THE ROLE OF MEDIATION IN **FORECLOSURES**

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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. The strategies have ranged from providing homeowners with legal assistance to developing million-dollar mortgage-refinancing programs run by state housing-finance agencies. Unfortunately, most of the foreclosure-prevention efforts have had limited success.

The exception appears to be foreclosure mediation. 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.

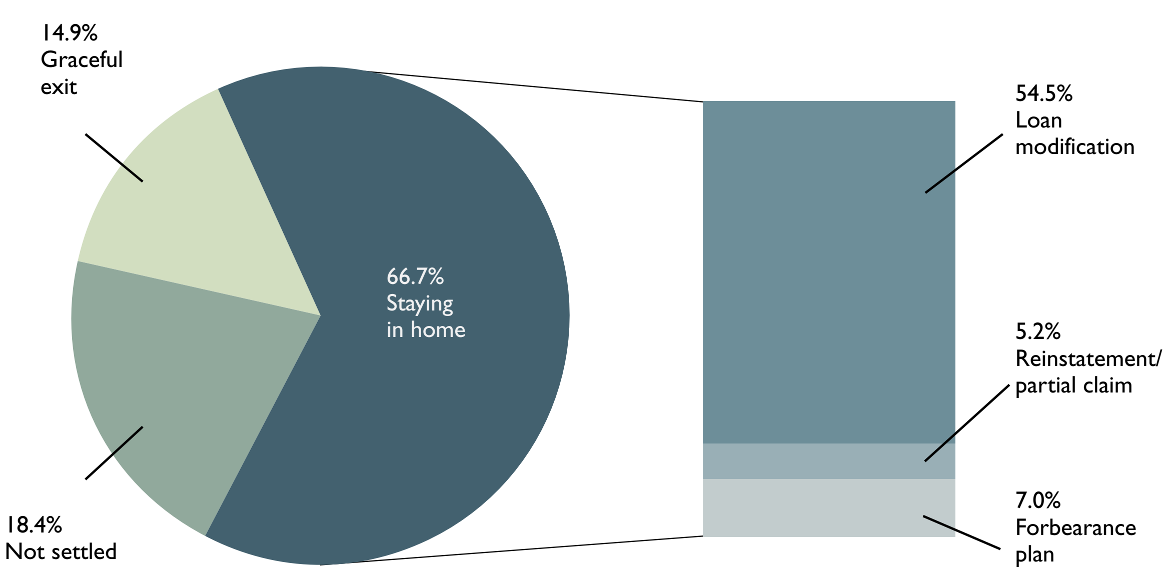
Beginning in 2008, a handful of states and municipalities have been utilizing mediation to prevent foreclosures. As these programs have showed signs of success with finding alternatives to foreclosure, more states and municipalities have developed programs. By the end of 2011, 24 states and the District of Columbia had implemented some form of foreclosure mediation.[1] Of the six New England states, Massachusetts is the only one to not have implemented a mediation program as of this writing.[2]

Successes and Challenges

Available evidence shows that when both parties communicate and participate in the mediation process, an alternative to foreclosure is likely to be found. For an example of the success of foreclosure mediation, we need look no further than the state of Connecticut. (See "Connecticut Foreclosure-Mediation Results.") Since the implementation of Connecticut's statewide foreclosure-mediation program on July 1, 2008, more than 12,800 cases have completed mediation. Of those, more than 10,400 cases (81.6 percent) have reached alternative agreements to foreclosure. A majority of the outcomes are loan modifications (7,000 cases) and other alternatives that allow homeowners to stay in their homes (1,500 cases). The remaining 1,900 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.[3] Such results are not unique to Connecticut. Other foreclosure-mediation programs have shown similar rates of success at finding alternatives to foreclosure in Nevada, New Jersey, New York, Ohio, and Pennsylvania.

Massachusetts chose to implement a 90-day "right-to-cure" period in 2008 and further extended the period to 150 days in 2010. The idea was that such periods would allow homeowners and lenders in Massachusetts more 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 only lengthened the foreclosure timeline and had

Connecticut Foreclosure-Mediation Results as of December 31, 2011



Source: Connecticut Judicial Branch of Statistics no impact on borrowers' ability to cure their mortgage defaults or obtain modifications.[4]

Although that may make foreclosure mediation look like an attractive policy option in comparison, it is important to note that the positive mediation outcomes cited for Connecticut and other states are not universal. New Hampshire, for example, was able to mediate only 100 cases, of which the participants in only 14 agreed to alternatives to foreclosure. That outcome was largely due to the fact the program was voluntary, and there was little incentive for borrowers or lenders to participate. Other programs with poor designs and incentive structures also have struggled to produce results.

