^6^0\) Id.  
\(^6^1\) Id. at 244. The HOLC molded the way in which appraisals were done and how the lending institutions utilized this developing discipline. The end result was a greater standardization of the real estate appraisal. The change also resulted in redlining more “risky” neighborhoods.  
\(^6^2\) Wright, supra note 11, at 243.
on property tax payment. Even though HOLC helped many homeowners, foreclosures still occurred on 2.5 percent of all of the HOLC’s loans. However, two-thirds of foreclosures resulted from the homeowner’s unwillingness to cooperate with the HOLC when estimated the homeowner had the ability to pay.

ii. Policy and Rulemaking Response

One year after signing the Home Owners’ Loan Act, President Roosevelt successfully lobbied for the National Housing Act of 1934 ("Housing Act"). It did not allocate relief aid, rather it laid the foundation for indirect administrative measures to accelerate recovery. The Housing Act created the Federal Housing Administration ("FHA"), which served as a catalyst to implement policy tailored to revive the ailing mortgage industry.

The FHA implemented revolutionary standards in the mortgage industry. The FHA offered deficiency insurance up to 20 percent of the loan amount so long as the private lender met federally-mandated criteria. Borrowers paid a mandated FHA .5 percent fee on top of the standard interest rate, which the FHA deposited into a reserve fund used to cover mortgage deficiencies. The FHA also progressively lowered the standard requirement for down payment. In exchange, the lender

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63 Id. at 251.
64 Id. at 250. When the borrower defaulted, the HOLC exercised broad restraint regarding deficiency judgments against borrowers. The HOLC pursued a deficiency judgment when the HOLC was certain the borrower could pay or when the deficiency was necessary to preserve its property interest according to state law.
65 Id. at 249.
66 Wright, supra note 11, at 251.
67 Id.
69 Wright, supra note 11, at 251.
70 Gordon, supra note 68, at 193.
71 Id. However, these changes were not completely for the better. While a lower down payment allowed younger homeowners access to mortgage funds, this also increased the likelihood of loss in
offered borrowers fully self-amortized loans\textsuperscript{72} with a high loan-to-value ratio, typically 80 percent.\textsuperscript{73} One of the more important benchmarks of the Housing Act was the fact a large amount of federal funding was not needed. Instead, borrowers paid for the program by paying a mortgage insurance premium integrated into the monthly principal and interest payments.\textsuperscript{74}

The same authority that permitted the FHA to insure mortgages emboldened the FHA to stipulate construction standards like setbacks, cul-de-sacs for residential neighborhoods, and zoning for commercial and residential property.\textsuperscript{75} The FHA clamped down on usurious interest rates on second mortgages, and limited lender and builder fees.\textsuperscript{76} The FHA requirements made borrowing for residential homeowners less expensive and less risky,\textsuperscript{77} and demand for new homes and new capital grew.\textsuperscript{78}

In response to the residential industry crisis of the Great Depression, systemic changes occurred in legislation, government administrative rulemaking, and in the private lending system. Generally, foreclosure moratorium law expanded beyond Minnesota, provided legal delays in foreclosure proceedings, balloon note usage was default. Where little equity exists in the home and there is a dramatic drop in property value, little equity leaves little incentive for the homeowner to keep the house. Rather, homeowners are likely to walk away. \textit{Id}. at 193-194.

\textsuperscript{72} Wright, \textit{supra} note 11, at 246. Before the mortgage industry changed during the Great Depression, most mortgages were short-term—between three to five years. Moreover, the loans were not amortized. This type of loan is commonly referred to as a balloon loan. The balloon loan was problematic during the Great Depression because frequently homeowners were not able to refinance the mortgage when the mortgaged “ballooned” at the end of the term. The HLOC offered 15-year amortized loans, a drastic change from the industry standard. The belief was that equity grew and the likelihood of default decreased. An amortized loan spreads principal and interest payments over the life of the loan. The monthly payment is fixed with the payment ratio of principal to interest incrementally increasing with each pay period.

\textsuperscript{73} Id. at 251.

\textsuperscript{74} Wright, \textit{supra} note 11, at 251, see also Gordon, \textit{supra} note 68, at 193.

\textsuperscript{75} Wright, \textit{supra} note 11, at 258.

\textsuperscript{76} Id.

\textsuperscript{77} Gordon, \textit{supra} note 68, at 194. Much pressure also came from developers, builders and other related business that were hit hard by the Depression. These entities relied heavily on the housing market and available capital.

\textsuperscript{78} Wright, \textit{supra} note 11, at 260.
replaced by amortization of principal and interest over the life of the loan, and
government regulators integrated new requirements to stabilize the housing market.
During the Great Depression, these measures collectively afforded homeowners
relief, assisted during subsequent disasters, and offered avenues to mitigate financial

III. Standardized Framework for Effective Mitigation

A. Introduction

Empowering contracting parties in disaster recovery is essential. The
previous historical analysis exemplified what was less effective—Congressional
funding of lending institutions, and more effective—rules and guidelines giving
direction to homeowner and lender.\footnote{As the Book of Acts illustrates: a lame man sat before the temple asking for alms and Peter said, “[s]ilver and gold have I none: but such as I have give I unto thee: In the name of Jesus Christ of Nazareth rise up a walk.” Acts 3:1-8. The lame man immediately received strength in his feet and ankles, arose, and walked. Id. Peter helped this man by a blessing of health, not by fleeting monetary aid.} This knowledge is paramount in developing modern measures to address disaster recovery. The comparison exhibits a valuable predictive function of what will hedge loss and hasten recovery.

The current pervasive notion is that homeowners must make all payments on
time or the lender will foreclose on the property.\footnote{Infra, note 121.} In reality, the industry is not so absolute. We should resist the over-trusting response to solely give financial assistance. Instead, we should enact a framework that empowers those effected by large-scale disasters. The difficult balance is to respect the contracting parties’ rights
while attempting to assist both parties. Consideration of less-effective and more effective mitigation measures will manifest workable standardized relief provisions that will create the necessary post-disaster perspective for the homeowner and lender while modifying pre-disaster contractual rights and obligations.

B. A Forward-Looking Standardized Response

Consistent, standardized relief provisions will improve the facilitation of mitigating financial loss arising from a large-scale disaster and increase lender profit.\textsuperscript{82} Like the FHA’s success during and after the Great Depression, rulemaking for standardized relief provisions will do more to recover from a large-scale disaster than simply opening the federal and state coffers to cure the ailment.\textsuperscript{83} The regulatory scheme is best implemented administratively at the federal level. Historically real estate regulation has been left to the State sovereignty, however, the U.S. Supreme Court recently upheld federal preemption over Michigan real estate lending regulations.\textsuperscript{84} The provision are a starting point that does not exist in many mortgage forms, and are feasible mitigation tools that diminish clouds of uncertainty that abruptly appear after a catastrophe. Standardized relief provisions work because loan conditions change, in favor of both parties, to accommodate effective terms in new circumstances resulting from a catastrophe.

If circumstances arising from a catastrophe cause homeowners to stumble into default and foreclosure results, the lenders direct financial losses are significant.\textsuperscript{85} Furthermore, indirect foreclosure costs accumulate: homeowners incur expenses

\textsuperscript{82} Cutts & Green, supra note 4, at 13.

