



## Housing Finance Policy Center Lunchtime Data Talk

# Resolution of Distressed Mortgages: Legal Framework and Lessons Learned

Jochen Andritzky, International Monetary Fund  
Larry Cordell, Federal Reserve Bank of Philadelphia  
Adam Levitin, Georgetown University Law Center  
Laurie Goodman, Urban Institute

June 9, 2015

# **Resolving Residential Mortgage Distress: Time to Modify?**

Jochen Andritzky

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# **Resolving Residential Mortgage Distress: Time to Modify?**

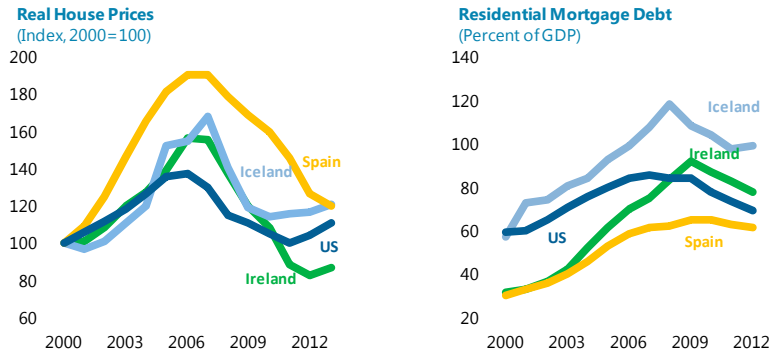
## **Agenda**

Introduction  
Comparing Recent Crises  
Trade-offs and Policies

# Introduction

## Backdrop

## Credit-fuelled housing booms



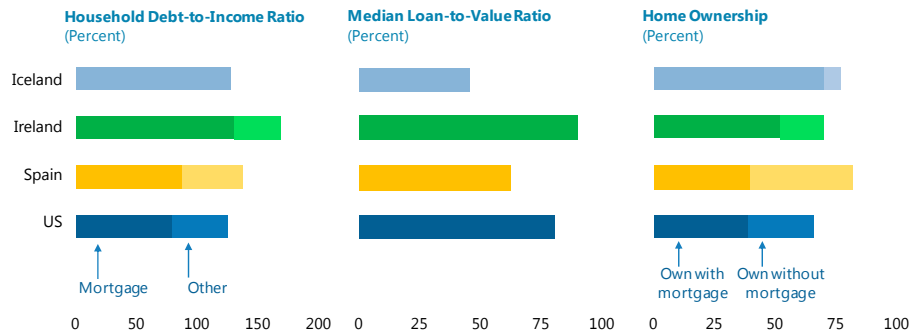
Sources: European Mortgage Federation; IMF WEO database; OECD; National Statistics Offices; US Bureau of Census; and IMF staff calculations.

# Introduction

## Backdrop

## Credit-fuelled housing booms

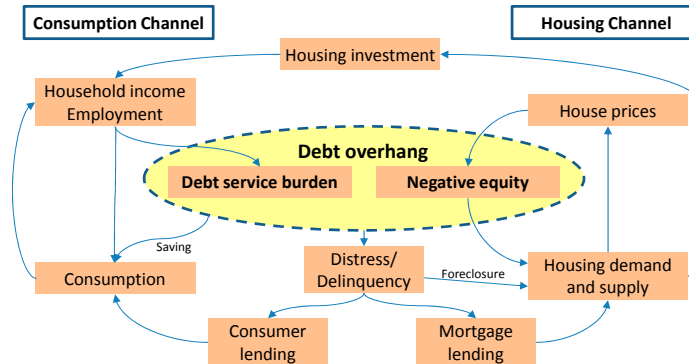
## High burden, low buffer, broad ownership



Sources: Central banks; European Mortgage Federation; IMF WEO database; MBA; and IMF staff calculations. Iceland: 2008Q1; Ireland: 2007Q3; Spain: 2008Q1; US: 2007Q1.

# Introduction

**Backdrop** Credit-fuelled housing booms  
 High burden, low buffer, broad ownership  
 Negative feedback loops



Source: IMF staff.

# Introduction

**Backdrop** Credit-fuelled housing booms  
 High burden, low buffer, broad ownership  
 Negative feedback loops

**Policy challenges** Break negative feedback loops  
 Minimize resolution cost  
 Do no harm

**Findings** No “one-size-fits-all”  
 Crises shift trade-offs

# Agenda

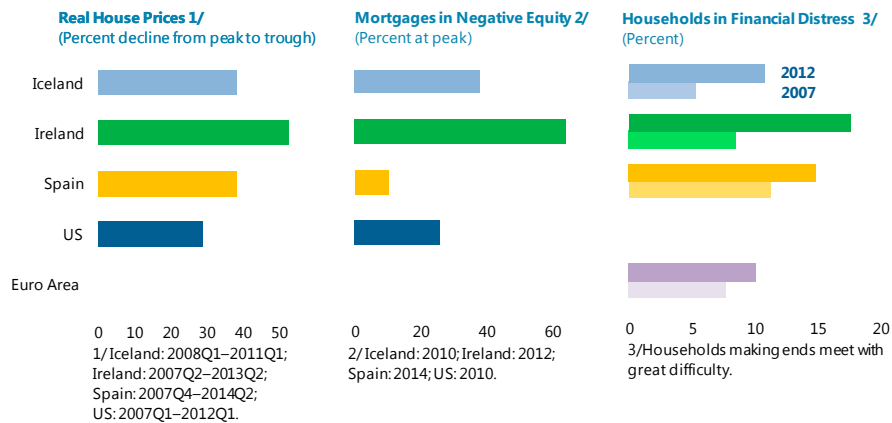
## Introduction

### Comparing Recent Crises

### Trade-offs and Policies

## Comparing Recent Crises

### Trough conditions...



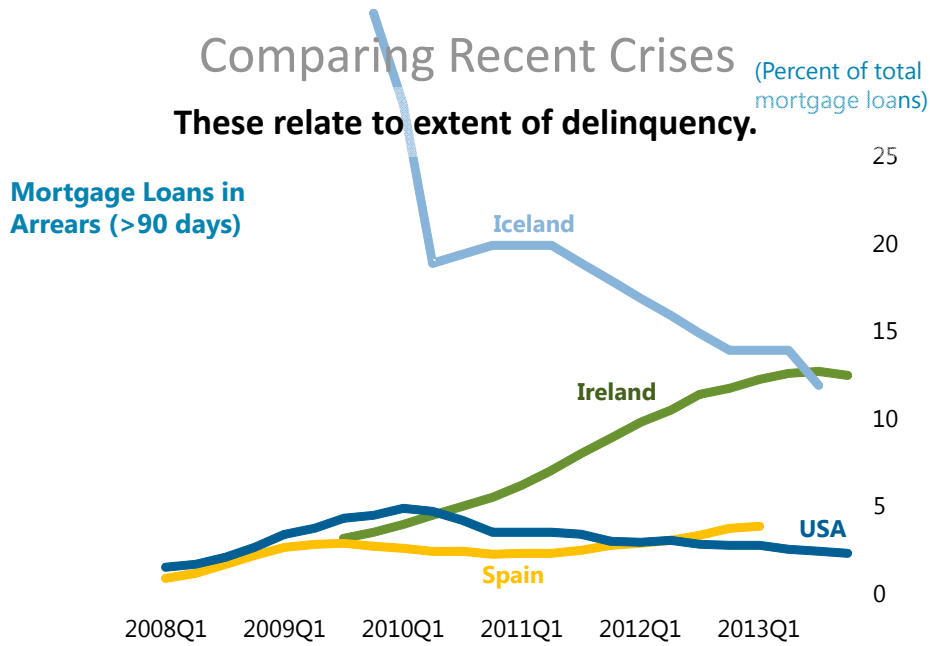
Sources: Central banks; Eurostat SILC; OECD; and IMF staff calculations.

# Comparing Recent Crises

...and crisis responses differed.

Iceland	Ireland	Spain	US
<b>2008</b> <ul style="list-style-type: none"> <li>Foreclosure moratorium</li> <li>FX/indexed loan freezes</li> </ul>	<b>2009</b> <ul style="list-style-type: none"> <li>Code of Conduct for Mortgage Arrears, including foreclosure protections</li> </ul>	<b>2009</b> <ul style="list-style-type: none"> <li>Mortgage assistance scheme</li> </ul>	<b>2007</b> <ul style="list-style-type: none"> <li>FHA Secure Program/HOPE NOW initiatives</li> </ul>
<b>2009</b> <ul style="list-style-type: none"> <li>Payment smoothing extended</li> <li>Debt restructuring framework introduced</li> </ul>	<b>2011</b> <ul style="list-style-type: none"> <li>Court ruling impedes repossession</li> </ul>	<b>2012</b> <ul style="list-style-type: none"> <li>Code of Good Practice</li> <li>"Dación en pago"</li> <li>Eviction protections</li> </ul>	<b>2008</b> <ul style="list-style-type: none"> <li>Hope for Homeowners program</li> </ul>
<b>2010</b> <ul style="list-style-type: none"> <li>Supreme Court ruling on indexation</li> <li>110 percent LTV write-down option</li> </ul>	<b>2012</b> <ul style="list-style-type: none"> <li>Personal Insolvency Reform Act passed</li> </ul>	<b>2013</b> <ul style="list-style-type: none"> <li>Mortgagors Protection Law including partial discharge</li> </ul>	<b>2009</b> <ul style="list-style-type: none"> <li>Homeowners Affordability and Stability Plan including HAMP and HARP</li> </ul>
<b>2014</b> <ul style="list-style-type: none"> <li>Household debt relief program</li> </ul>	<b>2013</b> <ul style="list-style-type: none"> <li>Mortgage Arrears Resolution Targets (MART) introduced</li> <li>Provisioning guidelines updated</li> <li>Barriers to repossession removed</li> </ul>		<b>2010</b> <ul style="list-style-type: none"> <li>Principal Reduction Alternatives</li> </ul>
			<b>2012</b> <ul style="list-style-type: none"> <li>HAMP extended, including to GSE</li> </ul>

