



# It's Time We Talked

## Mandatory mediation in the foreclosure process

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Andrew Jakabovics and Alon Cohen June 2009

# Introduction and summary

It is estimated that as many as 9 million homeowners may lose their homes to foreclosure over the next four years, with nearly one in eight mortgages currently delinquent or in the process of foreclosure. And the foreclosure crisis is not limited to borrowers who were offered subprime loans, either. The most recent data available from the Mortgage Bankers Association shows that prime loans account for most new foreclosures.<sup>1</sup>

State courts in the United States already are facing a deluge of home foreclosures. The number of foreclosure filings have doubled in those states hardest hit by the housing crisis, with some counties in Florida and California registering 10-fold increases over levels at the beginning of the crisis two years ago. National headlines capture the crisis, highlighting case files shuttled around overworked courtrooms on hand trucks and embattled homeowners receiving sometimes as short as 15-second hearings before losing their homes.<sup>2</sup>

Behind the headlines, however, lurks even worse news—most judges discover that the vast majority of foreclosure proceedings in their courts are the first time homeowners and their mortgage lenders and mortgage servicing companies have discussed these financial crises writ small across our country.<sup>3</sup> The judges' experiences bear out estimates that more than 80 percent of homeowners at risk of losing their homes had not engaged in any efforts to mitigate foreclosures with their lenders or servicers as of the end of last year.<sup>4</sup>

In addition, jurisdictions in nine U.S. states now employ so-called “alternative dispute resolution” methods, and in particular mediation, to help at-risk homeowners deal with looming foreclosures by mortgage lenders or servicers. These states now realize that mediation helps reduce the impact of the housing crisis on neighborhoods, unclog courts, and achieve faster, cheaper, and better resolutions for homeowners, mortgage lenders and servicers, and the community at large.<sup>5</sup> These mediation programs are still young, but the best ones are showing impressive results, resolving in nearly three-quarters of all participating foreclosure cases without the need for formal foreclosure proceedings.

The federal response to this burgeoning foreclosure crisis has also ramped up significantly since the Obama administration took office. The administration created the Making Home Affordable Program, or MHP, in late February 2009 to help at-risk homeowners keep their homes by refinancing or modifying their loans through two related programs: the Home Affordable Refinance Program, or HARP, which offers refinancing at attractive rates to

## Two approaches to foreclosure mediation

Bringing borrowers and servicers face to face at least once prior to the sheriff or trustees' sale is the goal of mandatory mediation, and early indications are that it works. Both Connecticut and Philadelphia represent two emerging approaches to foreclosure mediation, the differences between them stemming largely from the availability (or lack) of funding for the program.

Both Pennsylvania and Connecticut are judicial foreclosure states (where foreclosure is a court proceeding), but recent developments in states like Nevada demonstrate that the principles gleaned can be applied equally in nonjudicial foreclosure states, such as California, where foreclosure occurs without the court's involvement.

Philadelphia—one of the earliest mediation programs—receives no funding. It involves a two-step mediation process. First, the homeowner and lender's counsel meet informally in the courtroom during a "cattle call," with a housing counselor and, if necessary, a pro bono attorney present for the homeowner. The few cases that are not resolved informally are assigned to a mediator—a pro bono senior attorney or judge—who conducts a private session with the parties.

The program relies on departments within the court to make staff available and on volunteer attorneys to make it work. The success of the program is due in part to the fact that Philadelphia is a dense urban setting with a large legal community and robust community organizations able to provide counseling and outreach.

Connecticut represents the second approach. Covering an entire state, the program received \$2 million to date and is scheduled to receive \$6 million in the coming two years. The large geographic area involved makes a coordinated in-person housing counseling effort impractical as well as any statewide nonprofit outreach effort. The program relies instead on a full-time staff of approximately 30 people, a mediator and case flow coordinator in each of the state's 12 districts, several clerks, and a full-time administrator. These employees also engage in outreach, attending homeowner and industry events to raise awareness and participation.

