

## Are we hearing the rumblings of another mortgage meltdown?

by [John Nelson](#), partner, Weissman, Nowack, Curry & Wilco P.C.

The recent decision by some large lenders to suspend foreclosures might be the first rumblings of what could be another mortgage meltdown that would directly affect home builders in Georgia and the entire economy and make the previous crisis pale in comparison.

It started last week when evidence emerged that teams of so-called "robo-signers" hired by large lenders had signed hundreds of thousands of foreclosure documents without reviewing them, which prompted several large lenders to suspend foreclosures to try to fix the problem.

Although this particular issue was limited to the 23 states that require court approval for foreclosure (which Georgia does not), it has opened the door on what could be a much bigger documentation nightmare for lenders—one that could derail most foreclosures in every state, invalidate foreclosure sales that have already occurred, and put more stress on an already fragile credit and real estate market.

At the heart of this controversy is the practice of electronic registration of mortgage transfers, which is handled by a company called Mortgage Electronic Registration Systems or MERS. It was created by the mortgage industry to allow financial firms to quickly sell and resell mortgage loans without signing and recording the documents that are traditionally required to prove who legally owns the loans. It was the innovation that enabled big financial firms to bundle thousands of mortgages into securities that could be traded electronically with a keystroke, over and over again across the globe.

This was a huge departure from the traditional practice of signing and recording documents for every transfer of a security deed to prove who owns the deed and, subsequently, who has the right to foreclose on the property. MERS allowed financial firms to sidestep this practice, thereby saving time and billions of dollars in recording fees.

The problem is that it becomes extremely difficult to prove a clear chain of title through dozens and dozens of unrecorded electronic transfers when it comes time to foreclose. And it becomes even more difficult if someone forgets to report a transfer to MERS or something gets overlooked in a shuffle (say, for example, when the FDIC takes over a bank). But few objected until millions of homes began to fall into foreclosure.

Now more courts are questioning who really owns the loan and therefore the right to foreclose. MERS is facing class action lawsuits in California, Nevada, and Kentucky, as well as individual legal challenges across the country on a variety of legal arguments. Until now, MERS has won most court challenges, but the cases are starting to spread and gain traction.

In May, judges in New York and California dismissed foreclosure cases because of objections to the method that MERS had used in handling the loan documents. Then in August, the Maine Supreme Court threw out a foreclosure case because it found that "MERS had no standing to initiate the foreclosure action" because it had not been harmed by the borrower's default since it had no stake in the loan.

If more courts rule against MERS, the consequences would be huge. MERS is used by the largest lenders in the country, tracking more than 64 million titles and handling more than 60 percent of new mortgages. It is involved in the majority of foreclosures in Georgia and across the country.

So how will this affect home builders? For home builders who are facing foreclosure or who have already lost properties to foreclosure, it might be good news, at least in the short run. They could attack the MERS system to try to stop those foreclosures, negotiate a favorable workout, invalidate prior foreclosures, and perhaps even argue for a claim for damages.

But the larger impact could severely hurt the housing market and overall economy, and, by extension, home builders. That's because home builders, the housing market, and the overall economy all depend on the availability of credit, and credit becomes scarce when lenders are financially hurt or scared.

If successful attacks on MERS continue to spread, it could financially devastate lenders and make them unable or unwilling to extend home loans and credit to home builders. At a minimum, lenders would face the huge cost and delay of sorting out paperwork on millions of old mortgages, and lenders would probably lose the ability to foreclose on some properties altogether. Lenders would also face lawsuits by borrowers who have already lost their properties to foreclosure, as well as suits by their own investors for using the electronic registration system in the first place without safeguards in place.

Additionally, builders who have invested in foreclosed lots could face claims that they do not have clear title to those lots, or they might face problems when they try to sell.

Title insurers who have backed the titles of millions of these foreclosed properties could face a mountain of claims, and some have already stopped insuring titles for foreclosed homes. That will make it that much more difficult to sell properties that were previously foreclosed.

Given the sheer enormity of the consequences, legislatures will likely step in to fix the problem—eventually. The Minnesota legislature, for one, has already passed a law that makes it clear that MERS has the right to bring a foreclosure action. But other lawmakers might be reluctant to be seen as once again bailing out the financial firms that many believe created the problems in the first place. Without a fix, however, this issue has the potential to explode into a host of far-reaching problems for Georgia home builders, the national housing market, and the global economy.