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## Comparing Recent Crises

### **Forbearance helped mitigate distress in all countries.**

<b>Iceland</b>	Temporary freeze of debt service levels Benefiting 10 percent of households
<b>Ireland</b>	Implicit: arrears of 0.6 percent of GDP Explicit: temporary restructurings
<b>Spain</b>	10 percent of loans rescheduled/restructured
<b>US</b>	Payment plans for 13 percent of loans

## Comparing Recent Crises

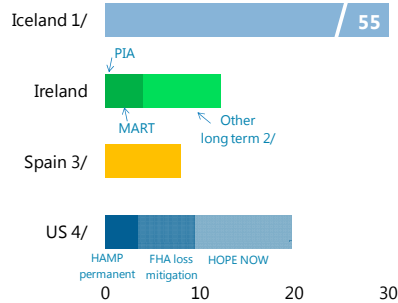
### **Policies to facilitate loan modification differed...**

<b>Iceland</b>	Take-up of new restructuring schemes slow Across-the-board debt relief initiatives
<b>Ireland</b>	Comprehensive insolvency reforms Supervisory engagement and targets
<b>Spain</b>	Moral hazard concerns Code of Good Practices
<b>US</b>	Industry initiatives (e.g., HOPE NOW) Home Affordable Mortgage Program

# Comparing Recent Crises

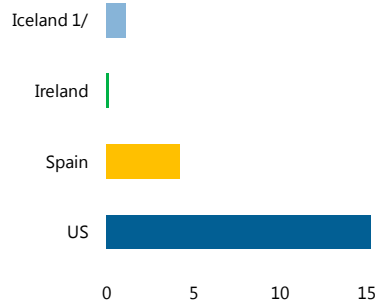
**...yet take up of modification initiatives remained low.**

## Loan Modifications (Percent of loans)



Sources: Central banks; ISI; US Treasury; and IMF staff calculations.  
1/ Household loans which perform after restructuring.  
2/ Selection of restructurings classified as long term.  
3/ Mortgage loans reported refinanced or restructured.  
4/ Cumulative since April 2009. Categories may overlap.

## Foreclosures (Percent of loans, cumulative since crisis)



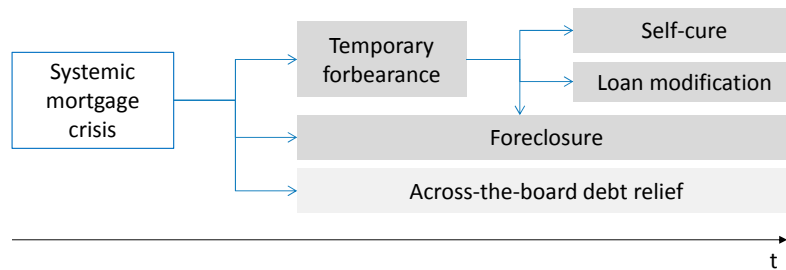
Sources: Central banks; CoreLogic; Fuentes *et al.* (2013); and IMF staff calculations.  
1/ Until end 2012.

## Agenda

- Introduction
- Comparing Recent Crises
- Trade-offs and Policies

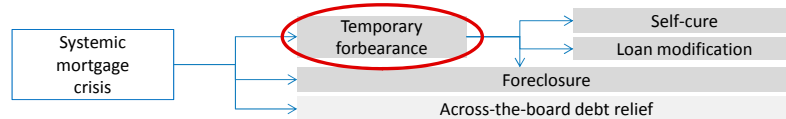
## How to address mortgage distress?

### Roadmap:



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## Providing time for loan resolution?



### Delaying mortgage workout can improve outcomes

- Recovery from undershooting of incomes and house prices
- Economic stabilization facilitates the triage of cases
- Time required for reforms and building of workout capacities

### Temporary forbearance can cushion the downturn

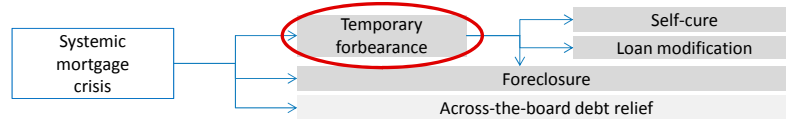
- Distressed households can adjust consumption more gradually

### Forbearance is costly

- “Free rent” can invite borrowers to “strategic default”
  - Viable foreclosure threat
- Arrears accumulation can undermine banks’ capacity to lend
  - Provision appropriately (ESRB, 2012)

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## Should policies facilitate temporary forbearance?



### Blanket foreclosure moratoria have severe drawbacks

- Circuit breaker, simple, popular
- But higher overall workout cost (Zhu and Pace, 2011; López-Vicente, 2013)
- Maybe difficult to remove

### Lenders may already prefer to “wait and see”

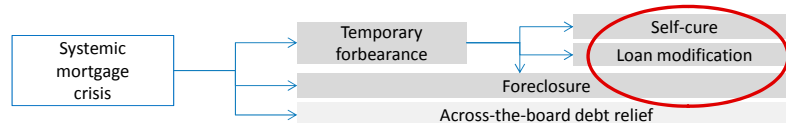
- Lenders have incentives to delay the resolution
- But lenders may prefer implicit forms of forbearance

### Forbearance through temporary restructuring arrangements

- Better targeting
- Borrower and lender remain engaged

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## Loan modification or foreclosure?



### Foreclosure must remain a resolution option

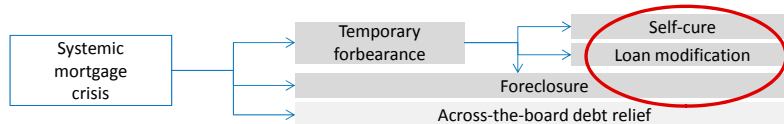
- Least cost resolution, “fresh start”, and deterrent

### Loan modification offer benefits but often remain under-used

- Loan modifications may offer higher recovery value
  - Collateral deficiency
  - High foreclosure cost (Campbell et al., 2011)
- Modifications can limit negative foreclosure externalities
  - Price spillovers (Harding et al., 2008; Case, 2008)
  - Social effects (Nelson et al., 2011; Immergluck and Smith, 2006)
- Yet, the extent of loan modification often remains low
  - High renegotiation cost?
  - Misaligned incentives?

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## Stronger policies to facilitate loan modification



### Enable creditor coordination and reduce renegotiation cost

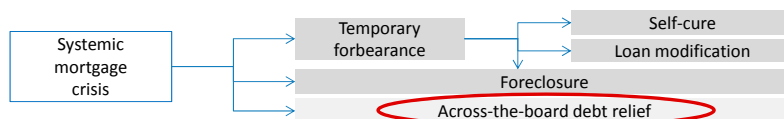
- (Voluntary) code of conduct and procedural standards
- Statutory framework to tackle creditor coordination problems

### Regulatory and tax measures to incentivize modifications

- Adjust risk weights, provisioning requirements, and reporting rules
- Temporary tax break for debt write-offs; dealing with tax debts
- Subsidies, e.g. incentive payments, free counseling (Collins et al., 2011)
- Supervisory guidance
  - Workout process (eligibility criteria, verification)
  - Monitoring to avoid “evergreening”
  - Workout targets (e.g., Ireland’s MART)
- Foreclosure tax?

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## Across-the-board debt relief?



### Advantages

- Contain negative feedback on incomes and house prices
- Quick crisis response

### Disadvantages

- Burden sharing can cause negative spillovers (banks, sovereign)
- Effectiveness hard to evaluate
  - Relief is only partly aligned with borrowers’ capacity to pay
  - Low multiplier compared to other fiscal expenditures
- Possible legal challenges
- Possible damage to future intermediation

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## Conclusions

- Crises suggest a larger role for forbearance and loan modification
  - Temporary arrangements to gain time and certainty
  - Systemic effects warrants preventing a bias towards foreclosure
  - Yet, foreclosure threat must remain (with appropriate protections)
  
- Policies should...
  - grant time and facilitate “breathing space” through explicit temporary restructuring arrangements
  - provide a framework for loan modifications to lower renegotiation cost
  - set sufficient incentives for sustainable loan modification
  
