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AIMING AT MOVING TARGETS: HOME FORECLOSURE MEDIATION IN THE UNITED STATES

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The leading wave of the economic tsunami that in 2007-08 caused the deepest recession in the United States since the Great Depression of the 1930s resulted from and began with a unique approach to financing home mortgages. Mortgages are the lending vehicle used to buy residences in the U.S. Although this crisis has lessened slightly on some levels, many Americans continue to suffer severely from its consequences.

One manifestation of economic pain from this crisis is a tremendous increase in the number of homeowners facing loss of their homes. Foreclosure is the legal process by which mortgage owners get court orders to confiscate a homeowner's property for failing to make loan payments. More than 2.3 million homeowners faced foreclosure in 2008, an 81% increase from 2007. An additional ten million homeowners face foreclosure in coming years. Approximately 55 million Americans carry a mortgage on their residence so nearly one of every five mortgaged homeowners will risk of losing their home in a foreclosure.

In the U.S., states rather than the Federal Government regulate homes and real property located within their borders. Because courts conduct judicial foreclosures in a majority of states, current and anticipated foreclosure numbers severely strain already under-financed state court systems. Recognizing the potential advantages mediating possesses to create resolutions that better meet the interests of all participants, twenty-one American states have developed mediation programs to cope with this strain. Several more states are considering instituting similar approaches.

This paper analyzes this evolving use of mediation to confront the U.S. mortgage foreclosure crisis. After briefly sketching the historical context that created the current crisis and explaining generally how foreclosures work in the United States, this paper examines the reasons mediation has emerged as the preferred resolution approach. Using Florida as an example, this paper ends by analyzing two categories of the substantial challenges that mediators face assisting and enhancing foreclosure negotiations effectively.

1. HISTORICAL CONTEXT

The unusual financing approach that caused the general economic crisis in the United States was a recent innovation to a long-standing practice of issuing mortgage-backed securities. Mortgage-backed securities involve selling shares of home loans to investors. In recent decades, these securities largely replaced the traditional home financing method where local banks loaned purchasers the money to buy houses. In return, banks received an upfront fee, usually one to three percent of the loan, interest, and principal payments for the life of the loan, a period ranging from 5 to 30 years.

Seeking to increase these lucrative upfront fees and avoid tying up their money for long periods, banks long ago lobbied government for ways to sell these loans. The U.S. Federal Government responded in 1934 and created financial machinery to permit this. Called Fannie Mae, this agency bought bank mortgage loans as long as the borrower had a decent income, a good job, and made a substantial down payment of usually 20% of the home's purchase price. Originating local banks continued to service these loans and collected principal and interest payments on behalf of Fannie Mae but moved these mortgages off their books and gained more capital to relend. Fannie Mae then sold these loans to investors with a guarantee that the federal government would repay them if borrowers failed to make obligated payments.

In 1968, the Federal Government applied a mortgage-backed securities approach to loans it guaranteed by other administrative agencies such as the Veteran's Administration. It also created a new agency, the Government National Mortgage Association, called Ginnie Mae, to pool all government-backed loans and chop them into securities. Ginnie Mae then sold these securities to investors. All of these securities were identical in terms of risk and interest rates. The federal government guaranteed deficiencies so investors were fully protected. Over the following years, 85% of homeowners paid off their mortgages underlying these securities without defaulting.

Companies that traded investment products soon created new financial products based on and derived from Ginnie Mae securities. Solving uncertainties stemming from possibilities that underlying mortgages might be paid back early, these derivative securities provided fixed interest rates for fixed time periods and other options. In the mid to late 1980s, derivative traders recognized that there was a huge potential mortgage market that had nothing to do with the federal government and Fannie and Ginnie Mae agencies. This market was called subprime because it consisted of economically marginal buyers who could not qualify for prime

mortgages in Fannie and Ginne Mae programs. These loans were given to persons regardless of their job or income, and often required little or no down payment. Skyrocketing home values and the low 15% default rate initially made this look like a good bet.

