

Legal analysis to guide the mortgage industry and protect its interests.

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A Moratorium on Foreclosures? There is Precedent.

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With the number of foreclosures on the rise, some state legislatures are considering the possibility of enacting statutes that would halt foreclosures. So far, none of these “foreclosure moratoriums” have made it very far in the legislative process. It is important, however, to remember that there is legal precedent for the enactment of such moratoriums.

During the height of the Great Depression, three-and-a-half years after the stock market crash of 1929, homeowners across the country were losing their residences because they could not stay current on their mortgage payments. In response, the Minnesota Legislature declared an “emergency” and enacted the Minnesota Mortgage Moratorium Law. The statute, enacted in 1933, allowed homeowners to petition state court judges to temporarily halt the foreclosures of their mortgages. The statute also extended the right of redemption for up to two years, provided that the homeowners made “reasonable” monthly payments that were to be applied to their mortgage payments, property taxes and insurance during the extended period of redemption.

While many hailed the moratorium as the type of essential measures needed to protect citizens from the economic crisis, lenders argued that the moratorium violated the contract clause of the U.S. Constitution: The statute retroactively altered the lenders’ rights under the mortgage contract voluntarily entered into by the homeowners because the extension diluted the lenders’ rights and increased the borrowers rights, contrary to the express terms of the mortgage. The constitutionality of the statute was challenged when one couple, the Blaisdells, sought protection under the law after their home was foreclosed upon because they were delinquent on their mortgage payments. The trial judge ruled in favor of the Blaisdells, extending their right of redemption for two years, and the Minnesota Supreme Court affirmed the ruling. On appeal to the United States Supreme Court, the statute was upheld by a 5-4 vote. *Home Building & Loan Ass’n v. Blaisdell*, 290 U.S. 398 (1934).

The majority opinion, written by Chief Justice Charles Evans Hughes, found that the law did not violate the contract clause and was thus constitutionally valid. The Supreme Court upheld the law on five grounds. First, the Court found that an emergency existed in Minnesota, one which gave rise to a “proper occasion” for the state to protect the vital interests of the community. Second, the Court found that the legislation had a legitimate purpose and was not enacted to protect certain individuals, but for the protection of society as a whole. Third, the Court found that the relief provided to homeowners by the statute was only permitted in certain, limited conditions. Fourth, the Court found that contractual rights were reasonably protected: Homeowners were required to maintain payments during the postponement of the foreclosure, and the obligation under the mortgage was not extinguished. Fifth, the Court relied upon the fact that the legislation was temporary and set to expire in 1935 (although it was later extended until 1942).

Writing for the dissent, Justice George Sutherland viewed the moratorium as the precise type of government action that the contract clause meant to prevent, especially in view of the pre-constitutional practice of legislatures enacting measures to mitigate the sometimes harsh consequences that debtors suffered as a result of financial or economic troubles.

Today, with the number of foreclosures on the rise, some states are considering enacting similar measures, modeled after the moratorium upheld in the *Blaisdell* case. A similar bill is under consideration by the Michigan Legislature (S.B. 1306), and Minnesota is again considering a foreclosure moratorium (H.F. 3612). The Minnesota legislation, which would apply only to owner-occupied properties, would block foreclosures for a year, and is designed to force lenders to modify the terms of the loans rather than foreclosing. Mortgages eligible for the moratorium must be either sub-prime or negative-amortization loans for which the minimum monthly payments have increased. The borrowers would be required to maintain a reduced payment — the lower of 65 percent of the payment at the time of default or a payment calculated with the initial interest rate. If the borrowers failed to maintain the payments, the lender is permitted to proceed with the foreclosure process. During the deferment period, however, the lender cannot charge the borrower for any amount other than the reduced payment.

With the government takeover of Fannie Mae and Freddie Mac, there have been increasing calls for a federal foreclosure moratorium. Already, a bill has been introduced in the House of Representatives, H.R. 6076, that proposes to amend TILA to permit certain homeowners to take deferrals on their foreclosures. And, earlier this year, in response to a City Council measure that called for a foreclosure moratorium, the Philadelphia sheriff refused to hold court-ordered foreclosure auctions. However serious the current situation, it does not compare to the Great Depression, where the national unemployment rate reached more than 25 percent at its highest. While the Depression may have provided precedent for this type of legislation, these bills present several problems. In order to get a deferment on foreclosure, the borrowers will most likely be required to file a court action. Even if the court ultimately rules against the borrower, the foreclosure process has still been delayed, the borrowers are likely to have fallen further behind on their mortgage payments and the lender has incurred court costs and legal fees. These bills also raise several questions: What happens when the deferment period expires? Can the lender recover unpaid principal, interest and necessary advances that accrue during the deferment period? What happens to the unpaid amounts that pre-date the deferment period? Will the lenders be able to recover the costs that they incur as a result of borrowers filing court actions?

Since 1934, the *Blaisdell* decision has been widely criticized, and many view it as an unfaithful interpretation of the contract clause. Nevertheless, *Blaisdell* has never been explicitly overruled, and the decision has set the stage for future mortgage moratoriums. Whether these measures will be passed is uncertain. But, if these measures are passed, the mortgage industry will face an uphill battle in having *Blaisdell* overruled and these measures declared unconstitutional.