\textsuperscript{83} See supra note 68.


\textsuperscript{85} See supra note 5.
during foreclosure, home value in corresponding neighborhoods become depressed, and state and local governments lose tax revenue. The cumulative estimated costs total $73,300 per foreclosure. The ripple effect may also extend to municipality services and school systems that rely on property tax revenues. Having standardized relief provisions in place before disaster strikes will successfully mitigate post-disaster loss, in particular, keeping foreclosure at bay. All this can be done at no or negligible direct costs to state or federal governments.

C. Inefficient Disaster Response Happens

On January 17, 1994, a 6.7 magnitude earthquake struck the densely populated community of Northridge, California. The Northridge quake left Sondra Sutherland’s Northridge residence uninhabitable, and she vacated the premises while major repairs were performed. As a result of the earthquake’s damage, the home’s value plummeted to approximately $51,000. Sutherland had purchased this condominium in 1992 for $105,000, and had executed a mortgage for $101,000 with Barclays.

Sutherland communicated with a lender representative three days after the earthquake and they agreed to “stop” the account while she rented an apartment.

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86 Desiree Hatcher, Foreclosure Alternative: A Case Study for Preserving Homeownership, Profitwise News and View (Feb. 2006) at http://www.chicagofed.org/community_development/files/02_2006_foreclosure_alt.pdf. Homeowner, $7,200; Lender, $1,500; Servicer, $1,100; FHA-HUD, $26,500; City, $27,000; Neighbors, $10,000 (last visited September 9, 2006).

87 A&P Bankruptcy 86 Hearings (9), at 95 (1985) (statement Ewen M. Wilson). Robert Travis Scott, State working on Bridge Loans (January, 27 2007) at http://www.nola.com/search/index.ssf?/base/library-119/1169882100214980.xml?ZZLIBB&coll=1 &thispage=1 (last visited February 7, 2007) (In particular, St. Bernard Parrish is struggling to access millions of dollars in order to make repairs many infrastructure projects. Civic leaders are looking to private bridge loans to begin the repair work, but are looking to FEMA to pay the loans rather than tax payers.).


89 Id. at 304-305.

90 Id. at 305.

91 Id. at 304.
during the repairs.\textsuperscript{92} The stop consisted of no monthly payment due, no notices of default, and no reporting to credit agencies.\textsuperscript{93} Sutherland relied upon this three-month stop oral agreement, and reallocated her funds to pay for earthquake related costs during the agreement.\textsuperscript{94}

Contrary to Sutherland’s belief the postponed payments would be added to the end of the loan period, the lender billed Sutherland for all outstanding back payments along with the current monthly payment.\textsuperscript{95} The lender threatened foreclosure if Sutherland failed to bring the mortgage current.\textsuperscript{96} Subsequently, Sutherland brought action for a declaratory judgment to clarify the oral agreement and to enjoin the lender from foreclosing.\textsuperscript{97}

The confusion arising from the ambiguity resulted in default by the borrower, costly litigation fees for both parties, and near foreclosure on Sutherland’s condominium.\textsuperscript{98} The ambiguity of terms to the oral “stop” agreement these problems would have been averted had a standardized framework been in place before the earthquake. A standardized framework fosters certainty in communication, facilitates more efficient and quicker responses to a vital community interest, and forbears impending foreclosure proceedings to give homeowners the opportunity to get back on their feet. The framework gives homeowners and lenders a better chance to mitigate loss and shorten recovery time.

\textsuperscript{92} Sutherland, 53 Cal. App. 4th at 305.
\textsuperscript{93} Id.
\textsuperscript{94} Id.
\textsuperscript{95} Id.
\textsuperscript{96} Id. at 306.
\textsuperscript{97} Id. at 299.
\textsuperscript{98} Id. at 306.
D. Standardization is Necessary

Standardization of disaster response for lenders and homeowners provides controlled flexibility during catastrophes, instead of requiring parties to navigate the complex existing laws that are not structured to respond to such disasters. A standardized response plays a critical role to protect and preserve the legitimate social interest of homeownership by mitigating loss without requiring additional allocation of taxpayers’ dollars. Large-scale disasters give rise to unforeseen financial burdens flowing from circumstances beyond the homeowner’s control. Providing uniform measures for homeowners to retain possession encourages them to repair and maintain the home that serves as collateral for the mortgage debt, instead of homeowners complacently allowing foreclosure for twenty or fifty cents on the dollar. The value of lenders’ collateral is retained. Lenders avoid costly foreclosure proceedings. Moreover, foreclosures can lead to greater long-term loss due to declining home prices and abandonment of homes. Individually and collectively, the mortgage industry avoids a depressed housing market. Standardized relief measures will “enable these families to remain on land they love and in the communities that they have been a part of for generations.”

99 Cong. Record, supra note 46, at H4773 (daily ed. June 24, 1985) (statement of Rep. Gunderson). The flexibility will make it more likely that the family farmer can keep the farm. Similarly, flexibility will help the homeowner’s likelihood of retaining the home.
100 Cong. Record, supra note 46, at H4769 (daily ed. June 24, 1985) (statement of Rep. Synar). Congress found these arguments persuasive when passing the Chapter 12 bankruptcy relief provisions in response to the financial crisis farmers were facing in the 1980’s. See infra, note 183 for more detailed discussion on redistribution of wealth. See also supra note 7.
101 See Cong. Record, supra note 46.
E. Triggers for Disaster Relief Assistance

Disaster relief for the homeowner should be made available when circumstances substantially impair the homeowner’s capacity to make short-term mortgage payments.105 A less effective alternative trigger is to award relief only when “equitable and just” to do so.106

A relief trigger may take various forms.107 The contracting parties can simply include contract terms that trigger for mutually agreed disaster relief measures.108 Lawmakers can pass legislation declaring the application and availability of assistance to disaster victims.109 Courts can order the disaster relief be made available.110 A gubernatorial proclamation111 or a presidential declaration can enable relief measures, via state and federal agencies, specifically for victims located in disaster areas.112

Historically, courts and agencies have looked at particular factual circumstances to determine whether the homeowner has an involuntary inability to pay, thus triggering relief measures.113 Factors considered were: significant property

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106 Amundson & Rotman, supra note 14, at n.156.
107 The scope of what will trigger disaster relief should be dynamic enough to address a single residence flooded by a storm or to an entire region emasculated by a barrage of hurricanes. The test should be a substantial impairment of the homeowner’s ability to make short-term payments which impairment is the result of circumstances beyond the homeowner’s control.
108 U.S. CONST. art. I, § 10, see also Louisiana—Single Family—Fannie Mae/Freddie Mac Uniform Instrument Form 3019, at http://www.freddiemac.com/uniform/unifsecurity.html (last visited September 8, 2006). The mortgage provides conditional clauses controlling default, acceleration, and cure. This form could expressly provide disaster remedies and identify under what conditions assistance can be made available to the homeowner in the event of a disaster.
109 Amundson & Rotman, supra note 14, at 824.
110 Wright, supra note 11, at 240.
113 Cutts & Green, supra note 4, at 8.
damage or depreciation, economic shock from a disaster, unemployment, underemployment, illness, and death of a family member.\textsuperscript{114} The test has not been a bright line; rather, the decision maker has had the discretion to balance the facts and consider the circumstances.

