



## ***Can They Save Homes?***

*September 2009*

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## **State and Local Foreclosure Mediation Programs: Can They Save Homes?**

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## EXECUTIVE SUMMARY

### ***The Promise of Foreclosure Mediation Programs***

In the ongoing struggle to control the ravages of the foreclosure crisis, mediation programs have emerged as an increasingly attractive option. Many consumer advocates and community groups have supported the implementation of foreclosure mediation programs and continue to do so. In a little over a year, from mid-2008 to mid-2009, more than 25 distinct foreclosure mediation programs were launched in fourteen different states. State legislatures, state supreme courts, and local courts all played roles in creating these programs.

Foreclosure mediations hold out the hope of removing major obstacles that have hindered efforts to slow the spread of the foreclosure epidemic. In particular, the securitization of mortgage debt has erected significant barriers between homeowners and the owners of their mortgages. When homeowners want to negotiate over a loan modification or other alternative to foreclosure, they often cannot find a person authorized to negotiate with them. With homeowners cut off from effective negotiations, foreclosures move ahead and losses to investors mount with each completed foreclosure. Today, the rate at which loans are being modified remains extremely low in relation to the high numbers of ongoing foreclosures

### ***Separating Facts from Fiction***

In preparing this report we interviewed legal services attorneys, court officials, and other advocates who have been working directly with the 25 foreclosure mediation programs we considered.

Our review raised concerns about the kind of expectations that these programs may be encouraging. For example, there is as yet no data to confirm that foreclosure mediation programs anywhere have led to a substantial number of affordable and sustainable loan modifications. Such data would be very helpful in building support for more mediation programs. However, thus far this information is uniformly lacking.

Foreclosure mediation programs have the potential to play an important role in preventing needless loss of homes. However, we found that the existing programs routinely fail to impose significant obligations on mortgage servicers. Without the imposition of these obligations, it is unlikely that mediations will lead to fewer foreclosures. The programs we considered often lack mandatory rules and fail to impose sanctions for non compliance with what minimal rules exist. The programs do not require servicers to provide information substantiating a right to foreclose. They do not mandate analyses of loan modification alternatives. Many set unreasonable procedural barriers that restrict large numbers of homeowners from participating.

Ultimately, under most of the existing foreclosure mediation programs servicer discretion prevails. If the programs continue to demand little or no accountability from servicers, they will likely go the way of other efforts to control foreclosures that relied on voluntary compliance by the lending industry. They will become another piece of imagery the industry uses to support its claims that voluntary efforts work, that statutory and other government mandates for loan modifications are unnecessary, and that jargon about the benefits of communication can solve the foreclosure crisis.

### **Servicer Discretion in Foreclosure Mediation and Other Efforts to Control Foreclosures through Voluntary Efforts by Servicers**

The popularity of foreclosure mediation programs is built upon some major assumptions. The arguments in support of the programs tend to portray the lack of movement on loan modifications primarily as a “communication” problem. The assumption seems to be that servicers want to modify loans, they want to make payment terms more affordable for homeowners, and they want to avoid foreclosures on a large scale. According to this view, the problem has been that homeowners simply have not been able to find the right people to talk with and the right setting for a talk.

While homeowners have definitely encountered barriers in trying to communicate with their mortgage holders, these barriers have clearly not been the only impediment to more loan modifications. To begin with, there is the undeniable track record of the lending industry over the past two years. Since the beginning of the foreclosure crisis the industry has tried systematically to defeat and evade every enforceable obligation related to implementation of loan modifications that anyone has attempted to impose upon it. The industry has consistently fought to preserve servicers’ discretion to refuse loan modifications whenever they wished to do so.

Foreclosure mediation programs must be viewed in the context of other federal and state actions that were intended to encourage affordable loan modifications. Early initiatives at the federal level stressed cooperative efforts among servicers and federal agencies. These programs invariably allowed servicers to exercise complete discretion in deciding whether to modify a particular loan. As a result, very few loans were modified under these programs. At the same time, the industry opposed efforts to make loan modifications mandatory. Earlier this year the mortgage lending industry succeeded in a well-financed campaign to defeat legislation that would have

required loan modifications in bankruptcy without servicers’ consent.

With the industry’s encouragement, crucial elements of accountability have been omitted from the Treasury Department’s Home Affordable Modification Program (“HAMP”). Now, over six months after its inception, this new federal initiative serves only a small percentage of eligible homeowners. At the state level the lending and servicing industries have opposed efforts to strengthen mediation programs by requiring that servicers document their loan modification calculations.

Today most servicers operate under a duty to comply with federal guidelines requiring that they perform a loan modification review before a foreclosure sale. HAMP and similar government sponsored initiatives impose loan modification obligations upon servicers responsible for more than 80% of all home loans. Mediation programs can play a vital role in ensuring that servicers comply with these federal obligations. The data released so far on servicers’ compliance with HAMP guidelines reveals a pressing need for more oversight. Mediation programs should play an important role in this review. However, as most foreclosure mediation programs are structured today, few are capable of performing this role. Substantial changes are needed before they will be effective.

### ***Recommendations for Improving Foreclosure Mediation Programs***

#### **Imposing Necessary Servicer Obligations**

Court-supervised mediation programs will benefit homeowners only if they impose meaningful obligations on servicers. This report reviews a number of these obligations and recommends that programs impose the following requirements on all servicers:

1. Require that the servicer give the homeowner a document showing its affordable loan modification calculation and net present value calculation.

2. Require that the servicer produce specified documents, such as a pooling and servicing agreement, loan origination documents, an appraisal, and loan payment history.
  3. Require that servicers comply with all mediation obligations in good faith—negotiate in good faith and be subject to sanctions for the failure to do so.
  4. Require that servicers establish proof of the mortgage holder's standing and status as the real party in interest.
  5. Require that the servicer document that it has considered specific alternatives to foreclosure, such as loan modifications, applications for state and federal financial assistance programs, workout agreements, short sales, etc.
1. Establish procedures for automatic participation by homeowners subject to foreclosure proceedings;
  2. If participation is not automatic, allow requests for mediation to be made up to the time of a foreclosure sale;
  3. Stay all foreclosure proceedings until a mediator or court determines that the servicer has complied in good faith with all participation obligations;
  4. Provide for direct court supervision over the enforcement of servicer obligations to mediate, including the imposition of sanctions when necessary. Sanctions must include dismissal of judicial foreclosure actions and orders barring non-judicial proceedings;
  5. Provide funding for outreach, housing counselors, and qualified counsel for homeowners;
  6. Prohibit the servicer from shifting to the homeowner its attorney's fees or other costs of participating in the mediation process;
  7. Require junior lienholders to be notified of and allowed to participate in mediations.

### **Enforcing Servicer Obligations**

In addition, programs should document and enforce compliance with these obligations by:

1. Not permitting a judicial or non-judicial foreclosure to proceed unless a mediator or court has certified the servicer's compliance with the five basic requirements set forth above;
2. Requiring documentation of all outcomes, including the nature of loan modifications arrived at through mediation.

### **Increasing Homeowner Participation and Improving the Process**

Assuming that there are meaningful servicer obligations in place, then it becomes appropriate to consider how to structure a program so that it will bring in as many homeowners as possible. The final part of this report reviews procedural and structural options for increasing participation in programs. The report recommends several devices that can lead to effective participation by the greatest number of homeowners. These recommendations include:

### **State Authority**

States clearly have the authority to impose the servicer obligations and procedural requirements outlined above. Implementing a program with these features is well within the scope of the states' police power, particularly during a period of economic crisis. Based on this report's analysis of constitutional issues, it is apparent that the states have been vastly under-using their authority to act in this area.

### **Foreclosure Mediations Are Not a Substitute for Effective Federal Legislation to Require Loan Modifications**

Finally we conclude that it would be a mistake to pass up any opportunity to regulate servicers and

lenders at the federal level based on a belief that states will somehow deal effectively with the problem of servicers' who fail to implement sustainable loan modifications. This is particularly true with respect to ensuring that servicers comply with their obligations under HAMP and similar federal programs. Congress and federal agencies have the primary responsibility for creating and enforcing strong standards for these federal programs. Servicers have already demonstrated their ability to exert substantial control over state

mediation programs. At best, well structured state mediation programs can play a limited role as a check on servicers' compliance with federal standards. However, if there are no mandatory federal standards requiring truly affordable loan modifications, it is unlikely that state and local governments will create effective enforcement tools. Federal policy makers should not look to states, and particularly to state and local mediation programs, as a substitute for strong federal mandates.



# STATE AND LOCAL FORECLOSURE MEDIATION PROGRAMS

## *Can They Save Homes?*

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### **Introduction**

As the foreclosure crisis deepened over the past eighteen months and counter measures at the federal level proved ineffective, state and local governments struggled to come up with responses of their own. Many advocates for homeowners urged the adoption of foreclosure mediation programs as reforms that could be implemented promptly, often with considerable community support. As a result of these efforts there are now at least 25 foreclosure mediation programs in operation in fourteen states around the country. Programs requiring mediations or conferences before foreclosure sales are underway in several states with the most severe levels of foreclosure, including California, Florida, Nevada, Michigan, and Ohio.

Foreclosure mediation programs are still a relatively new phenomenon. The oldest programs have been in effect for just over one year. Meanwhile, the implementation of new programs has been accelerating. During the month of July 2009 alone, new statewide foreclosure mediation programs began to operate in five states. At the local level during the same month new programs went into effect in states ranging from Pennsylvania to New Mexico.

### ***Variation in Foreclosure Mediation Programs and Authority to Set Them Up***

Foreclosure mediation programs have come in many forms. They have appeared in both judicial

and non-judicial foreclosure states. In some programs courts refer residential foreclosures to the court's existing alternative dispute resolution system where parties follow established mediation protocols. Other programs provide a special court-supervised settlement conference for parties to a foreclosure. Some programs do not involve formal mediation or mediators at all. Instead, they merely direct mortgage servicers to contact homeowners to discuss settlement options before the servicers proceed with foreclosures.

In states with primarily non judicial foreclosures there are invariably judicial foreclosure statutes still on the books. Although not frequently used, these judicial foreclosure statutes can create the basis for a court role in supervising mediations in non judicial foreclosure states. For example, mediation statutes may refer non judicial foreclosures to the state judiciary's alternative dispute resolution system or provide for referral of disputes arising during mediation to the courts. Nevada and Michigan are non judicial foreclosure states that recently implemented conference or mediation legislation that provide for judicial involvement under certain circumstances in foreclosures that otherwise would proceed without court involvement.

### **Programs Reviewed in this Report**

For purposes of this report we will use the term "mediation" very loosely to mean any program that requires a mortgage holder or servicer to have some contact with a homeowner for the purpose of considering alternatives to foreclosure before

## JUDICIAL AND NON JUDICIAL FORECLOSURES

The states are fairly evenly divided in whether they require mortgage holders to go through a formal judicial proceeding in order to foreclose against a home. About half the states allow lenders to conduct a foreclosure without direct court supervision. These non-judicial foreclosures are called by various names, including foreclosure by "power of sale" or "foreclosure by advertisement." In non judicial foreclosure jurisdictions a state statute typically sets out the procedures a lender must follow to conduct an auction sale that leads to transfer of the property to a high bidder. Because a lender does not initiate a court proceeding to start a non judicial foreclosure, the homeowner must file a lawsuit for an injunction to stop the sale. Absent such a lawsuit by the homeowner, the courts do not supervise non judicial foreclosures. By contrast, a judicial foreclosure proceeds as a civil lawsuit through the court system, with the court entering a judgment for foreclosure, ordering a sale, and typically reviewing a report of the sale.

In the following states judicial foreclosures are the predominant method of foreclosure.

Colorado, Connecticut, Delaware, Florida, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, New Jersey, New York, North Dakota, Ohio, Pennsylvania, South Carolina, Vermont, Wisconsin

In the following states non judicial foreclosures are the typical method of foreclosure.

Alabama, Alaska, Arkansas, Arizona, California, District of Columbia, Georgia, Hawaii, Idaho, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, Oklahoma, Oregon, Rhode Island, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, Wyoming

In a few states, there is a mixed procedure that combines elements of both:

Oklahoma, North Carolina, South Dakota

proceeding to a foreclosure sale. The programs themselves may use various terms to describe these procedures, including mediation, foreclosure diversion, conferences, or simply "meetings." They may or may not require personal appearances by borrowers or lenders in one place at the same time. Under certain programs a conference can take place between a homeowner and a servicer without third party oversight.

We have attempted to review program operations and have conducted personal interviews with individuals involved in all existing foreclosure mediation programs. The 25 state and local programs we reviewed are listed on pages 4 and 5. An Appendix released simultaneously with this report provides a detailed analysis of each of the programs. We may have omitted some local programs. For example, in Ohio there are a number of smaller county programs that have adopted variations on a state model foreclosure media-

tion protocol. We have not included all of the Ohio counties, focusing instead on four counties with well established programs. We also do not include programs in which the servicer's participation is voluntary. Thus, we do not include programs in which both the servicer and the homeowner may elect to opt out entirely. Finally, there are new programs in development in a number of localities, including in Pennsylvania, and we do not yet have the final details on these programs.

The authority to set up foreclosure mediation programs has come from three basic sources. First, state statutes have created many programs. These include the programs now underway in California, Indiana, Maine, Michigan, Nevada, New York, and Oregon. Second, state supreme courts have taken the lead in developing programs in

two states, New Jersey and Ohio. Finally, local courts have acted on their own to create programs in various localities in Pennsylvania, Florida, Kentucky and New Mexico. In the latter type of program the local courts act under a general state statute on the judiciary or a state supreme court rule that delegates substantial authority to local courts to manage cases as they see fit.<sup>1</sup>

### ***The Goals of Foreclosure Mediation and How They Are Being Achieved***

It is not surprising that foreclosure mediation programs have been an attractive option at the state and local level. Policymakers have emphasized the need to modify mortgage loans as a way to reduce the number of foreclosures, particularly where loan balances exceed the current market value of homes.<sup>2</sup> Given the realities of today's real estate market, investors lose substantial value with every foreclosure. For example, a national survey of mortgages in foreclosure during November 2008 indicated that lenders were incurring losses averaging \$124,000 in each foreclosure.<sup>3</sup> With the loans in foreclosure having an average value of \$212,000, this meant that the lenders were losing 57% of their investment each time they completed a foreclosure. Average losses on second mortgages subject to foreclosures were nearly 100%.<sup>4</sup>

A June 2009 update of the same study found that investors' losses from foreclosures of first mortgages had risen even higher, to 64.65% of the value of the loans.<sup>5</sup> At the same time servicers were rarely modifying loans to make payments more affordable to homeowners. According to the same survey, in the relatively few instances when servicers agreed to write off a portion of loan principal in order to make payments more affordable, the servicers wrote off amounts averaging only \$14,353. The loss severities from these loan modifications averaged just 6.4% of the original loan amounts. In the overwhelming majority of cases lenders did not modify loans at all. They pursued foreclosures instead, incurring average losses of \$143,987, or nearly two thirds of the value of their investments.<sup>6</sup> It would thus appear

obvious that if the homeowner and lender could negotiate an affordable and sustainable loan modification in place of a foreclosure, all parties would almost always be better off.

The potential for incurring these overwhelming losses would appear to give servicers and homeowners much to talk about. Mediation programs typically require the servicer's attorney to appear by phone or in person together with a representative of the current holder of the mortgage. The representative must have authority to modify the loan. To the extent that mediations can facilitate this direct communication, cutting through the barriers created by securitization and loan servicing bureaucracies, they should perform a valuable service.

Because they have such great potential to promote rational conduct as an alternative to massive destruction of value, foreclosure mediation programs have appeared as one of the few bright spots in the otherwise gloomy media coverage of the foreclosure crisis. The launching of some programs has been accompanied by optimistic forecasts of thousands of homes to be saved. For example, in announcing the implementation of the New Jersey foreclosure mediation program in January 2009 the state Attorney General's office indicated that "planners anticipate as many as 16,600 homeowners will participate in the foreclosure mediation program this year."<sup>7</sup> As will be discussed later in this report, this estimate turned out to be wildly optimistic.<sup>8</sup> After Nevada's assembly passed the state's foreclosure mediation bill by a 41-0 vote in May 2009, the assembly speaker announced that the law could keep 17,700 families from losing their homes to foreclosure.<sup>9</sup>

### **Lack of Reporting and Evidence of Results**

The growing popularity of foreclosure mediation programs cannot be disputed. Yet, despite this popularity, one fact is common to all the programs. Although the goal of these programs has been to produce long term settlements that will

## SUMMARY OF 25 FORECLOSURE MEDIATION PROGRAMS

**California**

*Authority:* Cal. Civ. Code §§ 2923.5

*Structure:* Unsupervised conference between servicer and homeowner before filing notice of default in non judicial foreclosure.

*Eligibility:* Servicer must attempt to initiate conference in all residential foreclosures

*Modification analysis/NPV disclosure:* None

**Connecticut**

*Authority:* Conn. Gen. Stat. Ann. § 8-265ee

*Structure:* Court sponsored mediation in judicial foreclosures

*Eligibility:* Homeowner must file appearance after receiving summons and complaint

*Modification analysis/NPV disclosure:* None

**Florida 1st, 11th, and 19th Judicial Circuits**

*Authority:* Administrative orders by circuit chief judges

*Structure:* Judicial foreclosures: formal mediations managed by private non profit: Collins Center

*Eligibility:* Automatic referral of residential foreclosures to mediation

*Modification analysis/NPV disclosure:* None

**Florida 9th Judicial Circuit**

*Authority:* Administrative order by circuit chief judge

*Structure:* Judicial foreclosure, servicer must schedule formal mediation with certified mediator

*Eligibility:* Automatic unless servicer asserts exemption

*Modification analysis/NPV disclosure:* None

**Florida 12th Judicial Circuit**

*Authority:* Administrative order by circuit chief judge.

*Structure:* Servicer to attempt phone conference with homeowner

*Eligibility:* Automatic, homeowner need not formally request.

*Modification analysis/NPV disclosure:* none

**Florida 18th Judicial Circuit**

*Authority:* Administrative order by circuit chief judge

*Structure:* Formal mediation with court or parties choosing mediator

*Eligibility:* Residential foreclosures referred automatically to mediation

*Modification analysis/NPV disclosure:* none

**Indiana**

*Authority:* Senate Enrolled Act 492 effective July 1, 2009

*Structure:* Homeowner may ask to participate in conference with servicer after served with summons and complaint in judicial foreclosure.

