



Foreclosure Mediation Going Forward

States Need to Expand Their Programs if the Federal Government Steps Back

Alon Cohen | April 2011

Introduction

If Congress later this year decides to end the Obama administration's main mortgage foreclosure mediation program, the Home Affordable Mortgage Program, or HAMP, then Congress should empower the states to expand foreclosure mediation programs to ensure homeowners who can afford to keep their homes are given every opportunity to do so. A number of state programs are demonstrably helping responsible homeowners renegotiate their mortgage terms through foreclosure mediation—programs Congress should encourage other states to adopt.

The House of Representatives and Senate both have legislation under consideration, which, among other things, would create a competitive grant program to encourage and support state foreclosure mediation programs. Reps. Steve Cohen (D-TN) and Alcee Hastings (D-FL) introduced the Preventing Homeowners from Foreclosure Act of 2011 (H.R. 1131), and Sen. Jack Reed (D-RI) along with eight co-sponsors introduced the Preserving Homes and Communities Act of 2011 (S. 489).¹ These bills would support homeowners, their lenders, and investors in home mortgages packaged up and sold as mortgage-backed securities, and more broadly would help stabilize the housing market for all of us.

The two bills offer a proven, effective tool to combat the continuing housing crisis as Congress appears poised to end HAMP because it has not provided the numbers of home-loan modifications hoped for by the Obama administration and its supporters in Congress. Supporting tools for homeowners and lenders or servicers to modify mortgages instead of foreclosing are critical, with continuing record foreclosures and the risk of a “double-dip” in housing prices, which in turn could slow the current economic recovery.

Many states are working hard to resolve the housing crisis, which of course has decimated communities in their cities and towns, eroding property values and thus lowering the property taxes that pay for state and local services from schools to sanitation, and

hurt their businesses whether connected to mortgage finance or not. Among the tools these states have deployed in growing numbers is foreclosure mediation—a last, best chance for the homeowner and mortgage lender or mortgage servicer to sit down in the presence of a neutral third party who understands the foreclosure and loan modification processes and determines whether there is any deal that nets both sides greater value than would foreclosure.

The results are encouraging, with more than half of all participants in mature foreclosure mediation programs reaching a settlement. This issue brief will examine what the legislation before the House and Senate would do to support and expand these state-based efforts around the country through a competitive grant program, demonstrating that the two bills before Congress deserve bipartisan support.

What S. 489 and H.R. 1131 would do

While the two bills differ in specifics, both S. 489 and H.R. 1131 would direct the Department of Housing and Urban Development to create a competitive grant program for states wanting to deploy or enhance a foreclosure mediation program. To qualify for a grant, state programs would need to meet criteria set based on the best practices developed in existing successful state programs in Connecticut, Pennsylvania, Nevada, and New York, among others.

Qualifying programs would require the presence of a neutral third party to mediate with both the homeowner and a lender's or mortgage servicer's representative attending in person. In addition, qualifying programs would require access to a lender or servicer representative with the authority to enter into a settlement during this mediation process. These requirements are common to nearly all programs in effect across nearly half the states and the District of Columbia.

S. 489 and H.R. 1131 also would require that all qualifying programs embrace automatic mortgage mediation, in which homeowners must opt out of mediation when foreclosure looms on their homes rather than have to opt in at some point in foreclosure proceedings. This is in recognition of what the longest-standing and most successful foreclosure mediation programs taught us. Philadelphia and Connecticut began as opt-in programs and registered settlement rates of 75 percent for those homeowners that participated, yet few homeowners took the affirmative step to opt in.² When both the city and the state switched to automatic, or opt-out, mediation, participation jumped from approximately 20 percent to 75 percent—while settlement rates remained constant among participants at 75 percent. S. 489 and H.R. 1131 seek to spread that best practice.

The two major objections to federal loan modification and foreclosure assistance are that the federal government is reaching into property law, which is classically the pur-

view of states, and that intervention slows down foreclosures on homes that in fact need to be foreclosed upon because the homeowners cannot afford to pay their mortgages even if the terms were renegotiated.

S. 489 and H.R. 1131 address both of these objections. As discussed in our papers on foreclosure mediation—from “It’s Time We Talked” in June 2009 through “Talking It Up” in January 2011—the automatic foreclosure mediation process benefits not just homeowners who stay in their homes but also investors and lenders who can salvage their investments in troubled loans.³ This in turn helps communities achieve stable home prices and greater rates of home occupancy, reducing strain on local services such as police, health, fire, judiciary, and social works that combat blight and displacement.