In efforts to circumvent the inherent riskiness of securitizing high risk loans, financial engineers developed an approach that sliced subprime loan pools unequally. They designed them so that some packaged slices were arguably more secure while others were far riskier. Displaying marketing ingenuity, they used the French word for slice, tranche, for these pieces. These products sold their allegedly more secure tranches for lower rates of return while riskier slices earned much higher returns. Solving another problem, these product developers persuaded the major bond rating agencies, Fitch's, Moody's, and Standard and Poor's, that their top tranches were worth of AAA ratings, meaning they were virtually as good as you could get without federal government backing.

This AAA rating permitted institutional investors who were legally restricted from making large purchases of speculative securities, such as pension funds, insurance companies, and banks, to buy them. This rating also made these collateralized debt obligations [CDOs] based on essentially toxic mortgages respectable and appealing. Subprime mortgage securities also injected additional participants to mortgages beyond a local lending bank and a homeowner in itsr community. This created potentially complex negotiating dynamics that now complicate mediating home foreclosures.

Paralleling successes deriving investment instruments from prime mortgage backed securities, imaginative, immensely complex derivative securities soon appeared based on these same mortgage loans to borrowers who did not qualify for federal government guaranteed protection. One notable example, credit default swaps, permitted selling hundreds of thousands of derivative CDOs based on these underlying pools of subprime mortgages. These transactions linked together thousands of firms so that a major failure of a few underlying CDOs potentially could paralyze the entire financial system.

This scheme worked well for several years during the U.S. housing boom of the early 2000s. Subprime mortgages that became past due fell from 15% in 2002 to 10% in 2005. Purchasers of risky, low level tranches routinely earned high returns ranging as high as 20 to 40% on their investments. Sub- and near-prime loans grew from 9% to 40% of new securitized mortgages by 2006.

By summer of 2006, however, homebuilders had overbuilt, the supply of homes outstripped demand, Americans found they had too much debt to handle on their increasingly stagnant incomes, and the housing bubble burst. Home prices declined and frequently sank below the value of outstanding mortgages, leaving these borrowers "under water." Subprime borrowers were not able to make their mortgage payments and the disappearance of escalating housing prices prevented them from refinancing at lower interest rates or selling their property to buy something more affordable. Home prices have continued to fall and many communities report a loss of 40% or more on housing values. In addition, more homes came on the market as a result of increasing foreclosures, complicating the resale of reclaimed residences. Most U.S. communities ended up with numerous vacant homes.

Risk also returned to sub-prime mortgage-backed securities. First, the bottom tranches went belly-up, then the middle levels quickly followed, and soon the allegedly secure AAA senior tranches started taking losses. Every subprime tranche based on actual loans that collapsed took with it all of the numerous derivative securities based on them. This derivative pyramiding explains how $300 billion of sup- and near-prime mortgage backed securities' loss more than tripled into losses of 1 to 2 trillion dollars.

By mid-year of 2009, 40% of all subprime loans were delinquent and in foreclosure. The economic fallout from this affected other mortgages and now the fastest growing segment of mortgage delinquencies is prime mortgages. It is projected that home prices will not stop falling until 2011 at the earliest, and that the high end of the mortgage market will be the next to collapse. California and Florida, the two states this paper examines, illustrate the current crisis. The nation-wide housing market collapse hit both hard. California projects 532,000 foreclosures in 2010 and 1,888,716 foreclosures from 2009 to 2012. Similarly, Florida projects 445,100 foreclosures in 2010 and 1,482,279 over the same three year period.

2. THE U.S. FORECLOSURE SYSTEM

As increasingly large numbers of mortgage holders failed to make their mortgage payments, the need for mortgage owners to foreclose on these loans to try to recapture some value increased. In a majority of U.S. states, foreclosure proceeds as a law suit handled by courts. Foreclosure law suits proceed the same way other litigation occurs in the United States.

Although not all states follow this sequence identically, this litigation usually requires filing a pleading, called a complaint, alleging the loan and default, and requesting relief. This pleading must be served on the homeowner who then has an opportunity

to file a responsive pleading or a motion attacking aspects of the complaint or the service. Pre-trial civil discovery, a major expense in American litigation, is permitted. Eventually a trial occurs and a judgment is rendered. If the plaintiff-mortgage owner wins at trial, and they win the vast majority of these claims, an auction sale occurs for this home. If bids at this auction do not exceed what the plaintiff thinks the property is worth, the mortgage owner may buy it. This occurs frequently now in deeply depressed U.S housing markets so mortgage owners acquire homes to resell them in another manner. If the defendant homeowner does not respond to the complaint within the required time, the plaintiff may take a default. The plaintiff then must give at least statutorily prescribed notice of the auction sale.