- Across-the-board debt relief may be too costly or poorly targeted

# A Cost-Benefit Analysis of Judicial Foreclosure Delay and a Preliminary Look at New Mortgage Servicing Rules

Resolution of Distressed Mortgages:  
Legal Framework and Lessons Learned

Urban Institute

June 9, 2015

Larry Cordell

Lauren Lambie-Hanson

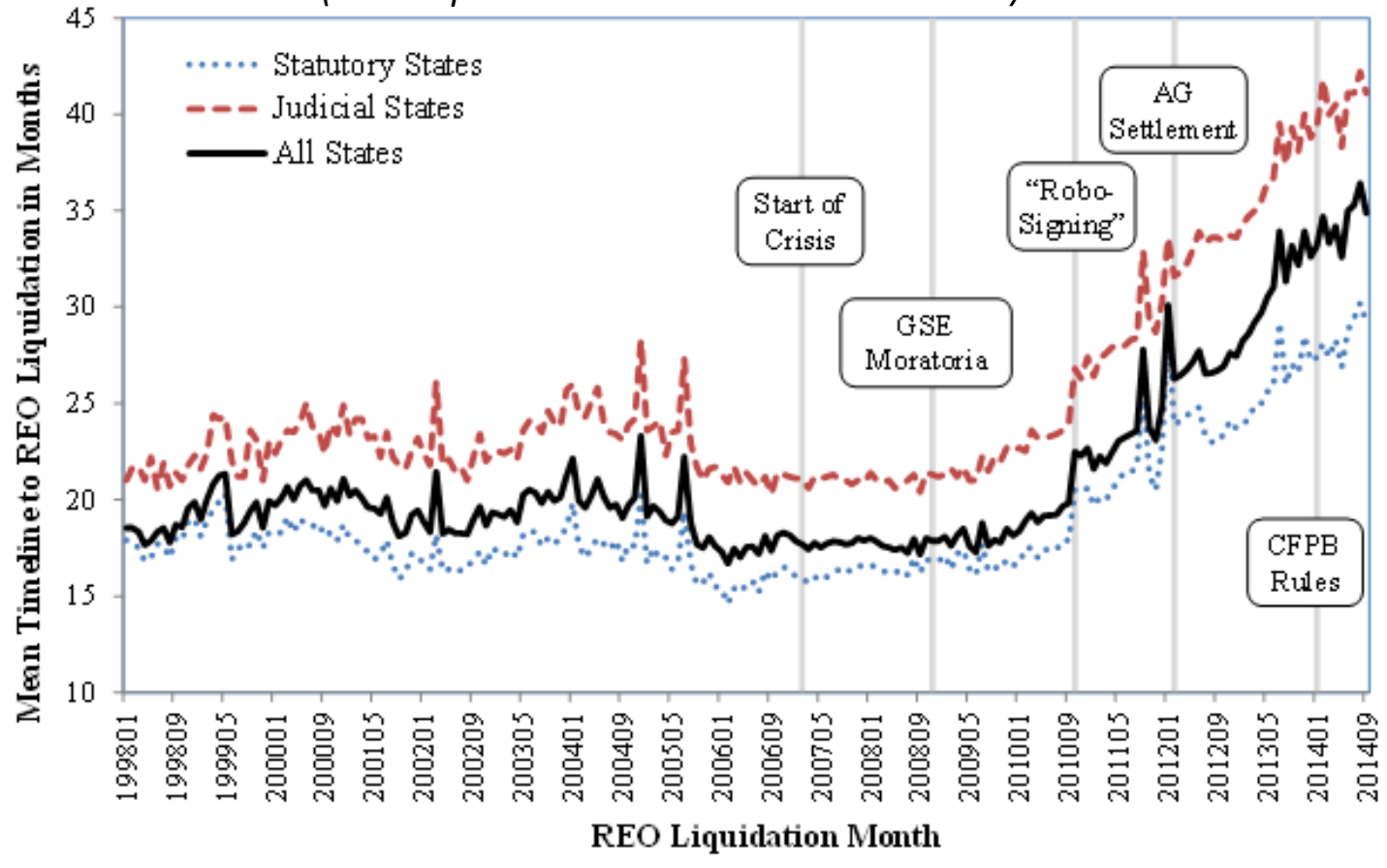
# Disclaimer

The views expressed in this paper represent our views and not those of the Federal Reserve Bank of Philadelphia or the Federal Reserve System.

# Motivation

## REO Liquidation Timelines Have Extended to Historic Highs

*(REO Liquidation Timelines 1998--2014Q9)*

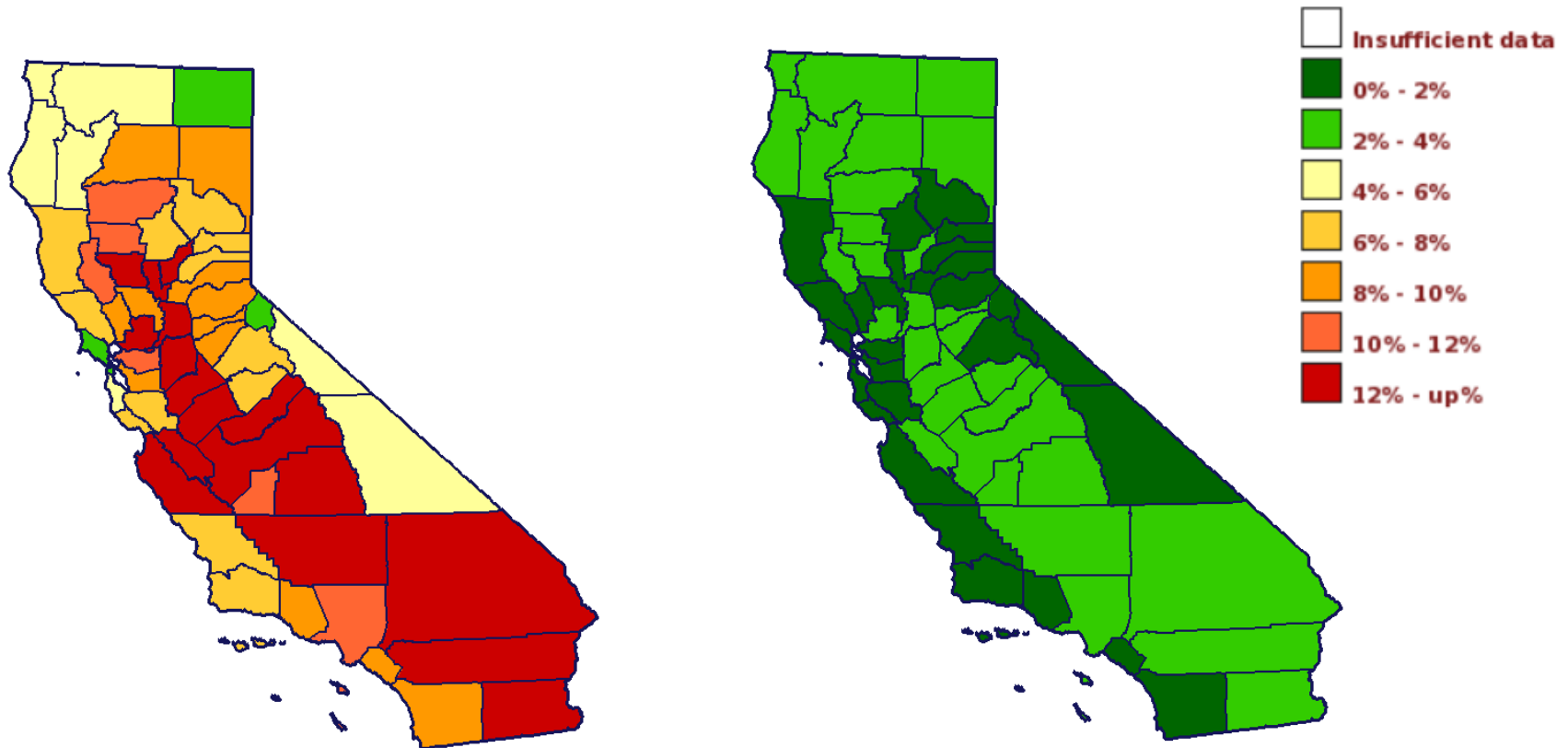


Source: McDash Analytics, Cordell and Lambie-Hanson (2015), Figure 2.

# Delinquencies in California—Peak of Crisis Till Today

January 2010

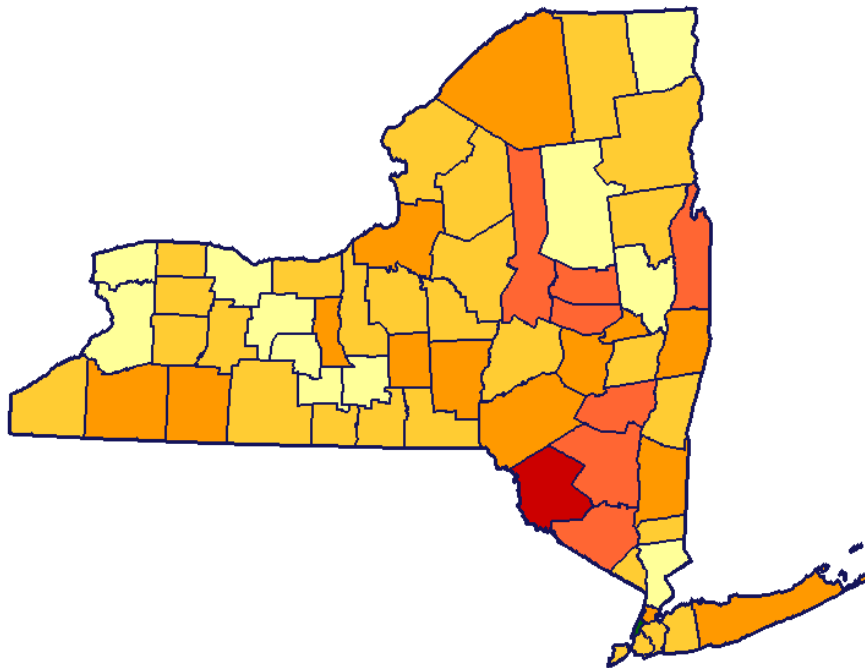
March 2015



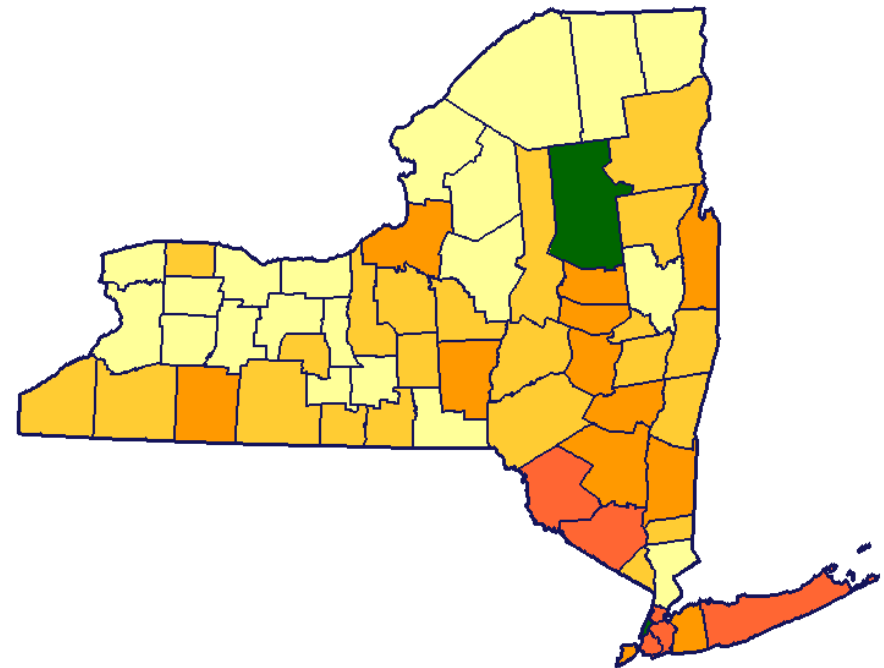
Source: McDash Analytics and Federal Reserve Bank of Philadelphia RADAR Group