To understand and help states and local governments set up such programs, we interviewed administrators of existing programs to learn how they set up their programs, how the programs functioned, what they planned to change, and what data they had regarding results. We've spoken to program participants, including homeowners, housing counselors, lender's counsel, community organization, and other policy experts. What has emerged is a better understanding of the need for mandatory mediation in foreclosure proceedings, the interplay between such mediation programs and the federal government's recent Making Home Affordable Program as well as best practices for creating, promoting, and running such programs (see main sections of the report)

homeowners with loans owned or guaranteed by Fannie Mae or Freddie Mac, including those who may owe slightly more on their house than it is currently worth; and the Home Affordable Modification Program, or HAMP, which seeks to help at-risk homeowners by providing incentives to their mortgage servicers to modify loans by reducing the interest rate, extending the length of the mortgage, or forbearing interest on the loan to reduce a homeowner's payments to a sustainable 31 percent of her gross income.

Each of these programs has already reached over 50,000 homeowners in the first few months, but it is far from certain that all eligible homeowners are receiving MHP-compliant modification or refinancing offers. MHP's compliance audit will not begin for another quarter and its efficacy is unknown, a concern already being voiced by mem-

bers of Congress.<sup>6</sup> Adopting mandatory mediation in the foreclosure process provides homeowners who do not receive assistance under MHP, irrespective of the reason, an opportunity for sustainable modifications and refinancings. Among these are not only those deemed ineligible under MHP, but also the nearly 25 percent of homeowners whose servicers are not participating in the program.

In this paper we will argue that the federal government has an important role to play in expanding the implementation of mandatory mediation programs at the state and local level, as described below. Given the magnitude of the crisis and the degree to which the federal government is already invested in mortgages, we believe the federal government should take a more direct role in providing opportunities for mediation, as follows:

## Best practices

The best practices detailed in the paper are focused on maximizing benefits for all parties. Here is a map to our best practices guidelines, which are detailed in the appendix on page 40:

### Best practices for running a mandatory mediation program

- Maximize eligibility, maximize participation
- Involve housing counselors wherever possible
- Implement outreach programs
- Servicer or its counsel must have the authority to make a deal
- Require parties to meet in person where possible

### Best practices for administering a mandatory mediation program

- Find a champion within the system
- Get buy-in from stakeholders
- Obtain funding, but do not wait for it
- Put in place a case management system
- Continually evaluate your program
- Require ongoing training for participating professionals

### Open questions

- Should programs require a pre-mediation meeting with a counselor?
- Should there be a mediation time limit?
- Who should have the power to declare an impasse or lack of good-faith dealing?
- Should mediation stay foreclosure proceedings?

- Congress should fund state and local mandatory mediation programs just as it provides neighborhood stabilization funds to alleviate the housing crisis.
- In the interim the Department of Housing and Urban Development should issue guidance that explicitly permits community development block grants to be used to fund mandatory mediation programs.
- The government should require mediation for all federally insured home mortgages. This would be an extension of HUD's existing requirement that all servicers of Federal Housing Administration loans engage in loss-mitigation efforts prior to foreclosure and would minimize losses to the already stressed FHA insurance fund.
- By extension the Federal Housing Finance Agency, acting as the conservator of Fannie Mae and Freddie Mac, should require all servicers acting on behalf of those entities to participate in mediation prior to foreclosure.
- Likewise, the federal government should require all servicers participating in HAMP to participate in mandatory mediation prior to foreclosure in cases where a modification is not possible under program rules as a way of ensuring a level playing field and speedy resolution of offers for short sales and deeds in lieu of foreclosure.

For state and local governments, we present a set of recommendations for best practices gleaned from our analysis of existing programs in Philadelphia, Pennsylvania; Connecticut; Florida; and California. Philadelphia and Connecticut are examples of successful, established programs. Florida and California are examples of as yet ineffective responses. In addition, we analyze the forthcoming program in Nevada.

In Philadelphia, the Supreme Court of Pennsylvania established a pilot program that uses a two-step mediation system. The court runs an open session once a week during which servicers' counsel, homeowners, housing counselors, and pro bono attorneys engage in informal negotiations. Those cases that reach impasse are referred to formal mediation. The program receives no funding and relies on volunteers and housing counselors.

Connecticut runs a successful statewide program with 30 full-time staff including a dedicated mediator and clerk in each of the state's 12 counties. The program is funded by the state, but its geographic scope makes the inclusion of local housing counselors at the mediations impractical.

Unlike Pennsylvania and Connecticut, California, is a nonjudicial foreclosure state, which means that servicers need not involve the court to foreclose on a property. It has foregone true mediation and requires only that the parties conduct an informal telephone conference prior to foreclosure. Notably, it does not require the servicer to include its loss mitigation staff on that call.