The “equitable” approach is vague, uncertain and difficult to achieve uniformity in response. It relies on political sentiments and notions of fairness. The “inability” approach quantifies parameters, and can be readily ascertained between homeowner and lender. It works better in a case-by-case basis, rather than broadly addressing large numbers of mortgages.

Once the cumulative effects substantially impair a homeowner’s ability to meet short-term obligations, then relief measures should be triggered.\textsuperscript{115} Foreknowledge of disaster response triggers will allow lenders and homeowners to better gauge when relief measures will apply in the wake of an unforeseen disaster and when to implement such measures in a uniform manner.\textsuperscript{116}

F. Standardized Workout Plan

While no statutory requirements currently exist for lenders and homeowners to use a workout plan to aid hurricane victims, Fannie Mae has encouraged servicers to use relief provisions.\textsuperscript{117} Using such relief provisions will protect the residential

\textsuperscript{114} See Amundson & Rotman, \textit{supra} note 14, at 831; Cutts & Green, \textit{supra} note 4, at 8.
\textsuperscript{115} \textit{Supra} note 109.
\textsuperscript{116} \textit{Koopmans v. Farm Credit Services of Mid-America}, 102 F.3d 874, 876 (7\textsuperscript{th} Cir. 1996). The interest rate basically consists of two parts: the base and the amount of risk. The base is set by the market and the interest exceeding the base reflects what the company hopes to make and what the risk is worth to the lender.
\textsuperscript{117} Fannie Mae LL01-06: Hurricane Related Special Relief Measures, (reminding mortgage sellers and services of relief provisions to be used: forbearance, foreclosure moratorium, and deed-in-lieu of foreclosure, and limited circumstances for foreclosure. Fannie Mae also encouraged waiver of any prepayment penalty if the mortgage was to be paid off by insurance proceeds.) \textit{available at} http://www.efanniemae.com/sf/guides/ssg/anmltrs/pdf/2006/ll0106.pdf (last visited February 17, 2007).
housing market, which President Franklin D. Roosevelt viewed as the “wheel that moves the whole economic engine.”

A workout plan is a tool used between a lender and a defaulting homeowner to ensure repayment of the mortgage, but in terms alternative to the original note. Notably, this malleable tool seeks to overcome a pervasive paradigm regarding residential mortgages: either the homeowner is current with all payments or one missed payment results in a lender’s absolute right to foreclose. The mortgage industry is in the beginning stages of overcoming this stigma as evidenced by empirical data on the success rate of workout plans used to prevent foreclosure. Workout plans showed an 80 percent reduction in the probability of home loss among all loans, and a 68 percent reduction in loss for low- and moderate-income homeowners. Concerning the 2005 Gulf Coast hurricanes, Fannie Mae has utilized workout agreements consisting of forbearance for a determined period of time, foreclosure moratorium on residences located in the hardest hit counties, and not reporting delinquencies to credit bureaus.

Legislation making workout plans mandatory may not be necessary. The parties have the ability to modify the contract, and some lenders have offered workout plans on their own volition. Some states permit lenders to begin foreclosure seven months after acceleration of the loan, and this may be adequate time for homeowners

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118 Wright, supra note 11, at 250.
119 Cutts & Green, supra note 4, at 2.
120 Id.
121 Id. at 1.
122 Supra note 118.
to resolve their problems. Some may go so far as to argue that legislated workout agreements should not occur because such legislation violates the sanctity of contract that existed at the time of formation.

While lenders and homeowners may modify the agreement, the lender maintains superior bargaining power because the mortgage is an adhesion contract. Moreover, the lender is currently not required to offer any workout agreement. The lender-homeowner relationship is analogous to the railway workers-railroad company relationship. During the first quarter of the 1900s Congress began to recognize rail transportation was paramount to the economy. In response, Congress passed the Railway Labor Act (“RLA”) to institute a system to avoid interruptions to commerce. Railroad companies had broad, extensive powers over the industry and workers were upset over poor treatment and low wages. During the dispute, workers used the weapon of striking to advance their argument. The harm from the strike was not limited just to the railway companies, it reverberated throughout commerce. The RLA was legislation used to foster peace between the parties and to provide economic security. Just as the RLA provided regulatory stability to a vital

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124 To sell the house one must wait the longer of seven months from the date of filing or three months from the date of judgment. 735 ILL. COMP. STAT. 5/15-1603 (West 2006). “No sale of a dwelling house of two units or less when currently occupied by the owner as his or her principal residence may take place within seven months of service of the foreclosure complaint, unless the court finds that the occupant is making waste of the property or the parties mutually agree after suit to a shorter period.” VT. STAT. tit. 12 § 4531a (West 2006).
125 See, e.g. Blaisdell, 290 U.S. at 448-482 (arguing an advancing gradual encroachment upon the sanctity of private and public contracts.).
128 Id.
129 Id.
130 Id.
131 Id.
area of the economy, standardized relief provisions offer similar stability to the residential housing industry by providing better mitigation of loss incurred from a large-scale natural or economic disaster.

Justice Holmes rightly declared experience is the life of the law, and no experience is greater than crisis or emergency. Times of crisis demonstrate certain formalities of the law inevitability yield to practical solutions to human problems. In fact, lenders are increasing use of workout agreements to avoid additional loss. Lenders voluntarily turned to workout plans for 155,495 delinquent mortgages in 2004; and the first quarter of 2005 alone recognized a significant increase to 89,741, an approximate 43 percent increase. While lenders are making efforts to manage the current stream of delinquent loans, current workouts are just a trickle compared to the massive delinquent reservoir from which it flows.

Overall, the workout plans implemented by legislation need to be consistent and sufficiently flexible in dealing with the legitimate social interest of homeownership. Measures discussed below can function individually or combine with others to mold the mitigation response to each fact-sensitive situation. Ultimately, the workout seeks to balance the lender’s contractual rights with the homeowner’s interest to fulfill the contractual obligations and retain the home.

132 Levinson, supra note 44, at 726.
133 Id. at 727.
134 E.g. Johnston, supra note 123; Amundson & Rotman, supra note 14; Cutts & Green, supra note 4.
135 Johnston, supra note 123 at 871.
136 Reporter Fact Book, supra note 6, at 36. The volume of mortgage originations in 2004 was $2.7 trillion.
137 Cutts & Green, supra note 4, at 13. See also supra note 54.
G. No- and Low-Cost Mitigation Measures

The challenge of any mitigation measure is to retain the initial contractual rights each side enjoyed prior to a catastrophe. The mitigation measure, by its very application in post-disaster relief, changes the balance, mostly against a lender’s interest. Some measures are easily implemented with insignificant costs, other measures truly have financial consequences for lenders. These measures could be deemed a societal cost worth assessing against lenders and move forward. Another view is that such measures discussed below are nominal in cost and do not impact a lender’s right and ability to eventually receive repayment of the indebtedness. Pragmatically speaking, the homeowner should give something in return for the benefit of mitigation measures in post-disaster relief.