# Delinquencies in New York—Peak of Crisis Till Today

March 2015



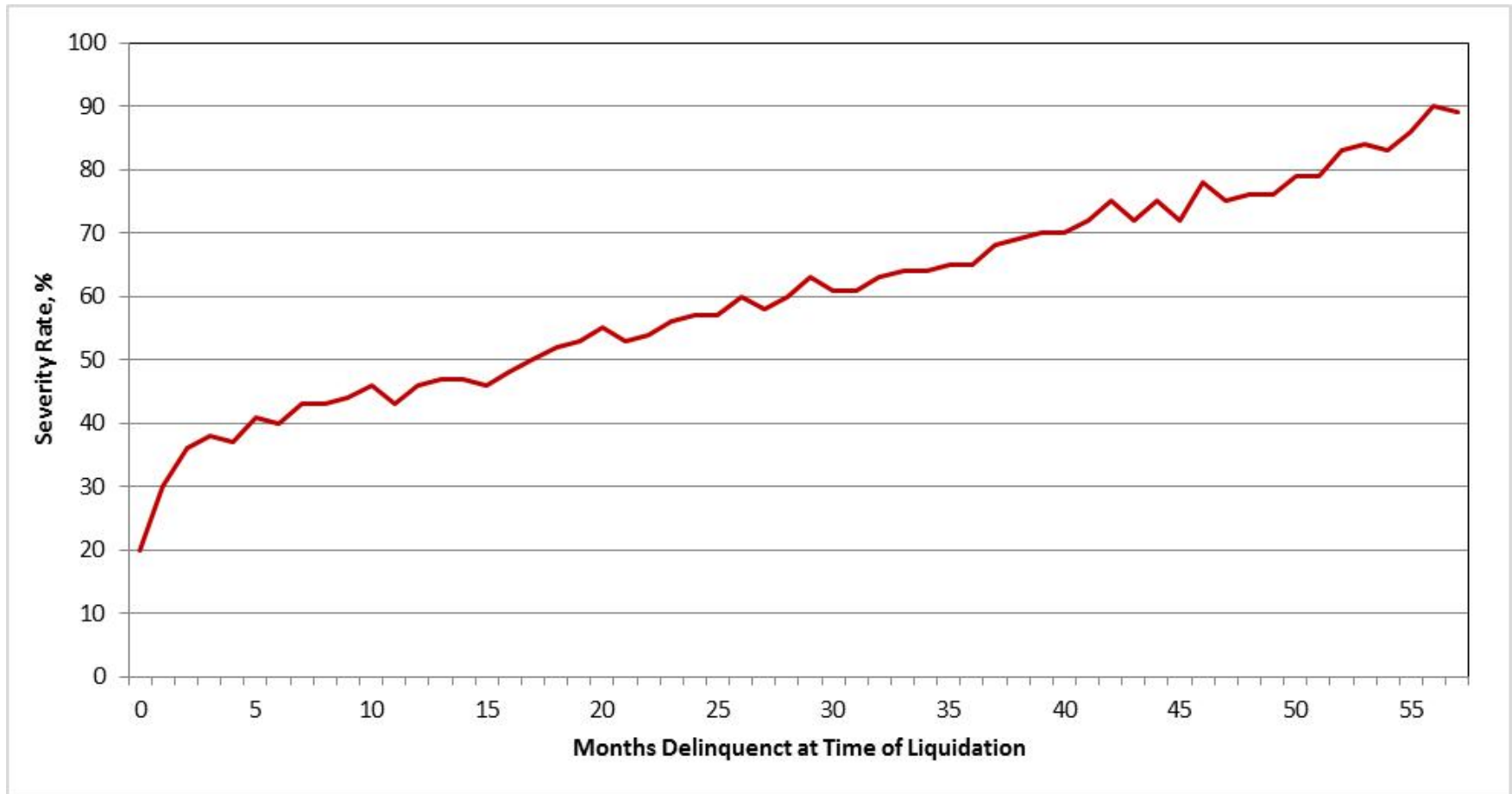
January 2010



Source: McDash Analytics and Federal Reserve Bank of Philadelphia RADAR Group

# Motivation

## Severity Rates Rise With Time Spent in Delinquency



Source: CoreLogic and Cordell et. al (2015)

# Central Questions

- How big are the costs of these foreclosure delays?
- Are the increased costs offset by increased benefits to the borrowers?
- Are there other costs?
- Update findings from several studies, and add our own analysis:
  - Cordell, Geng, Goodman and Yang (2015) “The Cost of Foreclosure Delay”
  - Gerardi, Lambie-Hanson and Willen (2013) “Do Borrower Rights Improve Borrower Outcomes? Evidence from the Foreclosure Process”
  - We examine other costs of foreclosure delays from a number of studies involving researchers at Fannie Mae and at Federal Reserve Banks in Atlanta, Boston and New York.

# Three Main Takeaways

1. Direct timeline-related costs have increased significantly in recent years, up to 15 percentage points in judicial states.
2. Foreclosure delays do not lead to more cures or modifications, just more persistently delinquent borrowers. Benefits are small, if any.
3. There are other potentially large costs for delays: slower reentry of defaulted “boomerang borrowers” back into the housing market; slower house-price recovery in judicial states; greater house price depreciation from nearby foreclosures; negative neighborhood-level effects caused by foreclosure delays.

**Bottom line: Judicial foreclosure review imposes large costs with few, if any, offsetting benefits. New CFPB servicing rules may increase modifications but are extending timelines further.**

# AGENDA

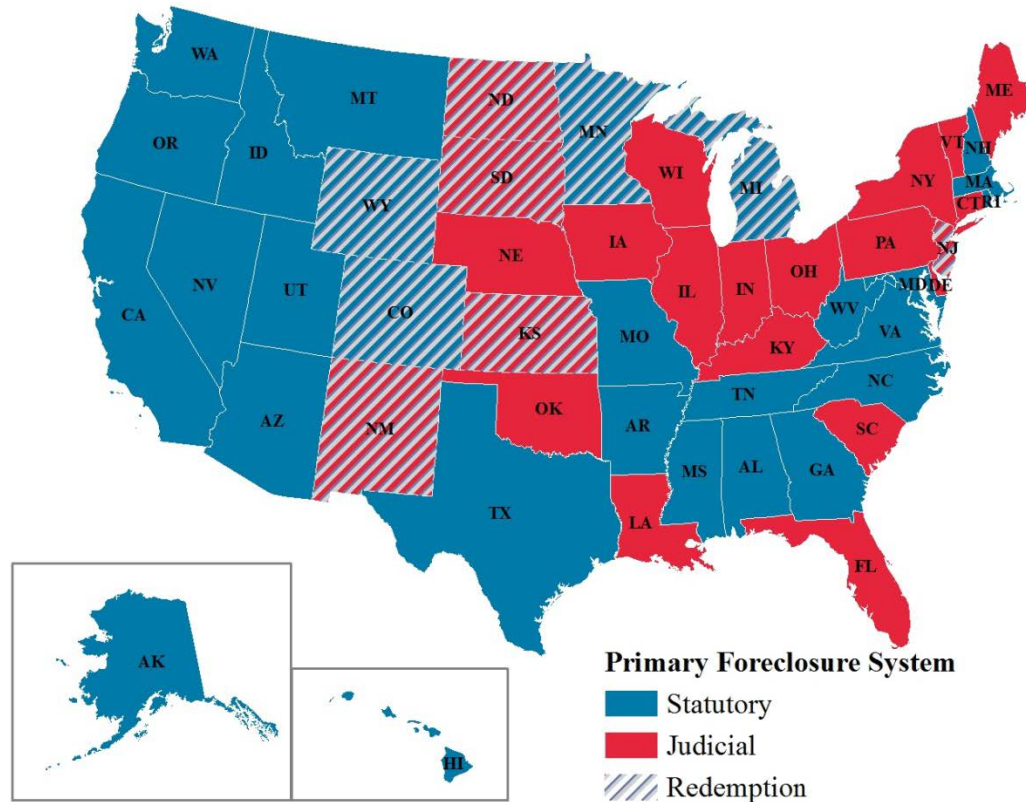
1. Legal and Regulatory Environment Impacting Timelines
2. The Cost of Foreclosure Delay (to Investors)
3. Borrower Benefits/Costs
4. Other Costs
5. Conclusions, Policy Implications

# Legal and Regulatory Environment

# Legal Environment

- **Judicial** foreclosure: lender must petition the court, which then executes the foreclosure by auctioning the property (22 states).
- **Statutory** foreclosure (a.k.a. “power of sale”): borrower at origination signs over the right to the lender to carry out a foreclosure auction in the event of default (28 states plus DC)
- **Redemption** states: have post-foreclosure rights of redemption (9 states).

