Testimony of Robert Clifford
Real Estate Hearing
Joint Committee on the Judiciary
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Chairwoman Creem, Chairman O'Flaherty, and other members of the committee:

Thank you for the opportunity to provide testimony. My name is Robert Clifford and I am a policy analyst at the New England Public Policy Center at the Federal Reserve Bank of Boston, where I have authored a report that reviews foreclosure prevention policies in the New England states.[i] My testimony reflects my own views developed through the course of my research on this topic and does not necessarily represent the views of the Federal Reserve Bank of Boston or the Federal Reserve System.

I would like to clarify at the outset of this testimony that I do not plan to advocate for a particular piece of legislation, but plan to discuss the merits of foreclosure mediation as a foreclosure prevention policy.

Since the onset of the housing downturn in 2006, foreclosures have weighed heavily on the recovery of national, state, and local housing markets. In response to the challenges posed by foreclosures, states and municipalities across the country have implemented a number of foreclosure prevention strategies. Such policies are not designed to prevent all foreclosure but aim to find alternatives to foreclosure when possible. Unfortunately, most of these foreclosure prevention efforts have meet with limited success. To be clear, there is no single solution or policy to solve the foreclosure problem.

In my review of recent foreclosure prevention efforts I found foreclosure mediation to be one of the more effective policy responses states and municipalities have to facilitate alternative agreements to foreclosures. The reason is that foreclosure mediation solves a basic challenge facing any foreclosure prevention effort: communication between homeowners and lenders. With a mediator serving as a neutral third party, homeowners and lenders have a clear channel of communication to pursue mutually beneficial alternatives to foreclosure. Available evidence shows that when both parties communicate and participate in the mediation process an alternative to foreclosure is likely to be reached.

For an example of the success of foreclosure mediation we need look no further than the state of Connecticut. Since the implementation of their statewide foreclosure mediation program on July 1, 2008, over 10,700 cases have completed mediation. Of those over 8,600 cases (80 percent) have reached alternative agreements to foreclosure. A majority of these outcomes are loan modifications (5,600 cases) or other alternatives that allow homeowners to stay in their homes (1,400 cases). The remaining 1,600 agreements were for "graceful exits," such as a short sale or deed-in-lieu of foreclosure, which allow the homeowner to leave the home through means other than foreclosure.[ii] Such results are not unique to Connecticut as other foreclosure mediation programs have shown similar rates of success at finding alternatives to foreclosure in Nevada, New Jersey, New York, Ohio, and Philadelphia, Pennsylvania.

By the end of 2010 every New England state except Massachusetts had implemented some form of foreclosure mediation program. Massachusetts alternatively implemented a 90 day "right-to-cure" period in 2008 and a further extension of that period to 150 days in 2010. The idea was that such periods would allow homeowners and lenders time to negotiate alternatives to foreclosure. A recent report by researchers at the Federal Reserve Banks of Atlanta and Boston found evidence that the implementation of the 90 day right-to-cure policy in Massachusetts only lengthened the foreclosure timeline and had no impact on borrowers' ability to cure their mortgage defaults or obtain modifications.[iii]

While this experience may make foreclosure mediation look like an attractive policy option in comparison, it is important to note that the positive outcomes cited for Connecticut and selected other states are not universal. The foreclosure mediation program in New Hampshire, for example, was able to mediate only 100 cases, of which the participants in only 14 agreed to alternatives to foreclosure. This was in large part due to the fact the program was voluntary, and there was little incentive for lenders to participate. Similarly, other programs nationwide have struggled to produce results due to poor designs and incentive structures.