In addition, many states offer homeowners a right of redemption. This provides a legal right to buy back property within a statutorily defined time period that may extend as long as two years. Redemption rights delay the mortgage owner's right to obtain clear title to the foreclosed property. Most states offering this right do not permit homeowners to waive it. As a result of all of this, pursuing judicial foreclosures imposes significant transaction costs on mortgage owners resulting from attorney's fees, court charges, and time delays occurred in litigating and waiting until redemption periods end. The time to conclude a full judicial foreclosure in New Jersey, for example, increased to 18 months in 2009 from 10 to 12 months previously.

A few states permit non-judicial foreclosure. This usually requires the mortgage owner to issue a notice to the homeowner that they intend to put the property up for sale at the end of a waiting period set by a statute. State courts are not involved. Non-judicial foreclosure is usually created and regulated by statute. Extensive variations exist within the states using this option. California is a non-judicial foreclosure state while Florida authorizes only judicial foreclosure.

3. A CASE FOR HOME FORECLOSURE MEDIATION

Mediation's advantages present enormous potential benefits to all stakeholders in the current U.S. mortgage crisis: homeowners, mortgage owners, neighboring property owners, state governments, and the American economy. Mediation's ability to reach interest-based agreements creates more optimal resolutions than are currently available under the win-lose frame foreclosure litigation uses. Mediators' skills at encouraging more constructive communication than typically occurs in litigation can help everyone see that better deals can be had by negotiating than foreclosures provide. Mediations proceed quickly with minimal expense. They permit confidential communication and generate more information that participants can use to generate high value-low cost trades. Mediations optimally occur once

everyone has adequate financial data to go forward, and consequently, they may solve problems much more quickly than litigation.

In addition to avoiding foreclosure expenses and stresses, mediation benefits homeowners by allowing them to explore all opportunities to stay in their homes. This occurs primarily through modifications of mortgage loans. All common mortgage terms, including principal amount; interest rate; payment amount; past, present, and future loan fees, costs, and charges; and loan length, are theoretically modifiable.

Other modification approaches that have emerged in early mediations include reducing and occasionally waiving late fees, other costs, and attorney's fees that are inevitably authorized in mortgage contracts. Sometimes negotiators agree to place delinquent payments at the end of the loan term which later produces a balloon payment or a negotiated extension of the loan's term. Stipulations to modify also occur occasionally. These are agreements where the mortgage owner agrees to accept reduced monthly payments for a trial period, usually 90 days, during which homeowners must pay on time to secure the modification permanently. Negative credit reporting continues on the original modification until the modification is complete and permanent.

Other common modification approaches include forbearance of principal and repayment plans. Forbearances move a portion of the principal to the loan's end, interest free. They allow for lower monthly payments but may also include a balloon payment at the term's end for the amount of the forbearance. Repayment plans encompass options where homeowners make often reduced payments but agree to pay this money later. These plans often include late fees, other cost add-ons, attorney's fees, and court costs. While not a mortgage modification, another way to keep homeowners in homes is a "right to rent" option. This allows mortgage owners to take ownership of the home and rent it to the former homeowner at the current market rental rate. This solution lets borrowers remain in the home and saves mortgage owners from incurring the expenses and hassles of continuing foreclosures and acquiring additional property.

If the homeowner's financial information indicates no abilities to pay even a modified mortgage, mediation allows negotiating a graceful exit from their homes. Graceful exits may achieve other important homeowner interests that foreclosures ignore such as providing time to finalize alternative housing and allow children to finish school terms years. Graceful exit options include: (1) a deed in lieu of foreclosure where homeowners transfer their title to owners, often in exchange for extra time before moving out; (2) a short sale which enables homeowners to sell their home for

less than the mortgage balance with the owner's consent; (3) cash for keys where homeowners receive assistance in transition to new residences; or (4) a negotiated departure date instead of an eviction which gives homeowners more control and peace of mind.