# Geography of State Foreclosure Laws

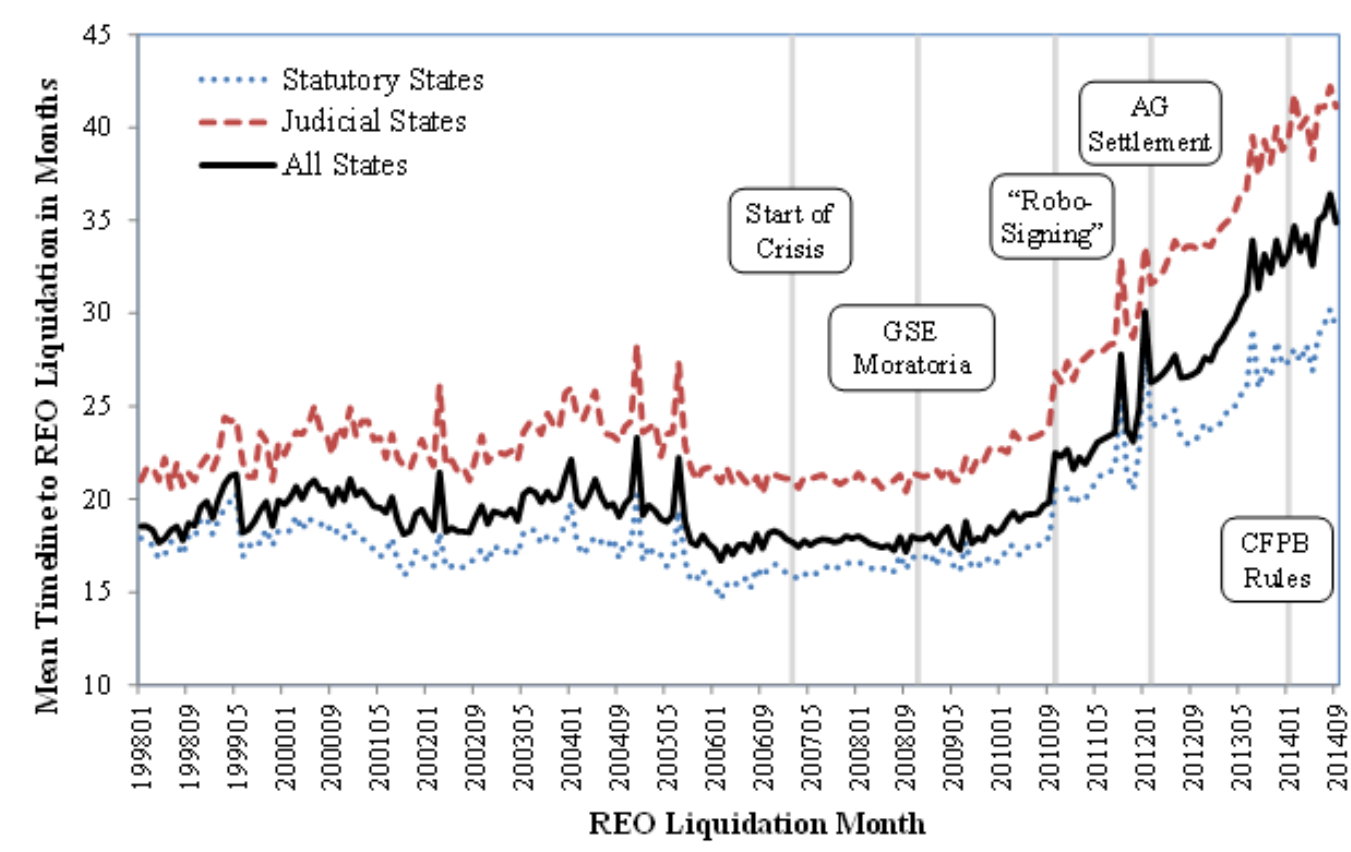


# Regulatory Environment: Six Subperiods

1. Pre-crisis: 1998 to January 2007
2. Start of Crisis, February 2007 to November 2008: First phase of housing crisis
3. GSE Moratoria, November 2008 to August 2010: GSEs announce moratoria, followed by large servicers and HAMP
4. “Robo-signing”, September 2010 to January 2012: Large servicers suspend foreclosures after improper practices uncovered
5. AG Settlement, February 2012 to January 2014: Follows attorneys general (AG) settlement through start of new CFPB servicing rules
6. CFPB Rules, February 2014 to September 2014: Enacted a set of servicing standards for largest mortgage servicers

# Long History Illustrates Issues with Recent Events

## REO Liquidation Timelines Have Extended to Historic Highs (REO Liquidation Timelines 1998—2014Q9)



Source: McDash Analytics, Cordell and Lambie-Hanson (2015), Figure 2.

# The Cost of Foreclosure Delay (to Investors)

# We Use An AFT Model To Adjust Timelines For Censoring

- These figures significantly understate REO liquidation timelines because they only include loans that have gone through the REO liquidation process.
- The huge “shadow inventory” of loans in the delinquency pipeline, called “censored observations,” also have to be modeled.
- Censored and uncensored obs are pooled and estimated with an Accelerated Failure Time model, with the following specification:

$$\log(T) = \mu + \sum (x_i \beta_i) + \sigma \cdot \epsilon$$

where  $T$  = event or censoring time,  
 $x_i$  = the value of the  $i$ th covariate,  
 $\beta_i$  = coefficient of the  $i$ th covariate, and  
 $\mu, \sigma$  = parameters to be estimated from baseline distribution.

# Forecasted Timelines Are Longer Today When Adjusted for Censoring

Judicial States	Uncensored Sample		Censored Sample		Combined Sample	
Default Period	Counts	Avg REO Timeline (months)	Loan Counts	Avg Duration as of 201409 (months)	% of Loans Censored	Estimated Timelines (months)
Period 1 (2005 - Jan07)	18,917	<b>25</b>			-	25
Period 2 (Feb07-Oct08)	203,441	28			-	28
Period 3 (Nov08-Aug10)	332,690	31	34,197	60	9%	37
Period 4 (Sep10-Jan12)	134,065	27	58,232	46	30%	41
Period 5 (Feb12-Jan14)	45,285	21	54,480	31	55%	<b>40</b>
Period 6 (Feb14-Sep14)	12,538	15	172,125	14	93%	<b>43</b>
Nonjudicial States	Uncensored Sample		Censored Sample		Combined Sample	
Default Period	Counts	Avg REO Timeline (months)	Loan Counts	Avg Duration as of 201409 (months)	% of Loans Censored	Estimated Timelines (months)
Period 1 (2005 - Jan07)	31,500	<b>19</b>			-	19
Period 2 (Feb07-Oct08)	392,690	20			-	20
Period 3 (Nov08-Aug10)	728,774	22	13,172	60	2%	23
Period 4 (Sep10-Jan12)	316,005	19	32,406	45	9%	24
Period 5 (Feb12-Jan14)	117,113	16	37,999	31	24%	<b>24</b>
Period 6 (Feb14-Sep14)	41,632	13	178,531	14	81%	<b>30</b>

Source: McDash Analytics, Cordell and Lambie-Hanson (2015), Table 1.

# The Cost of Delay—3 Time-Related Costs

## 1. Property Tax Advances

- Nationwide average is 1.54% (ranging from a high of just over 3.0% in New Jersey, to a low of 0.54% in Arizona. California is 2%)

## 2. Insurance Advances

- Payments must continue; if force placed insurance is used, the payments can be quite large.

## 3. Excess Depreciation

- Deferred maintenance
- Servicers pay for property maintenance costs after a property is in REO and is vacant
- Servicers incur costs as the loan sits in delinquency
- Insurance costs and excess depreciation (ED) are based on a factor calibrated from Cordell et. al (2015) severity model.

Note: P&I advances are not counted, nor is the “cost of carry.”

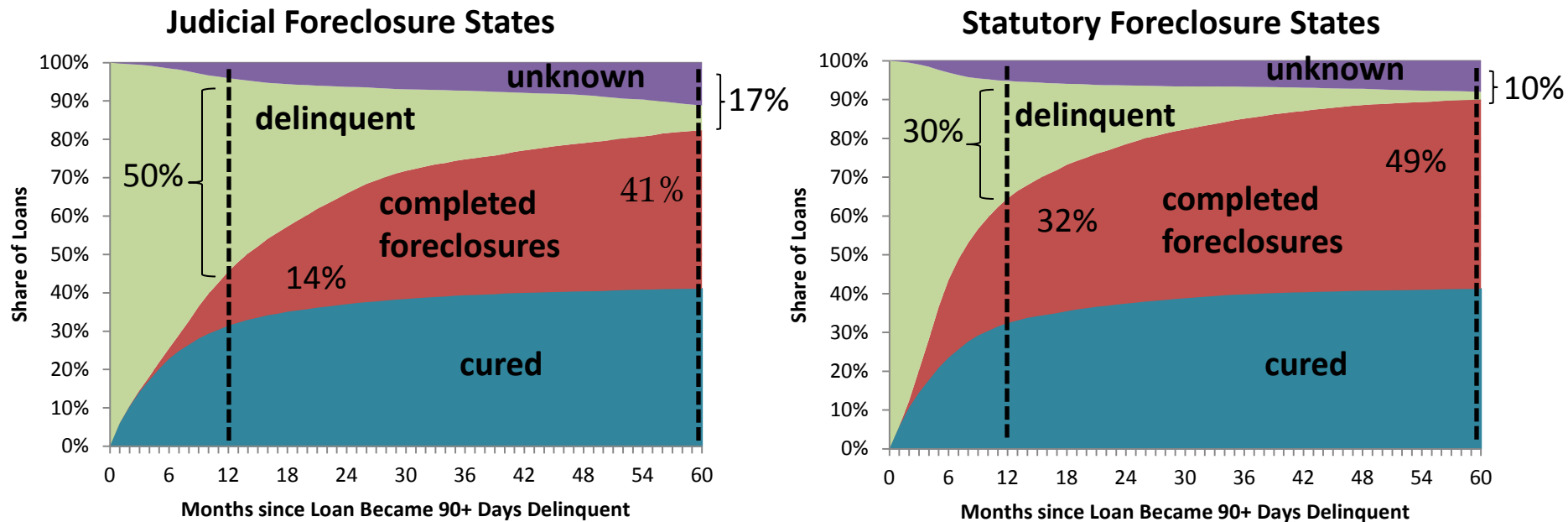
# Time-Related Costs Have Increased Significantly, Especially in Judicial States