Mediator optional, not required

*Eligibility:* Homeowner must notify court of intention to request conference.

*Modification analysis/NPV disclosure:* None

**Kentucky (Jefferson County—Louisville)**

*Authority:* Local court's general ADR authority

*Structure:* Notice of settlement conference with court issued with each judicial foreclosure

*Eligibility:* Applies automatically to residential foreclosures

*Modification analysis/NPV disclosure:* None

**Maine**

*Authority:* 14 Maine Rev. Stat. Ann. § 6321-A

*Structure:* Court sponsored mediations in judicial foreclosure

*Eligibility:* Case referred to mediation upon homeowner's request

*Modification analysis/NPV disclosure:* Mediations must use FDIC loan modification calculation

**Michigan**

*Authority:* Mich. Comp. Laws §§ 3205, 3205a-3205e

*Structure:* Opportunity for homeowner to engage in unmediated conference with servicer

*Eligibility:* Borrower can request conference and have 90 day pre foreclosure negotiation period before non judicial foreclosure can begin

*Modification analysis/NPV disclosure:* Servicer must provide a loan modification calculation but does not include net present value analysis

**Nevada**

*Authority:* Assembly Bill 149 effective July 1, 2009

*Structure:* referral of non judicial foreclosures to court supervised mediation

*Eligibility:* Homeowner must elect participation

*Modification analysis/NPV disclosure:* Servicer must provide mediator with "evaluative methodology" used to determine eligibility for loan modification.

**New Jersey**

*Authority:* Program of New Jersey Judiciary Jan. 2009

*Structure:* Court supervised mediation in judicial foreclosures

*Eligibility:* Homeowner must make timely election to participate

*Modification analysis/NPV disclosure:* None

**SUMMARY OF 25 FORECLOSURE MEDIATION PROGRAMS** *(continued)***New Mexico**

*Authority:* Administrative order of county court  
*Structure:* Formal mediation of judicial foreclosures administered as part of court's ADR system  
*Eligibility:* Homeowner must return a request for mediation form  
*Modification analysis/NP V disclosure:* None

**New York**

*Authority:* N.Y. C.P.L.R. § 3408  
*Structure:* Mandatory court supervised settlement conferences in judicial foreclosures  
*Eligibility:* Applicable automatically to foreclosures involving "high cost," subprime, and "non-traditional" loans.  
*Modification analysis/NP V disclosure:* None

**Ohio—Cuyahoga County (Cleveland)**

*Authority:* County program adopted under state supreme court guidelines  
*Structure:* Formal ADR type mediation in judicial foreclosures  
*Eligibility:* Homeowner must request mediation and court must approve request  
*Modification analysis/NP V disclosure:* None

**Ohio—Franklin County (Columbus)**

*Authority:* County program adopted under state supreme court guidelines  
*Structure:* Court and county organize mediations with certified mediators  
*Eligibility:* Homeowner must request during limited time frame  
*Modification analysis/NP V disclosure:* None

**Ohio—Lucas County (Toledo)**

*Authority:* County program adopted under state supreme court guidelines  
*Structure:* Magistrate and court supervised mediation in judicial foreclosures  
*Eligibility:* Homeowner may request mediation after receiving summons and complaint  
*Modification analysis/NP V disclosure:* None

**Ohio—Summit County (Akron)**

*Authority:* County program adopted under state supreme court guidelines  
*Structure:* Court reviews, refers for ADR process supervised by magistrate  
*Eligibility:* Applicable to cases with answers filed  
*Modification analysis/NP V disclosure:* None

**Oregon**

*Authority:* Senate Bill 628 effective July 1, 2009  
*Structure:* Homeowner may have unsupervised meeting with lender representative to discuss loan modification  
*Eligibility:* Homeowner must make timely request for meeting  
*Modification analysis/NPV disclosure:* None

**Pennsylvania—Allegheny County**

*Authority:* Administrative order of local court acting under state statute authorizing local courts to make administrative rules  
*Structure:* Court supervised conciliation conferences in judicial foreclosures  
*Eligibility:* Homeowner must make timely request for conference  
*Modification analysis/NPV disclosure:* None

**Pennsylvania—Bucks County**

*Authority:* Administrative order of local court acting under state statute authorizing local courts to make administrative rules  
*Structure:* Conciliation conferences before court appointed mediators  
*Eligibility:* Homeowner must make timely request to for conference  
*Modification analysis/NPV disclosure:* None

**Pennsylvania—Northampton County**

*Authority:* Local court acting under state law authorizing local courts to make administrative rules  
*Structure:* Court supervised conciliation conferences  
*Eligibility:* Case management order set automatically, homeowner must certify met with housing counselor  
*Modification analysis/NPV disclosure:* None

**Pennsylvania—Philadelphia County**

*Authority:* Administrative order of local court acting under state statute authorizing local courts to make administrative rules  
*Structure:* Court supervised conciliation conferences in judicial foreclosures  
*Eligibility:* Residential properties automatically scheduled for conciliation conference  
*Modification analysis/NPV disclosure:* None



preserve homeownership for households facing foreclosures, there is no concrete evidence showing that any of these programs is truly achieving this goal. Regardless of their location and structure, none of the 25 existing foreclosure mediation programs has offered any concrete data on the nature of the outcomes it has achieved.

We do not know, for example, whether foreclosure mediation programs bring about more loan modifications than would occur in a given locality if the program did not exist. We also know nothing about the quality of loan modifications that come about through these programs. In most localities officials do not keep any data on outcomes. Programs that release data on outcomes do so only under the vaguest categories, typically designed to place the programs in a favorable light.

Data on the manner in which a loan has been modified is particularly important in assessing the success of any foreclosure prevention effort. The tendency of many loan modifications to increase the homeowner's monthly payment has been well documented. In 2008, 58% of loan modifications nationally either increased monthly payments or left them unchanged.<sup>10</sup> Modifications that capitalize arrearages and raise payments re-default quickly. For example, according to the 2008 data, about half the modified loans that raised payments or kept payments the same re-defaulted within nine months of modification.<sup>11</sup> More recent surveys of modified loans on a national basis show payment reductions occurring more frequently, while principal write-offs have been almost non-existent and declining overall as a form of modification.<sup>12</sup> We do not know how modifications achieved through mediation programs compare with these general national trends.

This lack of data raises a number of questions about the role foreclosure mediation programs are playing in the current crisis. Is the hope the public has placed in them justified? Do they significantly alter the balance of power that typically allows servicers to dictate the manner in which a foreclosure is resolved? Are the programs a distraction from facing the need for substantive changes to laws that might be truly effective in

leveling the playing field and creating sustainable alternatives to foreclosure?

This report will address these questions, and others. We will look first at mediation programs in the larger context, considering features they have in common with plans developed at the national level to prevent foreclosures by encouraging loan modifications. We will then look at state and local foreclosure mediation programs to see whether these initiatives are likely to bring about results that are fundamentally different from what has occurred so far as a result of the federal efforts. To the extent there are weaknesses in existing foreclosure mediation programs, the report will consider how they can be strengthened in order to play a more effective role in preserving homeownership.

## **Other Federal Loan Modification Efforts**

Foreclosure mediation programs have not been the only effort undertaken to encourage loan modifications as an alternative to foreclosure. A number of initiatives at the federal level were launched with a similar objective.

### ***Preserving servicer control at the federal level***

#### **Voluntary Modification and Refinancing—Hope Now and Hope for Homeowners**

Over the past two years policymakers at the federal level promoted several programs designed to control the rising tide of home foreclosures. For the most part these efforts stressed voluntary cooperation from loan servicers. The hope was that servicers and investors would recognize their own interests in choosing alternatives to value destroying foreclosures. Instead, they would make less costly loan modifications.

Two highly publicized initiatives along these lines were the HOPE NOW and Hope for Homeowners programs. A provision to require loan modifications regardless of servicers' consent appeared in proposed amendments to the Bankruptcy Code.

**HOPE NOW.** In late 2007, the Treasury Department and HUD announced "HOPE NOW," a voluntary industry plan to modify home mortgages. Applicable only to a small portion of subprime borrowers with adjustable rate mortgages who were current in their loan payments, the program allowed servicers discretion to eliminate borrowers even though they otherwise fit the narrow criteria. Despite promises of millions of workouts, the program failed.<sup>13</sup>

**Hope for Homeowners.** In July 2008 Congress created the "Hope for Homeowners" program, intended to allow large number of homeowners to refinance into FHA conforming fixed rate loans. Publicity surrounding the implementation of the program announced that it would save 400,000 homes<sup>14</sup> Again, the program relied upon voluntary efforts by servicers to assist homeowners in making applications. In the first half year of its operation a total of 373 applications were processed and 13 approved.<sup>15</sup>

**Modification of Home Loans in Bankruptcy.** The mortgage lending industry ran a well-financed campaign to defeat legislation which would have allowed bankruptcy courts to modify home mortgages without mortgage holders' consent.<sup>16</sup> The industry pursued this anti-modification agenda despite the views of many prominent economists, academics, and bankruptcy experts who argued persuasively that widespread modifications imposed through the courts were the only measures likely to slow down the loss of homes in the foreclosure crisis. Proponents of the legislation made numerous concessions to the servicing industry in the course of the legislative process. Yet, the industry opposition persisted, leading to defeat of the measure on April 30, 2009.

### ***Incentives and Standards for Modification—the Making Home Affordable Modification Program (HAMP)***

#### **The Adoption of the HAMP Program**

In February 2009, the Obama Administration announced its own plan to encourage loan modifications.<sup>17</sup> The Home Affordable Modification Program (HAMP) consists of Treasury Department guidelines designed to encourage loan modifications on a large scale. The program allocated \$75 billion in financial incentives for servicers, investors, and borrowers who modify loans.<sup>18</sup> A separate program announced at the same time, the Home Affordable Refinance Program, focuses on incentives for refinancings into FHA loans.<sup>19</sup>

On paper the HAMP program mandates certain actions by participating servicers. Servicers who have signed participation contracts with the Treasury Department must conduct reviews for an affordable loan modification for qualifying homeowners who are in foreclosure or at imminent risk of foreclosure.<sup>20</sup> Significantly, if the review shows that the homeowner qualifies for an affordable loan modification under the program's standards, the servicer must modify the loan terms.<sup>21</sup> According to the Administration's estimates, by the end of 2012 the HAMP program will save three to four million at risk homes from foreclosure. Over 38 servicers, including the five largest, are now signatories to HAMP contracts and obligated to service loans and conduct foreclosures in compliance with the program guidelines.<sup>22</sup> The GSEs and the Federal Housing Agency (FHA) have implemented their own streamlined loan modification programs with guidelines similar to those of HAMP.<sup>23</sup> The guidelines for HAMP and the related GSE programs now apply to more than 80 percent of the home mortgages in the country.

#### **How HAMP Is Supposed to Work**

At the heart of the HAMP program is a requirement that servicers conduct a formal "net

### THE HAMP "NET PRESENT VALUE" CALCULATION

The HAMP loan modification analysis uses a calculation made up of two distinct parts.<sup>27</sup> The first part of the analysis runs data through a sequence of loan modification options to arrive at a new affordable monthly payment for the borrower. As applied in sequence, these options include the capitalization of arrears, an interest rate reduction in steps to as low as 2%, extension of the loan repayment term, and then forbearance of a portion of the outstanding principal.<sup>28</sup> Each option is applied in sequence until a monthly payment for principal, interest, taxes and insurance is reached that takes up no more than 31% of the household's current gross monthly income.

After the program has modified the loan terms as needed to arrive at an affordable monthly payment, it produces a dollar figure that tells the servicer the "net present value" to investors of the loan as modified. The net present value of the modified loan is figured using a percentage discount. This discount factors in the delay in receipt of the reduced scheduled payments under the modified loan. It also takes into account the possibility of a cure by the borrower and the likelihood and cost of a re-default.

Once it has come up with a figure for the net

present value of the modified loan, the HAMP calculation then compares this value with the estimated recovery the investors will obtain if a foreclosure is completed. In calculating the value to be received from a completed foreclosure, the model takes into account the current market value of the property and typical foreclosure losses, including the cost of delays in re-sale, the distressed REO value, and foreclosure costs.

After completing all entries on the net present value calculation, the servicer has two figures to compare: the estimated loss investors will incur from the loan modification and the estimated loss investors will incur from a completed foreclosure. The servicer, acting on behalf of investors, must choose the option producing the smaller loss. The calculation format allows for quick, streamlined analysis of the data needed to make this decision. From the homeowner it requires the input of limited information, primarily recent income figures. From the servicer it requires some readily available servicer-specific and industry-wide data on costs and losses associated with loan modifications and foreclosures. The calculation also factors in data on the current market value for the property.

present value" calculation for each loan in foreclosure to determine whether a loan modification is required. The outcome of this net present value test tells the servicer whether an affordable loan modification will better serve the mortgage holders' financial interests than a foreclosure.<sup>24</sup> The securitization industry has favored the use of these net present value models as a means to arrive at the most informed decisions on how to maximize recoveries for investors in mortgage-backed securities.<sup>25</sup> In early 2008 the FDIC announced a model net present value program and spreadsheet for use in the review of loan modifications for IndyMac loans that it held in receivership.<sup>26</sup> This FDIC model serves as the prototype for others, including, with certain modifications, the net present value analysis required under the HAMP program.

Under the HAMP guidelines participating ser-

vicers must evaluate all borrowers in their portfolio who are more than 60 days in default to see if they are eligible for an affordable loan modification.<sup>29</sup> Servicers must also screen borrowers who are current or less than 60 days delinquent if they inquire about a modification and appear to be at risk for imminent default.<sup>30</sup> The guidelines further require that a foreclosure sale be stayed pending review for a loan modification. The stay of sale must continue during the three-month trial payment period before final confirmation of a HAMP modification.<sup>31</sup>

A HAMP servicer may properly deny an affordable modification only in specific circumstances defined in the guidelines.<sup>32</sup> For example, properties that are not occupied as the owner's principal residence may be excluded. The property must be a single family (1-4 units) property with a maximum unpaid principal balance on the first mortgage of



less than \$729,750. The loan must have been originated on or before January 1, 2009. Before consideration for a loan modification the homeowner's payments toward the first mortgage must be more than 31 percent of the homeowner's gross monthly income. A modification for an eligible homeowner may not be required if the terms of a controlling pooling and servicing agreement between a servicer and an investment trust prohibit the modification. However, in order to claim this exception, the servicer must first negotiate "to remove those obstacles" created by the pooling and servicing agreement.<sup>33</sup>

If a foreclosure involves an eligible homeowner, participating servicers must follow the Treasury Department's HAMP guidelines, including completion of an approved net present value calculation. Servicers must implement the outcome of the net present value test. If the foreclosure will produce a greater loss to investors than the affordable loan modification, the HAMP contract and guidelines *require* that the servicer modify the loan.

Congress has specifically approved the use of these types of net present value loan modification models as the industry standard for residential mortgage servicing. Section 129 of the Helping Families Save Their Homes Act of 2009 provides that servicers comply with their duty to investors by selection of the most reasonable option shown under the HAMP or similar net present value test.<sup>34</sup>

### **HAMP Implementation Problems and Lack of Oversight**

Neither the Treasury Department nor its agents charged with implementing HAMP (Freddie Mae and Freddie Mac) have provided adequate supervision of servicers. Yet, it is servicers who play the key role in admitting homeowners into the HAMP program.<sup>35</sup> During the first months of its operation the HAMP program has been plagued by persistent problems. The Treasury's press releases indicate that as of the end of July 2009 only 9% of the homeowners eligible for reductions in payments under the HAMP program had

begun trial modifications.<sup>36</sup> Although intended to meet a pressing economic emergency, the full implementation of the program has been delayed by ongoing negotiations with servicer representatives. Servicers have demanded that the program include features that will ensure their control over significant aspects of the loan modification process. From the homeowners' perspective the primary benefit of the program appeared to be that it obligated servicers to follow an objective and transparent standard in evaluating a homeowner's eligibility for an affordable loan modification. Unfortunately, servicers have thus far succeeded in delaying the implementation of any clear and verifiable standards. Others abuses have been common.<sup>37</sup>

Many aspects of HAMP's implementation have been chaotic. Individuals who are eligible for the program's benefits because their servicer signed a HAMP contract may not receive any formal notice of this fact. Homeowners are not informed of how they can be considered for a modification. HAMP has no clear application rules, and as yet there is no structure for effective review of eligibility decisions. Government officials have thus far acceded to major servicers' demands that their net present value calculations be kept secret as "proprietary" information. "Rules," as the term is generally understood in the context of federal agency law and government benefit programs essentially do not exist for the HAMP program.

Whether through design or as a result of bureaucratic inertia, servicers' practices have led to widespread evasion of their obligations under HAMP contracts.<sup>38</sup> These practices have included:

- Soliciting eligible homeowners to waive their right to be considered for a loan modification under the HAMP guidelines;
- Offering homeowners loan modifications that do not comply with the HAMP affordability guidelines, including modifications with unaffordable payments, impermissibly high interest rates, and modifications for short time periods not authorized by the guidelines;

- Falsely informing eligible homeowners that the servicer does not participate in the HAMP program;
- Proceeding with sales and commencing foreclosure actions while delaying decisions on requests for a loan modification;
- Charging fees to consider or implement loan modifications despite HAMP guidelines prohibiting such charges;
- Refusing to inform homeowners of the grounds for denial of a HAMP modification, including refusal to disclose how a payment level was calculated, what NPV test was performed, and failing to provide any documentation related to denial or approval decision;
- Altering terms of trial modifications when it is time to implement the permanent modification;
- Adding improper late fees and other post-default fees;
- Demanding excessive documents from homeowners beyond what HAMP requires, and denying modifications for lack of documentation;
- Denying any review or appeal from denial decisions, and failure to inform the homeowner of decisions;
- Extensive delays in deciding modification requests or requiring homeowners to sign documents on short notice without a chance for review;
- Failing to coordinate modification negotiations with second lienholders.

Servicer practices like these have been endemic since the announcement of the HAMP program. If allowed to continue unchecked they may fatally undermine HAMP's most promising elements. These servicer practices pose a significant risk that HAMP will go the way of the other federal efforts that depended upon servicers' voluntary efforts to control foreclosures.

