No. 18-670

IN THE

Supreme Court of the United States

SFR INVESTMENTS POOL 1, LLC,

Petitioner,

v.

FEDERAL HOME LOAN MORTGAGE CORPORATION, FEDERAL HOUSING FINANCE AGENCY, FEDERAL NATIONAL MORTGAGE ASSOCIATION,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY BRIEF FOR THE PETITIONER

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REPLY BRIEF FOR THE PETITIONER

The petition explained why the Ninth Circuit's decision casts a cloud over virtually every foreclosure action that has occurred in the United States over the past decade, or will take place for the foreseeable future. The brief in opposition fails to undermine this essential point. And its defense of the decision on the merits is likewise unpersuasive. The petition should be granted.

I. The Ninth Circuit's Decision Casts A Cloud Over Virtually Every Foreclosure Taking Place Over The Last Decade Or In The Foreseeable Future.

The brief in opposition largely confirms petitioner's description of the breadth and consequences of the court of appeals' ruling and offers no serious basis to contest the rest.

1. The opposition confirms that FHFA views the Federal Foreclosure Bar as applying to every one of the millions of properties whose mortgages it holds in trust portfolios for securitized mortgages. BIO 7; *see also id*. 9 (confirming Bar applies to $4.6 *trillion* worth of real estate). FHFA also does not dispute that it has a blanket policy of refusing to consent to foreclosure on any property subject to the Bar. Pet. 18-19.[1] As a result, FHFA does not contest that the Ninth Circuit's decision applies to foreclosure attempts on vast numbers of properties by senior lienholders, including taxing authorities as well as HOAs. BIO 7-8. Indeed, respondents confirm that the practical effect is far

[1] Notably, this policy was developed only in response to litigation and has never been publicized outside that context.

greater, because it is impossible to tell from local land records whether FHFA holds any given mortgage, giving rise to the prospect in *every* sale that the Agency will come out of the wood works years later, seeking to take the property back. *Id.* 11-12.

That prospect is not merely theoretical. Respondents do not retreat from their representation to the Ninth Circuit that there are already hundreds, if not thousands, of cases in Nevada alone challenging title to foreclosed properties on the ground that the sales were subject to the Foreclosure Bar. Pet. 21. Indeed, there are so many affected properties that respondents originally filed this case as a defendant class action, identifying more than 3,000 relevant foreclosures in Nevada between 2010 and 2015. *See* D. Ct. Doc. 22 ¶ 45 (Oct. 1, 2015) (Complaint). And that includes only HOA foreclosures (not tax sales) and only in a single state.

Respondents further insist that the thousands who have purchased properties at foreclosure without notice of FHFA's involvement are stuck with both the sale and with FHFA's lien. BIO 13-14. And they don't dispute that this means that good faith purchasers may well end up paying hundreds of thousands of dollars for homes, only to find out years later that they are effectively worthless because they are incumbered by an FHFA lien that exceeds the property's value.

Finally, FHFA does not contest that this situation will continue unabated as there is no plan in place to end FHFA's conservatorship anytime soon. Pet. 22.

2. Respondents try to offer the Court three scraps of consolation, but there is no basis even for that.

First, respondents say that these concerns are overblown because the Bar, as interpreted, "creates no legal obstacle" to foreclosure. BIO 10. It's just that the buyer takes the property subject to FHFA's mortgage. *Id*. But that "is not a realistic solution." *Matagorda County v. Russell Law*, 19 F.3d 215, 225 n.11 (5th Cir. 1994). The entire reason that delinquent taxes and HOA dues are given superpriority status is because legislatures recognize that most of the time, no purchaser will be willing to buy a property that carries a substantial mortgage lien with it. Pet. 8-9. Particularly during an economic downturn, when the foreclosure remedy becomes most needed, the value of the property may well be less than the amount of the mortgage, making foreclosure impossible unless the property can be sold free and clear of junior liens. *Id*.; *Matagorda*, 19 F.3d at 225 n.11.