Finally, mediation agreements allow homeowners to eliminate the risks of claims following foreclosure. Forty states permit deficiency claims brought by mortgage owners who recover less than the amount of the original mortgage plus foreclosure costs when the reclaimed home is resold. Eliminating these claims helps homeowners avoid bankruptcy, another major consequence of the foreclosure crisis. More than 2 million Americans filed bankruptcy in 2010 and the vast majority involved mortgage foreclosures. This was an increase of 20% over already record high levels in 2009.

Owners seldom make money from foreclosures. They usually benefit from mediation outcomes that substitute modified, sustainable loan repayments for the uncertainties and expenses that foreclosure sales or property retakings generate. A 2008 national survey of mortgages in foreclosure showed that lenders incurred losses averaging $124,000 in each foreclosure. These loans in foreclosure averaged $212,000 so lenders lost 57% of their investment each time they completed a foreclosure. A September 2009 update of this same study showed that their losses rose to 65% of the value of the loans. Average losses on second mortgages subject to foreclosure were almost 100%.

Graceful exit outcomes save mortgage owners the expense of foreclosure litigation and the time these lawsuits consume. They also allow mortgage owners to avoid future claims. Mortgage owners can accept a deed in lieu of foreclosure that waives the homeowners' right of redemption. Although homeowners cannot legally waive this right after foreclosure, courts routinely permit waiver as part of a deed in lieu of foreclosure.

Mediated resolutions also eliminate mortgage owners expenses involved in retaking, holding, and reselling foreclosed homes. These costs include property taxes, home insurance costs, realtors' fees, and losses from further erosion of property values in declining markets. A Pennsylvania lawyer for mortgage owners estimated that her clients lose $50 to $100 every day a property is in foreclosure.

Mediated agreements continuing homeowners in their residence benefit neighboring taxpayers and the communities in which they live. Foreclosed and vacant homes drive down the value of surrounding properties. Studies show that property values decline an average of 0.9% for every foreclosure within an eighth of a mile of an

unaffected home. This decline rises to 1.4% in low- and moderate-income neighborhoods which face higher foreclosure risks because they contain a greater risk of subprime mortgages. The estimated lost home equity wealth in the United States due to nearby foreclosures in the three year period from 2009-2012 is $1.9 trillion. California projects lost home equity wealth due to nearby foreclosures in these three years of $627 billion from 12,249,824 homes experiencing nearby foreclosure-related decline. The amounts to an average loss per affected home of $51,171. Florida projects statewide lost home equity wealth during this same three year period of $331.3 billion from 8,028,664 affected residences. This constitutes an average loss per affected home of $41,271.

Mediated agreements keeping homeowners in their homes prevent further depression of local housing prices and save money for municipalities. Vacant properties attract vandalism, arson, and violent crime which reduce local housing prices further. More vacant and abandoned homes force municipalities to spend more of their increasingly limited resources to keep squatters, vandals, and thieves away. Community taxpayers ultimately absorb these costs.

Mediated agreements stabilize government income from property tax. Virtually all states in America experienced recent, sharp property tax revenue decreases directly attributable to this foreclosure crisis. This forces reductions in state public services and often generates layoffs in police, fire protection, and educational professionals. These agreements also save very real but harder to calculate costs caused by delays in the justice system. Unlike landlord-tenant disputes which often have dedicated courts and statutorily short time frames, foreclosures occupy the same docket as other non-criminal proceedings. This has crowded dockets and caused delays even though senior and retired judges are often recruited to help deal with this flood of cases. Courts in states with existing mandatory mediation programs, however, generally report that they are quickly resolving many cases and that this is acting as pressure release for their crowded dockets.

A final advantage mediation brings is its ability to convene homeowners and mortgage owners or their representatives. A vast majority of foreclosures are pursued by servicers on behalf of lenders. Servicers are often divisions or subsidiaries of large lenders. The eight major banks in the United States service 63% of the nation's mortgages through subsidiaries. On June 30, 2010, this amounted to approximately 33.3 million loans totaling almost $5.8 trillion in principle balances. As of late November, 2010, the entire U.S. banking system in the United States had 6,662 national banks, meaning that 1/10th of 1 percent of the banking system control almost two-thirds of all mortgage servicing. These servicers have pooling and service agreements with lenders which govern their rights and duties

regarding overseeing pools of securitized mortgages. These agreements, the fees paid to servicers, and the incentives that result significantly impact foreclosure mediations.