States have long seen the benefit of foreclosure mediation—nearly half of them boast at least one jurisdiction with some sort of program—because foreclosures have a direct effect on home values and thus property taxes. That’s why new state foreclosure mediation programs continue to grow at a regular clip even when state budgets are strained by the continuing housing crisis. Vermont recently created an opt-in foreclosure mediation in the spring of 2010.⁴ Washington state’s legislature passed an opt-in program on April 1, 2011, and it is expected to be signed by the governor shortly.⁵ And the Delaware Superior Court at the urging of Attorney General Beau Biden and members of the legislature created an opt-in program there as well.⁶

The proposed bills would encourage through funding states such as Delaware, Vermont, and Washington to implement automatic foreclosure mediation programs instead of opt-in programs, enabling them to see much greater participation and results from their foreclosure mediation efforts. The proposed congressional legislation could also provide resources to states with existing opt-in programs, such as Maryland and others, whose participation rates languish around 20 percent, to move to automatic, or opt-out, mediation and see greater participation and thus greater numbers of affected homeowners.

But there are differences between the two bills. S. 489 “stays” (stops) the foreclosure itself while mediation is going on. Under H.R. 1131 and nearly all existing foreclosure mediation programs, the mediation continues simultaneously with the foreclosure, with the caveat that the foreclosure cannot be completed until the parties have finished mediating. The idea is that foreclosure mediation can end the foreclosure much faster and with a better result for both parties if it succeeds, but it should not slow down the original process unless the parties continue to negotiate.

To date, there is no evidence of mediation stretching the foreclosure process. Quite the opposite, in fact. The average foreclosure takes 200 days in nonjudicial foreclosure states—those states where foreclosure mediation does not require the involvement of a court of law—and 271 days in judicial foreclosure states, where foreclosure is filed in court like any other civil lawsuit.⁷

When mortgage mediation is introduced into the process, mediations take on average around two sessions and 100 days to complete, with well more than half of these negotiations resulting in a settlement instead of a foreclosure.⁸ That means that properties that were taking 200 to 300 days to resolve are now resolved in one-half to one-third of the time, bringing the average down. The kicker, of course, is not just speed but speed that results in better outcomes for homeowners, lenders, servicers, investors, and communities.

Where they can, these programs maintain people in their homes and provide greater value to investors and lenders holding these assets. Where they cannot, mediations many times result in a short sale or deed in lieu of foreclosure, which allow the lenders and servicers to quickly dispose of a property in a much shorter timeframe than foreclosure. Finally, foreclosure mediation unclogs the regular foreclosure pipeline clogged by the housing crisis in most states.

Foreclosure mediation fills a gap in response to the housing crisis

In “Talking It Up,” I laid out the framework for determining the value of foreclosure mediation. Summarizing simply, before the housing crisis, foreclosing on a home valued at \$150,000 resulted in investors or lenders losing more than \$58,000, including losses at the foreclosure sale as well as legal costs and carrying costs.⁹ This calculation was intentionally conservative, based on data from 2002 before there was a housing crisis. The Center for Responsible Lending’s March 22, 2011, report, “Fix or Evict,” puts losses in foreclosure at \$76,500 for prime loans and \$112,500 for subprime loans.¹⁰

Using the 2002 data, I calculated that modifying a loan at mediation to reduce the homeowner’s monthly payments by 20 percent on average, including the cost of mediation and adjusting for the fact that not every case settles, results in a loss of \$22,000 for the lender or investors in that mortgage, a savings of more than \$36,000 per loan.¹¹ What’s more, that does not count the effect on surrounding homes, which are estimated to lose 1 percent of their value for every foreclosure in the neighborhood, or an additional \$7,500 if one assumes just five houses are affected by each foreclosure. Every foreclosure avoided keeps surrounding home values higher.

Even if there are savings to be had, do we really need another program? Banks have done more than a million proprietary modifications and there have been another 500,000 HAMP modifications alongside hundreds of thousands more modifications per year done by the two U.S. mortgage finance giants, Fannie Mae and Freddie Mac.¹²

First, the proof is in the pudding. Automatic mediation programs in Philadelphia and Connecticut see thousands of homeowners a year and continue to see settlement rates near 75 percent. New programs are ramping up in their numbers, with states such as Nevada, whose program started July 1, 2010, also seeing settlement rates near one-half. Mature programs see settlement rates of 75 percent. Newer programs need “ramp up” time.

Second, the Center for Responsible Lending's recent paper on modifications is instructive. The major concern for mortgage lenders and investors regarding modification is redefault—the chance that the time and expense of a modification will simply land the homeowner right back in foreclosure a few months down the line. Indeed, currently, one in three homeowners who receive a 20 percent reduction in their monthly payments redefault within 12 months.