In contrast to California, Nevada—also a non-judicial foreclosure state hit hard by the crisis—will deploy a full-blown mediation program on July 1, 2009. The program shares many characteristics with those in Philadelphia and Connecticut, including enhanced notice, referral to a housing counselor, and the requirement that servicer make available a representative with the authority to settle. If homeowners request mediation, any further action by the servicer is stayed until mediation concludes; the parties split the cost of mediation, capped at \$400.

## Defining terms in foreclosure mediation

**Mediation:** A process by which a neutral mediator assists parties in trying to reach a voluntary negotiated settlement to resolve their dispute

**Foreclosure mediation:** Mediation conducted in the course of foreclosure proceedings. The mediation can be a condition to initiating foreclosure or occur any time up to the sale of the property. The timing depends on the rules of the particular program. We also include “two-tier” mediation programs in this term. Two-tier programs, such as the one in Philadelphia, require the parties to hold an informal conciliation conference first without a mediator. If the parties reach an impasse, the case is referred to formal mediation.

**Voluntary versus mandatory mediation:** In voluntary mediation, a homeowner must request—or “opt in”—for mediation. In mandatory mediation, a session is automatically scheduled for both parties. A homeowner may or may not be able to “opt out” depending on the particular program.

**Judicial foreclosure versus nonjudicial foreclosure:** Foreclosure mediation can take place in one of two contexts: judicial foreclosure, in which the servicer has to file a complaint in court to initiate foreclosure; and nonjudicial foreclosure, in which a servicer simply provides public notice of the default and sale without court intervention. While many states permit both types of foreclosure, most focus on one.

**Mediation in a judicial foreclosure:** This generally begins simultaneously with the foreclosure proceedings. To initiate a foreclosure, the servicer

files a complaint and then sends the homeowner notice of that filing. Included within that notice is an additional document about mediation. If the mediation program is voluntary, then the notice informs the homeowner that mediation is available and explains how the homeowner can request it. If the program is mandatory, the notice includes the date and time of the first mediation session. Under most current programs, mediation occurs alongside the court proceedings—it does not stay them—so a homeowner must file an answer and provide discovery responses while also attending mediation sessions. Where mediation offers some protection on the back end, mediation is a condition for completing the foreclosure so the court will not enter judgment (which then leads to the sale of the property) until the mediation is complete. In cases where mediation is successful, the case generally settles and foreclosure proceedings are discontinued as unnecessary.

**Mediation in nonjudicial foreclosure.** This type of mediation takes place *before* the foreclosure proceedings, because nonjudicial proceedings are much faster and require far less process than judicial foreclosure proceedings. A servicer need only post a notice of sale and then sell the property after a set time period. Some states require one additional notice prior to the notice of sale telling the homeowner she has defaulted on the mortgage. For mediation to be effective, it must occur before the notice of sale is posted to give the parties sufficient time for adequate negotiations. If at all possible, it should occur before the notice of default. As above, if mediation is successful, the foreclosure proceedings generally become moot.



And in Florida so far it has been each judicial circuit for itself, with responses running the gamut: mandatory mediation, voluntary mediation, informal negotiations, and even a paper-based modification request resembling HAMP. The state's Supreme Court has a task force working to coordinate efforts with a report expected in August.

Our analysis of these programs leads us to propose a list of best practices for mandatory mediation—best practices that maximize benefits for all parties facing the prospect of foreclosing on a home. (See the “best practices” sidebar on page 3 for a list of these recommendations.) These best practices in mandatory mediation will help homeowners keep their homes or arrange for a “graceful exit.” They will help servicers shortcut the foreclosure process, saving them and their investors time and expense and resulting in an economically superior outcome. They will help courts save resources. And they will help communities reduce the tax and social costs of foreclosure.

We detail how the best practices work in existing state programs and how they could work across the nation in the appendix beginning on page 40. We believe the dissemination of data and the practical experience gained from these programs is important for other state governments grappling with their own foreclosure crises and for the federal government, which can and should plan a more expansive role in deploying foreclosure mediation programs.<sup>7</sup> As we will demonstrate, our analysis shows that mandatory mediation will help mitigate today's national housing crisis by reducing unnecessary foreclosures, minimizing losses to investors, and easing the burden on local governments and taxpayers, thereby helping our economy recover more quickly from the recession bequeathed to us by the Bush administration.