Accordingly, contrary to respondents' claim, BIO 10, even if a sale is legally permitted, that does nothing to diminish the constitutional doubt the Ninth Circuit's interpretation throws on the statute, or the conflict between its holding and the law of the Third and Fifth Circuits. In *Matagorda*, the Fifth Circuit declared the identical bar in a prior statute constitutionally doubtful despite the argument that the bar permitted foreclosure sales "provided the lien . . . is preserved." 19 F.3d at 225 n.11. The court explained that as "a practical matter the Taxing Units cannot sell this property which has a value of only some $333,000 with a potential FDIC lien of almost one million dollars." *Id*. In *Simon v. Cebrick*, 53 F.3d 17 (3d Cir. 1995), the Third Circuit "agree[d] with the Fifth Circuit in *Matagorda*," and noted that even the FDIC did not subscribe to respondents' present

argument. *Id*. at 24 (explaining that "the FDIC suggested at oral argument a compensable taking will occur when the tax liens plus accrued interest exceed the fair market value of the property"). There is therefore no reason to doubt that had this case been decided in the Third or Fifth Circuit, the court would have applied the constitutional avoidance canon to reach the opposite interpretation of the statute.

Second, respondents try to imply that the Bar affects relatively few properties because "the Enterprises remove non-performing loans from mortgage-backed security pools as a matter of course." BIO 11. That, of course, is hard to square with the hundreds of pending lawsuits in Nevada alone. Moreover, neither source respondents cite supports their claim, and other public documents undermine it. Respondents cite their own complaint, but that document says nothing relevant.[2] The other source, a typical Fannie Mae trust agreement, discloses that Fannie is required to remove loans from the pool only after the loan "becomes *24 months* past due." C.A. Supp. E.R. 93 (§ 2.5(1)(d)) (emphasis added). Even assuming a homeowner's delinquency on taxes or HOA dues begin no sooner than when the owner stops paying her mortgage, taxing authorities and HOAs often cannot afford to wait more than two years before foreclosing. Indeed, that exceeds the delay the Fifth and Third Circuits have held likely results in a violation of the Takings Clause. *See* Pet. 27-30.

Respondents note the Enterprises have the *option* of removing non-performing loans from the securitized

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[2] *See* BIO 11 (citing without reference to any particular paragraph, D. Ct. Doc. 22).

pools earlier, BIO 2, and imply that they routinely do, *id*. 11. But their sources provide no evidence of that. The complaint is again uninformative. And the trust document simply provides that Fannie Mae "may" remove mortgages from the pool in certain circumstances. C.A. Supp. E.R. 94 (§ 2.5(3)). FHFA's public reports, on the other hand, tell a different story. The agency issues an annual *Enterprise Non-Performing Loan Sales Report*.[3] The most recent year-end report states that the nonperforming loans sold in 2017 "had an average delinquency of *3.2 years*."[4] FHFA further reported that only "*[f]ifteen percent* of the Enterprises' loans that were one or more years delinquent at the beginning of 2017 were sold during 2017." *FHFA Report* at 4 (emphasis added).

That suggests that even if a taxing authority or HOA waited a year to foreclose on a property subject to a mortgage securitized by an Enterprise, there is an *85%* chance that the loan would still be held by the Enterprises and, on the Ninth Circuit's view, subject to the Bar.

And, of course, there is no ready way for a foreclosing party or purchaser to find out whether any particular property's mortgage was securitized and is held by one of the Enterprises. Pet. 20-21. Respondents

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[3] FHFA, *Enterprise Non-Performing Loan Sales Report* (Dec. 2017), https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/December2017_NPL_Sales_Report.pdf (*FHFA Report*).