Default Period	Statutory	Judicial	Redemption	Lowest-AZ	Highest-NJ	All States
Period 1 (Jan. 2005-Jan. 2007)	10%	16%	14%	9%	21%	12%
Period 2 (Feb. 2007-Oct. 2008)	9%	18%	15%	8%	25%	12%
Period 3 (Nov. 2008-Aug. 2010)	12%	31%	26%	9%	59%	18%
Period 4 (Sept. 2010-Jan. 2012)	13%	33%	28%	8%	52%	20%
Period 5 (Feb. 2012-Sept. 2013*)	14%	31%	30%	10%	45%	21%
Change, Period 1 to Period 5	<b>4%</b>	<b>15%</b>	16%	1%	<b>24%</b>	9%

Source: McDash Analytics, Cordell and Lambie-Hanson (2015), Table 2.

# Borrower Benefits/Costs

# Borrower Protection Slows Foreclosures but Does Not Increase Cures



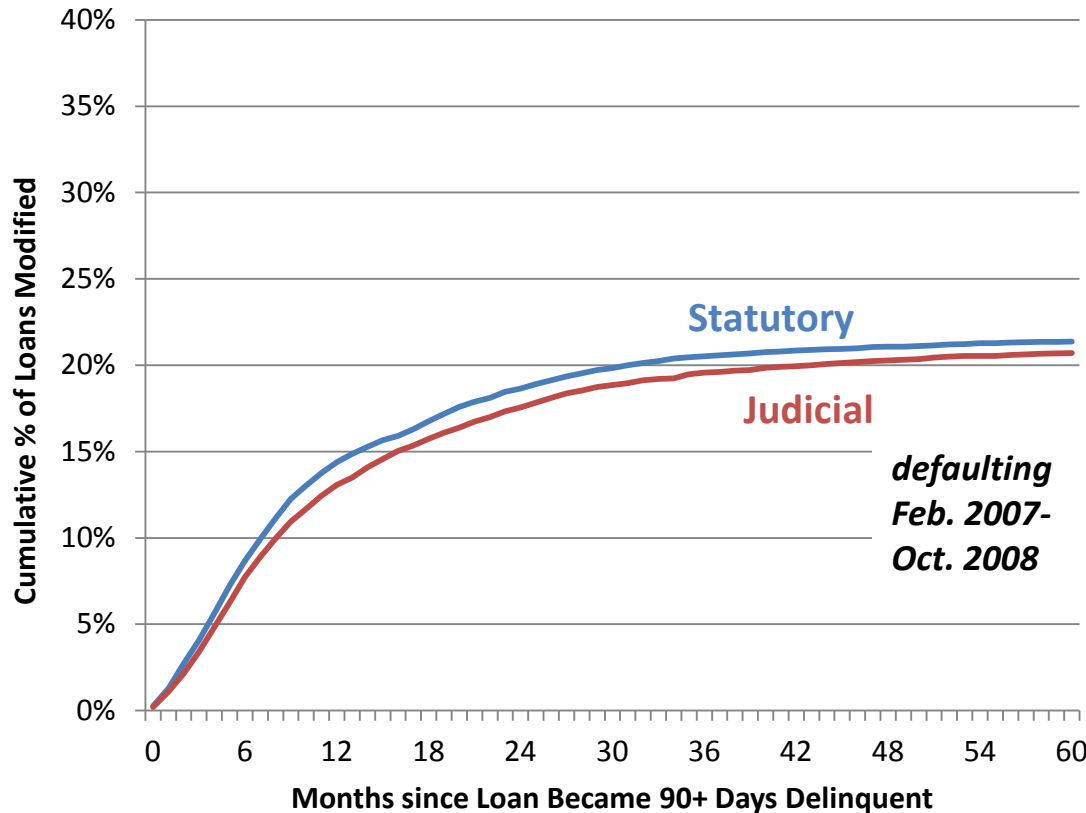
Source: Authors' calculations of McDash Analytics data for loans defaulting Feb. 2007-Aug. 2010

	<u>Judicial</u>				<u>Statutory</u>			
	12	24	36	60	12	24	36	60
Cured	31%	37%	39%	41%	32%	37%	40%	41%
Foreclosure completed	14%	29%	35%	41%	32%	41%	45%	49%
Still delinquent	50%	28%	18%	6%	30%	15%	8%	2%
Status unknown (loan exited sample)	4%	6%	7%	11%	5%	6%	7%	8%

Similar cure rates

Gap in foreclosures narrows over time

# Unconditional Modification Rates are Similar



- About 21% of early-crisis defaulters received mods within 5 years
- As crisis evolved, mods became more common in both types of states
- However, no significant difference in number of mods done

Source: authors' calculations of McDash Analytics data

<b>Mods involved:</b>	<b><u>Judicial</u></b>	<b><u>Statutory</u></b>
Principal reduction	6.2%	6.8%
Payment reduction	77.3%	78.7%

**Characteristics of mods appear similar**

# As Timelines Lengthen, Borrowers Save on Mortgage Payments If They Occupy

- During the mortgage crisis, foreclosure timelines increased by 15 months in judicial states, 3 months in statutory states.

	Pre-Crisis	Post-Crisis	
	2005-Jan. 2007	Feb. 2012-Sept. 2012	Change
<b>Judicial</b>			
Average timeline	17	32	15
Average payment (post-crisis)	\$1,200	\$1,200	
Estimated total savings	\$20,400	\$38,400	\$18,000
<b>Statutory</b>			
Estimated average timeline	11	14	3
Average payment (post-crisis)	\$1,450	\$1,450	
Estimated total savings	\$15,950	\$20,300	\$4,350

- Typical borrower in a judicial state benefits additional \$18,000 from unpaid P&I during this lengthened timeline (\$38,400 total)
- Typical borrower in a statutory state benefits additional \$4,350 (\$20,300 total)

**Note:** These are transfers from investors to borrowers we don't count as a cost.

# Effects on “Boomerang Borrowers”

- RealtyTrac (2014) project 7.3 million borrowers that defaulted during crisis will be eligible to buy a home between 2015-2022.

	Year in Which Borrower Defaulted				
	2007	2008	2009	2010	All Years
Statutory foreclosure state (D)	1.190 <sup>*</sup>	1.357 <sup>***</sup>	1.621 <sup>***</sup>	1.149	1.291 <sup>***</sup>
	-2.21	-3.45	-3.85	-0.83	-5.16
Bankruptcy (D)	1.281 <sup>**</sup>	1.377 <sup>***</sup>	1.331 <sup>*</sup>	1.183	1.299 <sup>***</sup>
	-3.2	-3.78	-2.51	-0.89	-5.36
Age of borrower at default					
18-34 (D)	<i>(omitted category)</i>				
35-50 (D)	0.830 <sup>+</sup>	0.886	0.969	0.830 <sup>+</sup>	0.913 <sup>~</sup>
	(-2.39)	(-1.49)	(-0.29)	(-2.39)	(-1.93)
51-65 (D)	0.598 <sup>***</sup>	0.671 <sup>***</sup>	0.771 <sup>~</sup>	0.598 <sup>***</sup>	0.697 <sup>***</sup>
	(-4.50)	(-3.63)	(-1.90)	(-4.50)	(-5.69)
66+ (D)	0.321 <sup>***</sup>	0.351 <sup>***</sup>	0.481 <sup>**</sup>	0.321 <sup>***</sup>	0.421 <sup>***</sup>
	(-4.44)	(-4.19)	(-2.72)	(-4.44)	(-6.68)
Credit score at default	1.003 <sup>***</sup>	1.004 <sup>***</sup>	1.003 <sup>***</sup>	1.003 <sup>***</sup>	1.003 <sup>***</sup>
	-6.11	-7.71	-4.31	-6.11	-10.94
% change in unemployment	0.667 <sup>*</sup>	0.724 <sup>**</sup>	0.679 <sup>***</sup>	0.667 <sup>*</sup>	0.803 <sup>***</sup>
	(-2.42)	(-3.01)	(-4.16)	(-2.42)	(-4.09)
% change in house price index	0.75	0.604 <sup>+</sup>	0.355 <sup>***</sup>	0.75	0.545 <sup>***</sup>
	(-1.29)	(-2.19)	(-3.66)	(-1.29)	(-4.65)
Default Cohort (D, by year)					Included
Borrowers	10,654	13,160	11,750	7,361	47,033
Chi-square	90.1	129.8	87.8	18.2	738.31
Log likelihood	-3,032.80	-3,091.10	-2,048.60	-997.2	-95,57.35

Source: FRBNY Consumer Credit Panel, Cordell and Lambie-Hanson (2015), Table 7.

- Random sample of 43K borrowers who defaulted on their mortgages
- Borrowers in statutory states about 1.3 times as likely to take out a mortgage, 1.6 times for 2009 defaulters.

