

EXECUTIVE SUMMARY

When the U.S. foreclosure crisis began four years ago, analysts predicted that up to 13 million families would lose their homes before the crisis was over.¹ The predictions appear to be coming true. By the beginning of 2011, lenders had completed foreclosures of 2.7 million homes with mortgages taken out during the subprime boom years from 2004 to 2008.² As of the fall of 2011, nearly four million homes were either in foreclosure or had mortgages that were seriously in default.³ Current predictions are that, in addition to the loans already foreclosed and those now facing foreclosure, another eight to ten million mortgages are likely to default and enter foreclosure before the current foreclosure crisis is over.⁴

We are now approaching the mid-point of a very prolonged crisis. Over the past four years, policymakers at the federal, state, and local levels have implemented various measures in an attempt to counteract the devastating effects of so many foreclosures. This is an appropriate time to step back and take stock of what efforts have been effective. This report looks at one strategy: foreclosure conference and mediation programs. It is now clear that these measures have worked.

Foreclosure mediation and conference programs can save homes from foreclosure. If these programs are strengthened and expanded, they can prevent millions of foreclosures that will otherwise take place over the next several years.

This report follows up on an earlier study of foreclosure mediation programs prepared by the National Consumer Law Center in 2009.⁵ Our 2009 report recommended program designs and best practices for mediation programs. Recommendations from the report have since been adopted in a number of states. The report raised some questions about the

lack of data supporting the effectiveness of foreclosure mediation programs. Those questions are in large part answered in this report. The National Consumer Law Center also prepared two annual updates to its 2009 report on foreclosure mediation programs.⁶ These reports contain statistical data on foreclosure conference and mediation programs and are available at the National Consumer Law Center website. The same website contains detailed state by state summaries and links to state program information, including texts of current and pending legislation, guides to programs, and other publications related to foreclosure conference and mediation programs.

Servicers are capable of making affordable and sustainable loan modifications.

Loan modifications are viable alternatives to foreclosures. Looking solely at outcomes from modifications made early in the foreclosure crisis, there may have been some doubt about this point. Mortgages modified during 2008 redefaulted at an alarming rate. Over half the loans modified during 2008 were in serious default within a year of modification. By the beginning of 2010, barely one quarter of the loans modified in 2008 were current. These outcomes should not be surprising. Most modifications made in 2008 did not decrease homeowners' monthly payments at all. Instead, the majority of modifications made then either raised payments or left them unchanged.

After 2008, this trend changed. To a much greater degree than before, recent loan modifications have taken into account how much the homeowner can afford to pay. Many modifications, particularly those under the federal government's Home Affordable Modification Program (HAMP), set the homeowner's

monthly housing payment so that it does not exceed a certain percentage of household income. HAMP rules set the acceptable ratio of the borrower's housing payment to income at thirty-one percent.

By the end of 2011, most new loan modifications were reducing homeowners' monthly payment for principal and interest by at least one-fifth. Less than ten percent of recent modifications have increased the payment or left it unchanged. Not surprisingly, the redefault rates on more recent modifications look much different than the rates from the 2008 modifications. For modifications made during 2010, redefaults within one year of modification occurred at about one-half the rate they did under the 2008 modifications.

Even in recent years, not all modifications have been the same. In dollar terms the average HAMP modification has been reducing the borrower's monthly payment by twice the amount of the average non-HAMP modification. As a consequence, the redefault rate for HAMP modifications has been at about half the level for recent modifications overall. Despite its many problems, HAMP showed that, by applying a test that balanced affordability for the borrower with the long term financial interests of the owners of the loans, it was possible to fashion sustainable modifications for one million home mortgages.

Without effective interventions on behalf of homeowners, servicers will deny millions of modifications and foreclose instead.

The history of the HAMP program has shown two things. One is that mortgage servicers are capable of making affordable loan modifications. The other is that many servicers are simply unwilling to modify loans on a scale that will have a significant impact on long term foreclosure trends. This is particularly true for the largest servicers, including Bank of America, JP Morgan Chase, and Wells Fargo. These banks

control a major share of the home mortgage servicing market. Unfortunately, their behavior tends to set the standard for the industry.