### ***Foreclosure Mediation Programs Have the Potential to Enable the Making Home Affordable Modification Program to Succeed***

Foreclosure mediation programs at the state and local level can play a critical role in ensuring that the HAMP program does not fail. So far the federal government appears to be content with glossing over the program's chaotic implementation. This chaos benefits servicers. The servicers' goals are simple: they want to move foreclosures as quickly as possible to sale, just as they always have done. Confused homeowners and lack of oversight are what servicers need to keep the current pace of foreclosures going.

Servicers' business models and staffing decisions favor quick foreclosures over the labor intensive and less lucrative work involved in modifying a loan.<sup>39</sup> The fee incentives under which servicers are paid similarly favor foreclosures over modifications.

An effective mediation program could identify participating servicers and ensure that foreclosure proceedings are stayed pending a review of HAMP eligibility. They could require production of net present value calculations, review data included in them, and ensure that modifications comply with HAMP guidelines. Mediation can set the groundwork for a court to deny foreclosure when a servicer violated the obligations of a HAMP contract.<sup>40</sup> For the overwhelming majority of homeowners in foreclosure who are not represented by attorneys, these checks on servicer conduct can be critical. Finally, mediation programs can be another resource for collection of data on servicer practices related to the HAMP program.

On the other hand, if foreclosure mediation programs cannot deal effectively with the blatant errors occurring routinely in the implementation of the HAMP program, the mediation programs themselves will go a long way toward demonstrating their own irrelevance. As will be discussed in the following sections, many foreclosure mediation programs are simply not structured in a way that allows them to deal

effectively with uncooperative servicers. Judicial oversight is often weak or simply non-existent. Patterns of servicer control have fallen into place over time. Still, in many instances the imposition of some basic obligations on servicers and improvements in structure of the programs could make a difference. The next section of this report will consider some recent legislative efforts to establish these obligations.

### **Bringing Standards to Foreclosure Mediation—Successes and Failures in Recent State Legislation**

In July 2009 statutes creating mediation and conference programs for foreclosures went into effect in four states, Oregon, Michigan, Nevada, and Maine. In each of these states the opportunity arose during the legislative process to require that before every foreclosure a servicer produce evidence that it had conducted a formal analysis for an affordable loan modification. The outcomes of these efforts say much about the servicing industry's attitude toward loan modifications, the HAMP program, and mediation systems.

As of March 2009, pending Oregon Senate Bill 628 mandated foreclosure mediations and required that in mediations in which the homeowner was not represented by counsel, the mediation must produce a formal loan modification analysis using a net present value spreadsheet, either the FDIC spreadsheet or "a formula that is consistent with the Making Home Affordable guidelines issued by the United States Department of the Treasury."<sup>41</sup> The Bill would have effectively prevented a lender from using the state's non judicial foreclosure procedure if it had rejected a loan modification shown to be feasible under HAMP rules or a similar federal guideline. Oregon's financial lobby mounted a vigorous campaign against this proposed legislation.<sup>42</sup> In the end, the industry succeeded in removing all provisions of the Bill requiring mediators to review loan modifications under

any objective or verifiable standards. The Bill as enacted leaves the servicers with complete discretion to apply any standards they wish in evaluating a homeowner for a loan modification.<sup>43</sup>

The Michigan bill as originally passed by the state's House and Senate during the first half of 2009 required that the servicer produce a specific, transparent loan modification model whenever the parties had not arrived at a settlement. A conference committee later amended the bill, striking the requirement that the parties produce a specific net present value spreadsheet in all cases. Under the version of the bill that eventually became law, the homeowner does not receive an assessment of the cost of the modification compared to the cost of a foreclosure, as the legislation in its earlier version required.<sup>44</sup>

Nevada is another non judicial foreclosure state that implemented a foreclosure mediation program in 2009.<sup>45</sup> As part of the implementation of the new law, the State's Supreme Court promulgated a rule stating merely that the servicer must "under confidential cover, provide to the mediator the evaluative methodology used in determining the eligibility or noneligibility of the [homeowner] for a loan modification."<sup>46</sup> It is not clear what the term "evaluative methodology" as used in the Rule means. The requirement for disclosure only to the mediator is problematic, particularly because mediation rules typically require that all aspects of the mediation be kept confidential. Whatever it is that the servicer must disclose, the rule effectively keeps the homeowner and the homeowner's counsel from seeing it.

Unlike the three states described above, Maine recently enacted a foreclosure mediation statute with a provision that expressly requires documentation of a complete loan modification analysis prior to foreclosure.<sup>47</sup> The Maine law requires that parties to a mediation complete the FDIC's net present value spreadsheet.<sup>48</sup>

The Maine mediator's report must show that the parties completed the spreadsheet, and the positive or negative result of the test must be included in the mediator's report.<sup>49</sup> The new law

also requires ongoing public reporting of data about the program, including the number of loans restructured in mediation, the number of principal write-downs, and the number of interest rate reductions.<sup>50</sup>

Only one of the four states, Maine, succeeded in imposing a requirement that effectively checks a servicers' compliance with a specific federal modification program. Whether servicers control the Nevada procedures will depend on the courts' and mediators' willingness to use their power to impose sanctions. The Michigan program provides only partial transparency and no direct court supervision. The Oregon law provides no transparency and no direct court supervision.

## Evaluation and Recommendations for Improving Foreclosure Mediation Programs

### *Views from Advocates*

In preparing this report we interviewed attorneys and housing counselors who have appeared with homeowners in nearly all the foreclosure mediation programs that were in operation as of the end of June 2009. Participants' observations obviously varied from program to program. None were in a position to estimate the number of homes that may have been saved from foreclosure through mediations. Housing counselors generally found the programs more helpful than did attorneys in the same jurisdiction. For housing counselors the programs provided a structure for negotiations. This structure saved time in establishing lines of communication with servicers. According to the counselors, some servicers were more receptive to loan modifications than others. From the housing counselors' perspective the degree to which the mediation process affected the substantive results in a given case was unclear.

Legal services attorneys who regularly represented homeowners in foreclosures had mixed views about the mediation programs. Attorneys who were litigating substantive consumer claims against lenders did not find the mediations par-

ticularly helpful. Most mediation programs are designed to focus on financial calculations for workout agreements and loan modifications. The programs are less well suited for the consideration of complex consumer claims. Attorneys in some locations found the mediations to be a waste of time and would have preferred not to participate in them at all.

Attorneys who found foreclosure mediation programs helpful almost uniformly considered their major benefit to be in giving the attorney and the homeowner much-needed time to investigate the facts of a client's case. This respite led to more informed decisions about potential legal claims to assert.

Most foreclosure mediation programs require servicers to designate an individual authorized to settle a case and to have that person available for negotiations. Attorneys and housing counselors generally found this requirements helpful, although enforced laxly. Many advocates reported problems with servicers backing out of agreements made by a person who participated in a mediation session claiming to have authority to negotiate on behalf of the mortgage holder. In most mediation systems the person appearing for the servicer could satisfy the "authorized representative" requirement with a verbal assurance of authority.

Advocates for homeowners reported that a "take it or leave it" offer from a servicer satisfied mediation requirements in most jurisdictions. Occasionally the personal involvement of a judge with a strong interest in the mediation program could make a difference. In a few programs individual judges took an active role in making servicers produce documents such as payment history records and loss mitigation protocols. Judges or mediators sometimes ordered sessions continued several times until the servicer produced the requested documents. More often, the programs did not routinely require servicers to produce documents, or accepted at face value servicers' statements that certain documents, such

as detailed payment records or loan origination documents, were not available.

In statewide mediation programs advocates described a significant lack of uniformity in procedures from county to county and court to court. In statewide programs some courts freely tolerated token participation by lenders, while in neighboring counties courts adhered to stricter standards for appearances, production of documents, and good faith participation. Here again the personalities and interests of individual judges seemed to play a decisive role in creating these differences. Some judges invested enormous time and personal energy in their court's program. Many other judges viewed the programs as a docket control matter and took little interest in their day to day functioning.

Attorneys and housing counselors working with all programs reported mixed results in obtaining loan modifications through mediations. Virtually no one reported agreements to write off any loan principal. To the extent servicers agreed to loan modifications that reduced payments, these modifications most often involved interest rate reductions after capitalizing arrears, sometimes combined with a term extension. Forbearance of principal seldom occurred. The systems servicers used to arrive at these loan modifications were arbitrary. Few servicers seemed familiar with the HAMP program guidelines. No advocates reported seeing any net present value spreadsheets. Few servicers provided any form of detailed explanation for a refusal to modify a loan in a particular way. Servicers often claimed that there were barriers to modification under pooling and servicing agreements. However, these servicers did not produce the agreements, and mediation systems were not helpful in making them do so.

### ***The Existing Foreclosure Mediation Programs Lack Standards for Servicer Accountability***

Based on the interviews with participants in the 25 existing foreclosure mediation programs and review of the procedures in use, it is clear

that most of these programs place few meaningful obligations on servicers. Many do little to hold servicers accountable for decisions to foreclose. They do not require that servicers demonstrate that they considered loan modifications under a reasonable and objective standard. Servicers effectively control the terms of discussion in most programs.

In this section we will focus on five specific servicer obligations and two basic program requirements that can bring some accountability to a foreclosure mediation program. We will also look at how various existing programs are dealing with these issues and outline measures the programs could take to address them more effectively. The criteria we will consider are:

1. The mediation program should require that the servicer give the homeowner a document showing its affordable loan modification calculation and net present value calculation under one of the recognized federal guidelines.
2. The mediation program should require that the servicer produce specified documents, such as a pooling and servicing agreement, loan origination documents, an appraisal, and payment history.
3. The mediation program should require that servicers comply with all mediation obligations in good faith—negotiate in good faith and be subject to sanctions for the failure to do so.
4. The mediation program should require that servicers establish proof of the mortgage holder's standing and status as real party in interest.
5. The mediation program should require that the servicer document that it has considered specific alternatives to foreclosure, such as loan modifications, workout agreements, short sales, and applications for refinancings and other forms of financial assistance available under federal and state programs.



In addition, programs should document and enforce compliance with these obligations by:

1. Forbidding a judicial or non-judicial foreclosure to proceed unless a mediator or court has certified the servicer's compliance with the five basic requirements set forth above, and
2. Documenting all outcomes, including the nature of loan modifications arrived at through mediation.

### **Recommendations: Five Necessary Servicer Obligations**

The obligations placed on servicers need to be clear and objective. They should not be dependent of the predilections of an individual judge or mediator. They should be straightforward enough so that they can be enforced in cases in which the homeowner has no attorney.

#### **1. Does the Program Require That the Servicer Give the Homeowner a Document Showing its Affordable Loan Modification and Net Present Value Calculations?**

The obligation to calculate a modified loan with affordable payments and to offer the modified loan to the homeowner now applies to about 85% of the home mortgages in foreclosure today. As discussed above, the HAMP program guidelines require that participating servicers refrain from foreclosure sales while they calculate the modified loan for each borrower.<sup>51</sup> After calculating the modified loan, the servicer must determine whether the modification passes a "net present value" test. This test compares the estimated loss the investors will incur from the affordable loan modification with the estimated loss the investors will incur from the completed foreclosure. HAMP guidelines require that the servicer implement the loan modification if it will be less costly to investors than a foreclosure.

Under the terms of the HAMP contracts that most servicers have signed with the Treasury Department, the servicers receive financial incen-

tives to implement loan modifications. At the same time the servicers are obligated to offer and implement the loan modifications for all homeowners who qualify under the net present value test. An exception applies only when a contractual agreement, a "pooling and servicing agreement," between the servicer and an investment trust prohibits the modification. Although this kind of barrier can exist, true restrictions on modifications in pooling and servicing agreements are fewer than many servicers have claimed.<sup>52</sup> The obligation to calculate the affordable loan modification applies not only to servicers who have signed formal HAMP contracts with the Treasury Department; similar mandatory loan modification requirements apply to loans serviced for Fannie Mae and Freddie Mac, and for federal agencies, including the FDIC, FHA, and the VA.

Existing foreclosure mediation programs have had ample opportunity to adapt their rules to take into account the obligations that most servicers now have under the new federal loan modification programs. The mediation programs should be requiring that servicers show how they are fulfilling their obligations to modify loans. Ensuring compliance with HAMP can give a clear focus to mediations. As discussed above, the federal entities charged with implementing the loan modification programs have not been providing effective oversight. Foreclosures are taking place in violation of federal program rules. Without additional and strict oversight at the state and local levels where these improper foreclosures are taking place, the HAMP program will not fulfill its promise of preventing millions of foreclosures.

Despite the clear need for a mediation rule requiring that servicers show their compliance with HAMP guidelines, surprisingly few programs have actually implemented such a rule. Of the 25 existing foreclosure mediation programs, only the Maine program obligates a servicer to produce a physical copy of an affordable loan modification calculation and net present value test.

Maine's statute requires production of a loan modification and net present value spreadsheet completed under the FDIC "loan mod in a box" model. This calculation is similar to and provides much of the same data as the requirements under the guidelines of HAMP and other GSEs.<sup>53</sup>

Only the Maine program requires that a lender consider a loan modification in a manner that allows for objective review by the homeowner and a mediator. The servicer must use the calculations, assumptions, and forms that are established by the FDIC and published in its program guide.<sup>54</sup> The mediator's report at the conclusion of each mediation must show that the parties completed the net present value worksheet under the FDIC loan modification program. If the foreclosure action is not settled or dismissed, the report must include the outcome of the net present value worksheet.

While the Maine program focuses on production of the FDIC loan modification calculation, no foreclosure mediation program specifically mandates production of a HAMP calculation. As described above, industry lobbyists successfully opposed the creation of such a requirement when it was proposed for statutes in Oregon and Michigan. Except for Maine, servicers under all other foreclosure mediation programs retain complete discretion to review loan modification requests under any standard they wish, or under no standard at all.<sup>55</sup> An effective mediation program should mandate the use of a recognized loan modification model with a net present value test for all cases, not just for those involving HAMP or a related federal program. This will focus the mediations on the considerations that are truly relevant to the financial interests of investors and homeowners.

## **2. Does the Program Require That Servicers Produce Specified Documents, Such as Pooling and Servicing Agreements, Loan Origination Documents, an Appraisal, and Loan Payment History?**

An effective negotiation environment requires that the parties have access to objective, verifiable

data on all relevant topics. Only with such information available can there be a record of what the parties considered and did not consider. While many programs set out specific documentation requirements for homeowners, few impose similar obligations upon servicers. Homeowners must often complete multi-page forms, sometimes under oath, documenting their income, liabilities, and assets, and list other alternatives for assistance they have considered. When homeowners do not comply with these documentation requirements, they typically lose the right to participate in the mediation program.

A common complaint from homeowners participating in mediation programs is that servicers do not produce even basic payment history records and other basic loan documents. A typical scenario is for the lender to wait for the borrower's proposal, then verbally reject it. The servicers often assert that the homeowner cannot "afford" a particular settlement option. Homeowners find themselves disqualified from various options for not meeting some undisclosed and amorphous standard.

Many programs place no obligation on lenders to produce relevant documents before or at a conference. This is true for the statewide conference programs in California, Connecticut, and New Jersey. Similarly, the programs in the Twelfth and Eighteenth, judicial circuits of Florida and local programs in Kentucky, Ohio, and Pennsylvania set no explicit guidelines requiring lenders produce any specific documents for conferences or sessions. The absence of these requirements leaves homeowners without a basis for asserting that a servicer participated in bad faith. Servicers feel no real incentive to participate in good faith.

Several programs take a more balanced approach, although their requirements are far from comprehensive. The recent administrative orders for several judicial circuits in Florida require that servicers bring a copy of the applicable pooling and servicing agreement to mediation if the servicer contends that the agreement affects its abil-

ity to implement any settlement option. A court rule for the mediation program in Santa Fe, New Mexico requires the servicer to complete an information form ten days before the mediation. The form requires a listing of loan data, including the dates of all loan assignments, whether recorded or not, and a statement of options for settlement the lender will consider.

The new Indiana statute requires that the lender bring to the settlement conference a copy of the original note and mortgage, a payment record substantiating the default, an itemization of all amounts claimed due, and any other documents the court determines are needed. The Nevada rules for foreclosure mediations require that the servicer provide a current appraisal. As discussed above, the Maine and Michigan statutes require production of documentation related to the calculation of the homeowner's eligibility for a loan modification. The Maine statute requires the disclosure of a complete net present value analysis, while the Michigan law allows a more general partial disclosure. The Cuyahoga County, Ohio mediation program provides a "lender form" for servicers to complete. This form includes payment history and other lender data, but allows the lender to substitute an information form of its own.

Foreclosure mediation programs cannot depend on a few servicers who may voluntarily disclose necessary documents. Nor can they rely on the occasional judge who has a penchant for enforcing standards. Most homeowners will be appearing for mediations without counsel of their own. Therefore, mediation programs need to publish clear checklists of documents that servicers must produce. The list must include the complete net present value spreadsheet or data entry field, and any loan modification eligibility calculation for a government program related to the loan. The list must include the note and mortgage, the complete payment history, any applicable loss mitigation guidelines, the HUD 1 and Truth in Lending disclosures from the original transaction, and a current appraisal. As discussed below, the servicer must also produce documents

establishing the standing and real party in interest status of any foreclosing entity, as well as documentation of the designated representative's authority to settle for a trust owning the underlying obligation. There are already mediation programs that require servicers to produce one or more of these documents. An effective program should mandate a comprehensive list and enforce production of all the listed items.

### **3. Does the Program Require That Servicers Negotiate in Good Faith and Mandate Sanctions for the Failure to Do So?**

Any effective foreclosure mediation program must apply a requirement for good faith participation to all servicers. The consequences for not complying with program obligations must be meaningful. Dismissal of judicial foreclosure actions should follow when servicers show bad faith by not complying with program rules. Statutes governing non-judicial foreclosures should bar transfer of title without a mediator's certification of the servicer's good faith compliance with mediation obligations.

