

A Cloud of Gloom in the Sunshine State

The stormy conditions in the Florida housing market are representative of the nation's struggles.

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From a mortgage industry perspective, the Sunshine State looked a lot sunnier just a few years ago. The ripple effects from what began as a real estate bust and evolved into a full-blown foreclosure crisis have had a profound impact that extends throughout the servicing industry. And perhaps no state has been hit harder than Florida. Headlined by high-profile cases, such as the rapid collapse and subsequent scandal surrounding Florida attorney David Stern, his law firm, and his servicing company, DJSP Enterprises Inc., Florida has been at the forefront of these unwelcome developments.

In retrospect, it is clear that the housing bubble in Florida was larger and more fragile than the national average, making the state a prime candidate for foreclosure chaos. And when the bubble burst, the resulting mess was not only bigger, but has proven harder to clean up. There have been accusations of fraudulent practices and poor documentation, and the media has contributed its share of heated rhetoric to an atmosphere of recriminations and accusations. But how much of that is accurate, and how much of that is hype?

What is clear is that changes are being made at all levels. The servicing industry is doing its part to make positive moves, but legislative remedies—as well as governmental, judicial and procedural reforms—must also be included. Deciding what those solutions should be demands a detailed understanding of what went wrong in the first place. And that's where Florida comes in.

What makes Florida such an interesting—and potentially instructive—example to study is the fact that the state represents such a significant percentage of the foreclosure marketplace. While the subprime mortgage crisis is national in scope, the worst of it has still been remarkably localized in a few key regions. For example, at the peak of the crisis in 2008, just 10 states accounted for almost three out of four foreclosure filings nationwide, and Florida alone has accounted for anywhere from 20 percent to 30 percent (depending on how and when you measure) of the total number of national filings over the past few years. And that

top-heavy dynamic shows no sign of changing in the near future. In 2010, Florida—along with California, Illinois, Arizona and Michigan—continued to make up more than 50 percent of total U.S. foreclosures. In addition to the high volume, Florida is a judicial foreclosure state (meaning foreclosures are processed through the court system), making it the perfect storm: a worst-case scenario in terms of technical complications, judicial scrutiny and procedural inefficiencies.

What happened in Florida is not unique; it is a heightened, exaggerated version of what has happened everywhere else. The questions that were, and still are, being asked in Florida are the questions that are being asked around the country. Where do we go from here? Will these short-term reforms lead to workable long-term solutions? How is the default servicing industry evolving and what kind of economic and legislative reforms need to be put in place? Taking a closer look at the “Florida Problem” can give us a better idea of what a national solution might look like. If we can answer those questions in a state as complex and challenging as Florida, we can answer them everywhere.

TURNING UP THE VOLUME

In Florida circa 2006, the stage was set for trouble. The first rumbles of what would become a nationwide recession were beginning to shake the marketplace, a slide that began with a collapsing real estate market and would escalate into a full-fledged recession. An overbuilt and overleveraged Florida real estate market was especially vulnerable. Major foreclosure firms in Florida were unified and began pushing rates down, decreasing attorneys' fees as the number of foreclosure files was increasing dramatically...very dramatically.

According to RealtyTrac, there were 124,721 foreclosures in Florida in 2006 and 385,309 foreclosures in 2008, for an astounding increase of 206,588 files.

With that much volume exploding into the system, the industry simply could not cope. Law firms and servicers did not have the capacity to handle the influx. Though firms ramped up their staffing

and began to upgrade their systems, there was not yet sufficient managerial infrastructure and experienced talent to keep adequate control/oversight over the details of each individual file. At the same time, a chronically underfunded court system was making the situation worse. Florida courts were ill equipped to handle the foreclosure caseload, and it was not only the judiciary that was bogging down. Judges had packed calendars and clerks and clerical employees could not push documentation through at a pace necessary to avoid clogging the system. Add to that a lagging technical infrastructure, and it becomes clear why the courts could not handle the onslaught of new filings.

At first, the result of this logjam was that cases were moving through the court system rapidly with little oversight. This was a problem. Once the first signs of controversy and documentation errors began to show up, however, the response was to slow things down. An already overfull system was now more sluggish than ever, and the slowdown placed additional financial pressures on law firms.

CASCADE OF COMPLICATIONS

One of the truly troublesome aspects about the foreclosure crisis in Florida—and elsewhere around the nation—is the degree to which problems beget more problems, which exacerbated additional problems, and so on. Nothing happens in a vacuum, and a system with so many interdependent moving parts was particularly vulnerable to a cascade of complications that only deepened the crisis. The erosion of Florida's tax base as a result of the economic and real estate downturns, for example, had the impact of making even *less* money available for funding an overstressed judiciary. A number of connected problems became evident once the system was put under stress, from legal and technology factors to procedural issues and, finally, rare instances of genuine malfeasance.