Convening these participants is critical and often difficult. Most homeowners have no direct contact by phone or in person with their mortgage servicers before foreclosure. Homeowners trying to negotiate before foreclosure report that humans are hard to reach through computerized telephone systems servicers, long waits occur, and messages are often not returned. Even when contact occurs, follow up is difficult. Missed calls and letters are common. Relevant documents and records are frequently not accessible. Mortgage servicing is a low margin business which means that few mortgage servicers employ sufficient staff to adequately handle this unforeseen tidal wave of foreclosures.

Homeowners facing foreclosure are usually enduring very difficult times in many, if not all, aspects of their lives. Many are often are dispirited and despairing. Relatively few understand that they may have meaningful options so mediating often does not seem worth the effort. Few have sufficient income to consult lawyers or housing counselors who could explain their alternatives.

Limited comprehensive information regarding mediation outcomes exists. Connecticut, one the first states to create a fully funded state-wide foreclosure mediation program, reported that 74% of 3,386 cases settled in mediation as of February, 2010. Sixty percent of these agreements resulted in homeowners staying in their homes and 42% involved loan modifications. This report provided no data regarding how these modifications were structured, what loan provisions they involved, and average amounts of reductions. Fourteen percent of these agreements resulted in homeowners leaving their residence and 26% did not settle. As of June, 2010, 50% of 1850 mediations in New Jersey had settled and 70% of those agreements permitted homeowners to remain in their residences. No data was provided about loan modifications. The non-profit Collins Center for Public Policy, which administered a local program for Miami-Dade County, Florida, reported a 74% agreement rate for mediations completed through 2009. Again no data was provided regarding loan modifications.

The National Consumer Law Center, a non-profit organization that researches consumer issues, contends that the lack of data on whether loan modifications lowered loan principal, interest rates, and monthly payments make it impossible to determine whether foreclosure mediations are furthering homeowner interests. Limited data from non-mediated resolutions suggested that servicers were rarely modifying loans to make payments more affordable. In the few instances where

loan principal was reduced, the average reduction was $14,353, an average of 6.4% of original loan amounts. According to Congressional testimony in the fall of 2010, nearly 7% of homeowners facing home foreclosure ended up with larger monthly bills after modifications. The typical increase was $132.

4. HOME FORECLOSURE MEDIATING CHALLENGES

It gratifies many long-standing mediation advocates that policy makers have pushed broad use of mediating to attack the foreclosure crisis facing America. Substantial, comprehensive, state-wide foreclosure programs are now in place in Florida and five other states. Many more states are considering adopting them. California does not yet have one but is moving in this direction. The challenge that remains in Florida and elsewhere is how to implement these programs successfully.

Mediators face many daunting challenges applying their skills and ethical sensitivies to the complex contexts foreclosure mediations present. These mediations usually involve numerous and complex financial and legal issues. This paper concludes by analyzing a few of the complexities that apply to two difficult challenges that are likely to exist in many, if not most, foreclosure mediations.

A. AUTHORITY AND INCENTIVE ISSUES

Challenges arise in any mediation involving entity participants where fictitious persons are represented by individuals whose authority often is limited, and lawyers who do possess apparent authority to settle under U.S. law. Foreclosure mediations complicate this because mortgage owners are often entity investors in private pools at varying tranche levels. Florida's Residential Mortgage Foreclosure Program [RMFP], adopted at the end of 2009 and getting under way in 2010, requires that whoever files a foreclosure must supply a representative who attends the mediation. It also requires that this representative, usually an employer of the servicer, must possess full authority. Florida defines full authority as including, but not limited to, abilities to modify the existing loan and mortgage, settle the foreclosure case, and sign an agreement on behalf of the entity without further consultation.