While that may seem high, the Center for Responsible Lending calculates that homeowners could redefault at double that rate without lenders and investors losing any money. The reason: Cash coming in from homeowners with modified loans offsets foreclosure losses. Thus, lenders could be doing many more modifications without risking loss to their books or those of their investors.

Lenders and servicers are not required to report the assumptions about their proprietary loan modifications, which represent the vast majority done on privately held loans, so we cannot explain why so many modifications are going undone. What we do know is that these properties end up in foreclosure many times. Where there is an automatic mediation program, it acts as a last, best chance for modification and it works a majority of the time.

Conclusion

States are working hard under tremendous budgetary pressures to provide their constituents with foreclosure mediation programs because they work and continue to improve. Should Congress decide to end the federal government's most potent modification tool in HAMP, it should encourage our states to implement such solutions and grant programs that would be established under S. 489 and H.R. 1131.

The proven tools of foreclosure mediation embraced in the legislation and now used by states and cities around our country are a particularly effective vehicle to help responsible homeowners stay in their homes, which helps communities recover from the housing crisis and enables mortgage lenders and investors to recoup more of their investments in these and other homes than they would through the foreclosure process.

A win-win-win is certainly something members of Congress on both sides of the aisle can get behind.

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Endnotes

- 1 *Preventing Homeowners from Foreclosure Act of 2011*, H.R. 1131, 112th Cong. (March 16, 2011), available at <http://thomas.loc.gov/cgi-bin/bdquery/z?d112:h1131>; *Preserving Homes and Communities Act of 2011*, S. 489, 112th Cong. (March 3, 2011), available at <http://thomas.loc.gov/cgi-bin/bdquery/z?d112:s489>.
- 2 For an in-depth discussion of Philadelphia, Connecticut, and other state programs, see: Alon Cohen and Andrew Jakobovics, "Now We're Talking: A Look at Current State-Based Foreclosure Mediation Programs and How to Bring Them to Scale" (Washington: Center for American Progress, 2010), available at http://www.americanprogress.org/issues/2010/06/foreclosure_mediation.html. The numbers here were reported to us by program administrators.
- 3 Alon Cohen and Andrew Jakobovics, "It's Time We Talked: Mandatory Mediation in the Foreclosure Process" (Washington: Center for American Progress, 2009), available at http://www.americanprogress.org/issues/2009/06/time_we_talked.html; Cohen and Jakobovics, "Now We're Talking"; Alon Cohen, "Walk the Talk: Best Practices on the Road to Automatic Foreclosure Mediation" (Washington: Center for American Progress, 2010), available at http://www.americanprogress.org/issues/2010/11/walk_the_talk.html; Alon Cohen, "Talking It Up: How the Federal Government Can Implement Automatic Foreclosure Mediation to Help Homeowners, Lenders, Investors, and Taxpayers" (Washington: Center for American Progress, 2011), available at http://www.americanprogress.org/issues/2011/01/talking_it_up.html.
- 4 Vt. State Leg., H. 590 (May 29, 2010), available at <http://www.leg.state.vt.us/docs/2010/bills/Passed/H-590.pdf>.
- 5 Katie Schmidt, "State Legislature approves foreclosure mediation for Washington," *The News Tribune*, April 1, 2011, available at <http://blog.thenewstribune.com/politics/2011/04/01/state-legislature-approves-foreclosure-mediation-for-washington/>.
- 6 "Administrative Directive of the President Judge of the Superior Court of the State of Delaware, No. 2011-2," available at http://courts.delaware.gov/Superior/pdf/Administrative_Directive_2011_2.pdf. For more information, see: "Delaware Foreclosure Help," available at <http://www.deforeclosurehelp.org/mediation.html>.
- 7 David Kestenbaum, "How Long Does Foreclosure Take?," NPR Planet Money Blog, October 26, 2010, available at <http://www.npr.org/blogs/money/2010/10/26/130833818/foreclosure>. The post relies on data from RealtyTrac at <http://www.realtytrac.com>.
- 8 This number comes from conversations with administrators of multiple programs. Many are currently in the process of collecting this data and it should be available in the next few months in greater detail.
- 9 Cohen, "Talking It Up," p. 7.
- 10 Wei Li and Sonia Garrison, "Fix or Evict? Loan Modifications Return More Value Than Foreclosures" (Washington: Center for Responsible Lending, 2011), available at <http://www.responsiblelending.org/mortgage-lending/research-analysis/fix-or-evict.pdf>.
- 11 For a complete discussion, see: Cohen, "Talking It Up," Appendix A.
- 12 This data and its sources are detailed in: Cohen, "Talking It Up"; Li and Garrison, "Fix or Evict," p. 3.