A simple way is to predetermine the value of a relief provision, associate a dollar amount to it, and apply the relief cost to the balance of the loan upon implementation. The cost can be a flat fee or a percentage amount of the loan. A percentage-based fee is a better option because it addresses the degree of risk the lender faces—the larger the loan, the more the lender may lose. The flat-fee scheme is more difficult to assess the value from loan to loan and more arbitrary in determining an amount. Similar to a common practice to pay points at closing to reduce an interest rate, a percentage-based relief provision bases the fee on the outstanding principal balance at the time of implementation. For some of the mitigation measures below, it would be appropriate for the homeowner to pay for the relief option, rather than forcing the lender to solely shoulder the costs.
i. Notice of Rights

Some lenders currently use workout plans at their discretion; however, most homeowners have no notice or knowledge of the availability of such measures.\textsuperscript{139} Legislation should place an affirmative duty on lenders to notify homeowners in disaster areas of what rights or options homeowners have to manage mortgage obligation in the wake of a crisis.\textsuperscript{140} Notice overcomes a real problem unsophisticated homeowners face: what can be done after the disaster. Many homeowners fail to consider contingencies when signing financing documents. Lenders are in a better position to understand workout plans and educate customers.

Legislation, however, may not be necessary since some lenders already communicate relief provision to homeowners.\textsuperscript{141} The contractual agreement states obligations, rights, and remedies. The homeowner has a similar availability to communicate with their lender. Additional notice may be viewed as unnecessary because the contract already outlines remedies.\textsuperscript{142} Yet, mortgage terms and business practices are likely to vary within the industry and can be better managed by legislation.

Notice overcomes the homeowner’s mindset that lenders demand each monthly payment without modification. The cost to lenders is insignificant, and the party’s contractual obligations remain intact and unencumbered with such a simple

\textsuperscript{139} Admunson & Rotman, \textit{supra} note 14, at 849. Initially, the Minnesota moratorium law in 1985 did not require the homeowner be notified of statutory relief provisions. However, this was subsequently modified by the Minnesota Legislature in 1986.

\textsuperscript{140} \textit{Id.}

\textsuperscript{141} Johnston, \textit{supra} note 123, at 871. Fannie Mae strongly encouraged Servicers to contact the borrower and determine their status of rebuilding, payoff indebtedness, or abandonment. \textit{Supra} note 114.

\textsuperscript{142} See generally Johnston, \textit{supra} note 123.
Mandatory notice to a homeowner that the lender may discuss the modification of contract terms is a straightforward mitigation measure that needs no additional fees to implement.

ii. Credit Reporting Hold

The industry lending practice is for lenders to report late or missed payments to credit bureaus. A lender refraining from reporting missed payments to credit agencies due to a disaster is another no cost measure to mitigate loss. A hold on credit reporting acknowledges circumstances exist beyond a homeowner’s control, and avoids creating an inaccurate representation of the homeowners’ credit fitness.

While lenders generally reserve the right to report delinquent mortgage payments as leverage for repayment, this provision is not essential to the obligation for the homeowner to repay principal and interest. In the context of a disaster, a damaged credit rating decreases the likelihood of homeowners obtaining subsequent financing, rental housing, or other services based on credit ratings. Thus, the homeowner’s financial fitness and character is under additional strain, and the inability to prevent foreclosure increases. A hold on reporting mortgage payment delinquency is likely to avoid this result. This relief provision can readily be implemented with little cost to the lender. Thus, the homeowner should not be required to pay fees for such relief.

143 Johnston, supra note 123, at 871. Lenders post workout plan information on the website.
144 Fannie Mae LL03-06: Hurricane Related Special Relief Measures (May 11, 2006) (reminding mortgage sellers and services not to report delinquency to credit repositories if missed payments were likely attributable to the hurricanes.) at http://www.efanniemae.com/sf/guides/ssg/annltrs/pdf/2006/ll0306.pdf (last accessed February 17, 2006).
145 Id.
147 Id.
iii. Forbearance

Forbearance is a relief measure that many lenders have utilized in response to the 2005 Gulf Coast hurricanes. Forbearance can be a short-term suspension, one to three months, or long-term, four to twelve months, of mortgage payments. Repayment of the suspended payments may occur (1) at the end of the forbearance period as a “balloon” type payment or (2) the maturity date is extended to the extent of the forbearance period. Government security enterprises (“GSE”) like Fannie Mae and Freddie Mac have strongly encouraged mortgage partners to temporarily forbear collection of principal and interest payments to those effected by Hurricane Katrina.

A temporary delay in mortgage indebtedness payment is a financial risk to the lender. The delay in payment, in effect, shifts the short-term recovery costs to the lender even though many mortgage agreements leave the onus for payment on the borrower. While rarely recognized by courts, another risk a lender faces is forbearance acting as a waiver of the acceleration clause.

This “shock absorber” approach is unique because during forbearance the “middle man” protects mortgage investors and homeowners at no additional cost.
government expenditure. Forbearance is a highly viable relief measure because of the elasticity in the secondary mortgage market.\footnote{Peter M. Carrozzo, Marketing the American Mortgage: The Emergency Home Finance Act of 1970, Standardization and the Secondary Market Revolution, 39 REAL PROP. PROB. & TR. J. 765, 799-801 (2005).} GSEs have the capacity to absorb a large amount of non- or partial-payments with no additional government funding as illustrated by current lender response to the 2005 hurricane season.\footnote{Id. at 801.} This relief provision is more suited to charge a homeowner a percentage-based fee, which helps offset the strain on lender resulting from the temporary stoppage of payments.

iv. Reverse Mortgages

A reverse mortgage is another measure to provide relief to lenders and homeowners and mitigate loss deriving from a disaster.\footnote{Home Equity Conversion Mortgage Fact Sheet, August 2004, \textit{available at} http://www.fanniemae.com/lobal/pdf/homebuyers/hecmstriper.pdf;jsessionid=TB4FJ2QPV2I05J2FEC HSFGA. (last accessed February 16, 2007).} This mortgage tool has been historically used for elderly homeowners who have a low debt-to-equity ratio.\footnote{Amundson & Rotman, \textit{supra} note 14, at 844.} The “cash-rich” home serves as collateral for the mortgage, and the lender makes monthly payments for the “cash-poor” homeowner by charging against the home’s equity.\footnote{Id} All the fees to implement this measure can be lumped into the loan when reversed. At the end of the loan period the homeowner must pay the indebtedness in full or modify the loan terms.

One drawback is the possibility of a sharp reduction in the home’s equity caused by a disaster.\footnote{United States Housing Market First Quarter 2006 Report, 2006, at 6. Nearly three-quarters of homes impacted by Hurricane Katrina suffered a loss in equity up to half of the pre-disaster value, \textit{at}}
this type of financial tool to be feasible. Without the equity cushion, the lender would shoulder an unreasonable amount of the risk.

