Massachusetts Supreme Court Reverses Many Foreclosures

January 12, 2011 - This is something that we warned our readers about back in May of 2008. A ruling this week from the Massachusetts Supreme Court may affect foreclosures across the country. The court ruled against Wells Fargo and US Bank in their attempts to foreclose on homes when the banks couldn't actually prove that they owned the mortgages involved or that they had authority for foreclose. The case is likely to have consequences nationwide because the practices used by the banks in Massachusetts are actually used by banks across the country. And the laws violated by the banks in Massachusetts are similar to laws in most other states. Given the fact that this very same issue had presented problems in federal courts more than 2 years ago, with the same end results, the banks have nobody to blame but themselves.

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To understand the court ruling this week, you need to understand what the banks did. So here is the simple explanation.

For a number of years now, banks have been making home loans and then selling off those loans to investors. The way that the loans were sold off is that individual loans were divided up and then repackaged into new securities. Just think of it like this. You take out a home loan and then the bank sells off 1% of your loan to one person, and another 1% to someone else. After they make 100 sales of 1% each, the bank no longer owns your loan. It is almost like dividing up loans into shares of stock. The banks were a little more sophisticated than this but you get the idea.

This scheme is great for the banks but it creates a real problem for homeowners and for investors. After your loan is sliced and diced, it raises the question. Who actually owns your mortgage? That's an important question because only the entity that actually owns a mortgage can initiate a foreclosure. And that is the issue that the Massachusetts Supreme Court ruled on.

The reason that the banks got sued, rather than the investors, is that once the bank has sold off your loan, that doesn't really take them out of the picture. Most investors don't want to service individual mortgages. In fact, most of them would find that to be a nearly impossible task. So they sign an agreement to have the bank which originated your loan continue to collect your mortgage. In a perfect world, the bank is paid a commission and the investors receive monthly payments on the principle owed. But it is no longer a perfect world. A lot of home buyers have stopped paying their mortgages over the past couple of years. And it has been left to the banks that service these delinquent notes to foreclose on them.

That's creates a Catch 22 situation. The banks no longer own the mortgage; they just service it for the investors. Multiple investors all want their money but none of them can prove that they actually own the mortgage because it has been cut up into dozens of smaller pieces. And the banks that originally sold the mortgages to investors did a very poor job of keeping records of who owned what.

The banks' answer was to continue with business as usual. So they just continued to foreclose like they always had. And that worked up until they got sued.

The banks fought the law suit vigorously, but they lost. They appear to have been fighting using a defense of "but that's how it has always been done." That apparently didn't convince the court which wrote, "The legal principles and requirements we set forth are well established in our case law and our statutes. All that has changed in the plaintiffs' apparent failure to abide by those principles and requirements in the rush to sell mortgage-backed securities,"

In a concurring opinion, Justice Robert Cordy wrote, "There is no dispute that the mortgagors of the properties in question had defaulted on their obligations, and that the mortgaged properties were subject to foreclosure. Before commencing such an action, however, the holder of an assigned mortgage needs to take care to ensure that his legal paperwork is in order."

The ruling by the court was unanimous and its ramifications are astounding. In one fell swoop, the court reversed every single foreclosure in Massachusetts for which the banks couldn't prove their right to foreclose.

Virtually every state has the same requirements for foreclosure as Massachusetts. It is highly likely that this opinion will be used by attorneys across the country in similar suits, and there is no reason to believe that other courts won't see things the same way. In the end, the ruling could lead to financial ruin for many banks, and it could also create a firestorm of legal issues for anyone who has purchased a property that was bank owned. These properties could become uninsurable and unsellable for many years to come. And anyone who is currently thinking about buying a foreclosure of their own may want to think long and hard about it before committing. You may think you are getting a bargain when in reality you are just digging yourself into a legal and financial nightmare.
byJim Malmberg
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