[4] *FHFA Report* at 4 (emphasis added). The report generally does not say whether the loans were originally on the Enterprises' own books or in the securitized trusts, although there is one reference to a pool of "loans from a securitized trust," whose average delinquency was also 3 years. *See id*. at 7.

confirm as much, BIO 11, offering only that "FHFA has repeatedly and publicly committed to respond to inquiries from potential foreclosure-sale buyers about whether particular properties are encumbered by Enterprise liens," *id*. 12. By "repeatedly," respondents mean *five times* in the past ten years. *See id*. 12 n.3. And by "publicly," they mean in footnotes to briefs accessible only via PACER or the Nevada Supreme Court's electronic docket. *See id*. Readers who regularly browse PACER looking for informative footnotes will find representations that "for several months," respondents have "promptly responded with clear statements" disclosing whether the Enterprises have an interest in the "dozens of properties" subject to inquiry.[5]

* * *

The briefing thus makes clear what petitioner has asserted from the beginning: the Ninth Circuit's decision draws into question every foreclosure sale that has occurred since HERA was enacted a decade ago, and will continue to cast intolerable uncertainty over every such sale in the foreseeable future. A question of this magnitude warrants the Court's immediate attention.

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[5] Appellees' Br. at 19 n.6, *Alessi & Koenig, LLC v. Saticoy Bay LLC Series 102 Sun Dusk LN*, No. 18-16166 (9th Cir. Oct. 22, 2018).

II. The Ninth Circuit's Decision Conflicts With The Text Of The Statute And The Decisions Of Other Circuits.

Certiorari is further warranted because the law in the Ninth Circuit cannot be reconciled with the text of HERA or the decisions of other circuits.

1. Respondents' defense of the Ninth Circuit's application of the Bar to securitized mortgages boils down to a simple claim: the reference to "property of the Agency" includes property the Agency holds in trust because, they say, trustees have legal title to trust property. BIO 8. But respondents do not dispute that "property of" is no term of art. *See* Pet. 25-26. Those words thus do not necessarily carry over technical concepts from property law.[6] Moreover, respondents offer no answer to petitioner's showing that in common usage, it is more natural to think of someone's property as being what the person *owns* rather than what she is just holding for someone else. *Id.*

The petition further explained why petitioner's understanding is more likely the one Congress had in mind given the context in which it is used in this statute. Pet. 26-27. Respondents disagree, claiming petitioner's interpretation risks "subvert[ing]" the statute by endangering the Enterprises and diminishing the value and stability of their mortgage-backed securities. BIO 8-9. Not so. Recall that property law already prevents *junior* lienholders from extinguishing senior liens, like the first mortgages

[6] Even if they did, respondents do not contest that the securities' owners have equitable title in the pooled mortgages. Pet. 25. There would therefore remain a question regarding which kind of title Congress had in mind.

that comprise the vast majority of the Enterprises' securitized holdings. *See* Pet. 17. So petitioner's reading only affects the ability of *senior* lienholders – like taxing authorities and HOAs – to foreclose. And as the petition described, the Enterprises can prevent those foreclosures by ensuring that their servicers simply pay the relatively modest back taxes or HOA dues, as their servicing agreements in fact require. *Id.* 26-27. If the servicers fail in that duty, they have agreed to hold the Enterprises harmless for the costs of their mistakes. *Id*. 27. Respondents dispute none of this.

The security holders are even less at risk because the mortgages in the pool are guaranteed by the Enterprises, which have funded those guarantees through initial fees charged to the security's seller at the time a mortgage is put in to the pool. Pet. 10 n.4. Given this, respondents' claim that petitioner's position "could diminish the value of those securities and make them more volatile," BIO 9, is inexplicable.

2. Respondents further defend the Ninth Circuit's holding that the Foreclosure Bar does not actually bar foreclosure on delinquent properties, but simply prevents the sale from extinguishing the Enterprises' liens, thereby preventing innocent purchasers from unwinding the transactions. BIO 13-14; Pet. 30-31.[7]

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[7] Respondents dispute that *Berezovsky v. Moniz*, 869 F.3d 923 (9th Cir. 2017) settled the question, thereby making relitigation of the question before the panel in this case futile. BIO 12-13. But *Berezovsky* unambiguously held that HERA preempts the portion of Nevada law that "automatically extinguish[es] the Agency's property interest without the Agency's consent." 869 F.3d

Respondents admit that the Fifth Circuit has rejected their reading of the materially identical language in HERA's predecessor statute. *See* BIO 14-15. And they provide no reason why a court would construe the two provisions differently. *Id*.