However, in the cases where sufficient equity remains, temporary application of reverse mortgage principles ensures that full and timely payments are made to the lender and the homeowner does not default on the contractual obligation. The reverse mortgage is beneficial when the homeowner faces economic inability to make payments, e.g. employer’s business destroyed or delayed and homeowner has no income to pay the mortgage. The reverse mortgage avoids the high cost of government grants and regulatory oversight. Even though a reverse mortgage increases the lender’s risk with a higher loan-to-value ratio, the lender will receive monthly installments that would be in doubt without application of the reverse mortgage. With the homeowner remaining in the home the collateral is protected. The homeowner could simply petition the court for statutory exercise of the reverse mortgage.

http://www.huduser.org/periodicals/ushmc/spring06/USHMC_06Q1.pdf (last viewed February 16, 2007).

160 Supra note 158.
161 Amundson & Rotman, supra note 14, at 845. Legislation or the parties would need to establish a minimum amount of equity necessary. This base could be the amount needed for the homeowner to resume payment or remedy the default. For example, twelve months for a disaster small in scope and recovery is quicker and twenty-four months for a large-scale disaster where relief is slow. Victims of Hurricane Katrina would generally fall under the twenty-four month period. Id. See also, supra note 158.
162 Id.
163 See generally, Wright, supra note 11. The HOLC response to the Great Depression was making large amount of monies available for loans and the FHA implemented regulation on the mortgage industry seeking to improve the impoverished housing market. Additionally, the federal government has allocated $11.5 billion dollars in reconstruction efforts, $6.2 billion for Louisiana and $5.058 billion for Mississippi. Both states have also established state agencies to administer relief funds. Department of Defense Appropriations Act of 2006, Pub. L. No. 109-148, 119 Stat. 2680, 2779-80 (2005); Brown, supra note 1, at 51.
164 Amundson & Rotman, supra note 14, at 845. Essentially the fictional transfer from the lender to the homeowner serves as rent.
mortgage, which avoids the increased burden of out-of-pocket mortgage payments during efforts to repair the home and provide alternative housing.\footnote{E.g. \textit{supra} note 94. If repairs are necessary, the homeowner’s burden doubles: paying rent while fulfilling the obligation to make existing mortgage payments. All this is done while paying costs associated with the disaster: repairs, replacement of lost personal property, or additional travel expenses.}

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v. \textbf{Disaster Default Insurance}

Mandatory mortgage default insurance is another possible measure to mitigate loss resulting from a disaster.\footnote{Generally, hazard insurance issues fall outside the purview of this article.} Conceptually, default insurance is where an insurer continues to pay the monthly mortgage payments to the lender and the homeowner does not become delinquent on the loan. In contrast to hazard insurance, it does not insure against loss to the physical structure, just payment for mortgage payments to prevent delinquency. This measure would insure against the homeowner’s inability to pay the monthly mortgage payment due to circumstances beyond their control arising from a large-scale disaster.\footnote{Private Mortgage Insurance at http://www.hud.gov/offices/hsg/sfh/ins/sfh203b.cfm (last visited February 16, 2007). If the mortgage enters default and the home is sold for less than remaining mortgage debt, then the private mortgage insurance covers the shortage and the borrower has no deficiency judgment looming.} The homeowner would pay the premium along with the monthly payment of principal, interest, property taxes and hazard insurance.\footnote{Description of Principal, Interest, Taxes and Insurance at http://www.hud.gov/offices/hsg/sfh/res/respafaq.cfm (Description of the function and operation of the escrow account for the purpose of paying taxes and hazard insurance.) (last visited February 16, 2007).} After a crisis the homeowner files a claim and the third party insurer pays the lender monthly mortgage payments, on behalf of the homeowner, for a predetermined period of time. Thus, lenders receive their monthly mortgage payments while homeowners can apply available resources to recovery efforts without becoming delinquent on the loan.
In theory, default insurance spreads risk of loss across a greater base, thus, lessening the financial impact.\textsuperscript{169} The premiums paid by the homeowner are likely minimal and provide relief to each policyholder at a critical juncture for individual and industry recovery. In practice, however, this mitigation measure will ultimately fail. Historical experience with the hazard insurance industry teaches that insurance is too small a tool to deal with large-scale disasters.

While insurance on its face appears to be a reasonable loss mitigation measure, disasters have exposed a flaw of home hazard insurance: magnitude.\textsuperscript{170} For example, in 1992 Florida hazard insurance claims from Hurricane Andrew exceeded some insurance companies’ ability to cover the $17 billion in insured damage.\textsuperscript{171} As a result, 280,000 policyholders submitted claims and recovered only $11 billion, or 65 percent of total insured loss, and seven smaller insurers became insolvent.\textsuperscript{172} Florida’s legislative response to the insurance failure created the state-run Residential Property and Casualty Joint Underwriting Association and the Florida Hurricane Catastrophe Fund, which yields significant hope in response to future disasters.\textsuperscript{173}

However, the underlying problem remains: the magnitude of large-scale disasters. Many insurance companies have already exited the industry. If private insurers offer disaster default prevention policies, premiums are likely to be cost prohibitive. The state-run insurers have finite fiscal capacity. At this time there is


\textsuperscript{170} Id. at 167. Outlining the disastrous results of Hurricane Andrew, the largest natural disaster to date.

\textsuperscript{171} Id. Florida property insures collected $1.5 billion in premiums in 1992. Claims paid out were 10 times greater than premiums paid.

\textsuperscript{172} Id. at 168. Of the 300 insurers, 34 gave notice to state insurance regulators of the intent to withdraw permanently and 29 insurers reduced their coverage options in Florida. Even the reinsurance companies limited coverage to be offered to Florida residents.

\textsuperscript{173} Id.
not a third line of defense against astronomical economic loss, leaving the insurance industry vulnerable. If the state institution is to shoulder the over-burdensome economic loss, the government becoming insolvent is a grave possibility.

The 1994 California Northridge earthquake resulted in $12.5 billion in residential damage, and overwhelmed insurers’ financial capacity to respond to policyholders’ claims. This natural disaster resulted in 93 percent of earthquake insurers either drastically reducing hazard insurance or refusing to underwrite policies completely. Not only were Northridge Earthquake claims on shaky ground, reduction in participating insurers threatened the viability of the housing market and efforts to emerge from the current economic recession.

Some insurance companies in California residential industry exited the market and the State government responded by creating state-run insurance program. In 1996, California responded by organizing the California Earthquake Authority (“CEA”) as a privately funded, publicly managed program to insure against future earthquake loss. The State of California, per the autonomous CEA, is the largest residential earthquake insurer in the world.

Hurricane Andrew and the Northridge Earthquake resulted in unpaid or partially paid claims and essentially left the residential insurance market with few willing participants. One study estimated a reoccurrence of Hurricane Andrew with

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175 Id. To remedy the inability or exit of insurers, state government established state run insurance programs with the caveat that once existing reserves are exhausted no more relief is available.
176 Id.
177 Farber & Chen, supra note 169, at 168.
179 Supra note 174. This only took two years. CEA was enacted in 1995 and in 1997 it became the largest earthquake insurer.
the same force in the same location would cause damages close to $70 billion—nearly double the 1992 figure.\textsuperscript{180} State government is now the insurer, and it is unclear whether the state insurance programs can satisfy future natural disaster claims. Should an exorbitant number or amount of claims be submitted, who will bail out the state governments’ insurance implosion? State sponsored social welfare policies should not extend to include this kind of insurance program, which sustainability is unproven. Homeowners living in risk-prone areas should shoulder the risk when it arises, rather than requiring persons at much lower risk levels to assume heavy financial costs.