Although full authority does not require accepting final settlement offers, it does contemplate possessing realistic autonomy to negotiate within reasonable parameters. Florida's RMFP requires that before the mediation begins, the Program Manager must take a written roll of the participants. This process includes determining whether a representative with full authority is present, and managers are directed to report to the court their assessments that representatives did not possess full authority. No data yet exists on how this requirement is working.

Whether large corporate entities who file most foreclosures will comply with this requirement to authorize their representatives fully is not clear. The large number of foreclosure mediations needed and chronic understaffing at servicers make it unlikely that extensive consultations will occur between these entities and their representatives. They certainly do not occur in the partially analogous context where large corporate entities file large volumes of claims to collect credit card debts. Authority limits masked by refusals to accept proposals seem likely, particularly regarding reducing loan principal, which rarely occurs, reducing payments, and interest rates.

Principle, payment, and interest reduction modifications seem the most beneficial modifications to homeowners and have the greatest potential to create sustainable outcomes. The Home Affordable Modification Program [HAMP], a recent federal program designed to help homeowners survive the housing crisis, is intended to modify eligible mortgages to create a monthly payment equal to 31% of a homeowner's gross income, a widely-regarded income-housing debt ratio that most borrowers can sustain. HAMP modifications use a net-present-value [NPV] test that assesses whether expected return from the modification is greater than the expected return from foreclosing on a particular home. Essentially, eligible homeowners who pass this NPV test get HAMP modifications while those who fail get foreclosures. Mediations may uncover evidence of HAMP eligibility and produce modifications under its provisions.

Absent HAMP applicability, mediators can do little to move representatives who refuse to accept seemingly valuable proposals because they do not possess sufficient authority to accept them. Mediators can only tactfully push servicers in these directions, usually in caucus to avoid harming impartiality. If authority limits are disclosed, mediators can also encourage representatives to get more authority. Experiences with large corporate credit card companies bringing large numbers of claims to collect debts suggest that unrealistically limited authority representation may happen frequently. If it does, it severely constrains optimally settling foreclosures by mediation. It also may generate agreements that provide homeowners with only short term relief and prove unsustainable over time. Unless the U.S. economy and housing market recovers substantially, these sub-optimal mediation agreements probably postpone many aspects of the existing crisis until the future.

A related issue involves the incentives that influence servicers, many of which stem from provisions in their pooling service agreement [PSA]. PSAs typically provide that servicers' primary income source is a monthly service fee based on a fixed percentage of unpaid principal balance of the loans in the pool. This significantly

discourages offering principal and interest reductions needed to make modifications sustainable over long terms. It also encourages increasing loan principal by adding junk fees such as late charges and other creative add-ons. In addition, under rules of credit rating agencies and bond insurers, servicers are delayed in receiving repayment for the advances they make to investors of principal and interest payments on nonperforming loans when they modify but not when they foreclose. Servicers lose no money from foreclosures beyond the reduction in a pool's value, however, because they recover all of their expenses before investors receive payment.

Modifications require that investors who hold these mortgages acknowledge losses based on their investment's reduced actual value. Until modifications occur, investors can argue that their mortgage-backed securities are worth what they actually paid for them. Although a majority of PSAs permit servicers to modify mortgages in a pool to modify mortgages upon determinations that the loans are in default, it took Congressional legislation to resolve problems created by the 25% of PSAs that prohibited servicers from modifying mortgage loans.

Fears that investors will sue them for violations of their fiduciary duties may explain servicers' resistance to modifying loan principal and interest rates in foreclosure. The pool's disproportionate treatment of tranches ensures that modifications harm the lower tranches first and hardest, and this tends to encourage litigation by investors who lose all or most of their investment's value. Litigation raising these issues is pending throughout the United States and legal standards remain uncertain. The American Securitization Forum in 2007 set an industry standard that servicers should act in the best interest of investors in the aggregate and modify loans where the net present value of modifications are greater than anticipated foreclosure recovery. Although Congress enacted a statue in 2009 protecting servicers from liability for engaging in loan modifications, considerable legal uncertainty remains and this influences negotiating incentives. This uncertainty seems to still influence many servicers to resist making meaningful principal and interest modifications.