Instead, respondents argue that the Fifth Circuit got it wrong and the Ninth Circuit got it right because the relevant agency property is "its mortgage lien," not the real estate encumbered by the lien. BIO 13. On that understanding, they say, the Foreclosure Bar permits foreclosing on a property so long as the foreclosure does not extinguish FHFA's lien. *Id.*

That argument, however, ignores the word "foreclosure." *See* 12 U.S.C. § 4617(j)(3) (providing that "property of the Agency" shall not be "subject to . . . *foreclosure*") (emphasis added). As the petition explained, and respondents do not address, to *foreclose* on a property means to reassign ownership of that property from the original owner to another, as happens when a mortgaged house is foreclosed upon and sold at the foreclosure sale. Pet. 32; *see also, e.g.*, Restatement (Third) of Property (Mortgages) § 8.2 cmt. a, illus. 1 (1997) (referring to mortgagee filing judicial action "to foreclose on Blackacre"). Here, the property subject to foreclosure was the delinquent

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at 931. It therefore held that "Freddie Mac continued to own the deed of trust and the note after the sale to Berezovsky." *Id*. at 933. Given those holdings, petitioner could not have argued that, instead, HERA precluded any sale from taking place at all, making it irrelevant whether Nevada law would have extinguished the Enterprises' liens had a sale been permitted. Moreover, respondents point to nothing that required petitioner to request rehearing en banc before seeking this Court's review of a question already settled by circuit precedent. BIO 13.

homeowner's house, not FHFA's lien – that is, FHFA's lien was not seized and sold to a third party (as might happen, for example, when a mortgage debt and lien are put up as collateral in another transaction).

One can also talk of foreclosing *on a lien*, rather than the encumbered property. *See, e.g.*, *id.* § 8.2 (upon default mortgagee may "foreclose the mortgage"). Used in that sense, foreclosing on a lien means to exercise the rights under a lien to seize a debtor's property in order to satisfy the underlying obligation. *Id.* But FHFA's property was not subject to foreclosure in that sense either. The liens subject to foreclosure in this case were the *HOAs'* liens for unpaid dues, not FHFA's mortgages. If FHFA *had* foreclosed on its lien, one wouldn't say that the Agency had also "foreclosed on the owner's second mortgage to Bank of America," even if the legal effect of Fannie Mae's foreclosure was to extinguish that junior lien.

To be sure, the HOAs' foreclosure on *their* liens and on the *debtors*' houses had the legal effect of extinguishing all junior liens, including FHFA's. But that extinguishment as a matter of law is not a "foreclosure" as that word is normally understood.

It makes far more sense to construe the statute to prohibit the foreclosure on real property in which FHFA has a property interest. That, as the petition explained, is a more natural reading of the text. It protects the Enterprises by preventing the foreclosure sale that would extinguish their interests and allowing the sale to be unwound if it goes forward illegally. And it avoids the gross unfairness the Ninth Circuit's rule will inevitably visit on the thousands of innocent purchasers already in litigation, and the

many thousands more that may come in the future.[8] Pet. 30-31.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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[8] Respondents do not deny that their interpretation will be unfair in the run of cases, but try to argue that it is not unfair in *this* case because petitioner knowingly took a risk in buying the properties at issue here. BIO 14. That is so, they say, because it was unsettled whether the HOAs superpriority liens were, in fact, given superpriority. *Id.* Everything about that argument is a non sequitur. Surely the proper interpretation of the statute turns on its operation in general, not in this particular case. Moreover, any risk petitioner allegedly took regarding the status of HOA liens under state law had nothing to do with the unfairness the Ninth Circuit's interpretation of this statute creates.