For large-scale disasters, default insurance is a less effective mitigation measure. This type of insurance will fail to meet the overwhelming demand of claims filed by policyholders.\textsuperscript{181} In addition, insurance companies tend to limit coverage or withdraw from the insurance market after disasters resulting in numerous and costly claims, thus leaving the homeowner, housing markets, and general economic health exposed and vulnerable.\textsuperscript{182}

\textsuperscript{180} Farber & Chen, \textit{supra} note 169, at 168.


\textsuperscript{182} Farber & Chen, \textit{supra} note 169, at 161.
IV. The Heavy Hand of Cramdown Legislation

A. Introduction

Historically, farmers have been afforded financial relief by means of a forced debt reduction.\(^{183}\) Lawmakers have often compared the plight of farmers with that of homeowners.\(^{184}\) Homeowners in the wake of Hurricane Katrina suffered rapid home depreciation and undersecured debt just as farmers during the 1980s experienced notable depreciation of land that lead to undersecured mortgage debt.\(^{185}\)

The Chapter 12 cramdown provision made available for family farmers should also be available for homeowners.\(^{186}\) Many perceive farmers as the backbone of America.\(^{187}\) The residential mortgage industry, in the view of many, is essential to the American economy.\(^{188}\) Public outcry has rung in the ear of lawmakers during time of disaster and despair to assist the farmer and to assist the homeowner.\(^{189}\) A high number of farm foreclosures depresses equity of adjoining farms, just as a high number of home foreclosures depresses equity in the residential community.\(^{190}\) Lawmakers should give the same degree of deference to the homeowner recovering from a devastating catastrophe that Congress has offered to distressed family farmers.

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\(^{185}\) Geyer, *supra* note 138, at 333; *supra* note 3.


\(^{187}\) A&P Bankruptcy 86 Hearings (9), at 25 (statement of Thomas J. Tauke, U.S. Representative from the State of Iowa).

\(^{188}\) *Supra* note 118.

\(^{189}\) See Amundson & Rotman, *supra* note 14, at 822-823 (describing the public sentiment for the governor and legislatures to help ailing farmers; Wright, *supra* note 11 (showing Depression relief efforts in form of money allocation and regulatory oversight).

\(^{190}\) A&P Bankruptcy 86 Hearings (9), at 32 (1985) (statement of Senator Grassley).
B. Congressional Cramdown Precedent

Secured debt intervention dates back to the Depression Era with the Frazier-Lemke Act. From 1935 to 1949 this legislation enabled the adjustment of a farmer’s debt by bifurcating undersecured debt into secured debt (the actual present value) and unsecured debt (loan amount less the present value).

The farming credit crisis of the 1980s is another instance where lawmakers codified cramdown provisions. Nearly $150 billion of owner’s equity evaporated through land value depreciation from 1981 to 1985. Farm commodity prices were below the cost of production; unemployment levels were near record highs; the dollar was strong; exports were weak; interest rates were extremely high; and farmers were in grave risk of losing their farms through foreclosure.

Even though lawmakers conditioned Chapter 12 with a sunset provision, Congress has consistently renewed the provision so that cramdown relief is still available to family farmers. Congress continues extending cramdown provisions as a viable option for family farmers even though conditions at the time no longer generally exist. Therefore, cramdown is a tested and trusted means to protect a vital community interest and to give family farmers a fighting chance to recover from

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191 Geyer, supra note 138, at 334.
192 Id.
193 White, supra note 183, at 1-2.
195 See Wright supra note 11, at 806.
197 Id. This relief provision has been extended for twenty years since its enactment in 1986.
economic disaster. The cramdown measure should be available to qualified homeowners who are effected by natural or economic disasters.\textsuperscript{198}

In response to the 2005 Gulf Coast hurricanes, Congress once again considered cramdown provisions.\textsuperscript{199} In the 2005 “Baker Bill,” which did not pass due to its complexity and efforts to acquire hurricane damaged properties, the House considered offering the cramdown provision as a part of recovery efforts to Hurricane Katrina.\textsuperscript{200} Concededly, Congress’s action to forego the Baker Bill indicates less inclination to give homeowners the same benefits as farmers. However, the cramdown provision is still of interest to other politicians. Louisiana State lawmakers are debating whether to legislate similar cramdown measures for their citizens participating in the Louisiana Homeowner Assistance Program.\textsuperscript{201}

C. Basic Structure of Cramdown

Chapter 12 permits bifurcation of undersecured debt into secured and unsecured debt.\textsuperscript{202} The secured amount is the post-cramdown appraised value and the unsecured amount is the original mortgage amount less the secured post-disaster value.\textsuperscript{203} Some terms, such as the amortization period and interest rate, may be

\begin{footnotesize}
\begin{enumerate}
  \item Some opposed to cramdown measures argue that this measure is a “substantial and retroactive alteration” of the lender’s contractual rights and the homeowner’s obligation. Furthermore, the cramdown hinders homeowner’s power to mortgage. White, \textit{supra} note 183, at 1-2.
  \item \textit{Id.}
  \item John A. Lovett, \textit{Rebuilding a Region, Housing Recovery Efforts in the Wake of Katrina and Rita}, \textit{PROBATE \& PROPERTY}, September/October 2006 Vol. 20 No. 5, at 52.
  \item Geyer, \textit{supra} note 138, at 334.
  \item \textit{Id.} The rewriting of the debt is not unconstitutionally impinging upon the lender’s property right because the reduced debt is what the lender would have received from the foreclosure sale. \textit{Id.} at 338.
\end{enumerate}
\end{footnotesize}
changed under Chapter 12. The principal and interest payments are revised and
based only on the secured debt.

The potent cramdown provision is not a remedial measure for all, especially
those who are highly leveraged. The cramdown already passes a large un-
bargained loss to the lender. For highly leveraged financing, the lender takes a
greater loss than a lower loan-to-value ratio would sustain. The highly leveraged
homeowner has less incentive to recapture equity owing to the lender. However,
Congress in its wisdom made this provision available to family farmers even though
it deprives the creditor from having the power to foreclose the land.

Reducing principal and interest payments based solely on secured mortgage
debt is a practicable solution to lessen the monthly payment burden and empower
homeowners to repair and maintain the home. Thus, foreclosure is less likely to
occur because the lender’s security is preserved and likely to appreciate while the
homeowner continues making payments against the mortgage indebtedness.

One drawback of the Chapter 12 cramdown provision is that it fails to
recognize and secure any post-cramdown appreciation of the collateral that appears
under Chapter 11 of the bankruptcy code. While appreciation is likely to gradually
increase, it must be recognized and secured. With time and effective resources,

204 Id. at 334.
205 Id. at 335.
206 A&P Bankruptcy 86 Hearings (9), at 49 (1985) (statement of Richard F. Stagmen). If the farmer
has exceeded 60 percent debt to asset ratio, the cramdown provision is not an appropriate remedy.
207 See Blaisdell, 290 U.S. at 425. The moratorium statute was upheld with partial reasoning that the
right to foreclose was not eliminated. In this case, the lender’s right to foreclose, for practical
purposes, is foreclosed under Chapter 12 cramdown; White, supra note 183, at 17.
208 Geyer, supra note 138, at 335.
209 White, supra note 183, at 8-9.
210 Geyer, supra note 138, at 335. Chapter 12 merely provides the creditor the right to request an
“equitable share in future asset appreciation.”
most homeowners can regain pre-disaster equity, and this equity growth should be
shared with the lender in the form of correlating secured security interests. \(^{211}\) Mortgage cramdown is a more effective relief provision.