When the Obama Administration unveiled HAMP in early 2009, it predicted that the program would provide affordable modifications for three to four million households by the time the program was scheduled to end in December 2012. Instead, by the the end of 2012, it is likely that just over one million households will have been approved for permanent HAMP modifications. Another two to three million homeowners who met basic eligibility requirements and tried to obtain a HAMP modification will have been denied one.

Regrettably, these approvals and denials often had more to do with who a homeowner's servicer happened to be than with the homeowners' qualifications for HAMP. Some servicers approved HAMP modifications at rates that were two or three times higher than other servicers did. The arbitrariness of these decisions, affecting the vital interests of so many families, has been a major impetus for the creation of foreclosure mediation programs.

Foreclosure mediation programs and loan modifications

Servicers denied affordable loan modification to millions of borrowers through a process of calculated chaos. Common elements of this strategy included:

- Losing documents
- Failing to follow promised time frames
- Failing to notify homeowners of reasons for servicers' actions
- Giving invalid or blatantly false reasons for denials
- Providing ineffective review of decisions
- Foreclosing while reviewing for a modification or while the borrower was complying with a trial modification

The Treasury Department announced rules to prohibit many of these practices in the HAMP program. However, the rules were never routinely enforced.

Data now shows that mediation programs and similar interventions can increase the number of sustainable loan modifications.

Federal oversight of servicers' practices in reviewing homeowners for eligibility for loan modification has failed. This failure leaves states in the position of having to take over the task. Since early 2008, mandatory foreclosure diversion and mediation programs have been implemented in at least nineteen states. While procedures vary from program to program, they typically include mechanisms to counteract the most common deficiencies in servicers' loss mitigation reviews. The programs can establish protocols for the exchange of documents and require that servicers adhere to time frames for making decisions. Program rules can ensure that homeowners receive accurate notice of decisions and have an effective recourse for review. Most importantly, the programs can prevent servicers from moving ahead to a foreclosure sale until the review process has ended.

Do these mechanisms prevent unnecessary foreclosures? A recent study of the Philadelphia foreclosure diversion program by the Reinvestment Fund looked carefully at results obtained for homeowners participating in that program since 2008. The study found that as of March 2011 only 3.5% of homeowners who had participated in the program since September 2008 lost their homes through foreclosure sales. Borrowers who participated in the conferences were far more likely to remain in their homes than those who did not. The mediation process did not require significant use of court resources and did not slow down the overall foreclosure process for lenders.

An important feature of most foreclosure conference and diversion programs is that they connect homeowners in foreclosure with housing counselors. Another study released in 2011 documented the impact of a borrower's working with housing counselors on the likelihood that the borrower will lose the home to foreclosure. The study found that homeowners who received counseling were 1.7 times more likely to avoid a foreclosure sale than those who did not. The counseled homeowners had a forty-five percent higher probability of avoiding redefault than borrowers who obtained loan modifications without counselor assistance.

The clear lesson to be learned from these two studies is that allowing homeowners facing foreclosure to proceed alone when they interact with servicer staff and their attorneys is a recipe for disaster. Some form of third party intervention is essential to prevent unnecessary foreclosures and to keep paying borrowers in their homes.

Foreclosure mediation and conference programs have learned from past experience and continue to improve their effectiveness.

In about one-half of the states, lenders can foreclose without any court oversight at all. These are referred to as "non-judicial" foreclosures. During 2011, four jurisdictions enacted new foreclosure mediation statutes: the District of Columbia, Delaware, Hawaii, and Washington. It is noteworthy that non-judicial foreclosures are the predominant means of foreclosure in three of these jurisdictions. This brings to six the number of non-judicial foreclosure jurisdictions with mediation programs. Without the intervention from mediations, non-judicial foreclosures in these localities would take place without any third party oversight at all.

Newer foreclosure mediation initiatives have learned from the experiences of older programs. The more recent laws, such as those

in the District of Columbia and Washington State, provide clear authority for courts to enforce program rules. Over the past two years, courts in a number of states, including Connecticut, Indiana, Maine, Nevada, New York, Ohio, and Vermont, have sanctioned servicers for various deficiencies in their conduct in foreclosure conference and mediation programs. For example, courts imposed sanctions when servicers did not appear with an authorized representative who could make decisions on loss mitigation questions. Courts have sanctioned lenders who delayed unduly in deciding on applications for a loss mitigation option or failed to give reasonable explanations for their decisions. Sanctions have included monetary penalties, orders for servicers to bring in a qualified representative to negotiate, orders tolling accrual of interest and fees during periods of delay, and orders to modify a loan. When a servicer does not comply with program rules, a court can refuse to allow a foreclosure sale. In a non-judicial foreclosure jurisdiction, a mediation administrator can decline to permit a sale to proceed.