With the courts unable to keep up, and with servicers trying to shoulder a larger workload with a less sophisticated and experienced workforce, it was perhaps inevitable that a few bad apples would spoil the industry barrel. High-profile controversies got a lot of ink, and the result was dramatic. The public saw these emerging credibility issues as an indictment on the entire foreclosure process, and many administrative and political officials saw this as an opportunity to get some populist traction and “do something” by implementing hastily conceived legislative remedies or launching grand investigations. A series of overreaching investigations outside of accepted jurisdictional grounds further muddied the waters. Several attorneys general filed out-of-state subpoenas, a gesture that was little more than a fishing expedition for improper document execution under the rubric of consumer protection. Because the State Bar and the State Supreme Court regulate Florida attorneys, those subpoenas were invalid, but they contributed to an atmosphere of accusation.

The accusatory tone was disappointing. While it was all too easy to paint lenders and servicers as “bad guys,” the reality could not be further from the truth. The vast majority of attorneys and servicers are responsible and accountable professionals. All it took was a vocal minority of borrowers terming foreclosures wrongful to decrease the credibility that those attorneys and lenders would have in the courtroom. In any other legal matter, a straightforward breach of agreement would be handled expeditiously. But once the credibility was in question, the system began to give undue credence to dubious accusations, further slowing down the resolution of legitimate foreclosures.

DEVIL IS IN THE DETAILS

While the overblown reaction was counterproductive, the structural problems faced by attorneys and servicing professionals were very real.

Some legacy law firms in Florida had experienced rapid growth, in some cases increasing tenfold in a relatively short period of time. Specific authority to sign on behalf of their lending clients became a privilege that was abused. There were plenty of instances where an excessive volume or an absent staffer created a situation where unauthorized personnel signed off on documentation. In most cases, that did not mean that the fundamentals of the foreclosure were wrong, but the practice is still illegal. Corner cutting caused additional issues. Some foreclosures have been invalidated when the paperwork was documented at one facility and then notarized at another.

To be clear, there were a few distinct violators, but the Florida example illustrates the way the whole industry has been unjustly painted with a bad brush. The number of truly wrongful foreclosures in the state has actually been exceptionally small: somewhere between 0.1 percent and 0.01 percent of all files, but it is not hard to see how those extreme examples garner all the negative press and dominate the headlines. As we look at how and where to apply reforms and lasting solutions, it is important to remember that the basics of the system were sound; it was in the execution of those principles in a high-volume scenario where things began to fall apart.

PROACTIVE PROBLEM SOLVING

When we begin to assess what needs to change in the wake of Florida's—and the nation's—foreclosure problems, it is important to acknowledge how far we have already come. Nationwide, we are currently seeing the highest levels of compliance and professional expertise in the default industry ever. The industry has collaborated to implement an extraordinary level of exterior review and auditing. With all parties under public and financial scrutiny to get it right, rigorous procedural reviews and oversight are likely to be a prominent feature going forward. Periodic governmental evaluation and/or an independent third-party review of processes and procedures are possibilities.

New computer systems to handle the documentation, new security systems to safeguard information, and additional management and review personnel will all be important parts of a seamless and robust servicing framework. The bottom line is that law firms and servicers will need to display more sophistication, compliance and professionalism than ever before. Attorneys and servicing professionals around the country need to understand and adapt to the fact that judges, while generally inherently conservative and strong believers in the sanctity of contract, are now more than ever open to hearing and acting upon defenses mounted on a technical or clerical basis.

Looking at how events unfolded in Florida, it makes sense to devote additional legislative, funding and budgeting resources to make the system more robust and improve capacity. Some of these structural inefficiencies are still in place, and we need to make sure that is remedied before the next time foreclosure volumes increase. We also need to recognize that Florida's average timeline of almost 630 days (by some accounts) adds more financial pressure and strain on law firms. Raising fees to alleviate some of the pressure on those firms is one possibility.

How successfully we implement these reforms, and how well we are able to integrate positive, proactive, and thoughtful solutions instead of reactive and cumbersome bureaucratic hurdles, will determine how well Florida—and the nation as a whole—handles the next crisis. **DS**

James Albertelli serves as the founding partner of Albertelli Law. Powered by NDeX, the firm provides full-service real estate legal expertise in Florida and Georgia. For more information, visit www.albertellilaw.com.