In the pages that follow, we will first outline how mandatory mediation would fit into ongoing federal efforts to stem the national foreclosure crisis. We will then explore state foreclosure mediation programs in Pennsylvania, Connecticut, Florida, California, and Nevada going into extensive detail so that other state policymakers understand how these programs could work in their states and so that federal policymakers grasp where federal policy and state mandatory mediation programs could and should overlap.

We will then address possible barriers to mandatory mediation, including a detailed look at the complex array of contracts that govern mortgage-backed securities, which of course are where most residential mortgages reside these days. This analysis will enable us to demonstrate that there are no barriers to the institution of mediation in the foreclosure process based on either the Constitution's Contracts Clause or on takings concerns. In addition to a discussion of the issues at the Federal level, we also detail possible issues that may arise at the state level between the legislative and judicial branches.

We conclude with a summary of our recommendations for Congress and the Obama administration as well as state and local governments. We're confident these recommendations represent the best way to bring today's housing crisis to a swifter conclusion.

# Endnotes

- 1 Credit Suisse, "Foreclosure Update: Over 8 Million Foreclosures Expected," (2008), available at <http://www.nhc.org/Credit%20Suisse%20Update%20Dec%202008.doc>; "Delinquencies and Foreclosures Continue to Climb in Latest MBA National Delinquency Survey," available at <http://www.mortgagebankers.org/Newsand-Media/PressCenter/69031.html>.
- 2 Michael Corkery, "A Florida Court's 'Rocket Docket' Blasts Through Foreclosure Cases," February 18, 2009, available at <http://www.wsj.com/article/SB123491755140004565.html>.
- 3 Some mortgage lenders service their own loans; some service others' as well. Some companies are purely servicers. To avoid confusion, we will refer to the party that has the power to declare default and foreclose on a property as the "servicer" here, because it is almost always the servicer that has this power, whether it is the lender acting for its own portfolio or a third-party servicer acting on behalf of investors in mortgage-backed securities.
- 4 Conference of State Banking Supervisors, State Foreclosure Prevention Working Group, "Analysis Of Subprime Mortgage Servicing Performance" (Data Report No. 3, September 2008), p. 2, available at <http://www.csbs.org/Content/NavigationMenu/Home/SFPWGReport3.pdf>.
- 5 California, Connecticut, Florida, New Jersey, New York, Ohio, and Pennsylvania have programs. Milwaukee, Wisconsin and the states of Michigan and Nevada plan to bring programs online in early July 2009.
- 6 Lee Howard, "Dodd calls for more effective foreclosure-prevention program," The Day, June 4, 2009, available at <http://www.theday.com/re.aspx?re=b09b5a7c-045c-4e6c-be21-9be9ccee627c>
- 7 Localities considering mandatory mediation programs include Pima City, Arizona; Delaware; Atlanta, Georgia; Chicago, Illinois; Marion City, Indiana; Louisville and Jefferson Counties, Kentucky; Prince George's County, Maryland; Portland, Maine; Minnesota; Pittsburgh and Washington Counties, Pennsylvania; and Detroit, Michigan.



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## About the authors

**Andrew Jakabovics** is the Associate Director for Housing and Economics at the Center for American Progress. He works on housing, household debt, and higher education, as well as other issues related to sustaining and growing the middle class. Jakabovics frequently appears on television and radio and in print, most often for his research on the effects of the current mortgage crisis and potential policy solutions. He is a member of several task forces addressing the foreclosure crisis and developing proposals for restructuring mortgage finance. Prior to joining American Progress, Jakabovics served as the research chief of staff for the MIT Center for Real Estate's Housing Affordability Initiative. In 2004, he founded a grassroots organization, Kiruv for Kerry, which conducted outreach to the Orthodox Jewish community, drafted position papers, and connected policy issues with Jewish principles. He has also lectured on the relationship of Jewish law to the modern, democratic state. Jakabovics holds a B.A. in Urban Studies from Columbia University and an M.C.P. from the Massachusetts Institute of Technology, where he is currently pursuing his doctorate.

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Cohen maintains active legal and technical pro bono practices. In addition to his work with the Center for American Progress he has served as court-appointed counsel and guardian ad litem for parties in Washington, D.C.'s family court. Currently, he also provides marketing, design, and web development assistance to Street Soccer USA, a sports for social change organization aimed at engaging and empowering the homeless members of our community through soccer.

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