Requiring lenders to show good faith in foreclosure proceedings is not a novel idea. A good faith standard has always applied to mortgage holders who seek to foreclose. For centuries the courts have exercised their authority to apply a "clean hands" standard and other equitable considerations in determining whether a mortgage holder could foreclose.<sup>56</sup> Similarly, courts have power to enforce standards for good faith participation in settlement conferences and in any alternative dispute resolution proceeding. Rule 16 of the Federal Rules of Civil Procedure embodies this requirement for federal courts, and all or most state courts have similar rules.<sup>57</sup>

Most existing foreclosure mediation programs do not incorporate an express requirement for good faith participation into their rules. Programs without a good faith requirement include those for California, Connecticut, New Jersey,



New York, and Indiana. Similarly, the local programs in New Mexico, Kentucky, Ohio and Pennsylvania have no such requirement. At most, these programs provide for the possibility that a servicer's judicial foreclosure action may be dismissed if the servicer fails to appear or send an authorized representative to a mediation session. Even upon the servicer's failure to appear, most programs provide only that dismissal of the foreclosure is an option that may be considered at that point. For example, several Florida programs,<sup>58</sup> the local programs for Cuyahoga and Franklin counties of Ohio, and the programs in Allegheny and Northampton counties in Pennsylvania provide for optional consequences at the court's discretion if the servicer does not appear.

The recently implemented Maine and Nevada foreclosure mediation programs are the only ones that expressly impose a good faith requirement on lenders. The Maine statute provides that the parties and attorneys in a mediation must "make a good faith effort to mediate all issues."<sup>59</sup> A Maine court may impose "appropriate sanctions" if a party or attorney fails to attend or to make a good faith effort to mediate all issues. The mediator's report to the court must indicate whether a party failed to negotiate in good faith. Given that the Maine statute mandates use of a specific loan modification model and requires that the session address reinstatement of the mortgage, modification of the loan, and restructuring of the debt, the statute facilitates the development of a record that can lead to the imposition of sanctions in appropriate cases. The mediation record could also support the homeowner's equitable defense to foreclosure in an ongoing judicial proceeding.<sup>60</sup>

The Nevada mediation statute requires that a servicer file a certification of completion of mediation before it may proceed with a non-judicial foreclosure.<sup>61</sup> The certificate must include the mediator's finding that the parties acted in good faith and that the mediation was properly terminated. Without this certification, the trustee may not proceed with a non-judicial foreclosure sale.

The Nevada statute also provides that the mediator *must* prepare and submit to the court's mediation administrator a petition and recommendation for the imposition of sanctions if the lender does not participate in the mediation in good faith. The mediator must seek sanctions if the servicer does not bring required documents to establish standing, or does not have a representative authorized to modify the loan available at all times during a session. The Nevada statute specifically grants the court reviewing a motion for sanctions the authority to grant appropriate orders, "including, without limitation, requiring a loan modification in the manner determined proper by the court."

State courts act well within their authority in imposing sanctions against servicers who obstruct court-sponsored proceedings. Taken together, the Maine and Nevada statutes show an effective way to structure the imposition of sanctions. The Maine statute defines good faith to include compliance with the requirement to demonstrate completion of an appropriate affordable loan modification analysis. A servicer that has not produced physical evidence of this analysis will have participated in mediation in bad faith. Under the Nevada statute, instances of servicer bad faith in mediation must be referred to the court for sanctions. As a sanction the court can modify the loan in an appropriate way. This combination of substantive standards and remedies for enforcement can be an effective counterbalance to servicer evasion of obligations under HAMP and other federal modification programs.

#### **4. Does the Program Require That Servicers Establish Proof of the Mortgage Holder's Standing and Status as Real Party in Interest?**

An attractive feature of foreclosure mediation programs has been the expectation that they will help homeowners cut through the barriers created by securitization of home mortgage obligations. Mediation programs typically require that servicers appear in person or by phone, through a

person “with authority” to negotiate a settlement. While this requirement has a definite appeal, in practice the obligation is often satisfied by mere verbal assurances that an individual is authorized to negotiate a settlement on behalf of the owners of the obligation. Beyond these verbal assurances, most programs require little in the way of documentation to substantiate the claim. As a result, complications may arise when it is time to finalize or enforce agreements reached through mediation. Other programs simply do not enforce the appearance requirement at all.

Mediation programs often fail to address a more significant issue than the question of whether a designated person has authority to negotiate. This is the question of whether the entity that claims to own the obligation actually does own it. If the entity that authorizes a representative to negotiate on its behalf is not in fact the owner of the obligation, the authorization is meaningless. For many unrepresented homeowners proceeding through mediation, issues of the standing and real party in interest status of the foreclosing party are never considered.

In judicial foreclosures the courts have inherent authority to review questions of standing and real party in interest pertaining to the parties who appear before them. This authority clearly extends to alternative dispute resolution and other proceedings that take place under the courts’ supervision. Similarly, state legislatures and state agencies have ample authority to define who may use the state’s non-judicial foreclosure mechanism. Today, with multiple assignments of mortgage obligations and multiple securitizations often related to the same debt, the legislatures and courts are scrutinizing the status of parties who claim the right to enforce mortgage obligations.<sup>62</sup> Questions of standing often go to the court’s jurisdiction. If the entity bringing the foreclosure does not in fact own the obligation, the court may require the true owner to be joined as a party.<sup>63</sup>

Without standards and requirements to establish that the proper party is pursuing the foreclosure, there is a risk that mediations will give the judicial seal of approval to foreclosures against

unrepresented homeowners who have little understanding of these issues. This is unfortunate because mediations could serve the opposite purpose. They could set clear requirements to establish the standing of all parties seeking to foreclose.

A few existing mediation programs have adopted procedures to address potential standing questions. Under the Nevada law the beneficiary of a deed of trust must bring to the mediation the original or a certified copy of the deed of trust, the mortgage note and each assignment of the deed of trust or mortgage note.<sup>64</sup> The Nevada Supreme court’s rules implementing the mediation statute set out further requirements for the certification of loan documents and verification of lost notes in connection with mediation.<sup>65</sup>

Two local court mediation programs have instituted detailed requirements to show standing. These are the programs in Santa Fe, New Mexico and Summit County (Akron) Ohio. The Santa Fe program rules require servicers to provide copies of all filed and unfiled assignments in connection with the mediation.<sup>66</sup> A court-created Summit County Ohio foreclosure mediation program requires that plaintiffs file a “certificate of readiness” with the court.<sup>67</sup> This certificate requires production of copies of all assignments made since origination, with a declaration of custody and control of the original note and mortgage and the availability of documents for inspection upon order of the court. All assignments and name changes must bear a date prior to the filing date of the complaint.

Requirements under other programs, if any exist at all, are much more limited. Courts in Seminole county in Florida’s Eighteenth Judicial Circuit require lenders to file the original note with the clerk before any hearings or else satisfy lost note requirements under state law.<sup>68</sup> While the Cuyahoga County rules require the lender to fill out a form disclosing all assignments and explaining why any documents are missing, the rule allows lenders to substitute forms of their own. Under the Indiana statute the plaintiff

lender must bring to the settlement conference a copy of the original note and mortgage.

Maine and New York recently enacted statutes that amend their foreclosure laws to require that pleadings or documents filed in land records contain some general information related to the lender's standing to foreclose. These laws were enacted simultaneously with the mediation statutes in each state and apply to all foreclosures. The New York law applicable to high cost loans, requires that the plaintiff aver in the complaint that it owns and holds the note and mortgage, or has been delegated authority by the owner to foreclose.<sup>69</sup> The Maine statute requires that the plaintiff commencing a foreclosure action "shall certify proof of ownership of the mortgage and note and produce evidence of the mortgage note, mortgage and all assignments and endorsements of the note and mortgage."<sup>70</sup> A requirement similar to this Maine provision should apply to all servicers in foreclosure mediation programs.<sup>71</sup>

**5. Does the Program Require That the Servicer Document its Consideration of Specific Alternatives to Foreclosure, Such as Loan Modifications, Workout Agreements, Short Sales, and Applications for Refinancings and Other Forms of Financial Assistance Available Under Federal and State Programs?**

As discussed above, the HAMP program creates obligations, not just to consider loan modifications, but to implement them. For homeowners who do not meet the program's eligibility requirements for a loan modification, the HAMP guidelines still direct the servicer to "explore other foreclosure prevention alternatives prior to resuming or initiating foreclosure."<sup>72</sup>

In addition to mandating consideration of HAMP eligibility, mediations can set agendas. They can require that lenders review all options to avoid foreclosures and document that they considered these options in each case. Under their police power states have inherent authority to set these requirements, particularly when

foreclosures are undermining state and local economies.<sup>73</sup> While states may not postpone foreclosures arbitrarily or indefinitely, their authority to regulate foreclosure procedures certainly encompasses mandating serious, not token, consideration of alternatives to foreclosure.<sup>74</sup>

Serious consideration of alternatives does not occur when a homeowner is required to make a proposal, which a lender can simply reject without explanation before it proceeds with a foreclosure. Many existing foreclosure mediation programs operate on essentially this model. For example, the statewide programs in New Jersey and New York do not mandate that parties consider specific alternatives to foreclosure. Local court-operated programs in Ohio,<sup>75</sup> Florida,<sup>76</sup> Pennsylvania,<sup>77</sup> New Mexico, and Kentucky have no such requirement. In some programs the servicer may be required to respond to a proposal of the homeowner. In rare instances the servicer must make a proposal of its own, but most program guidelines do not mandate that the servicer's proposal address any specific options. The programs fail to place the servicer's exercise of discretion within any objective framework.

A few foreclosure mediation statutes describe a very general purpose for the program. For example, the New York statute requiring settlement conferences for cases involving high cost loans states that the purpose of the conferences is to consider "whether the parties can reach a mutually agreeable resolution to help the defendant avoid losing his or her home, and evaluating the potential for a resolution in which payment schedules or amounts may be modified or other workout options may be agreed to, and for whatever other purposes the court deems appropriate."<sup>78</sup> The Indiana law states that the purpose of conferences is to "attempt to negotiate a foreclosure prevention agreement." A servicer who adamantly refuses to consider any options to avoid foreclosure would arguably fail to comply with the spirit of these statutes. Otherwise, these general statements of purpose have limited usefulness.

The guidelines published by the Cuyahoga County, Ohio program state that lenders should consider loss mitigation options listed on a form provided by the court, but lenders are free to use their own model forms and standards, and there is no requirement for disclosure of how those options were considered. The Brevard County Florida Administrative Order provides a model foreclosure mediation agenda. The agenda lists options that parties may consider at a session. However, the only requirement is that the servicer consider one option from the list, which includes repayment forbearance, loan modification, short sale, deed in lieu of foreclosure, or consent to judgment.

A few foreclosure mediation programs have set out more specific guidance for options the parties must consider. Connecticut's statute provides that "[M] ediation shall . . . address all issues of foreclosure, including, but not limited to, reinstatement of the mortgage, assignment of law days, assignment of sale date, restructuring of the mortgage debt and foreclosure by decree of sale." Under the Florida Eighteenth Judicial Circuit program the servicer's representative must be authorized to make agreements on "alternatives to litigation, including refinancing, partial forgiveness of debts, approving sale to third parties, clarifying amounts owed, requirements to reinstate or discharge the loan, requesting a deed in lieu of foreclosure, procedures for protecting premises and establishing mutually agreeable date for relinquishing possession."

The Maine statute provides more specific direction for the conduct of foreclosure mediations. The law mandates the use of a well-established loan modification and net present value model. In addition, according to the statute, the mediation "must address all issues of foreclosure, including but not limited to reinstatement of the mortgage, modification of the loan and restructuring of the mortgage debt." Coupled with the law's express requirement for the servicer's participation in good faith, the Maine law creates a basic framework for serious consideration of issues.

State laws can go further than the Maine statute and mandate that servicers produce documentation of consideration of a series of options to avoid foreclosure. The programs should impose sanctions for failure to produce this documentation. The documentation should show, for example, the data the parties considered in evaluating potential workout and forbearance agreements and what factors were evaluated in looking at a short sale or deed in lieu of foreclosure. Programs can require that the servicer document efforts to assist the homeowner through various federal, state, and local programs designed to assist homeowners with refinancing and other financial assistance. An appropriate check list would show a triage of the options ranging from those most likely to preserve homeownership to those that allow for minimizing long term financial consequences for borrowers who are not keeping their homes. Requiring that lenders clearly document the reasonable consideration of all loss mitigation options before they are allowed to proceed with a foreclosure is a valid and necessary exercise of a state's police power.

### ***Recommendations: Enforcing Compliance with Servicer Obligations***

- 1. Does the program forbid a judicial or non-judicial foreclosure from proceeding unless a mediator has certified the servicer's compliance with the requirements listed as 1–5, above?**

A final requirement should tie together the list of obligations discussed above. Compliance with the servicer obligations in mediation should be a condition to allowing a foreclosure to proceed. This requirement can be enforced in both judicial and non judicial foreclosure states. In judicial foreclosures the mediation is often characterized as a referral from the regular trial docketing system to an alternative dispute resolution program. This referral should not terminate until



the mediator or other presiding official certifies that the parties have complied in good faith with their duties under the mediation rules. Similarly, in non judicial foreclosure states, the mediator should be authorized to issue a certificate indicating that the mediation has terminated with good faith participation by the parties and compliance with all mediation rules. The servicer should be required to file such a certificate before proceeding with a non judicial foreclosure sale. A non judicial foreclosure sale conducted without such a certification would not convey valid title to a purchaser at the sale.

## **2. Does the program document outcomes, including the nature of loan modifications arrived at through mediation?**

### *a. The Need for Data on Outcomes*

None of the existing foreclosure mediation programs has kept reliable and complete data on the outcomes of participating cases. This lack of data can be problematic for several reasons. First, it impedes self correction. Without accurate data on outcomes, those responsible for the programs can not know what works and what does not work, and make adjustments accordingly. For example does making homeowner participation automatic as opposed to requiring homeowners to opt in to mediation produce significantly more affordable loan modifications? Does mandating that servicers produce various documents make a difference? A number of programs, such as those in New York, New Jersey, and Connecticut, have received funds for outreach and other aspects of their mediation systems. If this funding is justified by verified positive results, these outcomes should inform decisions of other states that are considering funding similar programs.

Foreclosure mediation programs can also play an important role in providing a needed check on data about servicers' compliance with the HAMP program. Over the coming months we will likely see inconsistent data offered by government officials and servicers describing how the federal programs are being implemented,

whether they are successful, and how many homeowners they helped. The mediation programs will be in a unique position to provide a further control on this data based on actual modification results.

Deficiencies in the data about loan modifications and other loss mitigation actions have not been limited to foreclosure mediation programs. For example in its recent report on foreclosure relief actions, the Congressional Oversight Panel reviewed the state of data on loan modifications and found the lack of reliable information nationwide to be "distressing."<sup>79</sup> In the Panel's view, this lack of data has been a significant barrier to formulating sound policy responses to the foreclosure crisis. The Congressional panel summarized its review of existing data as follows:

*The result is that no comprehensive private or government source exists for accurately tracking loan delinquencies and loss mitigation efforts, including foreclosures and modifications on a complete, national scale. No federal agency has the ability to accurately track delinquencies and loss mitigation efforts for anything more than 60% of the market. The existing data are plagued by inconsistencies in data collection methodologies and reporting and are often simply unverifiable. Worse still, the data being collected are often not what is needed for answering key questions, namely what are causing mortgage defaults and why loan modifications have not been working.<sup>80</sup>*

Following the Congressional Oversight Panel's urging, the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) developed tracking systems for loan modifications. These agencies review data for institutions responsible for about 60% of home mortgage loans nationally. The data from these surveys will be released in quarterly reports, the first having appeared in April 2009.<sup>81</sup> These reports track loan modification numbers and record general facts about the nature of modifications. The surveys record loan modification data focusing on several categories of changed terms, including the

percentage interest rate reduction, the extent to which a loan repayment period was extended, the amount of principal forborne, and the degree to which the arrearages were capitalized.

The HAMP program has its own reporting requirements that apply to servicers.<sup>82</sup> These reports require servicers to provide extensive information about loan modification activities. Since most servicers are already under an obligation to prepare this type of data, mediation programs would not be requiring any additional work from servicers if they require that they provide similar data in connection with mediations.

The minority of servicers who do not participate in HAMP or similar federal programs can track data from cases in their systems using categories similar to those used by the OCC and OTS. This would require little more than a simple checklist about characteristics of loan modifications that would take a few minutes to complete for each case. The OCC and OTS also collect follow-up data on redefaults at quarterly intervals after the modification. A foreclosure mediation program that wished to demonstrate its beneficial impact could record and publicize follow-up data along these lines as well.

Data under the HAMP guidelines and OCS/OTS metrics can be recorded in general categories. Therefore, there cannot be any significant objections raised on confidentiality grounds if foreclosure mediation programs require that participants record basic loan modification data in accordance with these systems that are already being implemented nationally to record the same data.

b. The data collection on outcomes by existing programs is inadequate.

Statewide programs in California, Indiana, Michigan, and Nevada have no formal systems for tracking even the most basic data on the outcomes of mediations or conferences. Most local programs in Florida, Ohio, and Pennsylvania similarly use only the most general systems for tracking numbers of cases and outcomes. The Connecticut statewide program and a few local programs, such as those in Cuyahoga County,

Ohio, Brevard County, Florida, and Philadelphia, Pennsylvania have kept some statistics on numbers of cases mediated and outcomes. However the categories under which they record outcomes are so broad as to provide no concrete information about the nature of settlements.

The Connecticut Supreme Court has released figures covering the ten-month period from July 1, 2008 to April 30, 2009.<sup>83</sup> According to its report, during this time 21,251 foreclosure cases were filed in the state. Of these, 16,851 involved owner occupied properties eligible for mediation. During the time in question, 5778 eligible homeowners requested mediation. Mediations were completed in 2545 cases. Of the completed mediations, the report indicates that 1065, or 41% resulted in loan modifications. Put another way, loan modifications resulted in 6.3% of the foreclosure cases eligible for mediation.

The Connecticut data does not define how the terms of the 1065 modified loans were changed. We do not know the degree to which these modifications increased or decreased payments or increased or decreased principal indebtedness. The nature of loan modification needs to be defined clearly so that comparisons will make sense. For example, the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) Mortgage Metrics Report for the first quarter of 2009 indicated that in its national survey of mortgages there were 844,389 mortgages in foreclosure in the quarter. According to the Report, lenders modified mortgages in 185,156 of those cases during the quarter.<sup>84</sup> This would represent loan modifications in about 22% of the cases in foreclosure. As noted above, Connecticut was reporting a rate of 6.3% of the loans in foreclosure modified in mediations completed over a ten month period. This is a level significantly *less* than the national average for cases in foreclosure as reported by the OCC/OTS data.