# Other Costs

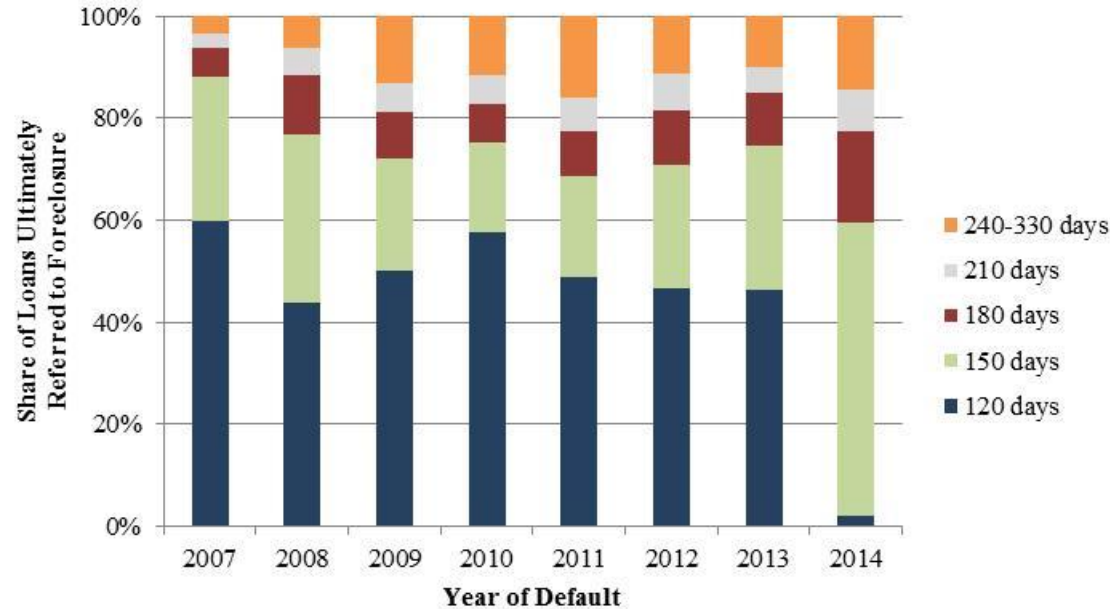
# Three Additional Costs With Foreclosure Delays

1. Foreclosures depress neighboring house values.
  - Each nearby foreclosure was found to lower a seller's price by an average of 1% for each foreclosure. (Campbell, Giglio, and Pathak, 2011; Gerardi, Rosenblatt, Willen, and Yao, 2012; and others)
  - Gerardi et al. (2012) find large effects when the properties are owned by borrowers who have spent long periods in default.
2. Foreclosures create community disamenities (crime, neglect)
  - Foreclosures shown to lead to additional crime, including violent crime (Ellen, Lacoé, and Sharygin, 2012). See also Lambie-Hanson, 2013.
3. House price recovery has been slower in judicial states.
  - Figure 9 of our paper updates research done by Aragon, Peach and Tracy, 2013.

# New CFPB Servicing Rules

## Foreclosure Referrals by Days Delinquent

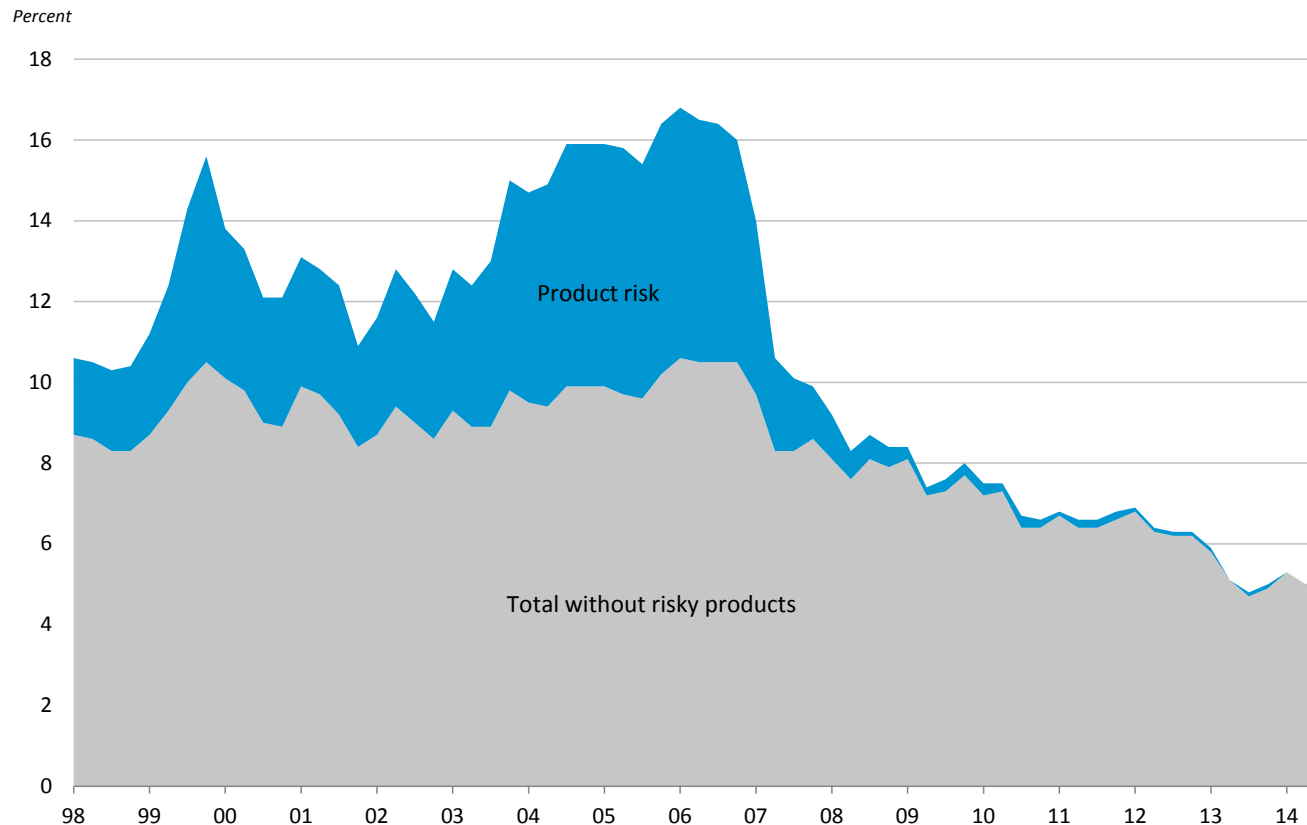
*(Borrowers 90+ Days Delinquent Firs Three Months of Years 2007-2014)*



Source: McDash Analytics, Cordell and Lambie-Hanson (2015), Figure 4.

# New Servicing Rules May be “Tightening the Credit Box”

## Credit Availability Index shows overall tightness



Sources: CoreLogic, HMDA and Urban Institute calculations.

Source: Wei Li and Laurie Goodman, “Measuring Mortgage Credit Availability Using Ex-Ante Probability of Default”, Research Report, Urban Institute, November 2014.

# Conclusions, Policy Implications

# Conclusions, Policy Implications

- Judicial review imposes large costs, but does not generate benefits in terms of saved defaults or more modifications.
  - We should move toward a national servicing standard or price for the costs of judicial review, rather than let it exacerbate disamenities or impair credit access.
- CFPB servicing rules should aim for a process that resolves the delinquency within a year (Cutts and Merrill, 2008).
  - The foreclosure process should be expedited for abandoned homes.
  - A review of procedures for how to get to a fairer and more efficient process should be formalized.
  - Warning: “...prolonged forbearance may defer needed adjustment, which can unduly delay the recovery and cause economic distortions,” Andritzky (2014, p. 26).
- Future work:
  - Continue to monitor the new servicing rules to measure costs and benefits
  - Verify effects of servicing rules on originations as in Pence (2006)
  - Study which types of modifications are working, which not

# Are Fast Foreclosures Better?

*Urban Institute*



Prof. Adam J. Levitin

Georgetown University Law Center

June 9, 2015

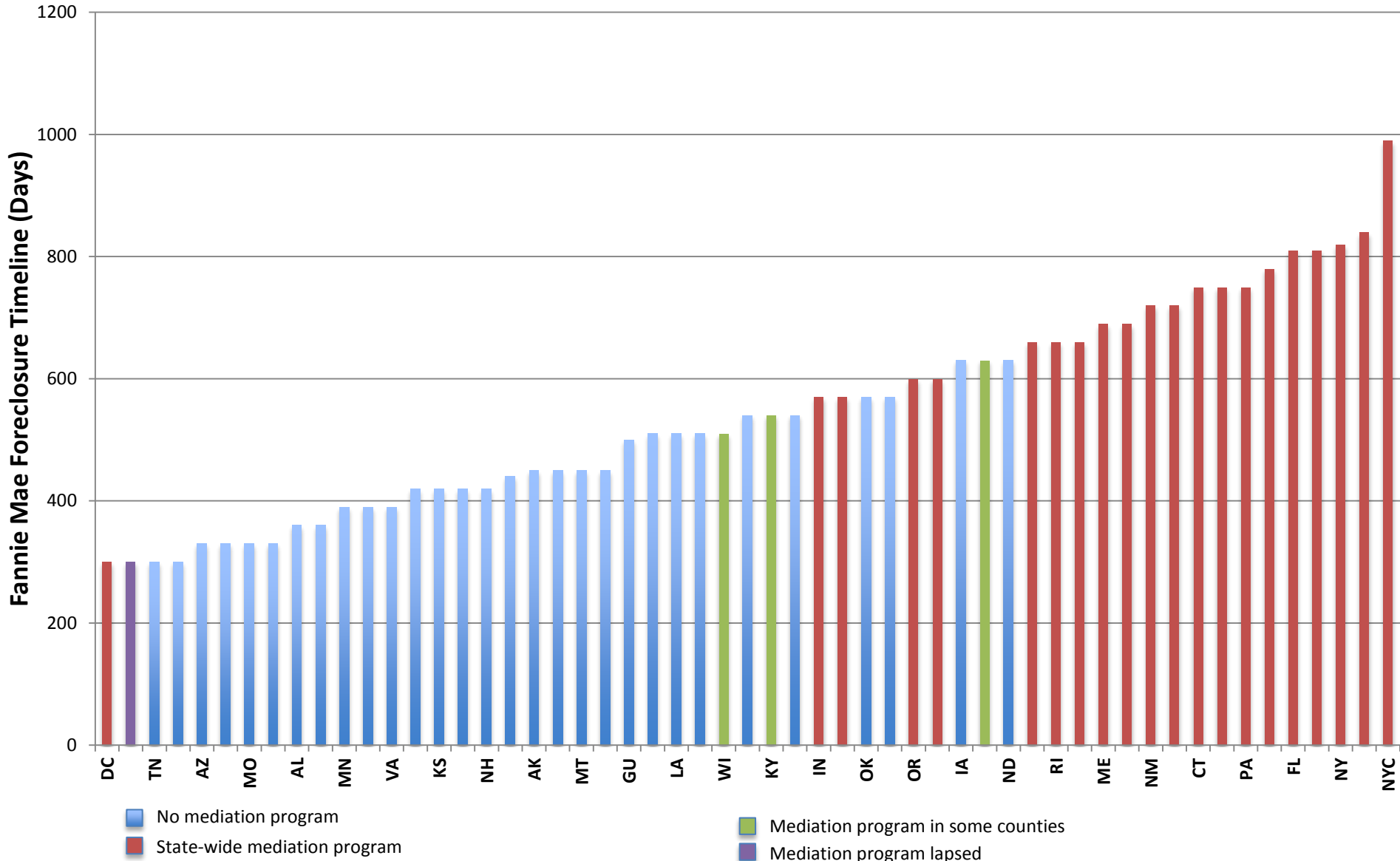
# Andritzky (2014)