To increase the likelihood of preventing foreclosures, a mediation program should apply the best practices of existing programs while avoiding their shortcomings. In my research I identified five policy recommendations for foreclosure mediation programs that I would like to share with the committee:

1. <u>Provide early intervention</u>: Mediation should get underway as early as possible in the foreclosure process. By doing so you get to homeowners in better financial situations, improve the chance of finding alternatives to foreclosure, and allow the maximum amount of time to facilitate communication.
2. <u>Do not unnecessarily delay foreclosures:</u> To mitigate the effects of foreclosures it is important that mediation programs do not extend the foreclosure process unless warranted. Working within a state's legal framework, mediation programs need to be completed in a timely manner that allows adequate time for all parties to pursue mutually beneficial alternatives. Only in limited circumstances should mediation be extended beyond the set period. Typically extensions are warranted only when homeowners and lenders request further time for mediation or when lenders delay the process.
3. <u>Maximize participation:</u> While available evidence indicates that the mediation process can facilitate alternatives to foreclosure, such success relies on getting both parties to the table. This usually means requiring lenders to participate, while either automatically initiating foreclosure mediation with the homeowner and/or requiring the homeowner to opt-out of mediation if they do not want to participate. Such programs tend to have participation rates near 60 to 70 percent, while other programs that only require homeowners to opt-in to mediation or are voluntary in nature have participation rates of no more than 20 percent.[iv]
4. <u>Align funding structure with incentives</u>: The most common form of funding for mediation programs are fees levied on lenders. In other cases homeowners pay a share of the fee for participating. The use of fees can provide adequate funding to meet the demand for mediation but can also deter participation of either party if their incentive to participate is not structured properly. Conversely, funding through grants or other funds limits the number of mediation cases a program can handle, but eliminates disincentives. The scale and funding of a mediation program need to be carefully aligned with participation incentives for it to be effective.
5. <u>Track progress and report results</u>: It is difficult to gauge the success of a mediation program without data on participation rates or outcomes reached. In a rush to implement mediation

programs many states and localities have failed to implement meaningful data collection mandates or reporting requirements. When results are collected and reported clearly, policy makers or program administrators have been able to respond to shortcomings in the design of mediation by changing their structure to improve results and extend the life of mediation as needed by showing the amount of demand for mediation services. At the very least a data collection and reporting requirement similar to Connecticut's is needed for any program to track its progress.

Upon the completion of my review of foreclosure mediation programs I was struck by the number of questions that still remain. A lack of data and analysis of these programs leaves questions about the success of alternatives researched in mediation and their translation into actual foreclosure prevention. In one program 85 percent of those who reached an agreement in mediation to stay in their home remained there a significant amount of time after mediation; for other programs, longer-term results of this sort are not available.[v] Other significant questions include: What are the characteristics of borrowers who reach alternatives in mediation relative to those who do not? What type of agreements are most likely to prevent a foreclosure and why? Do most modifications that result from mediation programs rely heavily on federal foreclosure programs such as Home Affordable Modification Program (HAMP) or Home Affordable Refinance Program (HARP)?

To summarize, foreclosure mediation appears to be one of the more effective foreclosure prevention tools available to states and municipalities. When designed and implemented correctly these programs can result in a high number of alterative agreements to foreclosure. It is paramount to the success of these programs that they regularly track, collect, and report meaningful results on how agreements reached in mediation translate into foreclosures prevented.

References

[i] Robert Clifford, "State Foreclosure Prevention Efforts in New England: Mediation and Assistance," NEPPC Research Report 11-3, Federal Reserve Bank of Boston, Boston, MA: September 2011.

[ii] State of Connecticut Judicial Branch, Judicial Branch Statistics, Foreclosure Mediation Program Results as of May 31, 2011. http://www.jud.ct.gov/statistics/FMP/FMP_pie.pdf

[iii] Kristpher Gerardi, Lauren Lambie-Hanson, and Paul S. Willen, "Do Borrower Right Improve Borrower Outcomes? Evidence from the Foreclosure Process," FRBB Public Policy Discussion Paper No. 11-9, Federal Reserve Bank of Boston, Boston, MA: December 2011.

[iv] Alon Cohen and Andrew Jakabovics, "Now We're Talking: A Look at Current State-Based Foreclosure Mediation Programs and How Bring Them to Scale," Center for American Progress, Washington, DC: June 2010.

[v] The Reinvestment Fund, "Philadelphia Residential Mortgage Foreclosure Diversion Program: Initial Report Findings," June 2011.