There can be several possible explanations for this divergence. Due to conditions of its housing market, it may have been harder to obtain a loan modification in Connecticut than elsewhere in the country. The systems may define the pool of

eligible mortgages differently. It is also likely that OCC/OTS and the State of Connecticut courts define loan modifications in different ways. The OCC and OTS appear to be using a broad definition of modification, which may include temporary interest rate reductions. As indicated above, the OCC/OTS database represents approximately 60% of residential loans nationwide and does not purport to be an accurate statistical sample of all mortgages. On the other hand, the Connecticut data appears to represent all residential foreclosures in the state. Ultimately, these data disparities highlight the inconsistencies of much of the national and local data on loan modifications.

During the first year of its operation Philadelphia's foreclosure diversion program did not keep track of loan modifications, either by numbers or by type. Residential foreclosures have been filed recently in Philadelphia at the rate of about 6000 a year. In a June 30, 2009 press release the Philadelphia court indicated that over the previous year 4690 homeowners participated in its foreclosure diversion program.<sup>85</sup> According to the press release, a sheriff sale was averted or the case was removed from the sheriff sale list in 1400 of those cases. These 1400 cases are considered successful outcomes. However, the reported category of cases with a sheriff sale averted or in which the case was removed from the sheriff sale list encompasses cases in which the underlying foreclosure lawsuit was not dismissed. The figure includes cases considered settled, including those with agreements other than loan modifications. For example a settlement may involve allowing a foreclosure judgment entered in the case to remain while the homeowner attempts to comply with a repayment agreement. Under such an agreement the lender may retain the right to enforce the judgment by re-listing the property for sale in the same foreclosure case upon a future default. Under the categories used by the Philadelphia court, it is not possible to tell loan modifications from repayment agreements in the 1400 cases reported as settled favorably for the homeowner. Nor is it possible to know anything about the nature of any loan modifications included in the group.

The Cuyahoga County Ohio foreclosure mediation program has likewise provided limited data for cases it handled during its initial year of operation. Lenders filed approximately 14,000 foreclosure cases in Cuyahoga County during each of the past two years.<sup>86</sup> Under the Cuyahoga County foreclosure mediation program homeowners must request mediation. The court reviews initial requests, and based on consideration of financial and other data, may or may not refer a case to mediation. Cases referred to mediation are scheduled for a pre-mediation session and then a formal session. The data for July 2008 to June 25, 2009 for Cuyahoga County were as follows:<sup>87</sup>

Requests for mediation	2914
Found unsuitable for mediation	441
Found suitable for mediation	2473
Had pre-mediation session	1575
Had full mediation	484
Settled	240
Dismissed for lender non appearance	58
Returned to foreclosure because homeowner did not comply with mediation rules	380

The figure for cases settled under the Cuyahoga County program does not provide any information on the nature of settlements.

Franklin County (Columbus), Ohio has a well established foreclosure mediation program that began to operate at the end of 2008. Approximately 9,000 foreclosure cases were filed annually in the county over each of the past two years.<sup>88</sup> The Franklin County program recently released data for cases handled over the first half of 2009. During this period there were 870 cases referred to mediation, of which 863 were found suitable for mediation. As of the end of June 2009, 566 of these referrals were listed as pending, scheduled, or rescheduled. In terms of outcomes, the report lists 44 cases as having settled with a "loan modification/loan workout." The report lists many other categories of outcomes, including "loan reinstatement or full agreement" (19 cases), "forbearance agreement" (24), and "partial agreement" (4).

Overall, this data is not clear on the number of loan modifications reached or on the content of the modifications.

New York has not been keeping statewide data on its statutory mandatory conferences for foreclosures involving subprime and other high cost mortgages. Some limited data covers the New York City boroughs, Nassau and Suffolk counties, and the Buffalo and Syracuse areas for the period from late January 2009 to mid June 2009.<sup>89</sup> This data indicated that over this period and in these courts there were conferences scheduled for 2890 cases. Homeowners did not appear in 1182 of these conferences. A total of 173 cases settled at the conferences.<sup>90</sup> Here, again, the data does not track anything specific about outcomes.

New Jersey has averaged approximately 60,000 foreclosures in each of the past two years. The New Jersey foreclosure mediation program released data on numbers and outcomes of mediations for the period from January 13, 2009 through June 30, 2009.<sup>91</sup> Mediations (including pre-mediations) were completed in 854 cases statewide during this period. Of those 854 cases, no settlements were reached in 390. Of the 445 cases described as settled in mediation, the report lists 281 as allowing the homeowner to avoid foreclosure and remain in the home. Of the rest, 35 involved settlements with agreements to move, and 129 were settlement of unknown content. The designation for settled cases involving retention of the home likely includes loan modifications, but the precise numbers and type of modifications were not described in the data released. A number of cases (1342) remain pending with housing counselors and some of these may eventually be subject to mediation.

Aside from Connecticut, New York, New Jersey, Philadelphia, Cleveland, and Columbus, other foreclosure mediation programs have not released even partial data on outcomes. Several statewide and local programs are still new at this time, and some of these may still decide to implement systems for tracking outcomes. Other existing programs may in the future develop more detailed tracking systems.

The Maine foreclosure mediation statute contains a requirement that data be submitted to the state legislature on a regular basis so that the program can be evaluated and modified as needed. The information to be reported includes: “The results of the mediation process, including the number of loans restructured, number of principal write-downs, interest rate reductions and number of homeowners who default on mortgages within a year after restructuring, to the extent the court has information available.”<sup>92</sup>

While the Maine statute directs that data on numbers and types of modifications be tracked, it does not on its face require data on the degree of reduction occurring for each category. For example, the statute seeks data on numbers of loan modifications with interest rate and principal reductions. It does not require data on the percentage reduction in interest rates or the amount of principal forborne or written off. The HAMP and OCC/OTS metrics described above do require reporting of this additional data. All of this information can be recorded by foreclosure mediation programs in order to evaluate their performance.

### ***Recommendations: Improving Homeowner Participation and Procedural Aspects of Programs***

It is certainly possible to design a foreclosure mediation program so that it will encourage as many homeowners as possible to participate in it. High participation rates may lead to better outcomes for more homeowners. However, this may not always be true. If the procedures styled as “mediation” leave servicers in substantial control of the process, then sending large numbers of homeowners, particularly unrepresented ones, through these procedures may not preserve homeownership for more individuals over the long term. For example, an unsupervised conference mechanism could easily become a system for servicers to obtain waivers of rights from *pro se* homeowners. If homeowners end up losing statutory redemption rights or rights to fair market appraisals when they participate in confer-



ences with servicers, these homeowners may be better off in the long run not participating.

To the extent that mediations apply mandatory standards and can protect homeowners from overreaching by servicers, then procedures designed to increase participation by homeowners will likely keep more families in their homes. This section will look at procedural aspects of foreclosure mediation programs and consider which features are likely to increase homeowner participation. Again, reaching these considerations assumes that there is some positive value to the homeowner's participation in the program at all.

The existing foreclosure mediation programs come with a wide variety of structures. For example, some programs apply automatically to all owner-occupied homes in foreclosure. In other programs the homeowner must take some formal action to "opt in" to the mediation program. For programs which require the homeowner to take some affirmative step to opt in, the length of time a homeowner has to exercise the option varies. Once a homeowner is participating in a program, the question of a stay of foreclosure procedures becomes crucial. In some programs a stay is automatic, while in others the homeowner must actively seek out a stay from the court pending mediation. These procedures are discussed in more detail below.

### **1. Does the Program Establish Procedures for Automatic Participation by Homeowners Subject to Foreclosure Proceedings?**

#### *a. Programs in which homeowner participation is automatic.*

Several mediation programs refer foreclosure cases to an alternative dispute resolution system automatically upon the filing of a complaint. In these programs the servicers must certify in the initial filing whether the case involves an owner-occupied property. Certification that the property is owner occupied triggers the application of the foreclosure mediation rules. A number of local court-initiated programs follow this general practice. These include the programs in

Louisville, Kentucky, in four Florida judicial circuits (the First, Eleventh, Eighteenth, and Nineteenth), in Santa Fe, New Mexico, and in Northampton and Philadelphia counties in Pennsylvania. The New York State conference procedure for high cost loans employs a similar system.

The automatic inclusion of residential foreclosures in some type of conference system can occur in non judicial foreclosures as well as in judicial foreclosures. For example, while the phone conference obligation under the California statute has no meaningful substantive component, the requirement applies across the board to all residential foreclosures.

#### *b. Programs which exclude homeowners who do not opt in.*

At the other end of the spectrum are programs that set up certain procedural requirements for homeowners to follow if they wish to participate in a conference or mediation. Compliance with these procedural thresholds is often mandatory. If homeowners do not follow the procedures, they do not participate. The statewide programs established in Connecticut, Indiana, Maine, Michigan, Nevada, New Jersey, and Oregon employ this device. The local programs in most Ohio counties and in Allegheny and Bucks counties in Pennsylvania set similar requirements.

The rules for these programs in which homeowners must "opt in" typically include a requirement that the court, a clerk, a housing agency, the lender, or a trustee serve the homeowner with a notice at the commencement of the foreclosure. The notice describes the nature of the mediation or conference opportunity that is available. The notice may direct the homeowner to housing counselors, a hotline, or a pro bono legal office. It may include information on how to exercise the option to have a conference with a lender representative. The homeowner must complete and send in the form as directed by a certain date. In some programs the filing of an answer or a verbal request is enough to secure the homeowner's right to participate. Under other systems, such as

the one for Bucks County, Pennsylvania, the homeowner must contact a housing counselor, who in turn submits the request.

## **2. Can Requests for Mediation Be Made Up to the Time of a Foreclosure Sale?**

Setting a time limit for submitting the request to participate in a mediation may significantly limit the number of participants. When programs set time limits, the deadlines vary widely from program to program. The range includes: Bucks County, Pennsylvania (ten days from service of summons and complaint), Michigan (14 days after date notice sent), Allegheny County, Pennsylvania (20 days from when notice received), Connecticut (fifteen days after return date of summons and complaint), Oregon (30 days from date of notice), Indiana (30 days from date of service), Nevada (30 days from date of service). The Ohio counties generally require some action by the borrower within a set time period, such as before an answer is due.

Restrictions on participation in mediations can take forms other than time limits. For example, in several Ohio programs a judge or other court official may conduct an initial review of a request before making a referral for mediation. Under the Maine and New Jersey guidelines the procedures for opting in are more flexible. In Maine the homeowner must file an answer, appear, or otherwise request to participate in mediation. In New Jersey there is not a fixed time limit for making a written request for mediation. However, under the New Jersey law foreclosure proceedings are not stayed automatically by the mediation request.

Creating these types of opt-in hurdles may produce a set of homeowners who are strongly motivated. These may be homeowners with the financial resources to benefit the most from mediation options. At the same time, these limitations on access may unreasonably exclude homeowners who simply misunderstand court procedures or irrationally fear them. With some encouragement, these homeowners might choose at some point to participate. At a minimum, it is safe to say that automatic inclusion of homeowners is

more likely to produce a greater number of homeowners who will be in a position to learn of their legal rights in the foreclosure and make informed decisions about whether to follow up with appearances and calls.

## **3. Are All Foreclosure Proceedings Stayed Until a Mediator Or Court Determines That the Servicer Has Complied in Good Faith With All Participation Obligations?**

A stay of entry of judgment and a stay of the foreclosure sale are essential if servicers are to take foreclosure mediations seriously. Without a stay, foreclosure mills will proceed along at their automated pace and sell the home. Mediation programs implement stays of proceedings in various ways. In some programs the homeowner's eligibility for mediation triggers a stay. In other programs the homeowner must make a formal request for a stay. In the latter type of program, absent such an order, foreclosure proceedings may go ahead. Programs also vary in the duration of a stay. Some programs stay proceedings for the duration of mediation or until a homeowner fails to appear for a scheduled session, while others set a fixed time by which mediation must be completed and the stay will terminate. Occasionally, if there are multiple sessions, a continuance order must be entered at the end of each session in order to clarify that the stay is continuing until the next scheduled meeting.

Programs that refer foreclosures to alternative dispute resolution upon the filing of a complaint typically stay proceedings as long as there is a reasonable basis for continuing the mediation process. Under the Maine statute the court will not enter judgment until mediation has concluded. In Connecticut proceedings are stayed pending mediation, although the defendant's time to file an answer is not stayed. The Indiana statute provides for a stay of proceedings for 90 days to allow for conferences to take place. At the local level, most court-initiated foreclosure mediation programs provide for some form of automatic stay of proceedings.<sup>93</sup>

The statewide programs in New Jersey and New York and the local programs in Santa Fe, New Mexico and Louisville, Kentucky, do not provide for an automatic stay or delay of proceedings. In these jurisdictions borrowers must apply to the courts or a sheriff for a stay if mediation is not completed by a pleading deadline or the sale date.

In programs in non-judicial foreclosure states, such as those in Oregon, Michigan, and California, there is no court imposed stay of a legal proceeding. Instead, the statutes require a delay of a fixed period—thirty, sixty, or ninety days—before the servicer may proceed with the next step in a non-judicial foreclosure. In Nevada, the trustee may not proceed with a non judicial foreclosure sale until the mediator certifies that the parties acted in good faith and could not reach an agreement.<sup>94</sup>

#### **4. Does the Court Have Direct Supervision Over the Enforcement of Servicer Obligations, Including the Power to Impose Sanctions?**

A number of programs styled as mediation or conference programs do not involve any direct court supervision over the interactions between servicers and homeowners. These include the programs in California, Michigan, Indiana, and Florida's Twelfth Judicial Circuit. These programs do little more than require a servicer to provide a statement that it attempted to contact the homeowner to work out a settlement. Servicers and their attorneys have unfettered control over any procedures mandated by these programs. For this reason the programs do not provide any meaningful structure for serious consideration of alternatives to foreclosure.

To be minimally effective a mediation program must authorize some neutral official to impose sanctions upon servicers who do not comply with specific obligations under the program. For example, someone acting in an official capacity must have authority to require servicers to comply with their obligations. A judge, court official, or mediator must be able, consistent with due process, to impose sanctions that include dismissal of a judicial foreclosure action,

an injunction against non-judicial foreclosure, and monetary sanctions. There is ample precedent under F.R. Civ. P. 16 and similar alternative dispute resolution rules for courts to impose sanctions for a party's non-compliance with mediation rules.<sup>95</sup>

A common complaint of advocates working with mediation programs is that servicers delay responses and do not turn over documents, sometimes proceeding with sales during these extended delays. In addition to making stays of foreclosure automatic, mediation programs must set clear deadlines for servicers to respond to proposals and produce documents. Cases must be dismissed upon non-compliance with deadlines.

#### **5. Is There Funding for Outreach, Housing Counselors and Qualified Counsel for Homeowners?**

Some states, including New York and New Jersey, have authorized considerable financial support for foreclosure mediations. This includes funding for housing counselors, outreach, and in the case of New Jersey, to pay for attorneys to represent homeowners in foreclosure cases. Yet, both the New York and New Jersey programs have garnered relatively low levels of homeowner participation so far. The low turnout may be due to a number of factors, including some structural restrictions on homeowners' access to both programs. For example, the New Jersey program lacks an automatic stay of foreclosure proceedings and requires that homeowners affirmatively opt in to the program. The New York program does not apply to all residential mortgage foreclosures.

On the other hand, public funding for counselors and outreach, when combined with structural devices that encourage homeowner participation, will likely produce better participation rates. For example, the local government funding for outreach and counseling under the Philadelphia program, combined with automatic participation and stays of foreclosure sales, has likely contributed to the high rate of participation there.

Where there is a strong commitment to expanding eligibility and bringing in as many homeowners as possible, it is likely that expenditures for outreach and counseling will produce a higher turnout. However, if the programs place no obligations on servicers, funding designed to bring more homeowners into mediation may produce few long term benefits for homeowners.

*The Availability of Counsel for Homeowners*  
Having attorneys represent homeowners in foreclosure mediations can help in a number of ways. The presence of an attorney for the homeowner can deter overreaching by servicers' attorneys and ensure that homeowners do not waive important legal rights. Court directives to waive conflict rules and allow limited attorney appearances in mediations can increase the numbers of volunteer attorneys available to assist homeowners. However, limited appearances by inexperienced attorneys may not provide substantial assistance for homeowners in the long run. The best option is obviously to have available free or low cost counsel who are experienced in representing homeowners in foreclosures and who can remain as counsel for the homeowner throughout the proceeding.

In most jurisdictions there are few attorneys with the experience necessary to provide full representation to homeowners in foreclosure, and this situation is not likely to change during the current foreclosure crisis. Housing counselors and relatively inexperienced *pro bono* attorneys will be appearing with homeowners in the vast majority of mediations. Given this fact, having strict standards for the conduct of the mediation sessions, including procedures that can be reduced to unambiguous checklists, forms, and spreadsheets, will be helpful.

#### **6. Are Servicers Prohibited from Shifting to the Homeowner Attorneys' Fees Or Other Costs of Participating in the Mediation Process?**

Most foreclosure mediation programs do not charge a fee to homeowners for participating in

the procedures. This is true for the statewide programs in California, Connecticut, New Jersey, New York, Maine, and Michigan, as well as for the local court programs in New Mexico, Kentucky, Ohio, and Pennsylvania. However, a few programs have set payment requirements for homeowners. In Nevada the borrower and the lender must each pay \$200 toward a total mediation fee of \$400. No mediation will be initiated if the borrower does not pay his or her share of the costs on time. Some programs, such as those in Maine and Nevada, have added surcharges to the fees for filing foreclosure complaints or notices of default as a means to finance the mediation programs.<sup>96</sup>

Two Florida mediation programs are managed by the Collins Center, a non-profit organization. These programs require that the lender make an up-front payment of \$750 to be applied to mediation expenses upon the filing of the complaint.<sup>97</sup> Two other Florida programs set advance payment fees for lenders of \$250 and \$350.<sup>98</sup> The administrative orders in these Florida districts specifically allow the costs to be taxed as part of a judgment against the homeowner should the foreclosure proceed to a judgment.

