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Delaying the Inevitable: The Effect of Foreclosure Moratoriums, Mediations and Other Programs

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February 7, 2012 by Christopher J. Pippett

In the fourth quarter of 2008, subsequent to the economic downturn and burst of the residential real estate bubble, residential foreclosure filings increased exponentially across the country. While some states, particularly California, Nevada and Florida, were particularly hard-hit, nearly all states and communities saw an increase in foreclosures as homeowners struggled with the double punch of job losses and the significant decline in their home values.

Unlike the real estate downturn that occurred in the late 1980s and early 1990s, which largely involved commercial real estate, this more recent downturn had a large impact on residential real estate and, thus, individual homeowners. As unemployment rose to all-time highs and the residential housing market evaporated, many homeowners were left between an economic rock and a hard place — they could neither pay their mortgage nor sell their property. Court systems, as well as state and local governments, struggled to cope with unprecedented numbers of residential mortgage foreclosure actions.

There was also public outcry over the widespread impact that foreclosures and displacement of families were having on individuals and communities as a whole, such as in Ohio, where the crisis started as early as 2006. As in other cities across the country, long-established neighborhoods in Cleveland were decimated by foreclosure, with nearly entire blocks deserted by home-owners who had either simply left or were evicted from the property. As a recent "60 Minutes" episode reported, the state's Cuyahoga County has even taken to demolishing abandoned homes in an effort to curb the problems presented by the volume of vacant homes, which at best can cause a decrease in the value of surrounding properties and at worst can become the target of scavengers and a haven for criminal activity.

In reaction to this plight and, in many cases, to stem the tide, courts and state and local governments imposed moratoriums, mediation requirements and other programs designed to encourage a resolution that would help homeowners stay in their homes. Moratoriums were imposed by courts and government entities in many areas in an effort to give them, as well as lenders and homeowners, a chance to step back, analyze available information and attempt to develop a solution. Some lenders engaged in self-imposed moratoriums to deal with procedural irregularities and document deficiencies related to the "robo-signing" scandal and other complications resulting from the large-scale securitization that had occurred in the residential mortgage industry.

A foreclosure crisis of this magnitude had never been encountered in the United States and, coupled with the continued rapid deterioration of the economy, there was a dearth of successful formats or prototypes upon which to model mediation or alternate resolution programs. The only programs in existence were a few local ones and the Homeowner's Emergency Mortgage Assistance Program, also known as Act 91, which had increasingly limited funds until August 2011, when funding for this program was exhausted.

Compounding the crisis was the fact that many homeowners facing foreclosure found themselves unemployed because of the deteriorating economy. Without the income necessary to take advantage of assistance, they would either be unable to reach agreement with the lender or comply with the terms of such an arrangement for any meaningful length of time. In addition, lenders, while not wanting to foreclose or take back a particular property, have been under considerable pressure to keep the process moving and liquidate bad loans. And the current timeline for the mortgage foreclosure process in many areas can be two years or more from a delinquency notice to a foreclosure sale. All of these factors can pose serious obstacles to the resolution of a delinquent mortgage loan.

While many states and court systems have adopted and/or imposed mandatory mediation before proceeding with mortgage foreclosure, the results of such programs, when reported, have been mixed. A study conducted by the Regional Housing Legal Services and May 8 Consulting on a mediation program implemented in Philadelphia County, called the Residential Mortgage Foreclosure Pilot Diversion Program, reported that approximately 85 percent of the borrowers who reached an agreement with their lender in 2008 are still in their homes.

It also revealed that approximately 70 percent of the borrowers targeted for the program participated in it. Its apparent success stands in stark contrast to a Florida program known as Residential Mortgage Mediation. Launched in 2009, it was terminated by Florida Supreme Court Justice Charles Canady in December 2011. Results of that program (reported on www.housingwire.com) indicated that approximately 64 percent of borrowers failed to reach any agreement with lenders. Even after issuing a rule forcing lenders to send an authorized

representative to the mediations, Canady terminated the program, concluding that after reviewing the findings, he could not justify its continuation.

When a foreclosure mediation is successful, everyone benefits. Borrowers get to stay in their homes, lenders have performing loans and are not saddled with vacated properties, which may have significantly depressed values and/or be in need of improvement or repairs in order to be sold, and communities and surrounding property values are preserved. However, when resolution is not achieved or is not possible, foreclosure mediation programs and moratoriums may have the effect of delaying the inevitable.

Reports form RealtyTrac in early 2011 indicated that while foreclosures in 2010 were up only 2 percent from 2009 levels, self-imposed moratoriums resulting from the "robo-signing" problems encountered by some of the larger national lenders may have affected those numbers. A report issued by the Office of the Comptroller of the Currency in December stated that while levels of delinquencies in the third quarter may have remained elevated, they had declined from the previous year. The report went on to state, however, that new foreclosures increased by 21.1 percent. This dramatic increase was attributed to the lifting of the voluntarily imposed moratoriums that some lenders had undertaken, as well as the exhaustion of foreclosure alternatives, such as mediation and modification, for a growing number of seriously delinquent mortgages that had been working their way through the system.

An interesting finding of the December OCC report was that from the beginning of 2008 until the second quarter of 2011, mortgage servicers had modified 2,258,026 mortgages. At the end of the third quarter of 2011, 50.8 percent of modified mortgages were still current or had been paid off. Even more telling was that 58.8 percent of all modifications resulting in a payment decrease of 10 percent or more were in the group that was still current, whereas only 36.4 percent of those where the decrease was less than 10 percent were still current.

These statistics and the apparent success of the programs, such as the one initiated in Philadelphia County, would tend to indicate that mediation and modification programs, if properly structured, funded and encouraged, can be beneficial to many borrowers and lenders and, consequently, the surrounding community. However, lenders must be willing to engage in serious discussions and be willing to make significant concessions (apparently, at least as much as 10 percent of the monthly payment). Likewise, borrowers must provide lenders with sufficient information to justify the concessions, such as evidence of an ability to pay the modified amounts.

Without the presence of these elements on each side of the equation, such programs are doomed to fail. Similarly, programs and moratoriums that merely postpone or slow the process, and modifications that are insufficient to change a borrower's ability to make regular payments, will serve only to delay the eventual foreclosure sale and, on a broader scale, possibly our economic recovery. Court systems and state and local governments need to closely examine

successful mediation programs and incorporate their best practices into new programs that will assist borrowers and lenders, now and in the future. Even as the pace and number of foreclosures diminish, such an investment is well worth it.