Best Practices

To have a good chance of finding alternatives to foreclosure, a mediation program needs to apply the best practices of existing initiatives while avoiding their shortcomings.[5] Such best practices include the following:

1. **Intervening early:** Mediation should get under way as early as possible in the foreclosure process. Early outreach gets to homeowners in better financial situations, improves the chance of finding alternatives to foreclosure, and allows the maximum amount of time to facilitate communication.
2. **Not delaying foreclosures unnecessarily:** To mitigate the effects of foreclosures, it is important that mediation programs do not extend the foreclosure process unless warranted. 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. **Maximizing participation:** The success of mediation relies on getting both parties to the table. That usually means (a) not allowing foreclosures to proceed unless lenders participate in mediation in good faith and (b) either automatically initiating foreclosure mediation with the homeowner or requiring the homeowner specifically to opt out of mediation if unwilling to participate. Programs with such features have participation rates of 60 percent to 70 percent of eligible homeowners. Programs that require homeowners to opt in to mediation or are voluntary for both lenders and homeowners have participation rates of no more than 20 percent.[6]
4. **Tracking progress and reporting results:** 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, policymakers and program administrators have been able to respond to shortcomings in the design of mediation by changing program structure to improve results. Additionally, being able to show the amount of demand for mediation services can extend the life of programs.

Unfortunately, a lack of data and analysis of mediation services leaves questions about the success of the alternatives reached in mediation and how well the alternatives worked to prevent foreclosure. In one program, 85 percent of those who reached an agreement to stay in their home remained there a significant amount of time after mediation.[7] For other programs, longer-term results are not available.

Other questions include: What are the characteristics of borrowers who reach alternatives in mediation relative to those who do not? What types 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 the Home Affordable Modification Program (HAMP)?

A Tool in the Kit

Foreclosure mediation appears to be one of the most effective foreclosure-prevention tools available to states and municipalities. When designed and implemented correctly, such programs can result in a high number of alterative agreements. Although it remains to be seen the extent to which these alternatives result in long-term foreclosure prevention, the initial findings are promising.

Mediation is one potentially effective tool for state and local policymakers to mitigate foreclosures, but mediation alone is not enough to combat the problem. The challenges posed by the housing downturn and the foreclosure crisis are multifaceted and therefore require a multifaceted policy response. Other important issues include the effects of the large stock of foreclosed properties that are now in the possession of the lender (real estate owned, or REO, properties), prolonged vacancies of homes, the stabilization of neighborhoods with concentrations of foreclosures, and the impact of foreclosures on families.

It is important for policymakers and community leaders to recognize there is no silver bullet to the issues surrounding foreclosure but that mediation is one piece that can be used to address a complex policy puzzle.

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Endnotes

1 For a complete list of state foreclosure-mediation programs, see the National Consumer Law Center, http://www.nclc.org/issues/foreclosure-mediation-programs-by-state.html.

2 On September 13, 2011, Springfield, Massachusetts, enacted a city ordinance requiring preforeclosure mediation. However, legal challenges to certain provisions make the future of the program unclear.

3 See http://www.jud.ct.gov/statistics/FMP/FMP_pie.pdf.

4 Kristopher Gerardi, Lauren Lambie-Hanson, and Paul S. Willen, "Do Borrower Rights Improve Borrower Outcomes? Evidence from the Foreclosure Process" (Federal Reserve Bank of Boston public policy discussion paper 11-9, December 2011).

5 Robert Clifford, "State Foreclosure Prevention Efforts in New England: Mediation and Assistance" (New England Public Policy Center research report 11-3, Federal Reserve Bank of Boston, September 2011).

6 Alon Cohen and Andrew Jakabovics, "Now We're Talking: A Look at Current State-Based Foreclosure Mediation Programs and How to Bring Them to Scale" (white paper, Center for American Progress, Washington, DC, June 2010), http://www.americanprogress.org/issues/2010/06/pdf/foreclosure_mediation.pdf.

7 Roughly two to three years. "Philadelphia Residential Mortgage Foreclosure Diversion Program: Initial Report Findings" (white paper, the Reinvestment Fund, Philadelphia, June 2011).