D. **Rationale for the Residential Mortgage Cramdown**

Reducing the secured debt and payments to pragmatic amounts reasonably
and effectively balances both parties’ interests. From the lender’s perspective, the
amount recovered at a foreclosure sale would, in theory, equal the post disaster value
of the home, but would include administrative and legal costs to realize the sale. \(^{212}\) The cramdown measure reduces the secured debt to the level at which the lender
would recover at a foreclosure sale and avoid most administrative fees. \(^{213}\) Some costs
arise to implement the cramdown. Therefore, the secured debt maintains the lender’s
interest in the value it would have received from foreclosure and costly foreclosure
costs are not realized. The cramdown measure places the lender in a similarly
situated to an executed foreclosure action. In addition, home values are not
decreasing which results in larger profits from interest rates based on larger loan
amounts. If lenders do foreclose, they remove their lender hat and begin to wear their
property manager hat. Generally, lenders are not in the business to maintain
properties, assume property liabilities, and dispose of homes.

From the homeowner’s perspective, they retain ownership and a vested
interest to rebuild and recover. \(^{214}\) A reduced mortgage payment facilitates the

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\(^{211}\) The argument made by creditors is that a debtor will use the cramdown provision when the market
is depressed, and then sell the land for a substantial profit when market prices increase. White, *supra*
note 183, at 8-9.

\(^{212}\) See *supra* note 203.

\(^{213}\) *Id.*

homeowner’s effort to make monthly payments and their financial well-being remains largely intact. Society benefits because greater loss in home values is avoided and the difficult situation is dealt with between the parties and does not require societal financial assistance. Also, tax revenues are preserved because the property tax based on home values is not further reduced during the post-disaster period.

Traditionally, lenders hold superior bargaining power over the homeowner by maintaining the threat of foreclosing on the security interest.\textsuperscript{215} In some instances the threat of foreclosure leads to the forced sale of the home, giving credibility to the threat.\textsuperscript{216} In practice, the lender does not have nor exercise superior bargaining power over homeowners because foreclosure threats made by lenders are seldom carried out.\textsuperscript{217} Moreover, the idea of sustaining the lender threat of foreclosure is minimized because the existing industry paradigm is that homeowners must pay the mortgage; if not, the lender will foreclose.\textsuperscript{218}

The cramdown measure efficiently mitigates loss because crippling foreclosure costs are not realized. Home value appreciation is more likely where the homeowner remains in the home with the incentive to repair and maintain the

\textsuperscript{215} White, \textit{supra} note 183, at 18-19.  
\textsuperscript{216} \textit{Id.} 
\textsuperscript{217} See \textit{supra} note 6, at 9. In 2002, over 50 percent of problem loans were resolved by workouts, an improvement from 30 percent in 1996. Lenders understand when they exercise the right to foreclose that in most cases foreclosure is cost prohibitive. \textit{Id.} at 5.  
\textsuperscript{218} \textit{Id.} at 2.
premises. Moreover, the appreciation directly reduces or eliminates the problem of the mortgage being undersecured.

Another reason why a cramdown is efficient mitigation is the lenders may adjust the interest rate according to risk when initially extending credit. Courts and legislators recognize “[m]arket rates of interest measure the real risks of nonpayment and the costs of collection.” Lenders are in the business to calculate the risk and charge borrowers accordingly. The downside is less credit is likely to be made available to homeowners, thus reducing homeownership affordability. In response to the family farmer crisis during the 1980s, lenders with knowledge of cramdown measures kept interest rates at comparable levels and implemented more conservative lending practices for future loans. The codification of the cramdown measure did not cause interest rates to spike like the lenders clamored it would. The farmers faced the same problem that confronts homeowners that would benefit from the cramdown: lenders extending less credit. A fewer number of homeowners would qualify for mortgage financing.

Most large-scale disasters expose the reality between those who have and those who have less. Historically, society collectively has taken efforts to extend a

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219 Geyer, supra note 138, at 337. When a homeowner retains possession taxes are likely paid, generating revenue for local government and schools, home values are not depressed by low foreclosure sales. Homeowners have incentive to work, which helps the economic recovery.
220 Id. at 334-335. Many are critical of Chapter 12 structure that prohibits the lender to recognize the appreciation of the collateral. If this fixed base line was removed, then the undersecured problem would be minimized.
221 Generally, Koopmans, 102 F.3d 874.
222 Id. at 876.
224 Id.
225 White, supra note 183, at 23.
helping hand to those who fall victim to such disasters.\textsuperscript{226} As noted above in the Great Depression, allocating Congressional funds is a less effective means to recover from a catastrophe. Rule and regulations have worked better to create a more effective recovery system. Overall, the cramdown measure extends assistance to disaster victims at nominal cost to government, business and individuals.\textsuperscript{227}

Some lenders argue that a cramdown measure increases the debtor’s wealth and decreases the creditor’s equity.\textsuperscript{228} The right to foreclose permits the lender to elect to foreclose and recapture the home’s value at the current levels or to defer foreclosure intending to hedge for future appreciation.\textsuperscript{229} The cramdown measure, in its most basic form, makes the decision for the lender. The Chapter 12 scheme suspends foreclosure and destroys the lender’s right to elect whether or not to carry the mortgage, thereby allocating appreciation to the debtor.\textsuperscript{230} Because the post-disaster recovery period is so pivotal to both parties and decisions must be made relatively quickly, the decision to make cramdown measures available must be made long before the unfortunate circumstances rear their ugly head.

A cramdown measure in response to large-scale disasters should integrate the concept of shared appreciation between homeowner and lender.\textsuperscript{231} Sharing the home’s appreciation is the most pragmatic approach to balance each party’s interests in the wake of a cramdown. Shared appreciation minimizes transfer of wealth from the lender to the homeowner and seeks to place both parties in the position they

\textsuperscript{226} Depression response, \textit{supra} notes 48 and 50; 1980 Family Farmer Economic Crisis, \textit{supra} note 190.
\textsuperscript{228} White, \textit{supra} note 183, at 23.
\textsuperscript{229} \textit{Id.}
\textsuperscript{230} \textit{Id.}
\textsuperscript{231} \textit{See supra} note 212.
would have been in but for the disaster. Moreover, little, if any, wealth transfers from richer citizens to poorer citizens because policy-based remedies cost taxpayers very little to implement this measure of disaster relief.\textsuperscript{232}

Congress allocated $11.5 billion in Community Development Block Grant ("CDBG") funds for areas impacted by Hurricane Katrina and Hurricane Rita.\textsuperscript{233} This is a patent transfer of wealth from the taxpayer that has more to the victim who has less.\textsuperscript{234} A cramdown measure, with shared appreciation, will not redistribute the wealth from the lender to the homeowner.\textsuperscript{235}

The general rule in America is that freedom of contract exists for all.\textsuperscript{236} Upon entering the mortgage obligation, one is bound to fully comply with such, no matter the circumstances.\textsuperscript{237} Many homeowners take pride in ownership and honoring their obligations to repay outstanding debt. Affording homeowners the chance to pay the

\textsuperscript{232} See generally Wright, \textit{supra} note 11. That is one reason why the FHA was so successful in long-term recovery efforts during the Depression Era.