The charges for mediation costs can be a deterrent to participation for low income homeowners. However, a related cost issue raises more serious concerns. In almost all foreclosure mediation programs servicers can shift their own attorney's fees incurred in mediation to the homeowner. Servicers and their attorneys often treat the expenses of mediation as simply another collection cost to be charged to the borrower. None of the programs appear to place a limitation on this practice. Advocates report that servicers often make express references to fee shifting liability in the course of mediations. This has a clear impact on homeowners' willingness to stick with mediations, particularly when repeated continuances are needed due to servicers' delays in producing documents or responding to proposals.

States clearly have the authority to limit the attorney's fees shifting terms of consumer contracts.<sup>99</sup> State common law and statutory provisions have placed limits on amounts and timing



of attorney's fees shifting in connection with mortgage foreclosures.<sup>100</sup> All states should prohibit fees shifting in connection with the foreclosure mediation programs. Homeowners should not have to fear that each continuance for the lender to comply with its obligations will add hundreds of dollars to their mortgage debt.

HAMP guidelines prohibit servicers charging homeowners for any costs of implementing a loan modification under the program.<sup>101</sup> If the mediation focuses upon implementing a loan modification through a participating servicer, the HAMP rule should be an additional basis for prohibiting fees shifting.

### **7. Is There a Requirement That Junior Lien holders Be Notified of and Allowed to Participate in Mediations?**

The presence of junior mortgages has been a common obstacle encountered in modifying first mortgages and in negotiating other settlements. A second mortgage holder may be the same entity that holds the first mortgage, or it may be a completely separate entity. For some types of mortgages, such as Alt -A loans, as many as half the loans in this category included a second mortgage at the time of origination.<sup>102</sup>

First lienholders may be reluctant to agree to modifications that involve concessions from them while second lienholders are unaffected. From the homeowner's perspective, the continuing financial burdens from a second mortgage may make re-default on a modified first mortgage more likely.

The Treasury Department, through its HAMP program, has announced a program for second mortgages that allows either modification or "extinguishment" of the second lien.<sup>103</sup> The HAMP second mortgage modification standards follow a waterfall similar to the first lien modification program. The Treasury Department provides subsidies to servicers, investors, and homeowners in connection with modifications of second liens. The program also authorizes payments of a small portion of the underlying debt in return for a second lienholder's agreement to extinguish its lien.

Most existing foreclosure mediation programs have not established procedures for routine inclusion of second lienholders in sessions and conferences. A few programs have established some minimal procedures for notification to second mortgagees. The administrative orders for two Florida circuit court programs provide that junior lienholders who have not been defaulted in the judicial foreclosure proceeding will be notified of mediation hearings.<sup>104</sup> The Louisville, Kentucky administrative order expressly permits junior lienholders to participate. Under the Maine statute, the mediator may include any entity deemed necessary for effective mediation. The Nevada statute requires that the trustee notify anyone with an interest in the property of the homeowner's election to mediate

Mediation rules should establish a clear requirement that holders of second mortgages be notified of all proceedings involving the property. Second mortgage holders should be permitted to participate in mediations. When a first mortgage loan is modified can be the ideal time to try to get rid of the second mortgage. The second lien holder might be willing to accept pennies on the dollar now when the likely alternative is to lose everything if a foreclosure proceeds.

## **Conclusion**

Our review of the status of foreclosure mediation programs has shown that there can be a danger in viewing them as an alternative to legislation that directs servicers and mortgage holders to make affordable loan modifications. For example, bankruptcy code amendments allowing courts to modify mortgages through reduction of principal would markedly increase the numbers of affordable modifications. Federal legislation setting out clear directives for enforcement of the HAMP program would be far more effective than expecting state and local mediation systems to oversee enforcement of this federal program.

In the absence of strong federal legislation, state foreclosure mediation programs could play a role in enforcement of guidelines under the various federal loan modification programs, including the HAMP program. They can provide a framework for more effective implementation of these federal programs. In the overwhelming majority of cases homeowners facing foreclosure will not have attorneys who can assist them in protecting their rights under the HAMP program. Mediations using simple and quick net present value calculations should be able to identify cases that are clearly inappropriate for foreclosure. Mandating mediation for all residential foreclosures and scrutinizing all cases under these tests can help to minimize unnecessary foreclosures. Mediations have the added benefit of requiring the appearance of a party responsi

ble for securitized loans. If there is a clear expectation that courts will enforce sound equitable standards, this should deter the responsible parties from moving forward before a court with blatantly wasteful cases.

Despite the potential to do so, the existing foreclosure mediation programs have yet to establish that they can exert any significant control over servicer conduct. The performance of these programs does not support hopes that voluntary efforts by servicers will somehow slow the surge in foreclosures. Thousands of preventable, irrational, and highly destructive foreclosures are being completed every week in the United States. Continuing to treat this epidemic as primarily a communication problem will ensure that it continues unabated.

# APPENDIX

## Constitutional Issues Related to State Foreclosure Mediation Laws

### Recent state regulation of foreclosures has not approached its full constitutional potential

Foreclosures have traditionally been the subject of state regulation. There is little likelihood that in the near future some new federal foreclosure law will come to the rescue of distressed homeowners and supplant the state laws that now regulate foreclosures. Unfortunately, since the onset of the current foreclosure crisis state legislatures have done little to revise archaic foreclosure procedures in ways that would reduce the loss of homes. The nine foreclosure diversion statutes enacted during 2008 and 2009 were some of the few new state laws enacted in response to the foreclosure crisis that were ostensibly directed at modifying foreclosure procedures for the benefit of homeowners. State courts and legislatures have much greater power than they have chosen to assert in this field.

No one would dispute that the current level of home foreclosures has created a severe economic crisis. Faced with this emergency, states have substantial authority to enact remedial legislation to protect the vital interests of their citizens and of the state itself. State regulation can take the forms of both modification of foreclosure procedures and the creation of new substantive rights for homeowners facing unreasonable and unfair foreclosures. As will be discussed below, appropriate foreclosure mediation laws can incorporate many of these needed reforms, both procedural and substantive.

### *States' Police Power and Mediation Procedures—Stay of Foreclosures*

In the exercise of the state's police power the legislatures and courts of a state have the authority to *stay* foreclosures for substantial periods of time. The law on this point has been well settled for more than half a century. For example, Depression era statutes typically authorized stays of foreclosure sales and extensions of post-sale redemption periods for several years.<sup>105</sup> Most states enacted some form of moratorium legislation during the early years of the Depression. Few of these statutes were ever challenged on constitutional grounds. When challenged, nearly all were upheld as valid exercises of the states' police power in the prevailing economic crisis.

In a landmark decision *Home Building & Loan Association v. Blaisdell*<sup>106</sup> the United States Supreme Court rejected a challenge to a Minnesota foreclosure moratorium law brought under the Contracts Clause of the U.S. Constitution.<sup>107</sup> The Minnesota statute allowed homeowners to petition a court for a stay of foreclosure for up to two years. Under the same law courts could also toll the running of the post sale redemption period for up to two years. According to the *Blaisdell* Court, the state had authority to modify contract rights in this manner under its police power. The potential for states to act in this capacity had to be recognized as an implied condition to any contract: "[T]he reservation of the reasonable exercise of the protective power of the State is read into all contracts."<sup>108</sup> Protecting all citizens from an

economic emergency was thus a permissible basis for limited impairment of private parties' contract obligations. Under the *Blaisdell* court's test, the pertinent question in assessing the validity of an exercise of the police power became "whether the legislation is addressed to a legitimate end and the measures taken are reasonable and appropriate to that end."<sup>109</sup>

The Supreme Court revised its formulation of the applicable Contracts Clause test in a 1983 decision, *Energy Reserves Group, Inc., v. Kansas Power & Light Co.*<sup>110</sup> Here the Court rejected a Contracts Clause challenge to a Kansas statute that set price caps on intrastate natural gas sales. As articulated in this decision, the Court's current formulation has three steps:

1. Is there in fact a substantial impairment of the creditor's contractual rights?
2. If yes, the state must have a significant and legitimate public purpose behind the regulation, such as remedying of a broad and general social or economic problem.
3. If this is a significant and legitimate public purpose, the adjustment of the rights and responsibilities of the contracting parties must be based upon reasonable conditions and of a character appropriate to the public purpose supporting the legislation.<sup>111</sup>

Under this standard, if a state law satisfies the second and third prongs of the above test, a court will uphold the law despite a substantial impairment of contractual rights under the first prong. The *Energy Reserves* test thus acknowledges that state laws may impair substantive contract obligations in a proper exercise of the police power. Prior decisions had characterized state laws as acceptable only when they regulated procedural "remedies," while unacceptable state laws impaired substantive contract obligations. The price controls imposed by the Kansas statute at issue in *Energy Reserves* clearly regulated substantive contract terms and did not merely alter enforcement procedures. Thus the courts have retreated from the strict remedy/obligation dichotomy.

The standards defined by the *Blaisdell* and *Energy Reserves* rulings allow states to fashion laws that stay foreclosures for extended periods of time. For example, in 1945 the Supreme Court upheld the constitutionality of a New York foreclosure moratorium law that had been in effect since 1933.<sup>112</sup> The New York law effectively stayed foreclosures based on non payment of loan principal. The law provided for some form of court-supervised payments by the homeowner during the pendency of the stay. Typically the payment would consist of some combination of interest, taxes and insurance. Otherwise, for an extended period of time the law substantially altered the lender's rights to collect regular contractual payments and to foreclose.

Foreclosure moratorium laws enacted during the nineteen-thirties typically required some payment, such as a fair rental value, taxes and insurance, or interest. These payment amounts were generally subject to court review, with the stay conditioned on the homeowner's continuing to make the payments. The court-ordered payments were invariably less than the contractual amount that the homeowner would otherwise be obligated to pay.

In a time of economic crisis, states clearly have the authority to set conditions on foreclosures, including authorizing the delays necessary for effective mediation. The stays of foreclosures that extended over many years during the 1930s were intended to delay foreclosures until the real estate market improved. Foreclosure sales were producing scandalously low prices. It was hoped that an improved market would bring higher prices or allow borrowers to refinance to avoid foreclosure.

A stay of foreclosures pending court-supervised mediations adds another strong rationale for a delay of foreclosure sales—the role of the mediation itself as an effort to arrive at a beneficial outcome for all parties. Minnesota's Supreme Court, for example, flatly rejected a Contracts Clause challenge to a mandatory foreclosure mediation statute applicable to farm properties during the 1980s.<sup>113</sup> The court found



the impairment of contracts to be no more significant than the extensive limitations imposed by the 1930s Minnesota moratorium law upheld in the *Blaisdell* decision.

As discussed elsewhere in this Report, many of the current foreclosure mediation programs defer significantly to servicers' and mortgage holders' interests in the way they limit stays of foreclosure pending a mediation. If there is no stay or a very limited delay pending a mediation, a servicer has little incentive to take the process seriously. Setting fixed time limits, such as sixty or ninety days has a similar effect. Servicers can focus on the clock rather than on any obligation imposed by a mediation rule.

The creditors' demands for short time limits for homeowners to request mediation seems to be motivated by a fear that homeowners might request mediation at a late stage in the foreclosure proceeding, and this would encourage delay. Given that legislation staying foreclosures for several years has been held constitutional, the incidental delays caused by a mediation at any time before a foreclosure sale do not seem substantial. When stays until the end of mediation are automatic, servicers who comply promptly with their obligations under the mediation law will not face any unreasonable delay.

### ***States' Police Power and Mediation—mandating consideration of specific options and requiring documentation***

State legislatures and state courts not only have broad authority to stay foreclosures. They can also compel effective mediation under standards that promote accountability. These standards must require that the parties consider distinct options and document that they have done so. States have a legitimate interest in minimizing the number of home foreclosures. They can set standards to ensure that foreclosure is an option of last resort. Mediation programs can be effective tools for enforcing compliance with these requirements. Unfortunately, most foreclosure mediation programs do not obligate the parties to consider anything.<sup>114</sup> Many set standards that

are so general that they invite servicers to make token "take it or leave it" efforts. Legislation or court rules can require procedures that are much more meaningful and require proof of consideration of specific options.

Most servicers are now obligated by federal law to perform a net present value analysis before they proceed with a foreclosure. It is appropriate for a mediation program to give teeth to this requirement by requiring that a servicer explain why it will not implement an affordable loan modification that protects investors better than a foreclosure. This is particularly true when the servicer has signed a contract with the federal government obligating it to implement the modification. Further, there is no reason why a mediation program cannot mandate this type of analysis for all cases, regardless of whether the servicer is signatory to a HAMP contract.

To be effective, a mediation program must also require that the servicer produce documentation showing the net present value calculation related to the proposed foreclosure. Typically this will require a disclosure of data submitted for the calculation, often a spreadsheet or other data entry record. Recent initiatives in Maine, Nevada, and Michigan have set requirements for some form of disclosure along these lines. However, to date only the Maine program requires complete disclosure of a specific net present value test. The other programs allow servicers to evade disclosure of this analysis with impunity. Servicing guidelines for various government insured and direct loan programs also set preconditions to foreclosure. To the extent that servicers and mortgage holders must comply with obligations under any government program, including compliance with FHA, RHS, and VA rules, mediation programs can require that servicers document compliance with those duties as well.

There are other documents that can be essential to an effective mediation, and programs must require that servicers produce them. As discussed in section II, *supra*, these documents can

include appraisals, pooling and servicing agreements, and documents necessary to establish that the foreclosing entity has standing to foreclose. Requiring that servicers produce these documents does not impair any contract rights. The requirement comports with the state's interest in minimizing the numbers of foreclosures. It is thus well within the state's constitutional authority to establish requirements to consider options and produce documents.

### **States' Police Power and Mediation—mediation's role in enforcing bars on foreclosure**

Mediation rules can set clear, mandatory standards that a servicer must comply with as a condition to the exercise of a right to foreclose. Mediations can play a critical role in enforcing the federal program guidelines that preclude foreclosures by non-complying servicers. In addition, mediation programs can set the stage for the application of courts' inherent equitable powers to limit foreclosures that are unfair and unreasonable. Analytical tools such as net present value tests can be produced through mediation. These will highlight the cases in which courts need to exercise their equitable powers to bar a foreclosure. The following sections will consider in more detail the impact foreclosure mediations can have in preventing foreclosures that violate equitable standards, both in relation to government programs and as a matter of traditional state law.

#### **1. Barring foreclosure upon non-compliance with rules of government programs—the role for mediation**

Federal agencies insure or originate home loans through a number of programs. These include programs under the Federal Housing Agency ("FHA"), the Rural Housing Service ("RHS"—a subdivision of the U.S.D.A.), and the Veterans Administration ("VA"). In these programs the federal agencies may hold the loans themselves,

as in the case of many RHS loans, or they may supervise the activities of private mortgage holders who own the insured loans. Federal agencies such as FHA promulgate regulations that direct activities of the insured private mortgage holders and their servicers. The regulations often require servicers to engage in specific loss mitigation activities before they foreclose on a government insured mortgage. For example, under the FHA program servicers must provide written notices to homeowners of certain options for avoiding foreclosure. Under the RHS program the mortgage holder may not foreclose without offering the homeowner the opportunity to apply for a moratorium, which is a temporary suspension of the obligation to make payments.

Over the past 35 years there have been many court rulings on the question of whether courts may bar foreclosures when a government agency or private mortgage holder owning one of these government related loans seeks to foreclose without complying with the federal agency's loss mitigation rules. Most courts have barred foreclosures when mortgage holders have not complied with these servicing regulations.<sup>115</sup>

In the recent decision in *Wells Fargo Home Loan Mortgage v. Neal*, the Maryland Supreme Court affirmed the continuing validity of this analysis.<sup>116</sup> The homeowner in *Neal* contended that his servicer had not performed certain loss mitigation actions before accelerating his loan. These actions included setting up a face-to-face meeting between the borrower and lender before accelerating the loan. The court agreed with the homeowner that, under the doctrine of clean hands, the servicer could not declare a default or accelerate the loan until it "complies with the statutory and regulatory imperative to pursue loss mitigation prior to foreclosure."<sup>117</sup>

As in many similar decisions involving allegations of servicers not following FHA loss mitigation rules, the *Neal* court applied general principles of equity to bar the foreclosure. In upholding an injunction to stay the non-judicial sale, the *Neal* court stated:

*A mortgagor seeking to raise a violation of the HUD loss mitigation regulations as a defense to foreclosure . . . is not required to pay his or her debt in full in order to be granted an injunction. This is because, under the principles of equity, a mortgagee's commencement of a foreclosure proceeding on an FHA-insured mortgage, without first having adhered to the mandatory HUD loss mitigation regulations, may invalidate the mortgagee's declaration of default.*<sup>118</sup>

The HAMP program guidelines announced by the Treasury Department in March 2009 placed significant obligations upon servicers. These obligations are at least as pervasive as those that apply to servicers of FHA insured and similar government-related loans.<sup>119</sup> A servicer who has signed a HAMP participation agreement must comply with program guidelines and review homeowners' circumstances to see if they qualify for affordable loan modifications. Participating servicers must evaluate borrowers who are more than 60 days in default for an affordable loan modification.<sup>120</sup> They must use an approved net present value test. Servicers must also screen borrowers who are current or less than 60 days delinquent if they inquire about a modification and appear to be at risk for imminent default. While evaluating a homeowner for a HAMP modification, the servicer must refrain from proceeding to a foreclosure sale.<sup>121</sup> A sale must not take place during the three-month trial payment period under the program.

Foreclosure mediation programs clearly could assist in implementing the HAMP program effectively. To do this, the programs must set certain requirements. For example, servicers must be required to disclose their roles as participants in HAMP. Meaningful sanctions must be imposed on servicers who misrepresent their status under the servicer contracts. The mediation rules must mandate that participating servicers produce the net present value calculation required under the HAMP guidelines. The mediator must refuse to conclude the mediation for servicers who are participating in HAMP but cannot document the required affordable loan modification calculation

and net present value analysis. Either directly through its scheduling powers or by referral to a court, a mediator must have oversight powers that can lead to a bar on foreclosing against a homeowner who is eligible for a HAMP modification or whose eligibility is under review.