The question of whether servicers and lenders have authority to foreclose when they say they do has recently received much attention. Mediation and conference programs can address this issue because a representative of the true owner of the mortgage debt must be involved in negotiations. Many mediation and conference programs now have rules requiring that servicer representatives document their authority to participate on behalf of the party who owns the loan. Particularly in non-judicial foreclosure states, this oversight may be the only check on whether the appropriate party is conducting a foreclosure sale.

Many foreclosure conference and mediation programs are now self-supporting.

The costs of foreclosures for homeowners, investors, and communities can be staggering. By contrast, mediation and diversion

programs often function at no cost to state and local governments. Many programs, particularly several of the more recently implemented ones, are completely self-supporting. Relatively small surcharges ranging from \$40 to \$400 added to court filing or recording fees cover these programs' operating costs. In several states such as Delaware, Washington, and Nevada, funds collected from filing fee surcharges also support housing counseling and legal services for homeowners in mediation. Fees collected under Nevada's foreclosure mediation law generate substantial revenues that flow to the state's general fund, reducing the state's overall budget deficit.

Conference and mediation programs do not prolong foreclosures.

Many lenders and servicers delayed completion of foreclosures during 2010 and 2011, building up significant backlogs of homes in foreclosure status. Foreclosure conference and mediation programs did not contribute to these backlogs. On the contrary, most programs work within the time frames for foreclosures under a state's existing laws. The recent study of Philadelphia's diversion program found that the typical case spent fifty-three days in the conference program. The average time frame for completion of an uncontested foreclosure in Philadelphia without a conference is ten months.

Recommendations Regarding Foreclosure Mediation Goals for 2012 and Beyond

This National Consumer Law Center report concludes with nine recommendations for the future of foreclosure conference and mediation programs.

- 1. States that do not have a foreclosure conference or mediation program should adopt one quickly.** As of the beginning of 2012, foreclosure conference

or mediation programs are in place in nineteen states.⁷ These programs require that a lender or servicer review loss mitigation options with a homeowner and neutral third party before a foreclosure can be completed. Thirteen of these states have a judicial foreclosure system, and six are non-judicial foreclosure jurisdictions. States without one of these programs should move promptly to implement one.

2. **States should retain foreclosure conference and mediation programs as permanent features of their foreclosure laws.** Several foreclosure and conference programs were implemented as temporary measures subject to a sunset date or future legislative review. These include the programs in Connecticut, New York, Vermont, and Maine. The laws should be made permanent additions to the states' foreclosure laws.
3. **States should fund housing counseling and legal support for homeowners through filing fee surcharges that also fund mediation and conference programs.** Foreclosure conference and mediation programs perform vital tasks that mortgage servicers' staff should be performing, but routinely do not. The programs make sure that servicers review homeowners for loss mitigation options before foreclosing. Most servicers have demonstrated their unwillingness to devote competent staff to this work. It is reasonable to pass on to servicers the costs of having others do their job for them. In states including Nevada, Washington, and Maryland, foreclosure mediation programs cover their administrative costs with revenue from surcharges added to fees servicers pay to record or file foreclosure documents. In these states the surcharges also fund important counseling and support services for the homeowners

who participate in mediations. Servicers should be prohibited by state law from shifting these costs to anyone else.