\textsuperscript{234} See \textit{supra} note 54. The HOLC focus was to thrust money into the mortgage market to reverse the tightening of available credit. The government allocated $4.75 billion and the impact was negligible at best.

\textsuperscript{235} The idea of wealth transfer is difficult to quantify. It is merely a guessing game contingent on factors like appraisal value, consumer surplus and market demand versus property owner's valuation. White, \textit{supra} note 183. Lending institutions argued that a cramdown measure would result in less credit available because banks would withdraw from the market. Furthermore, the exiting lenders would justify high lending costs and interest rates passed to the farmer. \textit{Id.} at 26-27. However, over time these fears were not realized. In fact, the interest rates remained at relatively normal levels and very small number of agricultural lenders increased interest rate. Given the farming credit crisis, the response was expected, with or without the cramdown provision. Banks implemented more conservative lending policies such as more reliance on cash flow and decreasing loans based on security interest in collateral. Geyer, \textit{supra} note 138, at 339-341.

\textsuperscript{236} \textit{Blaisdell}, 290 U.S. at 448; White, \textit{supra} note 183, at 17.

\textsuperscript{237} \textit{Id.}
debt retains their dignity and self respect, which public policy recognizes as traditional farmer and homeowner values.\textsuperscript{238}

This issue is real. In one setting, the onus felt by an indebted person to repay debt strained a citizen of North Carolina into taking his life because he was unable to cope with the dire circumstances of undersecured debt and his momentary inability to meet his pecuniary obligation.\textsuperscript{239} No financial obligation, no matter the amount, is worth a person’s life. Policy and law should encourage parties to honor financial obligations while caring for those reeling from a large-scale catastrophe.

E. Substitutes as Incentives

Where a lender is subjected to cramdown provisions and incurs financial loss from the homeowner’s delay in payments or failure to fully repay, substitutes should ameliorate the loss. The law should make certain “carrots,” as well as “sticks,” available to lenders whose secured mortgaged debt is reduced by cramdown measures.\textsuperscript{240} The intent of substitutes is to place the lender as close as possible to the original mortgage terms being fulfilled.\textsuperscript{241} Lenders are in business to increase profit by increasing revenue or reducing costs. While substitutes are likely not to increase a lender’s revenue, they can reduce costs lender’s have in their business operations. Tax incentives and a goodwill system are discussed in turn.

\textsuperscript{240} Craig E. Marcus, Beyond the Boundaries of the Community Reinvestment Act and the Fair Lending Laws: Developing a Market-Based Framework for Generating Low- and Moderate-Income Lending, 96 COLUM. L. REV. 710, 724 (1996). General discussion of the incentive and regulations surrounding the Community Reinvestment Act seeking to encourage lender to make financing available to low and moderate income communities.
\textsuperscript{241} A gap created by reduced payments and security is filled by incentives that fill the gap in terms different from the original mortgage obligation.
One incentive for lenders would be tax incentives to lenders who are subjected to cramdowns.\textsuperscript{242} For example, a tax credit or deduction based on all or part of the bifurcated unsecured mortgage debt financially benefits a lender and softens the financial blow. The reduction in tax revenue, admittedly, is to the detriment of the general tax base because this lender benefit would reduce tax revenue from lending enterprises.\textsuperscript{243} The lender would further benefit, in addition to the tax incentive, where the homeowner repays, in part or in full, the unsecured debt.

Creating a system to rank or standardize a lender’s recovery efforts is yet another incentive to enhance the goodwill of the lending institution.\textsuperscript{244} Just as borrowers are rated by a credit system, a lender can be evaluated on their efforts to help homeowners in a natural disaster.\textsuperscript{245} Although quantifying the value of goodwill imposed by such a system may seem complex to assess, the benefits are substantial. Lenders’ enhanced reputation will help retain current borrowers and prove to attract new customers.\textsuperscript{246} This is of particular importance in an industry where lenders are constantly seeking to retain and attract patrons.

Tax deduction and a goodwill system cannot replace the original terms of the mortgage contract. However, these incentive measures smooth over the scarring and

\textsuperscript{242} I.R.C. § 165 (2006).
\textsuperscript{243} \textit{Id.} Similar tax provision can be implemented to benefit those lenders affected by the mortgage cramdown.
\textsuperscript{245} See Marcus, \textit{supra} note 240, at 725-727.
\textsuperscript{246} \textit{Supra} note 197.
The cramdown measure is not intended to be an absolute cure; rather a tool of last resort. This stiff, but reasonable, measure gives homeowners a fighting chance to pick themselves up and continue forward with relief efforts. A looming cramdown equalizes the bargaining power during workout negotiations.247 As a result, fewer homes foreclose, fewer neighborhoods are economically depressed, lenders may receive payment in full, and the individual homeowner and community are empowered with an opportunity to overcome tremendous financial burdens.248

VI. Conclusion

Thus we see that recovery costs alone can be enormous as demonstrated by Hurricane Katrina’s estimated damages of $75 billion in property damage.249 If homeowners stumble into default and foreclosure results, the associated costs are significant for both the homeowner and lender.250 Furthermore, the ripple effect is

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247 White, supra note 183, at 26. The workout agreement is done in the shadow of the farmer’s alternative of a Chapter 12 cramdown. However, the lenders will soon modify the original agreement to include terms addressing the cramdown.

248 In comparing the cramdown provision to elements set forth by the U.S. Supreme Court in Blaisdell the debate is on what is “reasonable.” First, the cramdown seeks to protect a vital community interest, homeownership. Second, the legislation implementing cramdown provision addresses the protection of the legitimate social interest of disaster recovery and community sustainability. Third, the provision is based on the appropriate and reasonable conditions of a large-scale disaster that significantly impacts their lives, homes and communities. Fourth, conditions must consider both parties because appreciation in the home’s equity is recognized as secured debt and payments are based on the smaller secured debt—rather than on the original indebtedness. Fifth, the cramdown provision is only limited to the particular disaster. Blaisdell, 290 at 444-447.

249 See supra note 1.

250 See supra note 5.
wide spread, impacting both communities and industry through depressed prices, lost revenues, and lost tax base.\textsuperscript{251}

Empowering the contracting parties for long-term success, not ephemeral monetary aid, is the appropriate action to take. A standardized framework is the means from which lenders can determine future risk and associated costs, and by which homeowners are afforded knowledge of and access to mitigation measures. In considering less-effective and more effective mitigation measures, organizing standardized relief provisions fosters the necessary post-disaster perspective for the homeowner and lender, and preserves, while not perfectly, both parties’ prevailing contractual interests. The favorable, tangible end result is secured homeownership, diminished financial loss for the residential mortgage industry, and hasted community recovery.

\textsuperscript{251} See supra notes 85 and 86.