- Comparative perspective
  - Problem of details (Anna Karenina problem)
  - Illustrates the range of approaches that can be taken
  - Illustrates the range of things that can go wrong.
  - No one has found the magic bullet.
- Approaches to default management may change during systemic crises.
- Approaches adopted are highly constrained by politics.
  - Not simply a matter of what is the most effective at reducing losses, but also distributional politics.
  - Outcome depends on the focus of crisis response
    - Protecting financial system (US, Spain, Ireland)
    - Protecting consumers/social stability (Iceland, Ireland?)
- Analysis depends on particulars of national programs, not generic approaches.
  - E.g., details of modifications affect effectiveness
  - Details of modifications are often politically dependent (e.g., HAMP)

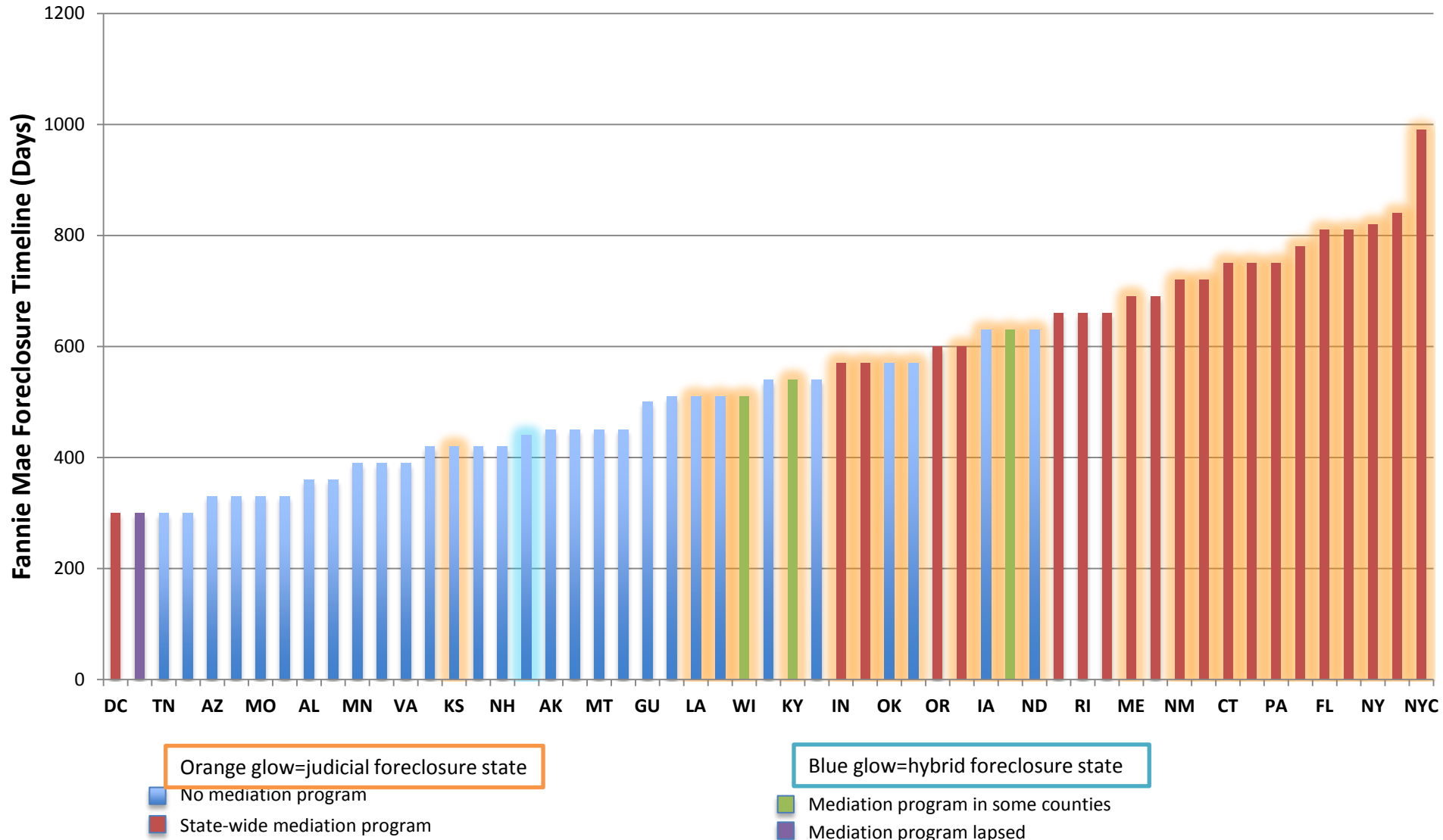
# Cordell & Lambie-Hanson (2015)

- Testing if judicial foreclosure results in greater delay and thus greater costs.
- Anomalous time period included (2010-14)
  - High foreclosure volume taxed judicial bandwidth
  - Robosigning issues
- Missing controls for legal environment that could affect delay independent of judicial foreclosure
  - Foreclosure Mediation Programs (22 jurisdictions + 3 partial jx)
  - State-specific court rulings (MA, ME, OR, WA, e.g.)
  - State-specific settlements (CA, IL, MA, e.g.)
  - State-specific legislative changes (CA, e.g.)
  - State-specific funds (Hardest Hit Fund, e.g.)
  - Foreclosure mill failure fallout (FL, NY)
- Macroeconomic endogeneity problem

# Mediation Programs & Foreclosure Timelines



# Mediation Programs & Foreclosure Timelines + Judicial Foreclosure Indicator



# Technical Coding Matter

- Judicial vs. Nonjudicial foreclosure
  - Not as binary as often assumed.
- Many states allow both procedures
  - One is usually preferred, but changes happen.
    - Hawaii was primarily nonjudicial until nonjudicial FC began to require mediation.
- Some states are hybrids (Massachusetts)
  - Judicial SCRA filing required.
  - *Fremont* (subprime) mortgages require judicial sign-off for foreclosure.
  - Sale is conducted through private auction.
- Major point: technically complex legal environment that does not lend itself to easy analysis.

# Cost-Benefit Analysis

- Completely excludes non-monetary factors.
  - Right to be heard
  - Fairness/legitimacy
- Does not attempt to quantify costs and benefits
  - How much cheaper credit?
  - How much loss mitigation?
  - Neighborhood externalities from avoided FCs?
  - Neighborhood externalities from delayed FCs?

# Not All Delays Are Equal

- Blanket approaches (Reg X, NYS FC referee system)
  - Deadweight loss or transfer from investors to borrowers.
- Servicer non-responsiveness in mediation programs
  - Deadweight loss or transfer from investors to borrowers.
- Mediation programs
  - Delay creates value

# Does Delay Change Foreclosure Behavior?

- Possibility 1: If delay functions as tax on lenders, will discourage foreclosures and thus reduce in foreclosure externalities.
  - If so, then blunt instrument delays like Reg X may improve net social welfare.
- Possibility 2: Servicer incentive/capacity issues mean delay achieves nothing because cost is born by investors.
  - If so, then blunt instrument delays like Reg X are at best transfers, and at worst deadweight losses.

# Policy Implications

- Localized foreclosure law makes no sense.
  - But politically impossible to change.
- What is goal in foreclosure policy?
  - Reduction of foreclosure externalities?
  - Cheaper credit?
    - What kind of credit? (Curtis *JREFE* 2014)
- Need to distinguish between types of delay.
  - Reg X should have a carve-out for states that mandate foreclosure mediation programs with minimum standards.
- 1-year max timeline proposal?

# Further Research

- Mediation programs
  - There are some studies of individual programs.
  - No comprehensive look at programs
    - Simple descriptive statistics
    - Analysis of what works
- Effect on credit from Reg X 120-day provision vs. other Reg X provisions and settlements
- Do servicers respond differently when faced with delays?
  - Hawaii case test case (shift from nonjudicial to judicial foreclosure to avoid mediation)