## **2. Barring foreclosure on general equitable grounds—loans outside the government housing programs**

As discussed above, courts have frequently barred foreclosures when lenders did not comply with loss mitigation rules established by government housing programs. For loans that are not directly subject to any governmental loss mitigation rules, mediation can still play an important role in deterring unfair foreclosures. There is a long tradition of courts exercising a supervisory role over foreclosures of property interests. When they deemed it appropriate, courts have denied the harsh remedy of forfeiture in order to prevent unfairness and overreaching by lenders.<sup>122</sup> The U.S. Supreme Court's decisions upholding state laws that limited foreclosing lenders' remedies emphasized repeatedly that the state legislatures did nothing more than formalize a centuries-old practice of review of the fairness of foreclosures by state courts.<sup>123</sup>

The tools for calculating the relative values of foreclosures and loan modifications are new mechanisms that add some precision to a review of the fairness of foreclosures. When servicers pursue foreclosures that are not in the best interests of investors based on the net present value analysis, courts should step in to prevent the foreclosures. This may raise a potential constitutional question: Does a servicer's pursuit of a demonstrably unwise and destructive financial option implicate a contract right protected under the Contracts Clause? This question moves into uncharted territory of constitutional law.

Prior Supreme Court decisions upholding state laws that limited mortgage holders' deficiency claims suggest that actions by state courts and legislatures to bar blatantly unfair foreclosures

may not conflict with the Contracts Clause.<sup>124</sup> Many state statutes limit or prohibit deficiency claims after a foreclosure sale. These statutes effectively limited lenders' recovery to the value of the security property. However, according to several decisions of the Supreme Court, state statutes that limited lenders' deficiency claims did not impair any significant constitutionally protected property interests of lenders. Rather the statutes merely placed reasonable limits on the recovery of speculative monetary gains.<sup>125</sup>

In enacting anti-deficiency statutes the states balanced the borrowers' interest in being free from burdensome debt repayment obligations against the claims of lenders to a full monetary recovery under their notes and mortgages. In the Supreme Court's view, the state law's imposition on lenders was a reasonable exercise of the police power during an economic crisis. Whether implemented by courts using their inherent equitable powers or by state legislatures, limits on wealth destroying foreclosures should be seen as a proper exercise of states' police power during the current foreclosure crisis.

It may also be argued that barring foreclosures when an affordable loan modification is a better option for investors implicates the Takings Clause of the Fourteenth amendment.<sup>126</sup> The Takings Clause jurisprudence recognizes two types of "taking" by governmental action. One form of taking occurs when the government physically takes over property. The other involves a "regulatory" taking.<sup>127</sup> Control over foreclosures potentially implicates a regulatory taking of property rights.

In assessing the propriety of a regulatory impairment under the Takings Clause, the courts look at two factors: (1) the degree to which the governmental action interferes with distinct "in-

vestment backed expectations" of the owner, and (2) the character of the government action, including the purpose served.<sup>128</sup> Like the rule applied for the Contracts Clause, the Takings Clause analysis relies upon a standard of reasonableness: is the goal of the state regulation reasonable and are the regulatory burdens imposed to meet that goal reasonable?

State action barring lenders from foreclosing when the results of a net present value test show that the monetary harm to investors from foreclosure will exceed the cost of an affordable loan modification should not violate the Takings Clause. Many of the modification programs, such as those used under the HAMP program and by the FDIC, do not force lenders to write off any secured debt. At most, under these programs a part of the secured debt will be set aside and secured by a separate non-interest bearing lien. Under a Takings Clause analysis, preserving the lender's lien and allowing foreclosure upon a future default in payments should be adequate safeguards to protect the secured lender's property interest.<sup>129</sup>

By way of analogy, in decisions dating back to the World War I era, courts have rejected challenges to rent control laws brought under the Takings Clause.<sup>130</sup> Rent control laws impose substantial restrictions on property owners' rights. For example, the laws may bar owners from terminating leases, recovering possession of their properties, and collecting the full market rent they would otherwise obtain. Nevertheless, in most cases the courts have rejected Takings Clause challenges to rent control laws and similar types of property regulation so long as the laws included reasonable protections to determine the fair return on investment.<sup>131</sup>



## Notes

<sup>1</sup> See e.g. 42 Pa. C.S.A. § 325(e); Florida Rule of Judicial Admin. No. 2215(b)(2). The Florida Supreme Court commissioned a task force to evaluate restructuring its decentralized system of circuit court foreclosure mediation programs. The Florida Supreme Court Task Force's *Final Report and Recommendations on Residential Mortgage Foreclosure Cases* (August 17, 2009), recommends moving toward a more uniform statewide system.

<sup>2</sup> e.g., Cheyenne Hopkins, *Modification: Tentative Steps Toward a Regulatory Consensus*, American Banker (Nov. 27, 2007); *The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got Here*, Report and Recommendations by the Majority Staff of the Joint Economic Committee (October 2007); Remarks of FDIC Chairman Sheila C. Bair, American Securitization Forum (ASF) Annual Meeting (June 6, 2007). Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages (Sept. 2007), available at <http://www.occ.treas.gov/ftp/bulletin/2007-38a.pdf>; Associated Press, Paulson to Mortgage Industry: Help Curb Defaults (Oct. 31, 2007), available at [http://money.cnn.com/2007/10/31/real\\_estate/paulson\\_housing.ap/](http://money.cnn.com/2007/10/31/real_estate/paulson_housing.ap/); American Securitization Forum, *Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans*, Executive Summary (Dec. 6, 2007), available at <http://www.treas.gov/press/releases/hp706.htm>.

<sup>3</sup> Alan M. White, *Deleveraging the American Homeowner: The Failure of 2008 Voluntary Mortgage Contract Modification*, 41 Connecticut Law Rev. 1107 (2009). Electronic copy available at: <http://ssrn.com/abstract=1325534> at 14 *Id.*

<sup>4</sup> Alan M. White, June 25, 2009 Columbia Collateral File Summary, Valparaiso University Law School, available along with other monthly updates at <http://www.valpo.edu/law/faculty/awhite/data/index.php> . *Id.*

<sup>5</sup> *Statewide Mortgage Foreclosure Mediation Program Launched* Press Release Office of the Attorney General of New Jersey, Jan. 6, 2009 <http://www.nj.gov/oag/newsreleases09/pr20090109a.html>

<sup>6</sup> From January 2009 through June 2009 the program completed 854 mediations. See p. 23, *supra*.

<sup>7</sup> Las Vegas Review-Journal May 6, 2009 *Mortgage Mediation: Bill Shifts to Senate* <http://www.lvrj.com/news/44445017.html>

<sup>8</sup> Office of the Comptroller of the Currency and Office of Thrift Supervision, *OCC and OTS Mortgage Metrics Report Fourth Quarter 2008* (April 2009) p. 7.

<sup>9</sup> *Id.* at p. 8.

<sup>10</sup> Office of the Comptroller of the Currency and Office of Thrift Supervision, *OCC and OTS Mortgage Metrics Report First Quarter 2009* (June 2009) p. 25 (54.10% of modifications during first quarter 2009 reduced payments; less than 2% of modifications wrote off any principal); Alan M. White, July 27, 2009 Columbia Collateral File Summary Statistics, Valparaiso U. School of Law (data covering period June 25, 2009 to July 27, 2009) <http://www.valpo.edu/law/faculty/>

*awhite/data/jul\_09\_summary.pdf* (65% of loan modifications reduced payments, frequency of principal write-offs declined from previous survey periods).

<sup>11</sup> HOPE NOW press releases claimed servicers made 2,911,609 “workouts” between July 2007 and November 2008. Congressional Oversight Panel, *Foreclosure Crisis: Working Toward a Solution: March Oversight Report*, March 6, 2009, pp. 38 (available at <http://cop.senate.gov/documents/cop-030609-report.pdf>). The majority of these “workouts” were repayment agreements that increased homeowners’ monthly payments. *Id.* No hard data was ever provided on the loan modifications under the program, and other data have shown that most of the modifications during this period increased payments for borrowers, which led to substantial redefaults.

“Congressional Oversight Panel, *Foreclosure Crisis: Working Toward a Solution: March Oversight Report*, March 6, 2009, pp. 43 (available at <http://cop.senate.gov/documents/cop-030609-report.pdf>).

<sup>12</sup> *Id.*

<sup>13</sup> See generally Stephen Labaton, *Ailing, Banks Still Field Strong Lobby at Capitol*, New York Times, June 4, 2009.

<sup>14</sup> U. S. Department of Treasury, *Making Home Affordable Fact Sheet*, March 4, 2009 (available at [http://www.treas.gov/press/releases/reports/housing\\_fact\\_sheet.pdf](http://www.treas.gov/press/releases/reports/housing_fact_sheet.pdf)); see generally Report to Congressional Committees, *Troubled Asset Relief Program: Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable*, U.S. Government Accountability Office No. GAO-09-837 (July 2009).

<sup>15</sup> U. S. Department of Treasury, *Making Home Affordable Fact Sheet*, March 4, 2009 (available at [http://www.treas.gov/press/releases/reports/housing\\_fact\\_sheet.pdf](http://www.treas.gov/press/releases/reports/housing_fact_sheet.pdf)); Report to Congressional Committees, *Troubled Asset Relief Program: Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable*, U.S. Government Accountability Office No. GAO-09-837, July 2009 p. 9.

<sup>16</sup> See HAMP refinance program description: [http://www.makinghomeaffordable.gov/refinance\\_eligibility.html](http://www.makinghomeaffordable.gov/refinance_eligibility.html).

<sup>17</sup> HAMP program guidelines and directives, Servicer Participation Agreement, and FAQ available at [https://www.hmpadmin.com/portal/programs/hamp\\_servicer.html](https://www.hmpadmin.com/portal/programs/hamp_servicer.html).

<sup>18</sup> See Home Affordable Modification Program Supplemental Directive 09-01 April 6, 2009. p. 14 <https://www.hmpadmin.com/portal/docs/sd0901.pdf>

<sup>19</sup> HAMP Servicer Performance Report Through July 2009 (August 4, 2009) at <http://www.financialstability.gov/latest/tg252.html>; Testimony of Herbert M. Allison, Assistant Secretary for Financial Stability before the U.S. Senate Committee on Banking, Housing and Urban Affairs, July 16, 2009.

<sup>20</sup> Fannie Mae guidelines at <https://www.efanniemae.com/sf/mha/mhamod/> ; Freddie Mac guidelines at [http://www.freddiemac.com/singlefamily/service/mha\\_modification.html](http://www.freddiemac.com/singlefamily/service/mha_modification.html); FHA/HUD guidelines at [www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09.23ml.doc](http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09.23ml.doc).

<sup>21</sup> See HAMP NPV Model Overview at [https://www.hmpadmin.com/portal/docs/hamp\\_servicer/npvoverview.pdf](https://www.hmpadmin.com/portal/docs/hamp_servicer/npvoverview.pdf); HAMP Reviewing and Interpreting NPV Test results at <https://>

[www.hmpadmin.com/portal/support/training.htm](http://www.hmpadmin.com/portal/support/training.htm)

<sup>25</sup> American Securitization Forum, Statement of Principles, Recommendations, and Guidelines For the Modification of Securitized Subprime Residential Mortgages June 2007. p. 6 (“In evaluating whether a proposed loan modification will maximize recoveries to the investors, the servicer should compare the anticipated recovery under the loan modification to the anticipated recovery through foreclosure on a net present value basis. Whichever action is determined by the servicer to maximize recovery should be deemed to be in the best interests of the investors.”)

<sup>26</sup> FDIC Loan Modification in Box overview and guidelines at <http://www.fdic.gov/consumers/loans/loanmod/loanmodguide.html>

<sup>27</sup> <https://www.hmpadmin.com/portal/docs/npvoverview.pdf>

<sup>28</sup> In a major concession to servicers, the HAMP program does not require reduction of principal or a write-down of any part of the debt. The program may require forbearance of a portion of the amortizing principal—allowing lenders to retain a non interest bearing lien for any forbore principal. This forbearance creates a future balloon payment due at the end of the loan term or upon sale or refinancing.

<sup>29</sup> HAMP Supplemental Directive 09-0 1, *supra* at p.4.

<sup>30</sup> HAMP Supplemental Directive 09-0 1, *supra* p. 5–6.

<sup>31</sup> HAMP Supplemental Directive 09-01, *supra*. p. 14 <https://www.hmpadmin.com/portal/docs/sd0901.pdf>

<sup>32</sup> *Id.* at p. 2–3.

<sup>33</sup> *Id.* at p. 4.

<sup>34</sup> Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, 123 Stat. 1632 (2009). The Act provides: Notwithstanding any other provision of law, whenever a servicer of residential mortgages agrees to enter into a qualified loss mitigation plan with respect to one or more residential mortgages originated before the date of enactment of [the Act], including mortgages held in a securitization or other investment vehicle—

(1) to the extent that the servicer owes a duty to investors or other parties to maximize the net present value of such mortgages, the duty shall be construed to apply to all such investors and parties, and not to any particular party or group of parties; and

(2) the servicer shall be deemed to have satisfied the duty set forth in paragraph (1) if, before December 31, 2012, the servicer implements a qualified loss mitigation plan that meets the following criteria:

(A) Default on the payment of such mortgage has occurred, is imminent, or is reasonably foreseeable, as such terms are defined by guidelines issued by the Secretary of the Treasury or his designee under the Emergency Economic Stabilization Act of 2008.

(B) The mortgagor occupies the property securing the mortgage as his or her principal residence.

(C) The servicer reasonably determined, consistent with the guidelines issued by the secretary of the Treasury or his designee, that the application of such qualified loss mitigation plan to a mortgage or class of mortgages will likely provide an anticipated recovery on

the outstanding principal mortgage debt that will exceed the anticipated recovery through foreclosures.

(b) NO LIABILITY—A servicer that is deemed to be acting in the best interest of all investors or other parties under this section shall not be liable to any party who is owed a duty under subsection (a)(1), and shall not be subject to any injunction, stay, or other equitable relief to such party, based solely upon the implementation by the servicer of a qualified loss mitigation plan.

(c) STANDARD INDUSTRY PRACTICE.—The qualified loss mitigation plan guidelines issued by the Secretary of the Treasury under the Emergency Economic Stabilization Act of 2008 shall constitute standard industry practice for purposes of all Federal and State law.

(d) SCOPE OF SAFE HARBOR—Any person, including a trustee, issuer, and loan originator, shall not be liable for monetary damages or be subject to an injunction, stay, or other equitable relief, based solely upon the cooperation of such person with a servicer when such cooperation is necessary for the servicer to implement a qualified loss mitigation plan that meets the requirements of subsection (a).

<sup>35</sup> Troubled Asset Relief Program: Treasury Action Needed to Make the Home Affordable Modification Program More Transparent and Accountable, U.S. Government Accountability Office Report to Congressional Committees GAO-09837 July 2009.

<sup>36</sup> Making Home Affordable Program Report August 4, 2009 [http://www.treas.gov/press/releases/docs/MHA\\_public\\_report.pdf](http://www.treas.gov/press/releases/docs/MHA_public_report.pdf). See also Andrea Fuller, *U.S. Effort Aids Only 9% of Eligible Homeowners*, New York Times August 4, 2009;

<sup>37</sup> See generally Testimony of Diane E. Thompson, National Consumer Law Center, U.S. Senate Committee on Banking, Housing, & Urban Affairs July 16, 2009.

<sup>38</sup> *Id.*

<sup>39</sup> See generally Congressional Oversight Panel, March 6, 2009 Report *supra*, pp. 44-55.

<sup>40</sup> See e.g. cases recognizing affirmative defense to foreclosure in lender’s failure to comply with FHA loss mitigation guidelines: *Ghervescu v. Wells Fargo Home Mortgage*, 2008 WL 660248 (Cal. Ct. App. Mar. 13, 2008); *Wells Fargo Home Loan Mortgage v. Neal*, 922 A.2d 538 (Md. 2007); *Fleet Real Estate Funding Corp. v. Smith*, 530 A.2d 919 (Pa. Super. 1987); *FNMA v. Moore*, 609 F. Supp. 194 (D.C. Ill. 1985); *Associated East Mortgage Co. v. Young*, 394 A.2d 899 (Nj. Super. 1978); *FNMA v. Ricks*, 372 N.Y.S. 2d 485 (1975).

<sup>41</sup> Senate Bill 628 Engrossed Version—A, § 6.

<sup>42</sup> Ryan Frank, *Foreclosure Relief Bill Stalls in Oregon Senate*, The Oregonian, June 18, 2009 (<http://www.oregonlive.com/business/oregonian/index.ssf?/base/business/1245297321249740.xml&coll=7>); *Oregon Legislation: Mandatory Mediation Compromise to Emerge*, United Trustee Association eNews June 5, 2009 (<http://www.unitedtrustees.com/enews/461.php>).

<sup>43</sup> Oregon Enrolled Senate Bill 628.

<sup>44</sup> Enrolled bills 4453, 4454, 4455 as signed by Governor

May 20, 2009, effective July 5, 2009.

<sup>45</sup> Nevada Assembly Bill No. 149, effective July 1, 2009.

<sup>46</sup> Nevada Supreme Court Rule 7(3), effective July 1, 2009.

<sup>47</sup> LD 1418 §§ 3, 13, amending 14 Maine Rev. Stat. Ann. §



6231-A).

<sup>48</sup> The FDIC loan modification model is similar, but not identical to the standard HAMP spreadsheet calculation. See <http://www.fdic.gov/consumers/loans/loanmod/loanmod-guide.html>.

<sup>49</sup> LD 1418 §§ 3, 13, amending 14 Maine Rev. Stat. Ann. § 6231-A

<sup>50</sup>*Id.* at § 7.

<sup>51</sup> Home Affordable Modification Program Supplemental Directive 09-01 April 6, 2009. p. 14 <https://www.hmpadmin.com/portal/docs/sd0901.pdf>

<sup>52</sup> Congressional Oversight Panel, *Foreclosure Crisis: Working Toward a Solution: March Oversight Report*, March 6, 2009, pp. 49–52. (available at <http://cop.senate.gov/documents/cop-030609-report.pdf>).

<sup>53</sup> Information on the FDIC loan modification “loan mod in a box” spreadsheet can be found at <http://www.fdic.gov/consumers/loans/loanmod/loanmodguide.html>.

<sup>54</sup> 14 Me. Rev. Stat. § 6321-A.

<sup>55</sup> The Michigan and California conference statutes set out some very broad standards for loan modification guidelines that are deemed acceptable. However, homeowners do not receive the actual net present value calculation for their loan. The standards themselves allow servicers considerable discretion in considering a modification.

<sup>56</sup>*See*, Note 122, *infra*.