In addition, specific PSA provisions, such as buy back obligations and caps on the frequency, amount, or type of modifications permitted, generate litigation. For example, Countrywide's PSA required servicers to purchase modified loans from the pool at their original purchase price. Countrywide settled a suit by 11 state attorneys general in 2008 challenging its servicing practices by agreeing to modify at least 50,000 mortgages. Then Countrywide was sued by an investor seeking to enforce this buyback provision. Countrywide defended arguing that it did not apply to the distressed modifications now required.

Mediators can do little to counter these skewed incentives when the actual mortgage owners are not present. An analysis of foreclosure mediations from 2007-2009 in 25 programs from 14 states produced broad critiques that these mediations failed to impose significant obligations on servicers and failed to require them to negotiate in good faith while mediating. Although these criticisms reflect skewed incentives problems, they miss the crucial points that mediation provides a consensual process and that mediators have no ability to impose obligations on anyone. Fortunately, Florida's RMFMP does not impose good faith negotiating standards because they are subjective and usually produce more conflict than they resolve. All Florida requires is attendance by fully authorized representatives who are free to negotiate as they choose. Upon attending, they may legally decide not to negotiate at all. Florida's ethics committee has concluded that mediators attempting to determine whether participants are negotiating in good faith and thereafter report it are acting unethically.

B. ISSUES WHEN HOMEOWNERS ARE NOT REPRESENTED BY LAWYERS

Parties bringing foreclosures inevitably have lawyers representing them, usually members of bigger law firms in the community. The vast majority of homeowners facing foreclosure, on the other hand, cannot afford to retain lawyers. Florida RMFMP requires Program Managers to advise any homeowners not represented by counsel of their right to consult with an attorney at any point, and to seek volunteer pro bono representation in programs run by lawyer referral, legal services, and legal aid programs in their community. Florida mediators are ethically obligated to suggest the same things whenever they believe unrepresented participants do not understand their legal rights.

Free legal services in the U.S. are limited by budgetary and geographic factors with most understaffed publicly funded delivers located in urban areas. Little access is provided in rural areas. In addition, many homeowners earn incomes sufficient to disqualify them from legal services eligibility but not enough to sustain mortgage payments. As a result, a majority of homeowners participate throughout their foreclosure process without legal representation.

Mediating foreclosures when mortgage owners or servicers are represented and homeowners are not presents enormous challenges. It is virtually impossible to achieve mediation's goal of informed, autonomous decision-making when participants lack fundamental information about their legal rights and options. Mediators cannot de facto represent homeowners without violating their ethical duties of impartiality. Florida ethics rules allow mediators to provide information and

opinions their training qualifies them to share as long as they do so in ways that do not intrude on autonomous decision-making or dictate resolution of issues. This is a difficult line to draw. The legal rights involved in foreclosures are so complex that they do not easily fall into categories where simply providing basic information to legally unsophisticated homeowners suffices. Accurate analysis inevitably requires detailed fact-gathering to assess applicability of legal rules and doing that clearly crosses the ethical line from informing to practicing law. This is not a mediator's role or duty.

Getting homeowners to a housing or foreclosure counselor well in advance of mediation ameliorates some of these problems. Several state mediation programs incorporate homeowner counseling and Florida's RMFMP requires borrowers to meet with an approved counselor before mediations are scheduled. Counselors educate homeowners about the mediation and foreclosure processes, and hopefully teach them about modification and graceful exit options and strategies. They also explain other social services, such as social security, unemployment compensation, and food stamps, which might improve homeowners' financial situations.

Counselors also help homeowners assemble necessary documents to permit productive negotiation at the mediation. Florida requires borrowers to supply their financial disclosure mediation documents, which produce a comprehensive picture of income, assets, and debts, to the Program Manager who then uploads it to a web-enabled information platform used throughout the mediation. Plaintiffs can access it upon request within five days of the mediation.

Housing and foreclosure counselors usually are not lawyers so it unclear how much information they should and do provide about legal rights and strategies. Unless counselors explore these issues, for example, participants who do not also consult lawyers before or during their mediations seldom know if they were victims of predatory lending or fraud when they contracted for the mortgage under foreclosure. Both provide defenses to foreclosures as well as substantial negotiating leverage to get significant principal, payment, and interest reductions as part of modification-based settlements. The creation of sub-prime mortgages featured extensive predatory lending and fraud in a rush to create these loans, the securities they underpinned, and extensive derivative products based on them.