4. **States should use foreclosure and conference programs to maximize HAMP modifications during 2012 and 2013.** If servicers continue to approve new HAMP permanent modifications at the current rate of 25,000 to 30,000 monthly during 2012, this will leave up to 600,000 currently eligible homeowners without HAMP modifications at the end of the year. In addition, many borrowers remain in trial plans that should be converted to permanent HAMP modifications. During HAMP's final two years, states must adopt mediation programs with strong requirements for servicers to document their compliance with HAMP rules. These programs can hold servicers accountable for the commitments they made to modify eligible loans under HAMP.
5. **States should adopt mediation and conference programs that prevent foreclosures of loans already modified under HAMP.** Servicers are already foreclosing upon loans "permanently" modified under HAMP. This is occurring even when the homeowner is complying with all terms of the modified loan. In other cases, there are disputes over whether a default on a modified loan agreement occurred. Homeowners need access to a review before a neutral third party so these disputes can be fairly resolved. There is a significant danger that, absent oversight, servicers will conduct foreclosure sales regardless of past modifications.
6. **Mediation and conference programs must monitor how servicers propose their proprietary modifications.** During 2010 and 2011, servicers who were obligated to offer HAMP modifications to all eligible homeowners often gave them one

of their own proprietary modifications instead. Homeowners whose HAMP applications were denied or canceled for questionable reasons were frequently placed in these proprietary modifications. The proprietary modifications routinely contained more onerous terms, such as higher interest rates and less principal forbearance, than HAMP modifications. Mediations must require full and accurate disclosure of the terms of all modification options so that borrowers can make informed choices about whether to accept them. In particular, servicers who participate in the HAMP program must offer an eligible homeowner a HAMP modification before they solicit the homeowner for a proprietary modification.

7. **Mediation and conference programs must ensure that the FHFA servicing guidelines do not lead to unnecessary foreclosures.** Fannie Mae and Freddie Mac have implemented new servicing guidelines to comply with a directive from the U.S. Federal Housing Finance Agency (FHFA). The new guidelines encourage servicers to speed up foreclosures, particularly after a case has been referred to an attorney. These guidelines will make it increasingly difficult to stop foreclosure proceedings to review for loss mitigation options once a foreclosure has begun. In many states, conference and mediation programs will be the only effective alternative to the servicers' dual track of considering loss mitigation while forging ahead to a foreclosure sale. Rules for mediations and conferences must be tightened to ensure that stays of all foreclosure actions remain in place pending a full loss mitigation review.
8. **Borrowers in mediation must have accurate information about what to expect from an increasingly less affordable rental market.** For foreclosed borrowers,

renting almost invariably becomes the only available housing option. Today, renters are more than twice as likely as homeowners to spend more than half of their income for housing. The burden is particularly severe for low income families. Of low income families with children, nearly two-thirds who rent pay more than fifty percent of their income for housing. Homeowners in mediations must make decisions based on a clear understanding of what the likely future rental option means for them. Mediation programs should refer all homeowners to housing counselors who can present a realistic assessment of the rental option.

9. **Preserve minority homeownership by wiping out unfair loan terms and servicing practices.** Policymakers at the state level should see foreclosure conference and mediation programs as important tools for the preservation of minority homeownership. Minority households' gains over the past decade in home-based wealth are vanishing. Disparate targeting of minorities with unaffordable loans has led to foreclosures disproportionately affecting the same minorities. Today, African American and Latino families are facing a doubly high foreclosure rate, even when income differences are taken into account. Negotiations over loan modifications create the opportunity to change the terms of many of these loans, making them affordable—as they should have been in the first place. Minority borrowers are also steered into less affordable non-HAMP modifications more frequently than non-minority borrowers. Minorities are denied modifications more often than other borrowers for reasons such as missing documents. Mediations and conferences provide needed oversight over practices that continue to impact disproportionately upon minorities.

Foreclosure mediation and conference programs have now been operating in some localities for over three years. Where the programs were structured effectively, they reduce foreclosures and increase sustainable loan modifications. In the remaining years of the foreclosure crisis policymakers at the state level face a clear choice. One option is to give mortgage servicers free rein to pursue millions of new foreclosures, regardless of how arbitrary or unnecessary each one may be. The other option is to subject servicers' actions to reasonable scrutiny and encourage alternatives that are in the best interests of both investors in the loans and homeowners. The evidence is now in that a strong foreclosure mediation or

conference program can achieve the latter goal with little or no cost to states. State policymakers who ignore this option are needlessly exposing families and communities to severe, long-term hardships that can be avoided.

Absent this form of intervention, homeowners will continue to face mortgage servicers and their attorneys alone. And tragically, millions of needless foreclosures will occur, causing severe, permanent harm to homeowners, investors, and communities while stalling economic recovery in the United States. For these reasons, it is imperative that states without foreclosure conference and mediation programs adopt them and do so quickly.