<sup>57</sup> *See* Nick. v. Morgan’s Foods, Inc., 99 F. Supp. 2d 1056 (E.D. Mo. 2000), *affirmed* 270 F.3d 590 (8th Cir. 2000) (sanctions imposed for bad faith participation in ADR session); 43 A.L.R. 5th 545 (1996).

<sup>58</sup> Under the administrative orders for the First, Eleventh, and Nineteenth circuits the court may impose sanctions if the lender breaches a settlement agreement.

<sup>59</sup> Maine LD 1418, amending Maine Rev. Stat. § 6231-A.

<sup>60</sup>*See*, Note 122, *infra*.

<sup>61</sup> Nevada Assembly Bill No. 149, effective July 1, 2009.

<sup>62</sup>*See e.g.*, *Landmark National Bank v. Kesler*, (— P.3d —, 2009 WL 2633640 (Kan. Aug. 28, 2009) (MERS cannot make itself a necessary party to a foreclosure action by labeling itself a “mortgagee” in boilerplate language). *See also* *Mortgage Electronic Registration System, Inc. v. Southwest Homes of Arkansas*, — S.W.3d —, 2009 WL 723182 ( Ark., March 19, 2009) *In re* *Jacobson*, — B.R. —, 2009 WL 567188 \* 5 (Bankr. W.D. Wash. Mar. 10, 2009) *Wells Fargo Bank, N.A. v. Jordan*, 2009 WL 625560 (Ohio App. Mar. 12, 2009) *In re* *Kang Jin Hwang*, 396 B.R. 757, 770-7 1 ( Bankr. C.D. Cal. 2008) *In re* *Vargas*, 396 B.R. 511, 5 16-17 (Bankr. C.D. Cal. 2008) *HSBC Bank USA, NA v. Yeasmin*, 19 Misc.3d 1127(A), 866 N.Y.S. 2d 92 (Table) (N.Y. Sup. 2008) *In re* *Nosek*, 386 B.R. 374 (Bankr. D. Mass. 2008) (imposing sanctions of \$250,000 on creditor for misrepresenting status of holder of note during protracted litigation) *In re* *Foreclosure Cases*, 521 F. Supp. 2d 650 (S.D. Ohio 2007); *In re* *Parsley*, 384 B.R. 138 (Bankr. S.D. Tex. 2008); *In re* *Maisel*, 378 B.R. 19 (Bankr. D. Mass. 2007); *Everhome Mortgage Co. v. Rowland*, 2008 WL 747698 (Ohio Ct. App. Mar. 20, 2008); *DJL Mortgage Capital, Inc. v. Parsons*, 2008 WL 697400 (Ohio Ct. App. Mar. 13, 2008).

<sup>63</sup>*See e.g.* F.R. Civ. P. Nos. 17, 19.

<sup>64</sup> Nevada Assembly Bill No. 149, effective July 1, 2009.

<sup>65</sup> Nevada Supreme Court Rule 7(3).

<sup>66</sup> Alternative Dispute Resolution Rules New Mexico First Judicial District, <http://firstdistrictcourt.com/Forms/doc/Plaintiff's%20info%20response.doc>

<sup>67</sup> Summit County Ohio Court of Common Pleas Rules: <http://www.summitcpcourt.net/>

<sup>68</sup> Seminole County Procedure for Mortgage Foreclosure Hearings at [http://www.flcourts18.org/PDF/Foreclosures/Simmons\\_Foreclosure\\_Procedure.pdf](http://www.flcourts18.org/PDF/Foreclosures/Simmons_Foreclosure_Procedure.pdf).

<sup>69</sup>N.Y. RPAPL § 1302

<sup>70</sup> 14 Maine Rev. Stat. § 6321 [check]

<sup>71</sup>Mich. Comp. Laws Ann. § 600.3204.

<sup>72</sup> Home Affordable Modification Program, Supplemental Directive 09-0 1 April 6, 2009 p. 18.

<sup>73</sup> *See e.g.* Staff of Joint Economics Committee, 110th Cong., 1st Sess., *The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got There* (2007) [http://jec.senate.gov/index.cfm?FuseAction=Reports.Reports&ContentRecord\\_id=c6627bb27e9c-9af9-7ac7-32b94d398d27&Region\\_id=&Issue\\_id=](http://jec.senate.gov/index.cfm?FuseAction=Reports.Reports&ContentRecord_id=c6627bb27e9c-9af9-7ac7-32b94d398d27&Region_id=&Issue_id=), *infra*. (projecting foreclosed home owners will lose \$71 billion due to foreclosure crisis, neighbors will lose \$32 billion, and state and local governments will lose \$917 million in property tax revenue).

<sup>74</sup>*See* Appendix on Constitutional Issues, *supra*.

<sup>75</sup>Franklin, Lucas, and Summit counties.

<sup>76</sup> First, Eleventh, and Nineteenth judicial circuits.

<sup>77</sup>Allegheny, Bucks, Northampton and Philadelphia counties.

<sup>78</sup>N.Y. C.P.L.R. Rule 3408.

<sup>79</sup> Congressional Oversight Panel, *The Foreclosure Crisis: Working Toward a Solution* (March Oversight Report) March 6, 2009 at p. 15.

<sup>80</sup> *Id.* at p. 18.

<sup>81</sup> OCC and OTS Mortgage Metrics Report, Disclosure of National Bank and Federal Thrift Mortgage Loan Data, April 2009.

<sup>82</sup> Home Affordable Modification Program (HAMP) Servicer Reporting Requirements at [https://www.hmpadmin.com/portal/docs/hamp\\_servicer/hampreportingrequirements.pdf](https://www.hmpadmin.com/portal/docs/hamp_servicer/hampreportingrequirements.pdf)

<sup>83</sup> State of Connecticut Judicial Branch Data Report July 1, 2008 though April 30, 2009..

<sup>84</sup>*Id.*

<sup>85</sup> First Judicial District of Pennsylvania Press Release June 30, 2009 (“First Judicial District Marks One-Year Anniversary of Residential Mortgage Foreclosure Diversion Program as Approximately 1400 Philadelphia Homes Averted From Sheriff Sale”).

<sup>86</sup> David Rothstein and Sapna Mehta, *Foreclosure Growth in Ohio 2009* Policy Matters Ohio, March 2009 p. 2 (available at [www.policymattersohio.org](http://www.policymattersohio.org)).

<sup>87</sup> Data provided by Cuyahoga County Court of Common Pleas June 26, 2009.

<sup>88</sup> Data provided by “Franklin County Foreclosure Mediation Project (FCFMP) Memorandum” dated August 10, 2009.

\* Data provided by New York Office of Court Administration July 13, 2009.

\* The New York data records strictly settlements reached at conferences. It excludes settlements reached before and after the settlement conferences even though the case was technically involved in a conference proceeding at the time of settlement. The data was provided with the further caveat that not all courts within the designated counties were reporting data in consistent or systematic ways.

\* Office of New Jersey Attorney General, New Jersey Foreclosure Mediation Program Data Through June 30, 2009 (provided August 26, 2009).

\* Maine Public law LD 1418 § 7 B.

\* The programs in the First, Eleventh, and Eighteenth judicial circuits in Florida stay proceedings automatically while a foreclosure is referred to mediation. The programs in Bucks, Northampton and Philadelphia counties similarly stay proceedings automatically while mediation is pending. The automatic stays in Allegheny County Pennsylvania incorporate a fixed time of 90 days to conclude mediation. The Ohio county programs generally limit mediation to cases in which the homeowner has filed an answer, appeared, or made some formal request for mediation. Under the Cuyahoga County program the stay is for 60 days, with the court able to extend the time by separate order. The Franklin County, Ohio program extends the time to answer the complaint for 60 days in cases referred to mediation. Requesting mediation under the Lucas and Summit counties program in Ohio extends the time to file an answer, and proceedings for entry of judgment are stayed until mediation has been concluded.

\* Nevada 2009 A.B. 149 § 7.

\* See e.g. *Nick v. Morgan's Foods, Inc.*, 99 F. Supp. 2d 1056 (E.D. Mo. 2000), *affirmed* 270 F.3d 590 (8th Cir. 2000) (sanctions imposed for bad faith participation in ADR session); 43 A.L.R. 5th 545 (1996).

\* Court rules implementing Maine foreclosure diversion statute add a \$200.00 administrative fee to all foreclosure actions filed on or after June 15, 2009. This fee is imposed in addition to the filing fee upon all foreclosure action filings in the state. The revenue generated by the fee will be used to fund the diversion program. [http://www.courts.state.me.us/court\\_info/rules/fees.shtml#6](http://www.courts.state.me.us/court_info/rules/fees.shtml#6) 2009 Nevada Assembly Bill No. 65 added a \$50 new fee for recording a Notice of Default and Election to Sell effective July 1, 2009., to be paid over to account for foreclosure mediation <http://www.nevada.judiciary.us/images/foreclosure/trusteebrochure.pdf>

\* First and Nineteenth judicial circuits.

\* The Eleventh and Eighteenth judicial circuits.

\* See e.g. Ala. Code § 5-19-10; Iowa Code Ann. § 537.2507; S.D. Codified Laws § 15-17-39.

<sup>100</sup> See e.g. *In re Lake*, 245 B.R. 282 (Bankr. N.D. Ohio 2000) (Ohio common law prohibits enforcement of fees shifting provision of notes and mortgages that were not fairly bargained for); *Spencer Savings Bank, SLA v. Shaw*, 401 N.J. Super. 1, 949 A.2d 218 (2008) (New Jersey Fair Foreclosure statute prohibits claims for fees incurred prior to filing of

foreclosure complaint); *In re Hatala*, 295 B.R. 62 (Bankr. D. NJ. 2003) (provisions of New Jersey court rule, not terms of mortgage and note or lender's actual expenditures determine homeowner's liability for fees); *In re Schwartz*, 68 B.R. 376 (Bankr. E.D. Pa. 1986) (terms of Pennsylvania Act No. 6, 41 P.S. § 406 limit pre filing attorney's fees related to mortgage foreclosure to \$50.00)

<sup>101</sup> Home Affordable Modification Program Supplemental Directive 09-01, April 6, 2009 p. 22 (<https://www.hmpadmin.com/portal/docs/sd0901.pdf>)

<sup>102</sup> Congressional Oversight Panel, *Foreclosure Crisis: Working toward a Solution* (March 6, 2009) p. 47.

<sup>103</sup> Making Home Affordable: Introduction of the Second Lien Modification Program (2MP), Supplemental Directive 9-05 (August 13, 2009). [https://www.hmpadmin.com/portal/docs/second\\_lien/sd0905.pdf](https://www.hmpadmin.com/portal/docs/second_lien/sd0905.pdf).

<sup>104</sup> These are the Ninth and Eighteenth judicial circuits.

<sup>105</sup> *Osborne on Mortgages* § 331 (2d ed. 1979). See generally Poteat, *State Legislative Relief for the Mortgage Debtor during the Depression*, 5 Law and Contemporary Problems, 517 (1938); Feller, *Moratory Legislation: A Comparative Study*, 46 Harvard L. Rev. 1061 (1933); G. Glenn, *Mortgages*, Vol. II §§ 150 to 167 (1943); *Powell on Real Property* § 37.49 (1968 ed.).

<sup>106</sup> 290 U.S. 398 (1934).

<sup>107</sup> The "Contracts Clause," Article 1, Section 10 of the United States Constitution provides that "No state shall . . . pass any Law . . . impairing the Obligation of Contracts." The Constitutional Convention added this provision in reaction to a spate of debtor relief laws recently enacted by the states. The founders of the new national government perceived these state laws as a threat to the country's ability to build credit and compete as a growing commercial nation. See generally Samuel L. Olken, *Charles Evans Hughes and the Blaisdell Decision: a Historical Study of Contracts Clause Jurisprudence*, 72 Or. L. Rev. 513, 517-518 (1993).

<sup>108</sup> *Id.* 290 U.S. at 443-44.

<sup>109</sup> *Id.* 290 U.S. at 438.

<sup>110</sup> 459 U.S. 400 (1983).

<sup>111</sup> *Energy Reserves*, *supra* 456 U.S. at 411-412.

<sup>112</sup> *East New York Savings Bank v. Hahn*, 326 U.S. 230 (1945).

<sup>113</sup> *Laue v. Proctorville Credit*, 390 N.W. 2d 823 (1986). See generally Robert M. Lawless, *The American Response to Farm Crises: Procedural Debtor Relief*, 1988 Univ. of Ill. L. Rev. 1037 (1988); Roland C. Amundson and Lewis J. Rotman, *Depression Jurisprudence Revisited: Minnesota's Moratorium on Mortgage Foreclosure*, 10 Wm. Mitchell L. Rev. 805 (1984); Timothy D. Benton, *Iowa's Mortgage Moratorium Statute: A Constitutional Analysis*, 33 Drake L. Rev. 303 (1983-84); Note, 12 Real Estate Law Journal 366 (1984).

<sup>114</sup> See Part I, *supra*.

<sup>115</sup> See Note 40, *supra*. CAL.

<sup>116</sup> 922 A.2d 538 (Md. 2007).

<sup>117</sup> *Id.* 922 A.2d at 553.

<sup>118</sup> *Id.* 922 A.2d at 551

<sup>119</sup> Treasury's guidelines for the HAMP program, including guidelines for its net present value test can be found at <https://www.hmpadmin.com/portal/index.html>.

<sup>120</sup> See Note 29, *supra*.

<sup>121</sup> See Note 29, 30–31, *supra*.

<sup>122</sup> See e.g. Hebert T. Tiffany & Basil Jones 5 *Tiffany Real Property* § 1556 (2008); 55 Am Jur. 2d Mortgages § 676; Milton R. Friedman & James Charles Smith, *Friedman on Contracts & Conveyance of Real Property* § 3:6.5 (2008) 59 C.J.S. Mortgages § 512 (2009); *Northeast Savings v. Hintlian*, 696 A.2d 315 (Conn. 1997); *Sovereign Bank, FSB v. Kuelzow*, 687 A.2d 1039 (N.J. Super. Ct. 1997); *Rosselot v. Heimbrock*, 561 N.E. 2d 555 (Ohio Ap. 1988); *Woods v. Monticello Dev. Co.*, 687 P.2d 1324 (Colo. Ct. App. 1982). See also *Lo v. Jensen*, 88 Cal. App. 4th 1093, 106 Cal. Rptr. 2d 443 (2001) (applying equitable principles in non judicial foreclosure context); *Gilroy v. Ryberg*, 266 Neb. 617, 667 N.W. 2d 544 (2003) (same).

<sup>123</sup> See *Home Building & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 446-47 (1934); *Richmond Mortgage Corporation v. Wachovia Bank*, 300 U.S. 124, 129-130 (1937) *Honeyman v. Jacobs*, 306 U.S. 539, 543-44 (1939); *Gelfert v. National City Bank of New York*, 313 U.S. 221, 231-33 (1941). The *Gelfert* court, which upheld a New York statute barring post foreclosure deficiency claims, summed up this tradition as follows: "We mention these matters here because they indicate that for about two centuries there has been a rather continuous effort through general rule or by appeal to the chancellor in specific cases to prevent the machinery of judicial sales from becoming an instrument of oppression. And so far as mortgage foreclosures are concerned, numerous devices have been employed to safeguard mortgagors from sales which will or may result in mortgagees collecting more than their due." 313 U.S. at 232-33.

<sup>124</sup> *Gelfert v. National City Bank of New York*, 313 U.S. 221, 233-234 (1941); *Honeyman v. Jacobs*, 306 U.S. 124, 543-44 (1937).

<sup>125</sup> *Id.*

<sup>126</sup> [N]or shall private property be taken for public use, without just compensation." U.S. Const. Amdt. 5, made applicable to the states by the Fourteenth Amendment. See e.g. *Kelo v. City of New London*, 546 U.S. 469 (2005) (municipality's action to acquire private property for transfer to private entities as part of planned community redevelopment pro-

gram was for a public use and permissible under takings clause). *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992) (environmental regulation that essentially deprives real property owner of all economically viable use of land can amount to the same as a physical appropriation of the land under takings clause).

<sup>127</sup> See e.g. *Brown v. Legal Foundation of Washington*, 538 U.S. 216, 233 (2003) (noting distinction between analytical standards for regulatory as opposed to physical takings); *Palazzolo v. Rhode Island*, 533 U.S. 606, 617-18 (2001) (same).

<sup>128</sup> *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104, 130-134 (1978); see generally *Palazzolo v. Rhode Island*, *supra*, 533 U.S. at 633-34 (O'Connor concurring).

<sup>129</sup> *Wright v. Vinton Branch of Mountain Trust Bank of Roanoke, Virginia*, 304 U.S. 502 (1938).

<sup>130</sup> *Block v. Hirsh*, 256 U.S. 135 (1921); *Marcus Brown Holding Co. v. Feldman*, 256 U.S. 170 (1921); *Edgar A. Levy Leasing Co. v. Siegel*, 258 U.S. 342 (1922).

<sup>131</sup> *Yee v. City of Escondido*, 503 U.S. 519 (1992); *Pennell v. City of San Jose*, 485 U.S. 1 (1988). See also *Chicago Board of Realtors v. City of Chicago*, 819 F.2d 732 (7th Cir. 1987) (ordinance regulating charges and other obligations imposed on landlords did not violate contracts clause and other constitutional provisions); *Troy Ltd. v. Renna*, 727 F.2d 287 (3d Cir. 1984) (rent control limits on lease termination can be enforced as reasonable standard); *Help Hoboken Housing v. City of Hoboken*, 650 F. Supp. (D.N.J. 1986) (sustaining ordinance which imposed penalties for not renting properties); *Griffin Development Co. v. City of Oxnard*, 39 Cal. 3d 256, 703 P.3d 339 (1985) (sustaining ordinance restricting conversion of rental units to condominiums). *San Marcos Mobilehome Park Owners' Assn. v. City of San Marcos*, 192 Cal App. 3d 1492, 238 Cal. Rptr. 290 (1987) (reasonable rent control procedures for fair return); *Hutton Park gardens v. Town Council of Town of West Orange*, 68 N.J. 543, 350 A.2d 1 (1975) (same); *Hall v. City of Santa Barbara*, 797 F.2d 1493 (9th Cir. 1986) (rent control procedures unreasonable and overly confiscatory); *Ross v. City of Berkeley*, 655 F. Supp. 820 (N.D. Cal. 1987) (same).

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