

A Modest Proposal for Foreclosure Resolution-The DOLLAR Method

As a potential solution to some of the difficulties with current foreclosure resolutions and workouts, here is a Modest Proposal for the modification of the relationship between lender and homeowner/borrower for residential real estate, as an alternative to traditional foreclosure. Currently, under historic practices for mortgages and foreclosure, there is a stark binary choice: the lender does or does not get the property back through a deed in lieu of foreclosure or a sheriff's sale. There is little flexibility other than a loan modification, which perpetuates the mortgage relationship. As an alternative to traditional workouts, please carefully consider a proposed mechanism called **DOLLAR**, which stands for:

Deed in lieu of foreclosure,

Option for the homeowner/borrower to buy the home again in the future,

Lender-**L**ease where the bank immediately leases the property back to the borrower,

And First **R**efusal, where the lender and the borrower each have a right of first refusal before the other can transfer title to the property.

In the face of a delinquent mortgage where the homeowners living in the property want to keep the home and can pay something but not the full amount of the monthly mortgage, the **DOLLAR** process would work as follows, with all the component steps agreed on in advance as a package:

1. Preferably before filing a foreclosure action (in order to maximize the savings in fees) or very shortly after filing, the lender would accept a deed in lieu of foreclosure from the homeowners/borrowers. The lender would then have full title to the property as security.
2. The lender would immediately lease the property back to the borrowers at a monthly rate they could afford. The borrower retains uninterrupted possession so there is no diminution in value due to vacancy, lack of maintenance, or forced sale. There can be an opportunity for inspection of the property and an appraisal to establish a baseline for the condition and value of the property.

3. The lease has protections in it for the lender that if the borrowers/tenants miss a single monthly payment they are evicted and lose all rights to the house now and in the future. The lease also has provisions for the borrowers/tenants to pay taxes and casualty insurance, a requirement that the borrowers are responsible for all maintenance (so there is no problem with a distant lender being an absentee landlord), and a requirement that the borrower maintain liability insurance protecting both the lender and the borrower from liability suits (slip and fall, etc.). In effect, the arrangement would be similar to a triple net lease commonly used in commercial leases.

4. Concurrent with the lease, the lender and the homeowners/borrowers enter into an option for the borrowers to repurchase the home from the lender at market price or some other agreed value in the future, generally two to five years hence.

5. Each party grants the other a right of first refusal, so the lender cannot sell to a third party without the homeowners/borrowers having the ability to match the price, and the borrowers cannot sell the house on the open market without lender approval.

The advantages of the **DOLLAR** mechanism are:

- The lender immediately gets title to the property as security without the delay or expense of starting a foreclosure or pursuing one to conclusion,
- The homeowners retain possession so there is no vacancy, no disruption of their family or the surrounding community, and no moving expenses,
- The property retains its value by avoidance of vacancy, a short sale, or a sheriff's sale at a depressed price,
- Taxes are paid to the local government units,
- The homeowners have the ability to make their reduced monthly lease payments plus a powerful incentive to do so in the automatic eviction clause,
- The lender gets a steady stream of monthly lease payments instead of a growing arrearage and a difficult-to-collect deficiency judgment, thus mitigating its damages. The difference between the lease payments and the mortgage payments (which is less than the difference between the mortgage payments and zero) could be built into the option price or into a reworked mortgage when the borrowers have the ability to pay,

- The borrowers have an opportunity to buy back the home after a few years pass, and the economy, the job market, and the housing market improve,
- The lender gets market value for the home (as compared to a sheriff's sale price) in a lump sum when the borrowers exercise the option and buy it back through a refinance with the original lender, or a refinance or purchase funded by a different lender,
- Neither party can sell the home out from under the other without the first refusal review and sign off. The borrowers could not, for instance, sell to a family member or assign the option in a non-arms length deal (they don't have title anyway). Instead of a short sale at a reduced price, the borrowers could negotiate a sale to a third party at market price with the lender's approval. While the lender after the deed in lieu has all title rights, the tenants' option and right of first refusal gives them security and an incentive to perform by paying taxes and maintenance without the risk of having the house yanked out from under them without a chance to match the price,
- Both parties avoid costs, legal fees, and other foreclosure related expenses,
- Lenders avoid the cost of securing, maintaining, paying taxes on, insuring, and listing a vacant home in a depressed market, and the borrowers maintain their credit rating without the blot of a foreclosure,
- Court dockets (or non-judicial workloads) are drastically reduced,
- More homeowner/borrowers can avoid bankruptcy while remaining residents of their existing homes,
- No new legal instruments or concepts are required, just recognized legal documents such as deeds, leases, options, and rights of first refusal (which could be combined in one single document), all of which could be recorded to maintain clear title records,
- HUD would need to grant a waiver of its rule about a house being vacant for a deed in lieu of foreclosure, but there would be a savings to HUD and the taxpayers as there would be no mortgage insurance payout to the lender for a foreclosure,
- The **DOLLAR** mechanism, utilized in both judicial and non-judicial foreclosure states, would convert non-performing mortgages to valuable revenue generating assets on the lenders' books.

The **DOLLAR** mechanism is being put forth for discussion and possible use not as a “one-size-fits-all” approach, but instead as a general concept to be adapted and negotiated to fit the circumstances of each particular case. Matters such as junior liens, taxes, specific maintenance requirements, how to handle prospective buyers, etc. can and would be negotiated (or mediated) between the lender and the homeowners before signing the documents to enter into the **DOLLAR** arrangement. There is no suggestion here that the **DOLLAR** concept will work in every case or be set up exactly the same way every time.

With the **DOLLAR** mechanism in wide usage, lenders and borrowers would have a shared interest in maintaining a business relationship with a mutual desire to see the residential property appreciate in value while striving to pay off the underlying obligation. Rather than increasing the lenders’ inventory of difficult to sell homes in a depressed market and simultaneously forcing borrowers out of homes they wish to keep and maintain, the **DOLLAR** mechanism can realign the parties’ risks, incentives, and benefits in a new approach to how delinquent mortgages are resolved without the “lose-lose” consequences of a sheriff’s sale. In contrast to the current foreclosure process, which pits lender vs. borrowers in an adversary relationship, the **DOLLAR** mechanism is a potential “win-win” solution to delinquent mortgages.

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NOTE: Mr. Paddock is setting out this proposal in his personal capacity as an attorney with experience in foreclosure mediation. He is not speaking on behalf of the Clermont County Common Pleas Court, any other governmental unit, or any private organization.