Similarly, unless counselors cover these issues, unrepresented homeowners do not have a realistic opportunity to insist that servicers produce documentary evidence that the plaintiff they represent is the owner and holder in due course of the note and mortgage sued upon. This can be very important in light of disclosures emerging in the fall of 2010 suggesting a shocking lapse of industry diligence regarding

maintaining these documents. Evidence emerged that mass production of false and forged execution of mortgage documents including assignments, satisfactions, and affidavits, were created by persons without knowledge of the facts attested to occurred, and then were used to support foreclosures.

Considerable evidence suggests that the absence of accurate original documentation is common throughout the foreclosure crisis. A study of 1700 cases in bankruptcy involving foreclosure found that necessary documents were missing in more than half of them. Banks through their servicers have foreclosed on homes without this essential documentation, usually by taking advantage of homeowner defaults. They have foreclosed on people who actually had mortgages and whose mortgages were not delinquent. Federal regulators and attorneys generals in all fifty U.S. states are now investigating this situation to assess whether criminal and civil liability exists.

Critiques of existing foreclosure mediation programs recommend that they be designed to force transparency on servicers and Florida's RMFMP substantially follows this suggestion. For example, it permits borrowers to request paperwork proving ownership of the mortgage being foreclosed in a written document submitted to the Program Manager no later than 25 days before the mediation. Although lawyers will do this as a matter of course, it is doubtful that unrepresented homeowners will unless counselors help them do it. So this transparency protection will not help homeowners who lack a knowledgeable representative to invoke it.

Similar issues exist regarding the accuracy of paperwork presented and the appropriate net present value calculation, the keystone to determining whether modifications or graceful exits make the most economic sense. No unbiased NPV has been generally accepted and determining local housing market conditions and values contains extensive uncertainties. Understanding industry NPV calculations often requires using computer software, something unrepresented homeowners are unlikely to be able to do readily. Florida's RMFMP permits access to a statement of the plaintiff's position on the present value of the home in advance but similarly requires a timely written request that unrepresented homeowners are unlikely to initiate.

Even when lawyers for homeowners are present, disputes about NPV opinions are likely. Unable to resolve these disputes, or disagreements about predatory or fraudulent lending and additional, important legal questions that have not been definitely resolved, mediators can do little except explore the strengths and weaknesses of the participants' positions in hopes that doing this may persuade them to move closer to each others' views. Discussing strengths and weaknesses

on technical issues like NPVs and complex legal issues with unrepresented homeowners, however, is not likely to produce much beyond confusion.

5. CONCLUSION

Foreclosure mediation occurs in a context where owners or servicers possess immense discretion and homeowners typically have little power. Unlike other litigation-linked mediation where court outcomes are usually uncertain, successful foreclosure is inevitable in virtually all cases unless homeowners can prove predatory lending, fraud, other evolving legal rights, or absence of appropriate documentation. Even then, courts frequently resolve documentation issues by giving servicers opportunities to return with appropriate paper-work. This power imbalance seems to invite limited authority approaches. Many factors incentivize servicers to foreclose rather than modify mortgage loans. Many others limit the likelihood that principal and interest reduction-based modifications, the options most essential to sustainable mortgage satisfaction in the long run, occur.

Unrepresented homeowners often lack the negotiating skills that lawyers possess. Lacking legal and systemic knowledge, they may not appreciate their abilities to bargain for value. Strong possibilities exist that they may not know of or assert their legal rights. Strong possibilities also exist that they may accept graceful exits without full exploration of possible benefits that they could obtain in return for all the value this provides mortgage owners.

Florida and many other states have mediation ethics rules that prohibit mediators from substituting their views regarding the fairness of proposed outcomes. Discharging their duties to assist negotiation impartially, mediators cannot realistically do much in either of the above common scenarios. Unless homeowners qualify for HAMP's automatic modification, a mediator's ethical constraints potentially turns mediation into postponing foreclosure by minor modifications or facilitating graceful exits. These factors combine to make effectively balanced home foreclosure mediation very difficult.

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